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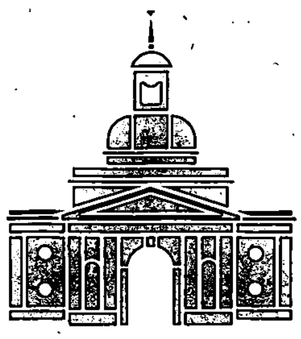
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for international fiscal documentation

Bulletin de Documentation Fiscale Internationale



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Bureau Internal de Documentation Fiscale
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BULLETIN FOR INTERNATIONAL FISCAL DOCUMENTATION

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(art. 2) The Object of the International Bureau of Fiscal Documentation is the foundation and maintenance of an international documentation bureau, in order to supply information in fiscal legislation and the application of fiscal law, and to stimulate the study of fiscal science.

(art. 3) The International Bureau of Fiscal Documentation shall endeavour to realise this object by:

a. founding a library on fiscal legislation, books, periodicals and other publications;

L'OBJET DU BUREAU

Le Bureau International de Documentation Fiscale fut fondé en 1938. Pour des raisons d'organisation, ce Bureau est établi comme une fondation séparée conformément au droit civil néerlandais. Le Bureau est une institution scientifique, indépendante, sans but lucratif et sans objet politique, dont le but est défini dans les statuts comme suit:

(art. 2) Le but du Bureau International de Documentation Fiscale est d'établir et de maintenir un bureau international de documentation tendant à fournir des informations concernant la législation fiscale et l'application du droit fiscal, ainsi qu'à stimuler l'étude de la science fiscale.

(art. 3) C'est par les moyens suivants que le Bureau se propose d'atteindre ce but:

a. en établissant une bibliothèque fiscale d'ouvrages, revues et autres publications;

b. supplying information;
c. giving any one the opportunity to study all material available in its library;
d. issuing a periodical;
e. any other appropriate measures.

In close cooperation with the I.F.A., and with the aid of expert correspondents throughout the world, the Bureau acquires as much information as possible in the field of international and comparative tax law. The Bureau is thus able to supply data (but not advice) on specific tax problems. A fee, necessary for the maintenance and extension of the Bureau, is charged on a time/cost basis. The Bureau has published several series of monographs including "Selected Monographs on Taxation" (a joint venture with Harvard Law School, International Tax Program).

The Bureau also publishes *European Taxation*, now a monthly journal on the tax systems of Europe. *Tax News Service*, published twice per month, provides rapid information on worldwide tax developments. *Supplementary Service to European Taxation* is a loose-leaf reference work.

The loose-leaf series, *Guides to European Taxation* comprises "The Taxation of Patent Royalties, Dividends, Interest, in Europe", "The Taxation of Companies in Europe", "The Taxation of Private Investment Income" and "Value Added Taxation in Europe".

The loose-leaf series, *Tax Treaty Guides* comprises "Handbook on the U.S.—German Tax Convention" and "Handbook on the Dutch—German Tax Convention" (in German). The Bureau has also published three loose-leaf reference works, *Corporate Taxation in Latin America*, *African Tax Systems* and *Taxes and Investment in the Middle East.*

b. en fournissant des informations;
c. en procurant à tous ceux qui s'y intéressent l'occasion de consulter ces ouvrages;
d. en publiant un périodique;
e. en recourant à tout autre moyen adéquat.

Par une coopération étroite avec l'IFA et avec l'aide de correspondants à travers le monde, le Bureau rassemble toutes les données possibles en matière de droit fiscal international et comparé. De cette façon, le Bureau est à même de fournir des renseignements, mais non des avis, concernant des problèmes fiscaux spéciaux. Des honoraires, nécessaires au maintien et à l'expansion du Bureau, sont demandés en fonction du temps nécessaire et du coût. Le Bureau a publié un certain nombre de monographies dont des monographies sur la fiscalité (études réalisées en association avec Harvard Law School, International Tax Program).

Le Bureau publie aussi *European Taxation*, qui est devenu une revue mensuelle sur les systèmes fiscaux européens. *Tax News Service*, publié deux fois par mois, donne une information rapide, à l'échelle mondiale, de tout ce qui touche à la fiscalité. *Supplementary Service to European Taxation* est un ouvrage de référence présentée sous feuilles mobiles.
Guides to European Taxation, également une publication sous feuilles mobiles, comprend "L'imposition de Redevances, Dividendes et Intérêts en Europe", "L'imposition des Sociétés de capitaux en Europe", "L'imposition de revenu des investissements privés" et "La Taxe sur la Valeur Ajoutée en Europe". *Tax Treaty Guides*, une autre publication sous feuilles mobiles, comprend le "Manuel relatif à la Convention fiscale Allemagne — Etats Unis" et le "Manuel relatif à la Convention fiscale Pays-Bas — Allemagne" (en langue allemande). Le Bureau a également publié, *Corporate Taxation in Latin America*, *African Tax Systems* et *Taxes and Investment in the Middle East*, ouvrages d'information sous feuilles mobiles.

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The I.F.A. was founded on the 12th of February 1938 by tax experts of a number of countries. Purpose and working-method are defined as follows in the Articles:

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The aim of the Association is the study and advancement of international and comparative law in regard to public finance and especially international and comparative fiscal law and the financial and economic aspects of taxation.

Plan of Action — Article 3

The Association shall endeavour by all legal means to realise this aim: a) by scientific research; b) by holding congresses and conferences; c) by publications; d) by cooperation with all data collecting organisations, especially the International Bureau of Fiscal Documentation in Amsterdam; e) by all other appropriate methods.

I.F.A. has branches in 27 countries. Residents in any of these countries (I.F.A. members or candidates for membership) can approach the secretary of the local Branch.

Members who live in countries where IFA has no Branch are registered as direct members of the Association. They can get in touch with the General Secretariat of I.F.A. (this also applies to candidates for membership).
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Introduction

After thirty years.

From the very beginning in 1938, the International Bureau of Fiscal Documentation contemplated the publication of a magazine in which tax developments from all over the world would be reported and the readers would be informed of new tax literature and significant court decisions and administrative rulings. Page proofs of the first issue of what was to be the **Bulletin for International Fiscal Documentation/Bulletin de Documentation Fiscale Internationale** were lying ready when World War II involved the Netherlands. It was not before the second half of 1946 that the project could be taken up again. The **Bulletin's** first volume appeared during the years 1946/1947. With the December 1976 issue, its thirtieth year was completed.

As its long name indicates, the **Bulletin** was never meant as a forum for doctrine. Its founder, Prof. Dr. P.J.A. Adriani (who was the Bureau's first managing director until 1954), in full agreement with the then leading members of the International Fiscal Association (I.F.A.), wanted to provide a regular source of information on the tax aspects of what was going on in all countries of the world. It was to be left to I.F.A. at its annual congresses to examine and analyse the developments from a more academic point of view.

When in 1957 six European countries established the European Economic Community, special focus was required for the approximation and harmonisation of taxes in the Common Market. This was of particular interest to the business community in Europe and overseas. The Bureau considered it as one of its basic objectives, as formulated in its statutes, to follow the new developments closely. In 1961 it published the first issue of **European Taxation**. At that time, hardly fifteen years ago, no publisher saw any purpose in a European tax magazine designed to report on and to analyse important new taxation issues and so, the Bureau had itself to publish the results of its own research activities. Shortly afterwards, some doctrinal works were published, followed by a loose-leaf reference service brought out under the title **Supplementary Service to European Taxation** and by four loose-leaf **Guides to European Taxation** in which great efforts were made to treat the various subject matters in such an analytical manner that despite often considerable differences in tax structures, comparisons could easily be made. These Europe-oriented publications gave the opportunity to change slightly the scope of the **Bulletin**. Business and financial relationships with developing countries were becoming increasingly important and it was just about the right moment for the **Bulletin** to give more attention to the tax situations in those countries. This was done — and could not have been done otherwise — with the true international cooperation of a network of local correspondents, all experts in their field, who over the years have become real friends of the Bureau.

The new orientation resulted in praise as well as criticism. Often, the latter is more useful to improve one's work and to increase one's efforts. Now, it is felt, the time has come to give a new momentum to the **Bulletin**. Rather than mere descriptions of tax systems in more or less countries, more active information seems to be of current interest. The background of new measures is often more important than the measures themselves. New international tax problems arise which are being discussed by all sorts of international or regional committees. The world is becoming smaller and smaller, also as regards tax matters. What happens in one country, or in a particular region, may affect other countries or may assist other regional groups to formulate policies or define desiderata.

In its unique library, the Bureau has so much available that only those who visit it for their own research, can find and really appreciate. It is felt that more of this material should be made available to the international tax community. The **Bulletin** would seem to be the best vehicle for this. In its former format, however, it would not have had emough space to report all there is to report. Therefore, it was decided to enlarge it by approximately 40 percent.

Although a combination of increased efficiency and improved technical processes help to keep the cost increase within certain limits, the new formula can only be successful if the number of subscribers increase as well, say also by 40 percent. It is for this reason that not only the many old and faithful subscribers receive this first issue in the new format and presentation, but all members of I.F.A. as well (the **Bulletin** is I.F.A.'s official organ, incidentally) and many other people with whom the Bureau maintains a long and pleasant relationship.

The international tax picture.

The term "International Tax Law" is wrong. I have reached this conclusion after many years of teaching, when I had to give my students a definition of the subject assigned to me. This is not because, as for instance **Maxime Chrétien** writes in his famous "A la recherche du droit international fiscal commun", there is no true and common body of law on international matters; one might say the same about international private law. Neither do I have any problem of the kind indicated by **Manlio Udina** who devotes many pages of his "Il diritto internazionale tributario" to a distinction (which cannot be made in English) between "diritto internazionale tributario" and "diritto tributario internazionale", the former term referring to a true international body of law (which, as everyone will agree, does not exist), the latter meaning those provisions which are found in domestic laws on international tax situations and as such are not international law at all.

No, the difficulty is that many problems of international tax "law" arise which are more in the nature of international politics, or economic policy, or of economics in general. It would, therefore, probably be much better if a more neutral term were used, such as "International Taxation". That this would be more appropriate may appear from a number of problems that nowadays attracts and keeps the attention of the international tax community.

The traditional question of **avoidance of international double taxation** — still a very important one, of course — can no longer be considered without the equally crucial question of **international tax avoidance and tax evasion.** This latter subject is of particular interest in the relationship with **developing countries** whose main concern often is how to find out what the overall tax situation is of foreign investors, mostly **transnational companies,** operating within their territory. As a result, there is an increasing tendency towards **regional co-operation** in tax and related matters. Nowadays, it is hardly possible anymore to deal with one of these subjects without looking at the whole spectre of problems.

International Double Taxation

An impressive network of bilateral tax treaties link all or nearly all developed countries with each other. There can be no doubt that the O.E.C.D. Committee on Fiscal Affairs has largely contributed to this significant situation. The Draft O.E.C.D. Treaty of 1963 and the proposed amendments thereto of 1974 did actually serve as a model for most treaties concluded since. In addition, many treaties came into being between developed and less developed countries. It is worth noting that in many respects these follow the O.E.C.D. Draft as well. Developing countries are more and more concluding tax treaties among themselves and sometimes these take the form of a multilateral treaty, such as the one between the countries of the Andean Pact and another one between several Arab countries. (Both texts have been published by the Bureau.) Finally, mention should be made here of the many treaties recently concluded between Western countries and most countries of Eastern Europe. (The English texts of these treaties are reproduced in Section C of SUPPLEMENTARY SERVICE TO EUROPEAN TAXATION.)

The number of countries providing for **unilateral** relief from double taxation is ever increasing. This is an interesting and important development and it shows that these countries accept the consequences of becoming increasingly involved in international trade and investment.

Tax Avoidance & Tax Evasion

Prohibitive taxation is bound to result in devices to reduce the tax bill. A distinction is made between those which are illegal (tax fraud or evasion) and those which are not (tax avoidance). Both phenomena have led to domestic and international counter measures. Several countries endeavour to tighten the rope — to tax evaders by strengthening their tax administrations and by increasing the means of punishment. International tax treaties usually contain special provisions for the exchange of information aiming at reducing the possibilities of both evasion and avoidance. The struggle against tax avoidance is reflected in such legislation as the recent German measures and the earlier provisions concerning controlled foreign corporations in the U.S. Internal Revenue Code. The United Nations Group of Experts on Tax Treaties between Developed and less Developed Countries made the exchange of information a special issue in its reports. The recently held ESCAP Seminar on Foreign Investment and Tax Administration also emphasized the importance of this subject. A brief note on this Seminar is given elsewhere in this issue.

Prohibitive taxation may result from high rates or an unrealistic computation of the tax base. Several Asian countries have found that a lowering of effective tax burdens increases tax compliance and constitutes an efficient instrument in the struggle against tax evasion. This is shown by Mr. Qureshi in the opening article in this issue. Prohibitive taxation may also result from unrelieved international double taxation. This may easily lead to the use of

Tax Havens

Why does a country become a tax haven and what can it offer? What are the reasons for individual and corporate taxpayers to make use of a tax haven? What counter measures may be expected from countries suffering from such use? These and other questions are dealt with by Mr. Pepper in a lengthy article the first part of which appears in this issue.

Transnational Companies

Several international organizations are dealing with the tax and other aspects of multinationals or, as they are now being referred to, transnationals. It is intended to report regularly in the Bulletin what is going on in this respect.

Foreign Investment and Oil

Discussions on the pricing of oil and other sources of energy are likely to go on. A large number of (mainly less developed) countries will have to pay the higher bill on oil imports unless they are willing or able to reduce such imports. Others try to receive some degree of compensation by investing in the oil producing countries. Recently, the Bureau organized a well attended international conference in Amsterdam on the investment opportunities (and the tax aspects thereof) in a large number of Middle East countries. A brief note on this conference is included in this issue.

Taxation and Inflation

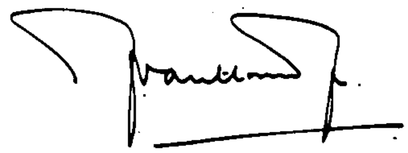
Many countries are faced with the problem of economic recession and inflation. Various counter measures are devised, with varying results. Belgium and Israel introduced or proposed special legislation in this respect, see pages 17 and 29.

Regional Cooperation

Several, if not all, of the problems briefly mentioned above result in an increased effort of countries belonging to a region, to cooperate more closely in tax and general economic matters. It is worth noting that while the E.E.C. seems to be at a stand still, outside Europe, regional cooperation, in Latin America, in Africa, and in the Middle East as well as in South East Asia, appears to indicate a strong political will to get together more closely. In matters of taxation the results may not yet seem spectacular but there is no reason to underestimate the significance of this tendency.

International Taxation

The international pattern of trade, industry and investment, the flow of capital, goods and also persons, the tremendous need of technology in many areas of this world — they are all economic features in a changing world. They are affected by and, in turn, affect taxation. These developments can no longer be viewed within a domestic or international legal framework. We, in the Bureau, feel that research in tax matters should more and more disentangle itself from the rather narrow traditional concept of international tax law. We are well aware of this and engage more generally in the study of all aspects of international taxation. I hope and trust that this will be reflected in the BULLETIN in its expanded format, which is not only a matter of form but especially of substance. I also hope that our many correspondents and subscribers will assist us in achieving our objectives.



J. van Hoorn Jr.

The following table is not meant to be a comprehensive list of all the tax havens in the world, but does include the most important of them. Some countries have expressed their intention of becoming tax havens, but not all have enacted the necessary laws and attracted customers. No attempt has been made in the text of this article to give a comprehensive account of all the services provided by each haven, and in any event the picture is constantly changing, as anti-avoidance laws in industrial countries limit the scope for avoidance, and havens adapt their services to meet the new demands upon them. For detailed commentary the reader is directed to the most up-to-date literature he can find — at the time of writing the publications in the bibliography probably give as up-to-date a picture as can be obtained by the general and professional reader.

Key to Code Letters

The functions of the havens can only be given in outline in a table, and the cryptic references need to be expanded by larger, specialised reference works to obtain detailed information as to the exact functions and potential of a particular haven.

Language
D = Dutch, E = English, F = French, G = German, S = Spanish.

Note In each country there is usually the possibility of obtaining English translations and explanations of the laws etc.

Functions
B = Banking; C = Companies ("offshore"); CIC = Captive Insurance Companies; HC = Holding Companies; IBC = International Business Companies; R = Residential; T = Trusts

Table of Financial and Tax Havens *

COUNTRY	LANGUAGE	FUNCTIONS
Andorra	F & S	R
Antigua	E	IBC
Aruba	D	B, HC
Bahamas	E	B, C, CIC, HC, R, T
Barbados	E	IBC
Bermuda	E	CIC, C, HC, S, T
Bonaire	D	B, HC
British Virgins	E	HC, R
Brunei	E	R
Caymans	E	B, C, CIC, HC, R, T
Costa Rica	S	HC, R
Curaçao	D	B, HC
Cyprus	E	S
Eire	E	R
Gibraltar	E	C, HC
Grenada	E	IBC
Guernsey	E	B, C, R, T
Holland	D	C, HC
Hong Kong	E	HC, T
Ireland, Republic (see Eire)		
Isle of Man	E	C, HC, R, T
Jersey	E	C, HC, R, T
Liberia	E	HC, S
Liechtenstein	G	HC, T
Luxembourg	F	C, HC, T
Malta	E	C, R, S
Monaco	F	C, R
Mauru	E	HC, T
Netherlands (see Holland)		
Netherlands Antilles (see Aruba, Bonaire, Curacao)		
New Hebrides	E & F	CIC, HC, T
Panama	S	C, HC, CIC, R, S, T
St. Vincent	E	IBC
Seychelles	E	R
Singapore	E	S
Switzerland	F & G	HC, R
Turks & Caicos	E	HC

* For a comprehensive article on Tax Havens see p. 31

IFA INTERNATIONAL FISCAL ASSOCIATION NEWS

During the week of 13-17 September 1976 the International Fiscal Association held its 30th Congress in Jerusalem (Israel). The two subjects discussed were (i) "Tax incentives as an instrument for achievement of governmental goals" and (ii) "The definition of capital gains in various countries". The following summaries of proceedings were released.

SUBJECT I.

TAX INCENTIVES AS AN INSTRUMENT FOR ACHIEVEMENT OF GOVERNMENT GOALS

The XXXth Congress of IFA studied "Tax incentives as an instrument for achievement of governmental goals — their role in income taxation and a comparison with alternative instruments regarding both economic and social goals".

There was general agreement as to the usefulness of defining and evaluating tax incentives. Such evaluation should include the effects achieved, the revenue losses involved, and any equity consequences. Some difficulty was seen, however, in formulating unambiguously and uncontroversially a revenue concept against which all incentives could be identified and the connected revenue costs measured. Another difficulty was seen in determining the initial cost to be attributed to a tax incentive in cases where e.g. foreign capital or foreign technicians would not be attracted in the absence of such incentive.

Another factor to be considered in evaluating tax incentives is their relationship to the juridical requirements of the various countries and to the necessity of conforming to constitutional and other legal standards of delegation of authority to administrative agencies.

The Congress also considered the factors involved in the choice between tax incentives and direct expenditures. The need was felt for further research to explore the factors and ascertain the criteria governing decisions in this respect.

On two points the Congress was in general agreement, one that tax incentive programs should be scrutinized as carefully as other matters of budgetary and economic policy, the other, that further research into the effect of tax incentive measures would be useful, in particular, in order to measure their cost/benefit ratio.

SUBJECT II.

THE DEFINITION OF CAPITAL GAINS IN VARIOUS COUNTRIES

The XXXth Congress of the International Fiscal Association noted that the problem of the definition of capital gains could not be examined independently of a particular tax system. Looking at the diversity of tax systems, the Congress came to the conclusion that no general definition of capital gains was possible.

The National Reports show, and the discussion confirmed, that most countries recognize a concept of capital gains. But no country was able to produce a clear and concise definition applicable to that country. Some of the participants felt that it was impossible to define capital gains without studying the goals desired in making the distinction between capital gains and ordinary income; others considered that in substance the definition should be independent of tax policy considerations.

The reports and discussions show that in some countries the distinction between business assets and private assets determines the tax treatment of the capital gains; in other countries, this distinction is not relevant.

The Congress, on the basis of the General Report, the National Reports and the discussions has ascertained that both objective and subjective criteria exist to distinguish between capital gains and ordinary income. It was common ground that objective criteria were normally to be preferred.

Pakistan, India, Sri Lanka and Bangladesh*

NEW ORIENTATIONS IN TAX POLICIES

By N.M. Qureshi, **Chairman**

Central Board of Revenue, Pakistan

Pakistan, India, Sri Lanka and Bangladesh have had a long common experience of British rule, and this common colonial heritage has produced many similarities in their socio-economic and administrative systems, including the taxation of income. In recent years, there has been quite a significant parallelism in the evolution of their systems of taxation of income in many important respects.

For nearly a quarter of a century since independence, the maximum marginal rates of taxes on personal incomes in these four countries had stayed quite high. They were a result as much of the popular social urge of redistributing income and wealth through progressive taxation as of pragmatic need of mobilising resources for use by government where private savings were inadequate or limited. For promoting private savings and investment in the face of high maximum marginal rates, an intricate system of tax incentives, in which the prime position was occupied by tax holidays, was evolved.

The concern with increased skewness in the size distribution of income and wealth was by no means unjustified. The gains of development accrued, in the early stages, to a small class of businessmen and manufacturers. Single minded pursuit of economic growth was associated with growing inequalities of income and wealth and increasing denial of social justice. Experience had, however, shown that highly progressive system of income taxation had done little to correct social inequalities. It was realised that a more fruitful approach to the problem will be the development of the counter-vailing powers of trade unions and state intervention. The emphasis in this field was, therefore, shifted to a re-alignment of productive resources and production relations and of the content of production in such wise as to combine development with reduction in economic and social inequality.

All the four South Asian countries have seen a considerable strengthening of the trade union movement under the impetus of ameliorative state legislation. The role of the public sector has also greatly increased, particularly in areas where market dominating positions emerged as a consequence of narrowness of the domestic market and rigidities, immobilities and imperfections of the market. This aspect of the situation will be adequately brought out by Pakistan's experience in the matter.

Increasing role of the public sector in Pakistan's industrial field will be clear from the establishment under the Economic Reforms Order, 1972, of the Board of Industrial Management which controls and manages as many as 53 basic industrial enterprises which account for over 20 per cent of large-scale industrial investment in the country. Public sector industry also now includes 26 hydrogenated oil mills. Certain service industries of petroleum products and shipping were taken over in January, 1974. The management and control of 32 life insurance companies was taken over by the Government in March, 1972, and major Pakistani commercial banks were nationalised in January, 1974. More recently, over 2000 small-scale establishments processing cotton, rice and wheat flour, came under public ownership and control.

The Government of Pakistan also moved in to regulate the private sector in fields that were found to be riddled with all types of oligarchic corporate controls that begot multifarious business malpractices, including the generation of black money. This resulted in the abolition of the managing agency system, introduction of cumulative voting system and proportionate representation in public companies. A similar purpose was served by activising the Securities and Exchange Authority of Pakistan and establishing the Monopoly Control Authority.

There have been parallel developments in India, Sri Lanka and Bangladesh of nationalising banks, imposition of ceilings on urban lands and property and increased regulation of private corporations. Land reforms with the lower ceilings of land holdings have also been the common experience of all the three countries as well as Pakistan. In all the four countries, there has thus been a common realisation of positive results in the direction of a more equitable distribution of incomes and wealth flowing through broader socio-economic policies rather than progressive taxation.

DECLINING MAXIMUM MARGINAL RATES

In recent years, some of the basic ideas of public finance have been called in question as to their general applicability to all countries in all conditions. One such proposition that has held ground for long as an axiom is the desirability of having a steeply progressive tax system emanating from the concept of the diminishing marginal utility of income. This proposition has been questioned through the 'fifties' and 'sixties' on the ground that requirements of capital formation and economic incentives for accelerating the growth of an economy are negated by too progressive a system of taxation which has serious disincentive effects on productive effort.

The progressive rates on personal incomes did not help much in the mobilisation of resources for use by Governments. In **Pakistan**, the share of income tax in total federal tax receipts amounted to 16.3 per cent in 1975-76. Although this was a considerable improvement over the low watermark of 13.0 per cent in 1974-75 and almost equally low figure of 13.5 per cent for 1973-74, it was lower than 17.9 per cent of 1972-73, 23.7 per cent of 1971-72, 18.3 per cent of 1970-71, 20.0 per cent of 1969-70, 20.7 per cent of 1964-65 and 25.4 per cent of 1959-60. This low relative share of income tax was, however, partly a result of inflationary expansion of receipts from ad valorem rates of customs, central excise and sales tax and partly of large fortuitous collections from export duties imposed in the wake of the drastic devaluation of the Pakistan Rupee in May 1972.

* The charts and tables illustrating this article have been prepared by Mr. M.P. Dominic, LL.B, B.Ph, L.Ph, associate of the International Bureau of Fiscal Documentation. The responsibility for them rests, therefore, not with Mr. Qureshi but entirely with the Bureau.

1. 1 lakh = 100,000.

Income tax provided 12 per cent of tax revenue in **Bangladesh** last year. In Sri Lanka in 1975 direct taxes contributed only 20 per cent to total tax revenues and the share of income tax was no more than 18 per cent. The position was no different in **India**, where a bold experiment in bringing down the rates of personal taxation was accordingly made with a view to remove one of the prime inducements for tax evasion, namely, the attraction of high return which tax evasion gave in the context of high tax rates. The rise in tax revenues recorded after the initial reduction of the maximum marginal rate in India from 97.75 per cent to 77 per cent for the fiscal year 1975-76 encouraged a feeling that a further reduction would induce greater voluntary compliance with tax laws without adversely affecting revenues. Accordingly, the maximum marginal rates of personal taxation were further reduced to 66 percent for the fiscal year 1976-77.

The evolution of the tax system in **Sri Lanka** over a period of time had also for the most part been in an ad hoc manner, with a heavy emphasis on mobilisation of resources and re-distribution of incomes. On the whole, direct taxes were practically left untouched in Sri Lanka during the past ten years except for changes in the tax rates relating to income tax which till 1976 generally tended in the direction of a steeper progressivity, but produced little effect on revenue. The growth of numerous tax concessions with the passage of years made the tax system increasingly more complicated and at times even inconsistent. The current phase in Sri Lanka which began with the budget of 1976 had as its aim the liberalisation of the climate for voluntary savings and investments by reducing the maximum marginal rate of income tax from 75 per cent to 50 per cent and doing away with schemes for compulsory savings and ceiling on income.

In **Bangladesh** too, the maximum marginal rate of tax on personal incomes has been brought down to 65 per cent. Furthermore, Bangladesh has abolished, from the assessment year 1976-77, the surcharge levied on the income of the assessees, not being a company, on income exceeding Taka 36,000.

In **Pakistan**, the highest marginal rate of tax on personal incomes was brought down from 70 per cent to 60 per cent in the budget for 1976-77. To protect revenue interests, this reduction was preceded by a rationalisation of tax incentives and improvement of tax-collecting machinery, a process that still continues. The reduction was followed by amnesty for tax evaders aimed at flushing out black money and securing a revenue windfall of nearly over 450 million rupees for public sector investment. Similar adjustments of tax policies have also taken place almost simultaneously in **Sri Lanka** and **India**.

The results will be available next year and are most likely to prove beneficial in the larger interest of revenue.

Changes in the Income Tax Rates Applicable to Resident Individuals

PAKISTAN

1974-75	Rate	Effective Rate	1976-77	Rate	Effective Rate
Rs. 2,000	2.5%	2.5%	Rs. 5,000	10%	10%
Rs. 2,000-Rs.4,000	Rs 50 + 10% of the excess	6.25%			
Rs 4,000-Rs 7,000	Rs 250 + 15% of the excess	10%	Rs 5,000-Rs 10,000	Rs 500 + 20% of the excess	15%
Rs 7,000-Rs 10,000	Rs 700 + 20% of the excess	13%	Rs 10,000-Rs20,000	Rs 1,500 + 30% of the excess	22.5%
Rs 10,000-Rs 15,000	Rs 1,300 + 25% of the excess	17%	Rs 20,000-Rs 30,000	Rs 4,500 + 40% of the excess	28.33%
Rs 15,000-Rs 20,000	Rs 2,550 + 30% of the excess	20.25%	Rs 30,000-Rs 70,000	Rs 8,500 + 50% of the excess	40.71%
Rs 20,000-Rs 25,000	Rs 4,050 + 35% of the excess	23.2%			
Rs 25,000-Rs 30,000	Rs 5,800 + 40% of the excess	26%			
Rs 30,000-Rs 35,000	Rs 7,800 + 45% of the excess	28.71%	in excess of Rs 70,000	Rs 28,500 + 60% of the excess	
Rs 35,000-Rs 40,000	Rs 10,050 + 50% of the excess	31.38%	Rs 100,000	Rs 46,500	46.5%
Rs 40,000-Rs 50,000	Rs 12,550 + 55% of the excess	36.1%	Rs 250,000	Rs 136,500	54.6%
Rs 50,000-Rs 70,000	Rs 18,050 + 60% of the excess	42.93%			
Rs 70,000-Rs 100,000	Rs 30,050 + 65% of the excess	49.55%			
In excess of Rs 100,000	Rs 49,550 + 70% of the excess				
Rs 250.000	Rs 154,550	61.82%			

TAX HOLIDAY

In trying to create a fiscal climate for investment, both local as well as foreign, tax holidays had increasingly been used by most developing countries, including Pakistan, Sri Lanka, India and Bangladesh as a device to attract such investment.

In **Pakistan**, the tax holiday scheme was abolished with effect from the assessment year 1971-72 on the ground that it never achieved its purpose of industrial dispersal but contributed to concentration of economic power and wealth and encouraged the establishment of uneconomic units.

The tax holiday scheme introduced in 1959 in Pakistan granted new industries set up between 1959 and 1965 tax holiday for 8, 6 and 4 years depending on their location, longer periods being meant for less developed areas. These industries enjoyed, in addition, liberal depreciation allowances on the original cost, on the expiry of the tax holiday. Later on, for industries set up between 1965 and 1970, the period of tax holiday was reduced to 6, 4 and 2 years. Also, the depreciation became admissible after the expiry of the tax

holiday period, on the written down value of assets rather than on their original cost.

There is no conclusive evidence that the pace of industrial development was quickened by the tax holiday. There is, however, conclusive evidence to show that tax holiday failed to attract industries to the less developed regions, for industries could not be attracted to remote locations if infra-structural facilities such as railways, roads, water, power, banks, post and telegraph communications did not exist. The scheme resulted in considerable direct revenue loss to the exchequer, besides the loss of revenue due to evasion of tax by the non-exempt units attributing their profits to tax-exempt expansion units.

Attempts were made by previous Governments to obtain some revenue from tax holiday companies in the form of surcharge or treatment of tax as interest-free loan but no bold and clear-cut decision was taken. The tax already realised for the assessment year 1971-72 was, therefore, treated as tax duly chargeable and not an interest-free loan. The Government was, however, still resolved to encourage setting up of industries in less developed areas and had already given full exemption from import duty in case of capital equipment to be installed in such areas. Equity Participation Fund was also revived for giving support to private entrepreneurs who set up industries in less developed areas. The Government also ensured that all possible facilities were provided for furtherance of its policy for the rapid industrial growth of backward areas. The abolition of tax holiday brought in an additional revenue of Rs. 60 million in 1972-73.

To compensate the incentive effect of tax holiday in a more rational way, the Government introduced a new tax credit scheme in the budget for 1974-75 at a revenue cost of Rs. 10 million per annum, to encourage the investment of corporate savings. Investment to equities of approved industrial undertakings set up between 1st July, 1974 and 30th June, 1980, qualified for a tax credit equal to fifteen per cent of the amount invested provided the undertakings were not located in the comparatively developed areas and for undertakings located in the comparatively under-developed areas to thirty per cent. Five years were prescribed as the minimum period of investment. In Pakistan's budget for 1975-76, this concession was made admissible not only for investment in new industrial units but also in the case of identifiable expansion of existing industrial units.

The budget for 1975-76 also provided that profits before taxation of an industrial undertaking which commenced commercial production between 1st July, 1975, and 30th June, 1980, would be reduced to the extent of 10 per cent of the capital employed if the undertaking was set up in the less developed areas and 5 per cent of the capital in the remaining areas other than certain specified areas.

The existing concession of special depreciation allowance of 15 per cent for new machinery was extended to industrial undertakings set up between July 1, 1975, and June 30, 1980. Furthermore, 5 per cent of rebate in super tax was allowed to smaller industrial undertakings set up between July 1, 1975 and June 30, 1980 provided the cost of fixed assets exclusive of the cost of land did not exceed Rs. 30 lakhs [1]. In the budget for 1976-77, provision was also made at a revenue cost of Rs. 2 million for tax credit at the rate of 10 per cent of the cost of new machinery to a company engaged in an industrial undertaking where such machinery was acquired for purposes of replacement, balancing and modernisation.

In **Sri Lanka** also a certain amount of disquiet over the usefulness of the tax-holiday device had tended to surface in the recent past. A serious disadvantage of tax holiday is seen to arise from the inequality of treatment between tax holiday areas of investment and other areas. Sri Lanka has also had the experience of everyone demanding tax holiday and holding it as a threat for non-investment. In any event, the low rate of income tax amounts to a partial tax-holiday for everyone without discrimination between the different areas of investment. Another interesting question that is being increasingly raised in Sri Lanka is that given the fact that the tax system of a country should reflect the socio-economic aims of the Government, whether tax holidays by providing narrow based havens for investors could result in social discon-

Changes in the Income Tax Rates Applicable to Resident Individuals

INDIA

1974-75	Rate	Effective Rate	1976-77	Rate	Effective Rate
Rs 5,000	Nil	—	Rs 8,000	Nil	—
Rs 5,000-Rs 10,000	10% of the excess	5%	Rs 8,000-Rs 15,000	15% of the excess	7%
Rs 10,000-Rs 15,000	Rs 500 + 17% of the excess	9%	Rs 15,000-Rs 20,000	Rs 1,050 + 18% of the excess	9.75%
Rs 15,000-Rs 20,000	Rs 1,350 + 23% of the excess	12.5%	Rs 20,000-Rs 25,000	Rs 1,950 + 25% of the excess	12.8%
Rs 20,000-Rs 25,000	Rs 2,500 + 30% of the excess	16%	Rs 25,000-Rs 30,000	Rs 3,200 + 30% of the excess	15.67%
Rs 25,000-Rs 30,000	Rs 4,000 + 40% of the excess	20%	Rs 30,000-Rs 50,000	Rs 4,700 + 40% of the excess	25.4%
Rs 30,000-Rs 40,000	Rs 6,000 + 50% of the excess	27.5%	Rs 50,000-Rs 70,000	Rs 12,700 + 50% of the excess	32.43%
Rs 40,000-Rs 60,000	Rs 11,000 + 60% of the excess	38.33+	Rs 70,000-Rs 100,000	Rs 22,700 + 55% of the excess	39.2%
Rs 60,000-Rs 80,000	Rs 23,000 + 70% of the excess	46.25%			
Rs 80,000-Rs 100,000	Rs 37,000 + 75% of the excess	52%	In excess of Rs 100,000	Rs 39,200 + 60% of the excess	
Rs 100,000-Rs 200,000	Rs 52,000 + 80% of the excess	66%	Rs 200,000	Rs 99,200	49.6%
In excess of Rs 200,000	Rs 132,000 + 85% of the excess		Rs 250,000	Rs 129,200	51.68%
Rs 250,000	Rs 174,500	69.8%			

tent and more validly lead to tax evasion on the part of non-beneficiaries of the benefits.

The other important reasons suggested for withdrawal of tax holidays in Sri Lanka are as follows:

(A) Areas of investment which qualify for relief under section 16CC of the Inland Revenue Act have been widened now and there is a shift of emphasis from the blanket tax holiday type of incentives for production, employment, promotion and conservation of foreign exchange earnings and receipts.

(B) The continuation of capital allowances in the form of lump sum Depreciation (LSD) and Development Rebate.

In the matter of tax holiday, there has been a contrary experience in **Bangladesh** flowing mainly from the fact that the stage of its economic development is quite different from that of the three other South Asian countries under consideration. Section 14A(i) of Bangladesh's Income Tax Act provides that the income, profits and gains of an industrial undertaking set up in Bangladesh between the 1st day of July, 1973, and the 30th day of June, 1974 (both days inclusive), shall be exempted from the income tax and super tax payable under the Income Tax Act for a period of five years, subject to the conditions that the industry is owned by a company and that its registered office is in Bangladesh, that the paid up capital of the company will not exceed taka 35 lakhs and that the subscribers of the capital should not be other than the Bangladesh citizens.

However, the scope of tax holiday for a company was widened by a further liberal provision in section 14 (2A). In the new provisions, the participation of a foreign national has been allowed in the contribution of the capital of the company. The period of tax holiday has also been extended to 7 years for an industrial undertaking which will be set up in less developed area and the period of setting up of the industrial undertaking has been extended to 1980. In places like Chittagong and Dacca, which are comparatively developed areas, the period of exemption from payment of tax by the company has been restricted to five years. The limit of capital has been raised to 100 million taka. There is no limit of capital for an industrial undertaking sponsored by the Government or corporations. One important provision for tax holiday company is that 60 per cent of the profit of the company is to be ploughed back for the extension of the said industrial undertaking or is to be invested in the purchase of the Government bond.

The other three countries having tried tax-holiday as a tool of development and abandoned it, it remains to be seen how far Bangladesh succeeds along with the lowering of the rate of tax.

BETTER TAX COMPLIANCE

During the past three or four years, increasing importance has been attached in Pakistan, Sri Lanka and India to better tax compliance through improvement of administrative arrangements. In **Pakistan**, the budget for 1973-74 brought about several amendments in taxation laws to make them more stringent and to enhance the penalties for tax evasion. Taxation Officers were given enhanced powers for obtaining information from taxpayers and for inspection of accounts and documents. Penalties for defaults by tax-payers in submitting returns and delaying payment of admitted tax were also increased. It was made mandatory for all income-tax assessees with annual incomes exceeding Rs. 50,000 to file wealth statements. In cases of tax evasion or wilfully furnishing of wrong information, taxation officers were authorised to initiate criminal proceedings. The tax assessments were expedited and the maximum period for finalisation of income tax assessments was reduced from 4 years to 2 years. Special Judges were to be appointed for trying the cases of tax evasion. Provision was also made for appointment of valuation experts for assessing the value of properties to facilitate assessment of direct taxes. The cooperation of the people was sought for detection

Changes in the Income Tax Rates Applicable to Resident Individuals

SRI LANKA

1975-76	Rate	Effective Rate	1976-77	Rate	Effective Rate
On the first Rs 1,800	7.5%	7.5%	On the first Rs 1,800	7.5%	7.5%
Rs 1,800-Rs 3,600	Rs 135 + 10% of the excess	8.75%	Rs 1,800-Rs 3,600	Rs 135 + 10% of the excess	8.75%
Rs 3,600-Rs 6,000	Rs 315 + 12.5% of the excess	10.25%	Rs 3,600-Rs 7,200	Rs 315 + 12.5% of the excess	10.63%
Rs 6,000-Rs 8,400	Rs 615 + 15% of the excess	11.6%	Rs 7,200-Rs 10,800	Rs 765 + 15% of the excess	12.08%
Rs 8,400-Rs 10,800	Rs 975 + 17.5% of the excess	12.92%	Rs 10,800-Rs 14,400	Rs 1305 + 20% of the excess	14.06%
Rs 10,800-Rs 13,200	Rs 1,395 + 20% of the excess	14.2%	Rs 14,400-Rs 18,000	Rs 2,025 + 25% of the excess	16.25%
Rs 13,200-Rs 16,800	Rs 1,875 + 25% of the excess	16.52%	Rs 18,000-Rs 21,600	Rs 2,925 + 30% of the excess	18.54%
Rs 16,800-Rs 21,600	Rs 2,775 + 30% of the excess	19.51%	Rs 21,600-Rs 25,200	Rs 4,005 + 35% of the excess	20.89%
Rs 21,600-Rs 28,800	Rs 4,215 + 40% of the excess	25.34%	Rs 25,200-Rs 30,000	Rs 5,265 + 40% of the excess	23.95%
Rs 28,800-Rs 36,000	Rs 7,095 + 50% of the excess	29.7%	Rs 30,000-Rs 37,200	Rs 7,185 + 45% of the excess	28.02%
Rs 36,000-Rs 43,200	Rs 10,695 + 60% of the excess	34.76%	In excess of Rs 37,200	Rs 10,425 + 50% of the excess	
Rs 43,200-Rs 50,400	Rs 15,015 + 70% of the excess	39.79%	Rs 100,000	Rs 41,825	41.83%
In excess of Rs 50,400	Rs 20,055 + 75% of the excess		Rs 250,000	Rs 116,825	46.73%
Rs 100,000	Rs 57,255	57.25			
Rs 250,000	Rs 169,755	67.9			

of tax evasion and a liberal system of rewards was introduced under which a portion of the amount of tax sought to be evaded was to be paid to the informer whose information led to the detection of tax evasion. The Central Board of Revenue was authorised to disclose the incomes declared by the important assessees and the income tax assessed in such cases.

In January this year, fresh administrative measures were envisaged in Pakistan in a meeting held by the Federal Finance Minister with a wide range of relevant tax officials. In the meeting, the Finance Minister underlined the importance the Government attached to administrative measures for tightening the ring round black money in the country. A comprehensive and integrated campaign was launched immediately after this meeting. The administrative measures included a country-wide survey which brought to light about 70,000 potential tax-payers. A dead-line, with a warning of severe consequences for defaulters, was fixed for voluntary filing of tax returns by persons who were liable to pay tax but had side-tracked their tax liability. This resulted in the emergence of over 4000 new income assessees. Some of the other measures adopted included strengthening of the newly set up Vigilance Wing to bring about improvements in realisations and to reduce major leakages of revenue to a minimum.

The Vigilance Wing in Pakistan is charged with the following important functions:

a) unearthing cases of under-valuation and misdeclaration of goods, suppression of correct income tax and sales tax and other taxes and duty.
b) probing into specific cases of frauds, collusion and other malpractices in the revenue administration so as to ensure timely and complete realisation of revenue.
c) paying surprise visits to concerned places, investigating cases of evasion of taxes and duties and granting suitable rewards to informers leading to detection of such cases in accordance with the rules already prescribed.

These measures resulted in a record income tax collection in Pakistan in 1975-76 of Rs. 2149 million, which was 69 per cent ahead of the budget estimates for the year. For all the principal heads of federal taxes, the revenue receipts of Rs. 13169 million for 1975-76 exceeded the preceding year's receipts by 20 per cent. These revenue receipts also exceeded the revised estimates of Rs. 12691 million by Rs. 480 million. The uncovered budgetary gap of Rs. 1700 million for 1976-77 was thus reduced to Rs. 1220 million.

For federal taxes, the tax-gross domestic product ratio of 11.2 per cent for 1975-76 was one of the highest recorded in Pakistan. This ratio had been ranging from 7.00 in 1959-60 to 10.0 in 1964-65, 10.8 in 1969-70, 11.1 in 1970-71, 10.8 in 1971-72, 11.1 in 1972-73, 11.7 in 1973-74 and 10.8 in 1974-75. The ratio for 1975-76 was exceeded only by 11.7 per cent of 1973-74, when federal receipts were swelled by large fortuitous collections from export duties.

In Pakistan, there has also been a welcome decline in the average cost of collections made by the Income Tax Department. Besides taxes on income, this department collects wealth tax, gift tax, estate duty and sales tax from inland transactions other than those in excisable commodities. All these collections varied from Rs. 1384.8 million in 1973-74 to Rs. 1634.8 million in 1974-75, Rs. 2505.3 million in 1975-76 and Rs. 2612.0 million (including presumptive collections from declarations of concealed income) in the budget estimates for 1976-77. The corresponding absolute figures of cost of collection incurred by the department are Rs. 20.8 million for 1973-74, Rs. 26.6 million for 1974-75, Rs. 28.6 million for 1975-76 and Rs. 31.0 million for 1976-77. The percentage cost of collection has thus declined sharply from 1.50 per cent and 1.62 per cent in 1973-74 and 1974-75 respectively to 1.14 per cent and 1.18 per cent in 1975-76 and 1976-77 respectively. These figures are quite indicative of administrative improvements in the recent past.

The reorganisation of tax administration in **Sri Lanka** through scheme of self-assessment and Pay-As-You-Earn has been quite similar to that undertaken in Pakistan. It resulted in a considerable reduction in the non-productive work-load on the assessing staff, which was consequently deployed for more productive work of enforcement, particularly the correction of tax liabilities declared by tax-payers. In Sri Lanka, tax fraud division is a specialised activity of the audit programme, which plays an important part in securing better tax compliance. The objective of this division is not so much to enforce the criminal statutes of the law or to prosecute tax-payers committing tax fraud as to create a spectre of jail and disgrace for those who constantly evade their just and legal share of the tax burden. For maximum deterrent, there is a careful representation of industries, geographic areas and economic groups in the selection of tax fraud cases. The punishments are supposed to deter tax offences by making them painful, financially and otherwise, by means of fines, penalties and prison sentences.

In **India**, the massive Taxation Laws (Amendment) Act, 1975, has come into force. This amended law is based on the recommendations of an expert committee known as the Direct Taxes Inquiry Committee, 1971, which was appointed by the government to recommend, among other things, concrete and effective measures to unearth black money and prevent its proliferation through further evasion. The powers of tax authorities to get at the hidden assets of tax evaders and to secure proof of tax evasion have now been enlarged. Penal provisions have been made more rational, more effective procedures for tax recovery have been streamlined and powers of the Recovery Wing enhanced. Most important of all, stiffer punishments have been provided for different types of tax offences, going in some cases upto seven years of hard labour, with stipulation for certain prescribed minimum sentences for some of the more serious offences.

In **Bangladesh**, the Director of Inspection or the Commissioner of Taxes may authorise search or seizure of books of accounts, or documents from any premises, if in consequence of an information he has reason to believe that a person has failed to comply with or there is a possibility that a person may not comply with notice under section 22(4) or 37, when it might be issued.

Further, if the Director of Inspection or the Commissioner has reason to believe that a person has any money or bullion, jewellery or other valuable articles or things and such money, bullion, jewellery, or other valuable articles or things represented either wholly or partly income or property which has not been disclosed for the purpose of Income-tax, he may authorise any Joint Director of Inspection, Joint Commissioner of Taxes, Deputy Director of Inspection or Deputy Commissioner of Taxes: (1) to enter and search any

building or place where such books, documents, money, bullion, jewellery or other valuable articles or things are kept, (2) to break open the door or locker, safe, almirach, and other receptacle where the keys are not available; (3) to seize books of accounts, documents, money, bullion, jewellery or other valuable articles or things.

TAX EVASION

Many developing countries have learnt it to their cost that there is a very close relationship between tax evasion and steeply progressive rates of direct taxes on income levied with a view to achieving distributive justice. Rates being steeply progressive, a good part of the assessable income goes into a hide-out to remain black.

Black money is a problem common to virtually all the market-economy countries where maximising profits and personal incomes are the overriding consideration. The scourge is not confined to the developing countries alone; the latter are, however, particularly susceptible to it for a variety of reasons, important amongst which are: (a) limited traditions of personal and business accounts; (b) limited traditions of using banking facilities and handling the inflated amounts of money incomes made possible by planned economic development; (c) absence of any automatic reporting system for property income and property transactions, analogous to the existing pattern for incomes from employment; (d) availability of facilities for registration of property in bogus names and (e) regulation of economic activity and imposition of fiscal discipline.

The need for rapid and planned economic development necessitates fiscal and monetary mechanisms. The mechanisms give rise to clandestine transactions and violation of regulations which, in turn, breed "unaccounted incomes" and tax evasion. For understanding the problem of black money, a clear distinction needs to be made between the primary and the secondary sources of its generation. In addition to the evasion of income tax, its primary generation in the fiscal field takes place through evasion of other direct taxes, sales tax, central excise duties, customs and other indirect taxes. It also takes place through under-invoicing and over-invoicing of foreign trade; circumvention of price, distribution and all other types of official controls, and kick-backs and other malpractices in official, corporate and private purchases, sales and contracts. When generated, its fall-out fans out to permeate virtually all the vital segments of the economy.

The amount of black money generated through these primary sources cannot be brought on the books that are amenable to examination in the Income Tax Department at the time of assessment, nor can it be used openly for legitimate investment. In the event, there are only two courses open to this black money. One of them is that it should keep off the ordinary investment stream and find its way into ineluctable channels which are economically unproductive and socially undesirable. The black money spills over into consumption, mostly ostentatious living and conspicuous consumption. Its impact on society is debilitating in nature. While it results in the erosion of social values, on the one hand, it tends to exert a demoralising effect on the rest of the society on the other. The bulk of the black money, left over after a part has been devoted to ostentatious living, may get petrified in the shape of gold, bullion or jewellery or real estate or be at rest in fake bank accounts.

The other course open to it is illegitimate investments of various types. Speculative trade in a developing country is by far one of the most lucrative and calls for no such managerial skill as attends upon investment in commercial concerns and industrial undertakings. Smuggling provides another equally lucrative field in which to illegally invest, with prospects of disproportionate returns. The black money may take to itself wings and fly across the national border also. Investments in real estate (particularly luxury construction), transport sector, industry generally and film industry in particular also hold out attraction, as in these fields under-statement of income is comparatively easy and assessment of income tax relatively difficult.

These illegitimate investments net in profits, often as good as a windfall, and as these profits cannot be diverted for legitimate investment in any sector of the economy, they continue to spill out on the periphery of

Changes in the Income Tax Rates Applicable to Resident Individuals

BANGLADESH

1974-75	Rate	Effective Rate	1976-77	Rate	Effective Rate
Taka 1,000	Taka 25	2.5%	Taka 1,000	Taka 75	7.5%
T. 1,000-2,000	T. 25 + 5% of the excess	3.75%	T. 1,000-2,000	T 75 + 5% of the excess	6.25%
T. 2,000-4,000	T. 75 + 10% of the excess	6.88%	T. 2,000-4,000	T 125 + 10% of the excess	8.13%
T 4,000-6,500	275 + 15% of the excess	10%	T 4,000-6,500	T 325 + 15% of the excess	10.77%
T 6,500-10,000	T 650 + 20% of the excess	13.5%	T 6,500-10,000	T 700 + 20% of the excess	14%
T 10,000-15,000	T 1,350 + 25% of the excess	17.33%	T 10,000-15,000	T 1,400 + 25% of the excess	17.67%
T 15,000-25,000	T 2,600 + 35% of the excess	24.4%	T 15,000-25,000	T 2,650 + 35% of the excess	24.6%
T 25,000-35,000	T 6,100 + 50% of the excess	31.71%	T 25,000-35,000	T 6,150 + 50% of the excess	31.86%
T 35,000-50,000	T 11,100 + 60% of the excess	40.2%	T 35,000-50,000	T 11,150 + 55% of the excess	38.8%
T 50,000-70,000	T 20,100 + 65% of the excess	47.29%	T 50,000-70,000	T 19,400 + 60% of the excess	44.86%
T 70,000-100,000	T 33,100 + 67;5% of the excess	53.35%	T 70,000-100,000	T 31,400 + 62.5% of the excess	50.15%
Exceeding T 100,000	T 53,350 + 70% of the excess		Exceeding T 100,000	T 50,150 + 65% of the excess	
T 250,000	T 158,350	63.34%	T 250,000	147,650	59.06%

the hoards of the black money, extending its volume every so often. A vicious circle is thus created and distortions in the economy as a whole set in.

The distortions in the economy are more pronounced and the circumference of the vicious circle is widened during a period of rapidly rising prices, a phenomenon which pervaded virtually all the market-economy countries in 1973-74 and 1974-75. Speculative hoarding of commodities, investment in real estate and smuggling are in full play to accelerate the secondary generation of black money.

To recapitulate, black money tends to inhibit the canalisation of domestic resources into planned investment in the public as well as the private sectors. It distorts social values and promotes inequalities of income distribution. It also fuels inflationary fire through speculative hoarding of commodities.

There is a very close relationship between black money and progressive rates of direct taxes on income levied with a view to achieving distributive justice. When the rates are too progressive in a developing country, very ingenious methods are employed by assessees in evading taxes, notable amongst which are suppression of sales and inflation of purchases, maintenance of duplicate sets of accounts, under-valuation of stocks and assets, concealment of branch profits, conducting business with fictitious partners, over-statement of salaries of employees and of expenses of establishment, wrong and inflated claims of depreciation and transactions under bogus names. Thus, black money may be generated by a variety of sources, but, to remain black, it must consistently escape the income-tax net. Tax is evaded mainly by the higher income groups who are liable to the highest marginal rates of personal income tax. And, tax thus evaded is added to the hoards in the hide-out.

In a developing country, it is not uncommon to find that high income earners in manufacturing, construction and professions evade income tax extensively even in respect of their legitimate incomes. What motivates evasion is not difficult of understanding. The more progressive the rates of income tax, the greater are the rewards of tax evasion and the consequential maintenance and inflation of the hoards of black money. In developing countries, income taxes are virtually always somewhat highly progressive. Critics of progressive taxation warn that it will absorb private savings and dull initiative and enterprise. They suggest that the developing and underdeveloped countries should wait until they have passed through at least the first stages of industrialisation before attempting highly progressive income taxation. Their contention has an empirical basis in the fact that the industrialised countries built up their capital stock at a time when the income tax was either low or non-existent.

In this age, however, it is hardly possible in a developing country to abandon the equity consideration of progressive taxation of income. Highly progressive taxation of income cuts down at once the standard of consumption of the higher income groups and the accumulation of wealth. Inequities of income, in the absence of government intervention, make possible wide disparities in the standards of current consumption and, in course of time, accentuate the unequal distribution of wealth, which breeds two undesirable consequences. The concentration of wealth in the hands of a few carries with it the concentration of economic power. Secondly, as large wealth-holdings are transmitted through inheritances, a class of rentiers is created, who earn large incomes and consume them extravagantly without any social rationale to sustain their claims on social product. Thus, a developing country wedded to egalitarian ideals is not likely to break the undesirable consequences of inequities. Highly progressive taxation is resorted to for purposes of preventing lavish consumption and unproductive investment on the part of higher income groups. Developing market-economy countries are thus faced with the twin problems of digging out black money and developing a mechanism which would ensure against its generation.

AMNESTY IN INDIA

In order to combat tax evasion and reduce severity of its adverse impact on the economy of India, a scheme for voluntary disclosure of undisclosed income and wealth and for payment of tax thereon, without any penalty or prosecution, was provided by a Presidential Ordinance promulgated on October 8, 1975. The objects of the scheme which was operative upto December 31, 1975, were
i) to offer an opportunity to persons who had evaded tax in the past to declare their undisclosed incomes and wealth and return to the path of rectitude; and ii) to secure canalisation of black money so disclosed into productive fields in the overall interest of the economy.

The Indian amnesty was based on certain "reasonable" standard rates on the disclosed amount. The tax was related to the amount disclosed, irrespective of the number of years over which it was earned. And immunity was granted from penalty, interest and prosecution. These standard rates were as follows:

a) In the case of a declarant other than a company	**Rate of Income-tax**
Slab of income declared up to Rs. 25,000	25%
Rs. 25,001 to Rs. 50,000	Rs. 6,250 plus 40% of the excess over Rs. 25,000
Over Rs. 50,000	Rs. 16,250 plus 60% of the excess over Rs. 50,000
b) In the case of a declarant being a company	60%

In addition to the tax payable, declarants were also required to invest 5 per cent of the disclosed income in notified Government securities within a stipulated time. The proceeds of these bonds were earmarked by Government for projects of high social priority.

Declarants were required to indicate the forms (e.g. cash, bullion, shares, commodities etc.) in which the income disclosed was being held. In respect of assets represented by the disclosed income, immunity from Wealth-tax was given for the then current year (1975-76) and earlier years.

Further, the declarants were required to credit the amount of income disclosed in their books of accounts or any other record and indicate this in the declaration. This was meant to provide a safeguard against money flowing back into illegal channels.

Declarants were ordinarily required to pay the tax due before making the declaration. Commissioners were, however, empowered to extend the time of payment, or grant instalments for payment, for good and sufficient reasons. Interest was chargeable on deferred payments.

The declarants were assured of full secrecy by a provision in the law itself that all particulars contained in the declaration shall be treated as confidential.

Declarations received under the scheme disclosed income and wealth of about Rs. 16,000 million, nearly half of which was income disclosed. The tax payable on the disclosed income and wealth and the amount required to be invested in Government securities together amounted to nearly Rs. 3,000 million.

MEASURES IN PAKISTAN

In order to smoke out the black money in Pakistan, the Federal Budget for 1976-77 held out the olive branch to the black money-generating and black-money using higher income groups by bringing down the highest marginal rate of income tax on individuals from 70 per cent to 60 per cent. However, fiscal measures alone could not ferret out black money unless these were supplemented by a judicious mix of economic policy and administrative steps. Specific measures adopted to smoke out black money was additon of the Fifth Schedule and Section 3C to the Income Tax Act, 1922. These legal provisions announced with the federal budget for 1976-77 were much simpler than in India and provided for declarations of undisclosed incomes at the uniform concessional rate of 30 per cent. The declarants were entitled to incorporate in their books of account such undisclosed income as was in tangible form and were not to be liable to either sales tax or wealth tax or Central Excise duties in respect of the income declared.

The Government gave the black money holders an opportunity to make their hidden earnings level by paying only 30 per cent as tax. In addition, the Government came forward with new concessions. If a limited company paid 30 per cent on its hidden income, the directors and shareholders were not asked to pay taxes on the dividend they had already received. The same concession was offered to the directors of private firms if the firms paid up the 30 per cent tax. The Government also came forward with a deferred payment scheme to help those who were not able to pay tax on their concealed income forthwith, but the deferred payment was subject to a rate of interest of 2 percent per month which was much higher than in India. Income Tax Officers were authorised to give deferred payment facilities up to June, 1977, and Income Tax Commissioners for periods beyond that. The government held out assurance that those availing themselves of the opportunity would not be put to any harassment or coercion and that the government would keep its pledge of treating the declarants fairly and justly. It was also promised that the declarations would enjoy complete secrecy.

A good deal of hidden income came up and the Government's efforts in this regard were a resounding success. Hidden income to the extent of Rs. 1,460 million was declared, besides the sealed envelopes including which the total might exceed Rs. 150 million. The Government of Pakistan received Rs. 270 million as tax, and the total tax inclusive of the deferred payments, was Rs. 450 million. The Government did the best it could to attract the hidden wealth painlessly. The low 30 per cent tax and a series of concessions offered to the tax dodgers were much too attractive for any realistic person with hidden income.

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According to a Reuter report published in Pakistan Time of November 11, 1976, with a Dacca dateline, the Bangladesh Government has also set up a Commission to ferret out undeclared taxable income known there as black money. According to a Government press release, adds the report, the commission will be headed by the Governor of Bangladesh Central Bank.

To sum up, the tax policies in Pakistan, India, Sri Lanka and Bangladesh have had two important features in common. One of them is the tightening of administrative arrangements for the collection of taxes on income. The other is the reduction of the maximum marginal rates of steeply progressive taxes on income. At 50 per cent this maxima is the lowest in Sri Lanka and at 65 per cent and 66 per cent, it is the highest in Bangladesh and India respectively. Pakistan's rate of 60 per cent falls in between, but it has been supplemented by a wide-ranging rationalisation of tax incentives.

Major Central Taxes in Pakistan, India, Sri Lanka and Bangladesh

PAKISTAN	INDIA	SRI LANKA	BANGLADESH
— Income Tax (including Company Tax)	— Income Tax (including Company Tax)	— Income Tax (including Company Tax)	— Income Tax (including Company Tax)
— Super Tax	— Customs Duties	— Expenditure Tax	— Customs Duties
— Customs Duties	— Union Excise Duties	— Remittance Tax	— Excise Duties
— Central Excise	— General Sales Tax	— Customs Duties	— Sales Tax
— Sales Tax	— Wealth Tax	— Excise Duties	— Wealth Tax
— Wealth Tax	— Gift Tax	— Business Turnover Tax	— Gift Tax
— Gift Tax	— Estate Duty	— Wealth Tax	— Estate Duty
— Estate Duty		— Gift Duty	
		— Estate Duty	

Major Tax Incentives in Pakistan, India, Sri Lanka and Bangladesh

	PAKISTAN	INDIA	SRI LANKA	BANGLADESH
Tax Holiday	—5 or 10 year tax holiday for new industrial undertakings set up in specified areas.	—5 year tax holiday for new industrial undertakings, hotels and ships. —40% of income of an Indian company or resident non-corporate taxpayers from royalties received from a person carrying on business in India. —Dividends and royalties received by an Indian Co. from export of technical know how.	—8 year tax holiday for export profits of approved new companies from traditional exports. —5 year tax holiday for existing approved companies for profits from increase in exports. —5 year tax holiday for approved hotel undertakings or for constructing buildings for hotels.	—5 or 7 year tax holiday for new industrial undertakings.
Tax Credit and Tax Rebates	—Investment in equities of approved public companies engaged in industrial undertakings. —Investment in balancing or modernization or replacement of machinery — 10%. —Tax rebates for exports. —Tax rebates for other activities.		—Investments by companies according to approved investment plans — 10%. —Foreign exchange brought in by a person carrying on an undertaking for purposes of the undertaking — 20% or amount equivalent to foreign exchange whichever is less. —Investment in housing and land development projects — 20%. —Increase in employment in 1976 — $20\% \times \frac{\text{Increase of employees}}{\text{Total no. of employees on Dec. 31, 1975.}}$ —New undertakings in 1976 employing at least 50 employees — 20% tax. —Increase in the quantity of exports of traditional export products — $20\% \times \frac{\text{Increase in exports}}{\text{Total quantity of exports in the year preceding the year of assessment.}}$	—Rebates for exports (30-50%).
Special Deductions	—Revenue expenditure on scientific research and technical training incurred by an industrial undertaking. —Capital expenditure on scientific research related to business to be apportioned between 5 consecutive years.	—Revenue and capital expenditure on scientific research in the first year. —1½ times the expenditure incurred by domestic companies and other resident taxpayers on export promotion.	—Capital expenditure incurred in the opening up of land for cultivation etc. —Export promotion expenses of approved export companies enjoying tax holiday.	—Revenue expenditure on technical training and scientific research. —Capital expenditure on scientific research related to business to be apportioned between 5 consecutive years.
Accelerated Depreciation	—Special depreciation allowance of 15% in respect of machinery. —Initial depreciation (10-30%) in respect of buildings, plant, machinery and ships.		—Lump sum depreciation ($33\frac{1}{3}$-80%) for specified assets. —Full depreciation in the first year for approved hotel undertakings in respect of plant, machinery, fixtures.	—Initial depreciation (10-30%) in respect of buildings, plant, machinery and ships.
Investment Allowance in respect of plant, machinery etc.		—25% of the cost of new ships, aircraft, new plant or machinery or distribution of power and electricity or construction, manufacture or production of specified articles.	—Development rebate (20 or 40%) for new plant, machinery, fixtures and industrial buildings.	
Foreign Technicians	—3 year exemption of salary under certain conditions. —5 year exemption of tax on tax.	—2 year exemption of remuneration up to Rs. 4,000 per month under certain conditions and exemption from tax on tax on the excess. —2 year exemption of tax on tax.	—Exemption of income from employment. Period depends on whether they are employed by the government or by a tax holiday undertaking.	—3 year exemption of salary under certain conditions. —5 year exemption of tax on tax.

Withholding Taxes on Dividends, Interest and Royalties paid to Non-Resident Companies

	PAKISTAN	INDIA	SRI LANKA	BANGLADESH
Dividends	—Received by a public Company and paid by a Pakistani Co. former after 14 Aug. 1947 — 15%. in other cases 20%.	25%	33 1/3% + 6% of the gross amount of the dividends.	—Received by a public Company and paid by a Bangladesh Company formed after 14 Aug. 1947 — 15%. Other cases 20%.
Interest	—Interest on Securities — 30%. In other cases — 60% (Income Tax 30% + Super Tax 30%)	—Interest on tax free Securities — 44%. In other cases — 70% + 3.5% surcharge	71.71%	—Interest on Securities — 30%. In other cases — 60% (Income Tax 30% + Super Tax 30%)
Royalties	—60% (Income Tax 30% + Super Tax 30%)	a) Royalties from approved agreements: i) made between 31.3.1961 - 1.4.1976 — 50% + 2.5% surcharge ii) made after 31.3.1976: —lump sum consideration for supply of industrial know-how — 20%. —balance — 40%. b) Technical Assistance fees from Agreements: i) made between 29.2.1964 - 1.4.1976 — 50% + 2.5% surcharge. ii) made after 31.3.1976 — 40%.	71.71%	—60% (Income Tax 30% + Super Tax 30%)
Treaties	*Dividend* The rate must be reduced by 6.25% of the super tax (i.e. about 14.06%) under the treaties with Denmark, Sweden, U.S.A., Japan, Sri Lanka (6%). Under treaties with West Germany, Ireland, Switzerland, United Kingdom, France, Poland and Canada, the maximum tax rates are 10%, 15% or 20%. *Interest* Under treaties with Japan, West Germany, France, Switzerland, the rate is reduced to 30%. Under the treaty with Canada, the rate is reduced to 25%. Certain types of interest are also exempt under different treaties. *Royalties* Exempt under treaties with Denmark, Sweden, U.S.A., Japan, West Germany, Ireland, Switzerland, U.K. and France. Under Ceylon treaty 50% reduction. Under Austrian treaty 20% tax. Under Canadian and Polish treaties — Industrial and cinematograph royalties — 20%. Technical know-how and information royalties — 15%. * The treaties with Canada, Poland and Malta are not yet in force. The treaty with India has expired.	No modifications are made under the tax treaties. Comprehensive tax treaties exist with Austria, Belgium, Denmark, Egypt, Finland, France, West Germany, Greece, Japan, Malaysia (not yet in force), Norway, Sri Lanka and Sweden. The Income Tax Double Taxation Relief (Dominions) Rules, 1956 apply to Sierra Leone.	*Dividend* No reduction of rates in the treaties. But, under the Japanese treaty, a special concession of refund of tax deducted at source for a period of 5 years after the expiry of the tax holiday period is given if the company holds at least 10% of the shares. *Interest* No reduction of rates in the treaties. *Royalties* Copyright and cinematograph royalties exempt under treaties with Sweden, Denmark, Norway, West Germany, Japan and Pakistan (only copyright). Industrial royalties — reduction of tax by 50% under treaties with Denmark, Norway, West Germany, Japan, Pakistan and Malaysia. * There is also a treaty with India.	No tax treaties

REORIENTATION OF BELGIAN TAX POLICY: THE 1976 PROGRAM LAW

As was also the case in 1974 and in 1975 the Belgian Parliament enacted for 1976 a "Program Law", i.e. a law which on the one hand aims at keeping Government expenditure within the limits as determined in the Budget Law and on the other hand attempts to redistribute national income on behalf of that part of the Belgian population which is hardest hit by the economic recession and inflation. For this purpose three sets of measures were introduced, i.e. tax measures, a change of the legal provisions regarding the financing of municipalities, provinces and universities and a number of social measures.
The tax measures are again subdivided into three different categories:

- an amendment of individual income tax in order to adjust current tax provisions to price inflation (based on an estimate of 12.9 percent per annum) and the reform of the taxation of so-called "replacement income" (generally social security benefits);

- the second set of measures aims at reducing the tax burden on married couples where both husband and wife are receiving earned income (as opposed to investment income);

- the third set of measures pertains to the introduction of a special excise duty on wines, the limitation of VAT credit with respect to investment goods and the extension of the statute of limitations in cases of tax fraud.

The various provisions of the Program Law were discussed in detail in the English language in the August 1976 issue of EUROPEAN TAXATION. The present article in French, written by Mr. André Spruyt, discusses a special aspect of the Program Law, i.e. the changes introduced in Belgian individual income tax law which in particular affect those taxpayers who receive "earned income" (revenus professionnels). These changes concern, inter alia:

- "Replacement income", i.e. income which is received as a result of the temporary or permanent loss of the source from which the taxpayer's income flows. Such "replacement income" includes social security benefits which under previous legislation were tax exempt provided their aggregate amount did not exceed 80 percent of the income they replaced. Since it has appeared too difficult to properly control this condition it was decided to discontinue the exemption in a two-step operation.

- Income received by active members of so-called "sociétés de personnes" (like the general partnership, limited liability companies etc.) was, under previous legislation, treated as business income and is now considered to be a "remuneration" and put on an equal footing with the remuneration of the members of the Board of Directors in a company limited by shares (société anonyme). Such income will, thus, be considered to be received in the year in which it was attributed (and no longer at the time of the closure of the financial year).

- Separate assessment of the incomes of husband and wife in a number of cases.

In order to realize the above objectives the Program Law redefines the concept of taxable earned income thus introducing a number of important changes which will, inter alia, considerably affect non-resident members and directors of Belgian companies. For instance, under previous legislation remuneration — including pensions — of employees and members of the Board of Directors was not subject to Belgian income tax if it was paid by a Belgian resident, company or association resident in Belgium for activities performed abroad. Under the Program Law pensions are no longer included in this exemption. However, remuneration paid to an active member of a "société de personnes" may now benefit from the exemption. A new restriction imposed is that the exemption is only available for that part of income which can be allocated to a foreign establishment.

Further provisions of the Program Law deny the lump sum expense deduction to, inter alia, pensions and — somewhat surprisingly — the earned income deduction is reduced in particular to the detriment of lower income groups.

Belgique: Modifications apportées par la loi du 5 janvier 1976 au régime d'imposition des revenus professionnels.

André J. J. Spruyt *

I. INTRODUCTION

1. La loi du 5 janvier 1976 relative aux propositions budgétaires 1975-1976 [1], couramment intitulée "loi programme", comporte un important volet de modifications aux lois fiscales. Les articles 1 à 57 modifient le Code des Impôts sur le Revenu, l'article 58 modifie le Code de la Taxe sur la Valeur Ajoutée, tandis que les articles 59 à 70 apportent des modifications aux droits d'accises.

La revision du Code des Impôts sur le Revenu que constitue la loi du 5 janvier 1976, vise principalement l'Impôt des Personnes Physiques [2]. D'autre part, elle prévoit l'extension des délais extraordinaires pour le recouvrement des différents impôts sur le revenu. La loi du 5 janvier 1976 aménage l'I.P.P. afin d'effacer les effets de l'inflation quant aux petits et moyens revenus, introduit des mesures en faveur des familles et modifie le régime fiscal des "revenus de remplacement", ce qui implique une adaptation du régime d'imposition des revenus professionnels.

Rappelons que l'I.P.P. frappe le montant global des revenus immobiliers, mobiliers, professionnels et divers des personnes physiques résidant en Belgique.

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1. Moniteur Belge, 6 janvier 1976, p. 81-130.
2. En abr. I.P.P.

Les montants nets de ces quatre catégories de revenus sont globalisés et, après déduction de certaines dépenses, le montant ainsi calculé forme le montant net imposable qui est soumis à des taux progressifs. Notons que les revenus des époux sont cumulés. L'impôt ainsi calculé peut être réduit notamment en raison de charges de famille, de l'origine étrangère des revenus etc.

La revision de l'I.P.P. que constitue la loi du 5 janvier 1976 apparaît comme assez compliquée en raison de l'introduction de nombre de modifications en deux temps: modifications applicables soit à partir de l'exercice d'imposition 1976 [3], soit à partir de l'exercice 1977 et modifications dont la portée est limitée à l'exercice 1976.
Ce présent exposé sera limité à l'étude des modifications apportées au régime d'imposition des revenus professionnels: revenus professionnels imposables, revenus immunisés, charges professionnelles, abattements sur le total des revenus professionnels et l'imposition distincte des revenus professionnels des époux.

II. MOTIFS DE LA REFORME EN MATIERE DE REVENUS PROFESSIONNELS

A. L'aménagement du régime fiscal des "revenus de remplacement"

2. Les "revenus de remplacement" sont les revenus qui constituent la réparation totale ou partielle d'une perte temporaire ou permanente de revenus professionnels. Il faut distinguer entre d'une part les allocations sociales se substituant à des revenus professionnels perdus et d'autre part les indemnités payées par le responsable du fait occasionnant la perte ou par son assureur.

a. Les allocations sociales constituant un "revenu de remplacement"

3. Il s'agit des allocations de chômage, de maladie, d'invalidité, d'accident de travail ou de maladie professionnelle, dont les travailleurs et employés peuvent jouir en vertu de la législation sociale. Selon le régime fiscal antérieur à la loi du 5 janvier 1976 ces allocations sociales étaient immunisées quand leur montant n'atteignait pas 80% de la rémunération brute perdue.

Cette immunisation avait été instaurée à une époque où ces allocations avaient en fait le caractère de secours. Dans l'état actuel des lois ces allocations ne sont pas seulement liées au montant des rémunérations auxquelles elles se substituent mais aussi à l'évolution du bien-être général. En outre le système antérieur donnait lieu à des difficultés d'ordre pratique en ce sens que parfois il était très difficile, pour ne pas dire impossible, de déterminer avec certitude si ces "revenus de remplacement" atteignaient ou non 80% de la perte effective de rémunération. La raison en était la complexité, la superposition et l'évolution constante des régimes légaux, conventionnels ou contractuels dont découlent ces allocations, sans compter que, dans de très nombreux cas des arrangements plus ou moins subtils étaient pris pour que l'indemnisation globale frise la limite de 80% sans l'atteindre tout à fait [4].

Un autre reproche qui était fait à la législation antérieure en la matière, est qu'elle engendrait des distorsions parfois considérables sur le plan de la charge fiscale subie par différents contribuables à ressources annuelles égales, suivant que ces ressources provenaient exclusivement d'une activité professionnelle, ou bien en tout ou en partie de "revenus de remplacement" [5].

4. Les exemples repris dans les travaux préparatoires de la loi du 5 janvier 1976 sont à cet égard éloquents [6]. Envisageons la situation d'un contribuable célibataire qui disposait pour l'année civile 1974 (exercice 1975) de 300.000 F.B. de ressources:

— **Première hypothèse:**	
— Salaire net	300.000 F.B.
— Montant net imposable (après déduction de l'abattement sur le montant total des revenus professionnels)	284.000 F.B.
— I.P.P. dû (avant application des centimes additionnels)	63.650 F.B.
— **Seconde hypothèse:**	
— Salaire net	200.000 F.B.
— Allocation de chômage	100.000 F.B.
— Montant net imposable (constitué par le salaire net dont l'abattement est déduit; l'allocation de chômage étant immunisée)	174.000 F.B.
— I.P.P. dû (avant majoration des centimes additionnels)	31.350 F.B.

Pour le même montant de ressources, la charge fiscale variait donc sensiblement.

5. Afin de remédier à cette situation, la loi du 5 janvier 1976 introduit un aménagement de loi fiscale qui intervient en deux étapes. Pour l'exercice 1976 ces allocations sociales restent immunisées dans la mesure où elles l'étaient sous le régime antérieur mais elles sont prises en considération pour déterminer le taux de l'I.P.P. applicable aux autres revenus.

Dès l'exercice 1977 les immunités antérieurement prévues sont supprimées [7]. Cette suppression est toutefois assortie de mesures assurant l'exonération de fait de certains "revenus de remplacement" lorsqu'il constituent les seuls revenus imposables des bénéficiaires [8].

b. Les indemnités payées par le responsable du fait occasionnant la perte ou par son assureur

6. Le régime fiscal de ces indemnités avait donné lieu à contestation:
(i) en ce qui concerne les indemnités constituant la réparation d'une perte *permanente* de bénéfices [9] ou de profits [10]. En effet, la jurisprudence [11] considérait que ces indemnités n'étaient pas imposables à défaut de disposition légale [12].

3. Ayant en règle générale pour base les revenus de l'année civile 1975.
4. Doc. Parl., Chambre, S. 1975-1976, n° 680-1, Exposé des Motifs, p. 12.
5. Doc. Parl., Chambre, S. 1975-1976, n° 680-10, Rapport, p. 6.
6. Doc. Parl., Chambre, S. 1975-1976, n° 680-1, Exposé des Motifs, p. 13-14.
7. A une exception près en matière d'assurance maladie ou invalidité cfr. infra n° 31.
8. Cfr. infra n° 35.
9. La notion de "bénéfices" indiquait les revenus retirés de l'activité professionnelle, de commerçant, d'industriel, d'agriculteur et d'associé actif de société de personnes soumise à l'Impôt des Sociétés (en abr. I.S.): cfr. infra n°s 7 et 8.
10. Par "profits" il faut entendre les revenus professionnels obtenus par les titulaires de professions libérales.
11. Cfr. Cass. 9 décembre 1971, J.P.D.F., 1971, p. 324 (avec note).
12. De telles indemnités perçues par des salariés et mandataires de sociétés par actions, étaient par contre imposables en vertu de l'ancien article 26, 2° C.I.R.

(ii) en ce qui concerne les indemnités constituant la réparation d'une perte *temporaire* de rémunérations [13]: La jurisprudence [14] considérait que ces indemnités n'étaient pas imposables à défaut de disposition légale [15].

Ces anomalies devaient tôt ou tard être corrigées par le législateur [16]. Bien que les Travaux Préparatoires de la loi du 5 janvier 1976 ne sont pas explicites [17] à cet égard, nous croyons que le nouveau régime fiscal des "revenus de remplacement" comporte aussi l'imposition de ces indemnités [18].

B. Aménagement du régime fiscal des revenus professionnels des associés actifs de sociétés de personnes soumises à l'Impôt des Sociétés

7. Dans le régime antérieur les sommes attribuées à de tels associés actifs en raison de leur travail personnel étaient soumises à l'I.P.P. dans le chef de l'associé en tant que "bénéfices" [19]. Dans le chef de la société, ces montants étaient déductibles en tant que charges professionnelles [20].
Notons que le revenus professionnels des mandataires de sociétés par actions étaient considérés comme "rémunérations".

8. Les conséquences de la qualification de ces revenus comme "bénéfices" dans le chef du bénéficiaire étaient que:

a. la société débitrice ne devait pas retenir le précompte professionnel [21]. Le Roi avait le pouvoir d'y soumettre ces revenus [22], sans cependant en avoir usé. Les associés actifs étaient par contre tenus d'effectuer des versements anticipés, sous peine de majoration de l'impôt dû sur ces revenus [23].
b. ces revenus étaient considérés comme étant recueillis par les associés actifs à la date de clôture de l'exercice comptable de la société [24]. En d'autres termes tous les revenus professionnels obtenus en tant qu'associé actif et se rapportant à un exercice comptable déterminé d'une société de personnes, appartenaient à la période imposable en matière d'I.P.P. pendant laquelle l'exercice comptable était clôturé et étaient imposés pour l'exercice d'imposition auquel la période imposable se rattache. Ainsi les revenus recueillis en tant qu'associé actif et se rattachant à l'exercice comptable 1973-1974 de la société, appartenaient à la période imposable 1974 de l'associé et étaient imposé dans son chef pour l'exercice d'imposition 1975 en matière d'I.P.P.
c. les associés actifs pouvaient attribuer une quote-part de leurs revenus professionnels à l'épouse qui les aidait effectivement sans disposer de revenus d'une activité professionnelle distincte. Cette attribution de bénéfices au conjoint aidant ne pouvait avoir pour effet de ramener la quote-part de l'autre conjoint au-dessous de 72.000 F.B. [25].

9. Lors de la discussion du projet qui est devenu la loi du 25 juin 1973 devant la Commission Sénatoriale des Finances, le Gouvernement avait pris l'engagement de soumettre les revenus professionnels des associés actifs de sociétés de personnes au même régime que ceux des mandataires de sociétés par actions. [26]. La loi du 5 janvier 1976 en prévoyant l'imposition des revenus professionnels des associés actifs comme "rémunérations", tend à réaliser cet engagement.

C. Allégement de la charge fiscale grevant les revenus professionnels des époux

10. Depuis la réforme fiscale de 1962, tous les revenus des époux étaient cumulés et l'impôt était établi sur l'ensemble de ces revenus avec application, toutefois d'un abattement spécial sur les revenus professionnels de l'épouse.

Pour des motifs d'ordre social, la loi du 5 janvier 1976 introduit l'imposition séparée des revenus professionnels des époux qui en raison de la modicité de leurs revenus, sont contraints à travailler tous deux [27].

III. REALISATION DE CES OBJECTIFS

11. L'introduction de ces innovations nécessitait la restructuration et la modification d'un grand nombre de dispositions du C.I.R. concernant les revenus professionnels imposables, les revenus professionnels immunisés, les dépenses professionnelles, les différents abattements et le cumul des revenus des époux.

A. Revenus professionnels imposables

a. Classification générale

12. L'article 20 C.I.R. distingue plusieurs catégories de revenus professionnels imposables, auxquelles s'appliquent des règles différentes.

Aux termes de l'ancien texte, il y avait quatre catégories de revenus professionnels:

(i) les bénéfices des exploitations industrielles, commerciales ou agricoles quelconques, y compris les bénéfices résultant du travail personnel des associés actifs dans les sociétés de personnes soumises à l'impôt des sociétés;
(ii) les rémunérations diverses:
  (a) de toutes personnes rétribuées par un tiers, sans être liées par un contrat d'entreprise, y compris les bénéficiaires de pensions ou de rentes viagères;
  (b) des mandataires [28] de sociétés par actions;
(iii) les profits des professions libérales et de toutes occupations lucratives;
(iv) les bénéfices ou profits qui se rattachent à une activité professionnelle indépendante antérieurement exercée.

Les règles qui s'appliquent à ces différentes catégories de revenus professionnels font l'objet des art. 21 à 25 C.I.R., en ce qui concerne les bénéfices, 26 à 29 C.I.R. pour les rémunérations, 30 C.I.R. pour les profits et 31 à 32 C.I.R. en ce qui concerne les bénéfices et profits se rattachant à une activité professionnelle indépendante antérieurement exercée.

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13. La notion de "rémunérations" indiquait les revenus retirés de l'activité professionnelle de salarié et de mandataire de sociétés par actions; cfr. infra nos 14 et ss.
14. Cfr. Cass. 22 juillet 1969, J.P.D.F., 1969, p. 246 et Gand, 25 février 1970, Bull. Ass., 1972, p. 157 (avec note).
15. De telles indemnités perçues par des industriels, des commerçants, des agriculteurs, des associés actifs de sociétés de personnes soumises à l'I.S. et par des titulaires de professions libérales étaient imposables en vertu des articles 22, 6° et 30, 2° C.I.R.
16. Cfr. note sous Cass., 9 décembre 1971, J.P.D.F., 1971, p. 326.
17. Incidemment une allusion à ces contestations est faite dans Doc. Parl., Chambre, S. 1975-1976, n° 680-10, Rapport, p. 24.
18. Cfr. infra, nos 16 et 24.
19. Cfr. l'ancien article 20, 1° C.I.R.
20. Cfr. l'article 108, 1° C.I.R. tel qu'il a été modifié par l'article 29 de la loi du 25 juin 1973, Mon. B. du 6 juillet 1973, pp. 8063 à 8081.
21. Les rémunérations attribuées aux mandataires de sociétés par actions étaient soumis à ce précompte en vertu de l'ancien article 180, 1° C.I.R.
22. L'ancien art. 181 C.I.R.
23. Cfr. l'ancien article 89, § 1 C.I.R.
24. Cfr. l'ancien article 169, § 1, b) de l'Arrêté Royal d'exécution du Code des Impôts sur le revenu (en abr. A.R. d'exécution du C.I.R.).
25. Cfr. l'ancien article 64, § 1 C.I.R.
26. Doc. Parl., Sénat, S. 1972-1973, n° 278, Rapport, p. 41.
27. Doc. Parl., Chambre, S. 1975-1976, n° 680-10, Rapport, p. 9.
28. Administrateurs, commissaires, liquidateurs, etc.

13. Le nouvel article 20 C.I.R. [29] applicable à partir de l'exercice d'imposition 1976 [30] distingue dorénavant cinq catégories de revenus professionnels:

(i) les bénéfices des exploitations industrielles, commerciales et agricoles quelconques;
(ii) les rémunérations diverses:
  (a) des employés, travailleurs et fonctionnaires;
  (b) des mandataires de société par actions;
  (c) d'associés actifs de société de personnes assujettie à l'impôt des sociétés;
(iii) les profits de professions libérales et de toute occupation lucrative;
(iv) les bénéfices et profits se rattachant à une activité professionnelle indépendante antérieurement exercée;
(v) les pensions, rentes et autres allocations en tenant lieu.

A la différence du régime antérieur, les sommes attribuées aux associés actifs d'une société de personnes en raison de leur travail personnel ne sont plus considérées comme "bénéfices" dans le chef de l'associé mais comme "rémunérations" [31].

D'autre part les pensions et allocations analogues ne figurent plus parmi les "rémunérations" mais forment dorénavant une cinquième catégorie de revenus professionnels imposables [32].

b. Définition des "rémunérations"

14. Comme indiqué ci-dessus le régime antérieur ne prévoyait que deux catégories de "rémunérations"; celles des appointés et salariés, y compris les pensions, et celles des mandataires de sociétés par actions. La loi du 5 janvier 1976 y ajoute une nouvelle catégorie — celle des rémunérations des associés actifs d'une société de personnes — et en exclut les pensions.

(i) des appointés et salariés:

15. Le nouvel article 26 C.I.R. [33], applicable à partir de l'exercice 1976 [34] les définit comme toutes celles, quels qu'on soient le débiteur, la qualification et les modalités de détermination et d'octroi, qui constituent pour le travailleur le produit du travail au service d'un employeur.

16. Elles comprennent notamment:

(a) Les traitements, salaires, commissions, gratifications, primes, indemnités et toutes autres rétributions analogues tels que pourboires et autres allocations même accidentelles, obtenues en raison ou à l'occasion de l'exercice de l'activité professionnelle.
(b) Les avantages en nature, ainsi que les avantages qui résultent de la prise en charge par l'employeur de dépenses professionnelles ou privées propres au travailleur, tels que les indemnités accordées aux travailleurs par leur employeur en remboursement de leurs frais de déplacement de leur domicile au lieu du travail [35]. Les indemnités obtenues en remboursement de dépenses effectives propres à l'employeur ne sont toutefois pas comprises parmi les rémunérations.
(c) Les indemnités obtenues en raison ou à l'occasion de la cessation de travail ou de la rupture d'un contrat de louage de travail, ou en réparation totale ou partielle d'une perte temporaire de rémunérations. De cette dernière disposition il ressort clairement que les "revenus de replacement" qui constituent la réparation totale ou partielle d'une perte temporaire de revenus professionnels sont dorénavant imposables. Cette disposition s'applique non seulement aux allocations sociales constituant la réparation totale ou partielle d'une perte temporaire de rémunérations mais aussi aux indemnités payées par le responsable du fait occasionnant la perte ou par son assureur. Le texte antérieur avait donné lieu à contestation en cette dernière matière [36].
(d) Les rémunérations proméritées par des appointés ou salariés mais payées ou attribuées à leur ayants cause.

(ii) des mandataires de sociétés par actions:

17. Le nouvel article 27, § 1 C.I.R. [37] les définit comme toutes celles qui constituent pour le bénéficiaire, le produit d'un mandat d'administrateur, de commissaire ou de liquidateur, ou d'un mandat ou de fonctions analogues, dans des sociétés par actions ou dans des personnes morales y assimilées ou assimilables, belges ou étrangères.

Notons qu'en cette matière la loi du 5 janvier 1976 a introduit une modification concernant l'Impôt des Non-Résidents. En effet dans le régime antérieur, les rémunérations obtenues par des non-habitants du Royaume, en raison d'un mandat d'administrateur, commissaire etc. d'une société par actions soumise à l'Impôt des Sociétés belge, n'étaient pas considérées comme revenus produits ou recueillis en Belgique lorsqu'elles étaient payées en raison d'une activité exercée à l'étranger par les bénéficiaires [38]. Il s'en suivait que ces revenus n'étaient pas soumis à l'Impôt des Non-Résidents. Le nouvel article 141, 2° C.I.R. [39] introduit une condition supplémentaire à la non application de l'Impôt des Non-Résidents. Dans le nouveau régime, cet impôt n'est pas applicable dans la mesure où ces rémunérations sont imputées sur les résultats d'établissements situés à l'étranger, en raison de l'activité exercée par les bénéficiaires au profit de ces établissements.

18. Elles comprennent notamment:

(a) les tantièmes et autres rémunérations fixes ou variables allouées à un titre quelconque, sauf en remboursement de dépenses effectives, propres à la société.
(b) les avantages en nature, les avantages résultant de la prise en charge par la société de dépenses propres au mandataire, les indemnités obtenus en réparation totale ou partielle d'une perte temporaire de rémunérations et les rémunérations proméritées par le mandataire mais payées à ses ayants cause.
(c) le crédit d'impôt au cas où les rémunérations allouées au mandataire n'ont pu être déduites des bénéfices imposables de la société. Rappelons que les rémunérations qu'une société par actions attribue à ses mandataires ne sont déductibles des bénéfices de cette société que lorsque les mandataires exercent des fonctions réelles et permanentes [40]. Cette déductibilité est cependant limitée à deux sociétés.

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29. Tel qu'il a été modifié par l'article 15 de la loi du 5 janvier 1976.
30. Art. 71, § 1, 2° de la loi du 5 janvier 1976.
31. Cfr. supra nos 7 à 9 et infra nos 19 à 23.
32. Cfr. infra nos 24 et 25.
33. Tel qu'il a été modifié par l'article 17 de la loi du 5 janvier 1976.
34. Art. 71, § 1, 2° de la loi du 5 janvier 1976.
35. Cfr. toutefois infra n° 29.
36. Cfr. supra n° 6.
37. Tel qu'il a été modifié par l'article 17 de la loi du 5 janvier 1976.
38. Cfr. l'ancien article 141, 2° C.I.R.
39. Tel qu'il a été modifié à partir de l'exercice 1976 par l'art. 31 de la loi du 5 janvier 1976.
40. Art. 99 C.I.R.

Lorsque les rémunérations attribuées aux mandataires ne sont pas déductibles des bénéfices de la société, un crédit d'impôt fixé à 46% du montant brut des rémunérations est accordé aux mandataires qui peuvent l'imputer sur l'I.P.P. dû [41].

Ce crédit d'impôt constitue toutefois un revenu imposable pour le bénéficiaire [42].

(iii) des associés actifs dans des sociétés de personnes:

19. Le nouvel article 27, § 2 C.I.R. [43] les définit comme toutes celles quels qu'en soient le débiteur, la qualification et les modalités de détermination et d'octroi qui constituent pour le bénéficiaire le produit de l'activité professionnelle exercée en qualité d'associé dans les sociétés commerciales belges, autres que les sociétés par actions lorsque leurs bénéfices sont imposés à l'Impôt des Sociétés [44] et dans les sociétés étrangères assimilables à ces sociétés belges.

Les rémunérations attribuées aux associés actifs peuvent être déduites des bénéfices imposables de la société en tant que charges professionnelles [45]. Les sommes allouées aux associés qui ne constituent pas la contrepartie de leur activité professionnelle d'associé, sont imposées dans le chef de l'associé en tant que revenus mobiliers.

20. Les rémunérations des associés actifs comprennent notamment:

(a) les sommes allouées ou attribuées aux associés actifs à l'exception de celles qui constituent des revenus mobiliers [46] dans le chef des associés ou qui sont payées en cas de partage total ou partiel de l'avoir social ou en remboursement de dépenses effectives propres à la société.
(b) les avantages en nature, les avantages résultant de la prise en charge par la société de dépenses propres aux associés actifs, les indemnités obtenues en réparation totale ou partielle d'une perte temporaire de rémunérations et les rémunérations proméritées par l'associé mais payées à ses ayants cause.

21. Bien que le nouveau régime considère les sommes attribuées aux associés actifs comme "rémunérations", elles ne sont pas — ou pas encore — soumises au Précompte Professionnel. En effet, comme dans le régime antérieur [47], le Roi dispose du pouvoir de soumettre ces revenus à ce précompte [48]. Il ne semble cependant pas encore vouloir user de ce pouvoir puisque l'art. 3 de l'Arrêté Royal du 25 février 1976 [49] modifiant l'art. 113 de l'A.R. d'exécution du C.I.R. qui soumettait toutes les "rémunérations" au Précompte Professionnel, tend en effet à en exclure les "rémunérations" payées aux associés actifs. Comme dans le régime antérieur, les associés actifs sont tenus à effectuer des versements anticipés s'ils veulent éviter des majorations d'impôt [50].

22. Le régime antérieur des "bénéfices" donnait l'occasion aux associés actifs d'attribuer une quote-part de leurs revenus professionnels à l'épouse aidante [51]. L'imposition de ces revenus comme "rémunérations" à partir de l'exercice 1976 fait obstacle à cette possibilité. Il importe toutefois de remarquer que lors de la discussion dans la Chambre des Représentants d'un nouveau projet de loi modifiant le C.I.R. un amendement introduit par M. Desmarets [52] et portant sur le rétablissement de cette possibilité à partir de l'exercice 1977, fût adopté [53, 54].

23. Le nouveau régime des montants alloués aux associés actifs de sociétés de personnes en vertu de leur activité professionnelle est applicable à partir de l'exercice 1976 [55]. Ces revenus étant considérés à partir de cet exercice comme "rémunérations", c'est la date à laquelle ces sommes sont payées ou attribuées qui détermine la période imposable à laquelle elles appartiennent [56]. Ainsi les rémunérations payées à un associé actif pendant l'année 1975, appartiennent à la période imposable 1975 et sont imposées dans son chef pour l'exercice d'imposition 1976 en matière d'I.P.P.

Rappelons que suivant le régime antérieur des "bénéfices", ces revenus étaient considérés comme étant recueillis par les associés actifs à la date de la clôture de l'exercice comptable de la société [57]. Cependant un régime de transition a dû être instauré pour le cas où l'exercice comptable d'une société de personnes clôturé en 1975 porte également sur l'année 1974.
Dans le chef des associés actifs de sociétés de personnes dont l'exercice comptable clôturé en 1975, porte également sur une partie de l'année 1974, les revenus recueillis en tant qu'associé actif et se rapportant à cet exercice comptable restent pour l'exercice d'imposition 1976, des "bénéfices" dans le chef de l'associé [58]. Toutefois, les revenus que ces associés obtiennent pendant l'année 1975, après la clôture de l'exercice comptable sont des "rémunérations", ce qui entraîne une imposition anticipée par rapport au système antérieur.

En effet suivant le système antérieur ces revenus auraient été considérés comme appartenant à la période imposable 1976, c.à.d. la période imposable pendant laquelle l'exercice comptable 1975-1976 est clôturé, et imposés pour l'exercice d'imposition 1977. Le nouveau régime a pour conséquence que les revenus payés ou attribués aux associés actifs pendant l'année 1975 mais se rapportant à l'exercice comptable 1975-1976, appartiennent eux aussi à la période imposable 1975 et sont imposés pour l'exercice d'imposition 1976. Cependant l'ensemble des revenus professionnels de ces associés actifs est ramené fictivement à l'année, compte tenu de la période de l'année 1974 couverte par l'exercice comptable de la société, pour déterminer le taux de l'impôt applicable aux revenus imposables pour l'exercice d'imposition 1976. Cette mesure de transition tend à éviter que les associés actifs dans une société de personnes dont l'exercice comptable ne correspond pas avec l'année

41. Art. 135, § 1, 2° C.I.R., tel qu'il a été modifié par l'art. 20 de la loi du 20 décembre 1974, Mon. B. du 31 décembre 1974.
42. Art. 135, § 2 C.I.R.
43. Tel qu'il a été modifié par l'article 17 de la loi du 5 janvier 1976.
44. En abr. I.S.
45. Cfr. l'art. 108 C.I.R. tel qu'il a été modifié par l'art. 29 de la loi du 5 janvier 1976.
46. Ex. les revenus de capitaux investis (art. 11, 3° C.I.R.) et les intérêts sur avances (art. 15, 2° C.I.R.).
47. Cfr. supra n° 8, a.
48. Cfr. l'art. 181 C.I.R. tel qu'il a été modifié par l'art. 34 de la loi du 5 janvier 1976.
49. Mon. B. du 10 mars 1976.
50. Cfr. l'art. 89 C.I.R. tel qu'il a été modifié par l'art. 25 de la loi du 5 janvier 1976.
51. Cfr. supra n° 8, c. et infra n° 37.
52. Doc. Parl., Chambre, S. 1975-1976, n° 879-3, Amendements, II.
53. Compte Rendu Analytique, Chambre, S. 1975-1976, Séance du 29 juin 1976, p. 1496.
54. Ce projet de loi n'est pas encore adopté par le Sénat.
55. Cfr. art. 71, § 1, 2° de la loi du 5 janvier 1976.
56. Art. 167, § 1, 3°, B de l'A.R. d'exécution du C.I.R.
57. Cfr. supra, n° 8, b.
58. Cfr. l'art. 49, § 1 de la loi du 5 janvier 1976.

civile seraient imposés à des taux élevés pour l'exercice d'imposition 1976 en matière d'I.P.P.
En plus aucune majoration pour cause d'insuffisance de versements anticipés, n'est appliquée sur la partie de l'impôt afférente à de tels revenus qui en vertu de la loi du 5 janvier sont imposés pour l'exercice d'imposition 1976, au lieu de l'exercice d'imposition 1977 [59].

c. Définition des pensions, des rentes et des allocations en tenant lieu

24. Dans le régime antérieur, les pensions étaient assimilées aux rémunérations. Le nouvel article 32bis C.I.R. [60] stipule que sont visées quels qu'en soient le débiteur, le bénéficiaire, la qualification et les modalités de détermination et d'octroi, les pensions et les rentes viagères ou temporaires, ainsi que les allocations en tenant lieu qui se rattachent directement ou indirectement à une activité professionnelle dont les revenus sont imposables en tant que bénéfices, rémunérations ou profits. Les "revenus de remplacement" qui constituent la réparation totale ou partielle d'une perte permanente de bénéfices, de rémunérations ou de profits, sont aussi visés. Le régime antérieur avait donné lieu à contestation. La jurisprudence considérait que les revenus de remplacement constituant la réparation d'une perte permanente de bénéfices ou de profits n'étaient pas imposables à défaut de disposition légale [61]. Le nouveau texte met fin à cette contestation.

25. La cinquième catégorie de revenus professionnels imposables comprend, notamment les pensions, rentes, capitaux ou valeurs de rachat de contrats d'assurance-vie constitués en tout ou en partie au moyen soit de cotisations patronales, soit de cotisations personnelles d'assurance complémentaire contre la vieillesse et le décès prematuré. En vertu de l'article 54, 2°, 3° et 5° C.I.R. ces cotisations personnelles peuvent être déduites du montant global des revenus professionnels. Ces pensions, rentes, capitaux ou valeurs de rachat sont cependant immunisés lorsque les cotisations n'ont pas été déduites par l'assuré.

B. Les revenus professionnels immunisés

26. A cet égard des modifications ont été apportées quant aux immunisations à caractère social ou culturel.

Dans le régime antérieur l'article 41 C.I.R. immunisait pour des raisons sociales ou culturelles plusieurs revenus ayant le caractère de "revenus de remplacement". Comme le projet qui est devenu la loi du 5 janvier 1976 tendait à imposer les "revenus de remplacement", la portée de l'ancien article 41 C.I.R. a dû être limitée. Le nouveau texte s'applique à partir de l'exercice 1976.

Le nouvel article 41 C.I.R. [62] ne garde l'immunisation que pour les indemnités, allocations ou rentes qui ont le caractère:
— soit d'un revenu de complément, telles les allocations familiales:
— soit d'interventions dans certaines dépenses d'ordre privé, telles les allocations pour soins de santé, pour frais funéraires, pour aide d'une tierce personne, etc.;
— soit de témoignages de la solidarité nationale, tels le revenu minimum garanti, les allocations aux handicapés non travailleurs, les pensions des victimes de guerre, etc.

59. Cfr. art. 49, § 2 de la loi du 5 janvier 1976.
60. Introduit par l'art. 19 de la loi du 5 janvier 1976.
61. Cfr. supra n° 6.
62. Tel qu'il a été modifié par l'article 20 de la loi du 5 janvier 1976.

THE ADJUSTMENT OF BELGIAN INCOME TAX TO INFLATION.

The Belgian Program Law offers a full indexation for inflation for income tax on incomes up to 200,000 Bfrs., a decreasing partial indexation for income tax rates for incomes from 200,000 to 500,000 Bfrs., whereas incomes in excess of 500,000 Bfrs. do not receive any compensation for inflation. The latter incomes are subject to a 10 percent surcharge on that part of the income tax which can be attributed to the income in excess of 500,000 Bfrs. and — with respect to 1975 income — again to an additional 10 percent surcharge on income tax on income in excess of 1,500,000 Bfrs. This results in an effective increase of income tax in the higher income brackets.

Individual Income Tax

Income (Bfrs.)	1975 rate	1974 rate	Difference
50,000	nil	5.70%	— 5.70
100,000	6.92%	12.70%	— 5.78
150,000	11.80%	16.67%	— 4.87
200,000	15.43%	19.35%	— 3.92
250,000	19.28%	21.38%	— 2.10
300,000	21.86%	22.82%	— 0.96
350,000	23.86%	24.34%	— 0.48
400,000	25.56%	25.68%	— 0.12
450,000	26.89%	26.91%	— 0.02
500,000	28.00%	27.97%	+ 0.03
600,000	30.67%	30.64%	+ 0.03
700,000	32.57%	32.55%	+ 0.02
800,000	34.17%	34.15%	+ 0.02
900,000	35.57%	35.55%	+ 0.02
1,000,000	36.69%	36.67%	+ 0.02
2,000,000	45.66%	44.46%	+ 1.20
3,000,000	51.44%	48.89%	+ 2.55
4,000,000	55.83%	52.48%	+ 3.35
5,000,000	58.55%	54.72%	+ 3.83

27. Notons qu'en matière d'indemnités ou d'allocations familiales, le régime antérieur les immunisait à concurrence d'une somme égale aux allocations analogues que l'Etat accorde à son personnel. Les allocations familiales légales dont bénéficient les administrateurs de sociétés de capitaux et les associés actifs de sociétés de personnes étant inférieures à celles dont jouit le personnel de l'Etat, il était de pratique courante que ces sociétés attribuaient à ces personnes des allocations familiales complémentaires qui étaient immunisées dans le chef du bénéficiaire.

Le nouveau texte de l'article 41, § 1, 1° C.I.R. par contre, ne prévoit l'immunisation que pour les allocations familiales légales.

28. Le nouveau texte de l'article 41 C.I.R. [63] prévoit de plus expressément l'immunisation des sommes obtenues en exécution d'un contrat d'assurance individuelle contre les accidents corporels. Sous le régime antérieur elles étaient aussi immunisées tandis que les primes d'assurance constituaient des dépenses professionnelles à concurrence de la partie de la prime qui était censée couvrir des risques d'ordre professionnel [64].

Dans le nouveau régime qui prévoit l'imposition des "revenus de remplacement", la déduction de ces primes d'assurance en tant que dépense professionnelle a été supprimée [65] tandis que les allocations perçues en vertu de tels contrats continuent à être immunisées.

29. Continuent à être immunisées comme dans le régime antérieur:
- les indemnités accordées aux travailleurs par leur employeur en remboursement de leurs frais de déplacement de leur domicile au lieu du travail dans la mesure où elles ne dépassent pas 5.000F.B. l'an:
- les rentes octroyées aux invalides du temps de paix ou à leurs ayants droit, dans la mesure où elles dépassent ce qui correspond à la pension de retraite ou de survie à laquelle les intéressés auraient pu normalement prétendre;
- les prix, les subsides, les rentes et les pensions attribués par les pouvoirs publics ou par des organismes officiels à des savants, des écrivains ou des artistes dans la mesure où ils ne sont pas versés à titre de rémunération de services rendus [66].

30. Bien que tous les "revenus de remplacement" [67] soient en principe imposables à partir de l'exercice d'imposition 1976, certaines allocations sociales continuent à être immunisées pour l'exercice 1976 seulement. Il s'agit des indemnités, rentes, pensions et capitaux en tenant lieu octroyés en exécution de la législation concernant l'assurance en cas de maladie et d'invalidité, l'assurance contre le chômage, la réparation des dommages résultant d'accidents de travail ou sur le chemin du travail ou causés par les maladies professionnelles, ainsi que les allocations complémentaires de même nature octroyées en exécution de conventions collectives du travail rendues obligatoires par arrêté royal [68]. L'immunisation est soumise à la condition que le montant total des allocations légales, éventuellement majoré des allocations extra-légales, n'atteigne pas 80% de la perte de rémunération brute. Cette condition d'immunisation existait déjà dans le régime antérieur [69]. Toutefois, dans le régime en vigueur pour l'exercice 1976 ces revenus bien qu'immunisés, sont pris en considération pour la détermination du taux de l'impôt applicable aux autres revenus [70]. A partir de l'exercice 1977, l'immunisation conditionnelle des allocations sociales constituant des revenus de remplacement est supprimée. L'application d'abattements spéciaux [71] assure toutefois leur exonération de fait ou tempère leur imposition.

31. A partir de l'exercice d'imposition 1977, une seule immunisation est encore prévue en matière de "revenus de remplacement". En effet, à partir de cet exercice seules les indemnités octroyées en exécution de la législation concernant l'assurance en cas de maladie ou d'invalidité sont immunisées à concurrence de 10% de leur montant [72], en raison des dépenses médicales dont ces revenus sont grevés.

C. Les dépenses professionnelles

32. En plus de la suppression de la déduction en tant que dépense professionnelle des primes d'assurance individuelle contre les accidents corporels [73], la loi du 5 janvier 1976 prévoit la modification du régime des dépenses professionnelles forfaitaires, c.à.d. des montants que le contribuable peut déduire en tant que dépenses professionnelles sans qu'il ait à en faire la preuve. La réforme de ce système est introduite en deux temps.

a. Pour l'exercice d'imposition 1976 cette déduction s'opère, tout comme sous le régime antérieur, sur les rémunérations, y compris les revenus recueillis en tant qu'associé actif de société de personnes, les profits et les pensions, les rentes et les allocations en tenant lieu. Le barème est toutefois considérablement simplifié [74].
En ce qui concerne les rémunérations des travailleurs salariés et les profits des titulaires de professions libérales, les montants déductibles en tant que dépenses professionnelles forfaitaires pour l'exercice 1976 sont:
- 20% de la première tranche de 150.000 F.B. de ces revenus;
- 10%de la tranche de 150.000 F.B. à 300.000 F.B.;
- 5% de la tranche excédant 300.000 F.B.

Pour les rémunérations de mandataires de sociétés par actions et d'associés actifs de sociétés de personnes les dépenses professionnelles forfaitaires sont fixées à 5% de ces revenus.

Le forfait ne peut en aucun cas dépasser 60.000 F.B.

b. A partir de l'exercice d'imposition 1977 les revenus sur lesquels une déduction forfaitaire pour dépenses professionnelles peut être opérée sont modifiés. En effet cette déduction ne s'applique plus qu'aux rémunérations, autres que les allocations constituant la réparation partielle d'une perte temporaire de rémunérations, et aux profits [75]. La déduction ne s'applique plus aux allocations constituant la réparation partielle d'une perte temporaire de rémunérations ni aux pensions, rentes et allocations en tenant lieu. En effet, à partir de l'exercice d'imposition 1977 des abattements spéciaux sont accordés en ce qui concerne ces revenus [76]. Les taux de déduction forfaitaire sont maintenus pour l'exercice d'imposition 1977. Cependant le montant maximum du forfait est fixé à 75.000 F.B. [77].

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63. Cfr. art. 41, § 1, 8° C.I.R.
64. Cfr. l'ancien art. 45, 6° C.I.R.
65. Cfr. l'article 21 de la loi du 5 janvier 1976, supprimant l'article 45, 6° C.I.R. à partir de l'exercice d'imposition 1976 et infra n° 32.
66. Ces revenus peuvent éventuellement être imposés en tant que revenus divers en vertu de l'art. 67, 2° C.I.R.
67. Cfr. supra n^{os} 3 à 6, 16, 18, 20, 24 et 25.
68. Cfr. l'art. 41, § 3 C.I.R. tel qu'il a été modifié pour l'exercice 1976 par l'art. 20 de la loi du 5 janvier 1976.
69. Cfr. l'ancien art. 41, § 2 C.I.R. et supra n° 3.
70. Cfr. l'art. 80, al. 2 C.I.R. tel qu'il a été modifié pour l'exercice 1976 par l'art. 36 de la loi du 5 janvier 1976.
71. Infra n° 35.
72. Cfr. l'art. 41, § 3 C.I.R. tel que l'art. 38 de la loi du 5 janvier 1976 le modifie à partir de l'exercice d'imposition 1977.
73. Cfr. supra n° 28.
74. Cfr. l'art. 51 C.I.R. tel qu'il a été modifié par l'art. 1 de la loi du 5 janvier 1976.
75. Cfr. l'art. 51, § 1 C.I.R. tel qu'il a été modifié par l'art. 39 de la loi du 5 janvier 1976.
76. Cfr. infra n° 35.
77. Cfr. l'art. 51, § 3 C.I.R. tel qu'il a été modifié par l'art. 2 de la loi du 5 janvier 1976.

D. Les abattements déductibles du total des revenus professionnels

33. Sous le régime antérieur l'allégement de la charge fiscale afin de remédier aux ou de tempérer les effets de l'inflation, était obtenu en modulant les abattements spéciaux sur le montant global des revenus professionnels. Pour l'exercice d'imposition 1976 une méthode d'indexation directe des barèmes d'I.P.P. est appliquée qui tient compte d'un taux d'inflation de 12,9% [78].

L'indexation directe ainsi réalisée est complète pour les petits revenus, c.à.d., ceux dont le montant net imposable n'excède pas 201.000 F.B., tandis qu'elle est partielle et dégressive pour les revenus moyens. En effet à partir d'un revenu net imposable de 465.000 F.B. l'effet de l'indexation est totalement supprimé pour les contribuables n'ayant aucune personne à charge.

L'application d'une technique directe d'allégement des effets de l'inflation permet la simplification des abattements sur les revenus professionnels imposables.

a. Pour l'exercice d'imposition 1976

34. L'abattement sur le montant global des revenus professionels est en principe fixé à 10.000 F.B. [79].

Lorsque les revenus professionnels d'un contribuable sont constitués exclusivement de pensions, rentes et allocations en tenant lieu, un abattement plus élevé est prévu afin d'assurer l'exonération de fait des pensions dites "sociales".

D'une part cet abattement spécial est fixé à 76.000 F.B. moins la déduction forfaitaire pour dépenses professionnelles [80], lorsque le bénéficiaire de la pension est:
— soit un contribuable marié dont le conjoint n'exerce pas ou n'a pas exercé une activité professionnelle distincte, c.à.d. lorsque le conjoint du bénéficiaire de la pension ne dispose pas de revenus professionnels;
— soit un contribuable célibataire, veuf ou divorcé.

D'autre part l'abattement spécial pour pensionnés est fixé à 53.000 F.B. moins la déduction forfaitaire pour dépenses professionnelles, lorsqu'un des époux ne jouit que de pensions, rentes et allocations en tenant lieu, tandis que son conjoint exerce une activité professionnelle distincte, ou lorsque les deux conjoints bénéficient chacun, séparément d'une pension.

L'abattement spécial pour pensionnés ne peut être inférieur à 10.000 F.B.

En ce qui concerne les ménages l'abattement de 53.000 F.B. moins les dépenses professionnelles forfaitaires, et celui de 10.000 F.B. peuvent être soit cumulés, soit appliqués deux fois lorsque les époux disposent chacun de revenus professionnels.

b. A partir de l'exercice d'imposition 1977

35. Le régime des abattements sur le montant global des revenus professionnels est à nouveau modifié [81]. Ce nouveau régime des abattements a dû être introduit afin d'assurer l'exonération de fait ou de tempérer l'imposition des allocations sociales constituant des "revenus de remplacement".

Rappelons qu'à partir de l'exercice 1977 les "revenus de remplacement" sont effectivement imposables tandis que la déduction forfaitaire pour dépenses professionnelles ne s'applique plus aux allocations constituant la réparation partielle d'une perte temporaire de rémunérations, ni aux pensions, rentes et allocations en tenant lieu [82].

Le nouveau régime des abattements du montant global des revenus professionnels prévoit:
(i) un abattement ordinaire de 10.000 F.B. pour le cas où les revenus professionnels comprennent uniquement:
— des bénéfices, rémunérations ou profits autres que des indemnités constituant la réparation partielle d'une perte temporaire de ces revenus;
— des pensions, rentes ou allocations en tenant lieu qui constituent la réparation totale d'une perte permanente de bénéfices, rémunérations ou profits.

(ii) Un abattement spécial égal à la différence entre d'une part le montant maximum annuel de l'allocation de chômage et, d'autre part, le minimum imposable pour les contribuables n'ayant aucune personne à charge.

Lorsque cet abattement aurait déjà été applicable pour l'exercice 1976, il aurait atteint en gros 118.000 F.B. [83]. Cet abattement spécial est appliqué lorsque les revenus professionnels comprennent exclusivement:
— des indemnités constituant la réparation partielle d'une perte temporaire de bénéfices, rémunérations et profits;
— des pensions, rentes et allocations en tenant lieu qui constituent la réparation partielle d'une perte permanente de bénéfices, rémunérations et profits.

(iii) Un abattement spécial égal à la différence entre d'une part le montant maximum annuel de l'indemnisation globale à laquelle les travailleurs âgés jouissant de la prépension, peuvent prétendre, et, d'autre part le minimum imposable pour les contribuables n'ayant aucune personne à charge. Cet abattement spécial s'applique lorsque la prépension constitue le seul revenu professionnel du contribuable. Notons que cet abattement ne s'applique qu'à la prépension instauré par la convention collective du travail du 19 décembre 1974 et que cette prépension n'est accordée que lorsque le travailleur est licencié par son employeur. La loi du 30 mars 1976 relative aux mesures de redressement économique [84] a introduit elle aussi un régime de "prépension" accordé à la demande du travailleur. Le système de "prépension" prévu par la loi du 30 mars 1976 n'est applicable qu'au 31 décembre 1976 avec possibilité de prorogation toutefois [85]. Bienque l'art. 62bis C.I.R. n'accorde l'abattement spécial sur les prépensions, qu'à celles qui sont prévues par la convention collective du 19 décembre 1974, il est cependant possible que cet abattement soit aussi appliqué aux prépensions accordées en vertu de la loi de redressement économique.

36. Le nouveau régime des abattements sur le montant global des revenus professionnels introduit à partir de l'exercice 1977 l'application d'une double règle de proportionnalité.

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78. Cfr. l'Annexe I à l'A.R. du 25 février 1976 (Mon. B. du 10 mars 1976, p. 2614 et ss) pris en exécution des art. 77 C.I.R. (tel qu'il a été modifié par l'art. 7 de la loi du 5 janvier 1976) et 48 de l'A.R. d'exécution du C.I.R.
79. Cfr. l'art. 54, 4°, a C.I.R. tel qu'il a été modifié uniquement pour l'exercice 1976 par l'art. 3 de la loi du 5 janvier 1976.
80. Cfr. supra n° 32, a.
81. A partir de cet exercice ces abattements sont régis par le nouvel art. 62 bis C.I.R., introduit par l'art. 45 de la loi du 5 janvier 1976.
82. Cfr. supra, n° 32, b.
83. Chambre des Représentants, session 1975-1976, n° 680-10, Rapport, p. 14.
84. Mon. B. du 1 avril 1976, p. 3923 et ss.
85. Cfr. l'art. 30 de la loi du 30 mars 1976.

En effet, chacun de ces abattements ne sera accordé qu'en fonction de la quote-part des revenus auxquels ils s'applique, dans l'ensemble des revenus professionnels. D'autre part dans les ménages ou les deux conjoints bénéficient chacun de revenus professionnels, ces abattements ne sont accordés qu'une fois et répartis proportionnellement pour déterminer le montant net des revenus professionnels de chacun des époux.

Ainsi lorsque les revenus professionnels [86] d'une contribuable célibataire comprennent pour moitié des salaires et pour l'autre moitié des allocations de chômage, les deux abattements correspondants sont aussi accordés pour moitié.

Lorsque le mari et la femme disposent chacun d'un salaire égal, l'abattement ordinaire de 10.000 F.B. est attribué pour une moitié au mari et pour l'autre à son épouse.

Même lorsque les revenus professionnels des conjoints sont imposés séparément [87], les abattements ne sont accordés qu'une fois par ménage.

E. L'abattement spécial sur les revenus professionnels de l'épouse

37. Dans le régime antérieur un abattement de 40%, avec un minimum de 19.000 F.B. et un maximum de 27.000 F.B., était appliqué aux revenus professionnels de l'épouse. Cet abattement s'appliquait cumulativement avec l'abattement sur le montant global des revenus professionnels. Il était déduit des revenus professionnels de la femme ayant une activité professionnelle distincte de celle de son mari ou de la quote-part des bénéfices ou profits pouvant être considérée comme attribuée au conjoint aidant effectivement le contribuable sans disposer de revenus d'une activité professionnelle distincte. L'attribution de bénéfices ou profits au conjoint aidant ne pouvait avoir pour effet de ramener la quote-part de l'autre conjoint au-dessous de 72.000 F.B.

38. Pour l'exercice d'imposition 1976, cet abattement est porté à 46.000 F.B. [88]. La limité en dessous de laquelle les bénéfices ou profits d'un conjoint ne peuvent descendre par l'attribution d'une quote-part à l'autre, est fixée à 120.000 F.B. Rappelons qu'avant la loi du 5 janvier 1976, les revenus professionnels obtenus en tant qu'associé actif d'une société de personnes, étaient imposés comme bénéfices. Ceci donnait à ces associés actifs la possibilité d'attribuer une quote-part de ces revenus à l'épouse aidante [89]. A partir de l'exercice d'imposition 1976, ces revenus sont imposés en tant que rémunérations ce qui empêche ces associés actifs d'attribuer une quote-part de leurs revenus à leur conjoint aidant [90].

39. A partir de l'exercice d'imposition 1977 l'abattement spécial sur les revenus professionnels de l'épouse est porté à 56.000 F.B. [91]. Cette augmentation s'explique par le fait qu'à partir de cet exercice l'abattement sur le montant global des revenus professionnels [92] n'est accordé qu'une fois par ménage. Notons que lorsque les revenus professionnels des conjoints sont imposés séparément [93] l'abattement spécial de 56.000 F.B. sur les revenus professionnels de l'épouse n'est pas accordé.

La limite en dessous de laquelle les bénéfices ou profits d'un conjoint ne peuvent descendre par l'attribution d'une quote-part à l'autre est portée, à partir dudit exercice, à 150.000 F.B. [94]

F. L'imposition séparée des revenus professionnels des époux

40. Avant la loi du 5 janvier 1976, le C.I.R. prévoyait le cumul de tous les revenus des époux [95]. A partir de l'exercice d'imposition 1977, l'imposition séparée des revenus professionnels des époux est introduite pour autant qu'il s'agisse de revenus professionnels modestes.

L'application de l'imposition séparée est soumise à la condition que les époux disposent chacun de revenus professionnels, que ceux-ci proviennent d'une activité professionnelle distincte, ou de l'attribution de bénéfices ou de profits au conjoint aidant. Les revenus professionnels nets cumulés des époux ne peuvent toutefois excéder 350.000 F.B. Par revenus professionnels nets il faut entendre les revenus professionnels bruts dont ont été déduits les dépenses professionnelles, les dépenses déductibles autres que professionnelles, et les abattements déductibles du montant global des revenus professionnels de chaque époux. Dans le chef de l'épouse, l'abattement spécial sur ses revenus professionnels [96] n'est cependant pas appliqué.

Lorsque les revenus professionnels nets cumulés des époux n'excèdent pas la limite de 350.000 F.B., les revenus professionnels de l'épouse sont imposés séparément sans qu'elle puisse bénéficier de l'abattement spécial de 56.000 F.B. Ses autres revenus, tels les revenus immobiliers, mobiliers et divers, continuent cependant à être cumulés avec tous les revenus du chef de famille. Au cas d'imposition séparée des revenus professionnels des époux, l'épouse n'est plus considérée comme personne à charge de son conjoint [97] bien qu'il y ait imposition cumulée pour ce qui concerne les autres revenus. Les autres personnes pour lesquels une réduction d'impôt pour charges de famille peut être obtenue sont considérées comme étant à charge de celui des conjoints ayant les revenus imposables les plus élevés.

Lorsque le régime du cumul serait toutefois plus favorable au ménage, c'est ce régime qui doit être appliqué. Cela peut arriver en raison des charges de famille importantes du ménage ou de la répartition des revenus professionnels du ménage entre le mari et la femme.

41. Lorsque les revenus professionnels nets cumulés des conjoints excèdent 350.000 F.B. une règle de palier est prévue afin de ne pas trop léser les ménages dont les revenus professionnels nets dépassent légèrement ce montant.

En effet en ce cas l'impôt calculé sur les revenus cumulés des conjoints ne peut dépasser celui dû par le ménage en imposant séparément les revenus professionnels, majoré de la moitié de la différence entre les revenus professionnels nets cumulés et 350.000 F.B.

86. Après déduction des dépenses professionnelles mais avant la déduction des autres dépenses déductibles. Cfr. l'art. 62bis, § 2, al. 2 C.I.R.
87. Cfr. infra nos 40 et 41.
88. Cfr. l'art. 63 C.I.R. tel qu'il a été modifié uniquement pour l'exercice 1976 par l'art. 5 de la loi du 5 janvier 1976.
89. Cfr. supra no 8, c.
90. Cfr. la remarque concernant le rétablissement probable de cette faculté au no 22 supra.
91. Cfr. l'art. 63 C.I.R. tel qu'il a été modifié par l'art. 50 de la loi du 5 janvier 1976.
92. Cfr. supra no 36.
93 Cfr. supra nos 40 et 41.
94. Cfr. l'art. 64, § 1 C.I.R. tel qu'il a été modifié pour l'exercice 1977 par l'art. 54 de la loi du 5 janvier 1976.
95. Cfr. l'ancien art. 73 C.I.R.
96. Cfr. supra no 39.
97. Cfr. l'art. 82, § 1, al. 2, 1° C.I.R. tel qu'il a été modifié par l'art. 53 de la loi du 5 janvier 1976.

TAXATION IN THE MIDDLE EAST.

Except to the relatively few insiders, little is known about tax and related questions in those Middle East countries on which, for one reason or another, the interest of businessmen and investors is more and more being focused. An international conference recently held in Amsterdam highlighted some of the most crucial problems with respect to eleven countries which offer interesting opportunities for all kinds of business activities. This note gives a necessarily brief summary of the main points discussed during the conference.

The countries of the Middle East can be categorized as developing countries. Unlike other developing countries, however, they generally have huge funds available from which they can readily pay for whatever they need in the context of their development programmes. In many countries there is a lack of managerial skill and technological know-how. In some of them there is even a shortage of labour, whereas others are faced with a crucial unemployment problem.
It is not surprising that the overall attitude towards foreign investment and business is positive. Even where legislation seems to be very strict, most countries have built in legislative or administrative outlets enabling them to grant special favourable treatment. While it is perhaps an exaggeration to say some laws only exist on paper but are not applied in practice -- although one sometimes cannot avoid getting this impression -- foreign activities deemed to be of interest for local development are positively looked upon and treated accordingly. It is, as always in the case of operations abroad, important to understand traditions and mentalities. This applies in particular to dealings with the authorities. Whereas in some countries there is a legislative and administrative machinery, in others it is the Ruler who determines what is to happen and his decree is the Law. In several cases, special investment laws or codes provide for rules which deviate fundamentally from the normal legal provisions and are, therefore, sometimes very attractive. Usually, special committees which have the authority to examine and to approve applications made in connection with new projects, operate quickly and efficiently.
During the Amsterdam conference some points of special interest dealt with in the Conference Manual were highlighted as a result of discussions with the 200 participants. A few of these points are summarized in this brief article. *The research staff of the Bureau, in cooperation with the speakers and other experts, is currently examining the possibility of preparing a detailed loose-leaf work scheduled for publication in the autumn of 1977.* **Meanwhile, a small number of copies of the Conference Manual are still available.**

An important point is the criterion of "being engaged in trade or business" within a country. This point has two main aspects. On the one hand, the question arises as to whether a foreign firm is *allowed to do business* **in a country. On the other hand, one wants to know when tax liability arises.**

Foreigners restricted in doing local business

The basic attitude towards foreigners wishing to engage in trade *within* Middle East countries is restrictive. In nearly all countries foreign individuals are prohibited to carry on a local business. Saudi Arabia and Kuwait, for instance, grant the right to engage in business as a commercial agent exclusively to the nationals. Other countries follow this same pattern by requiring every merchant to be registered but then provide that such registration is only possible for nationals.
Doing business in the form of a company is generally more suitable for foreigners. Companies are allowed to engage in business within the countries but a normal requirement is local participation in the share capital as well as in the management. As regards Saudi Arabia, commercial law does not provide for restrictions as to foreign ownership, but under the provisions of the Foreign Capital Investment Code permission is required for the investment of foreign capital.

Alleviation of restrictions in special cases

For special projects the restrictions are generally waived and in many cases even incentives are offered. The exceptions to the normal rules apply mostly if for the project concerned foreign know-how is a prerequisite for the realisation of the project. In most situations a special Committee has to consider whether the project is in the public interest. If this is found to be the case, the investors are entitled to the benefits of the various investment laws or codes.

Tenders

Usually, the international business community is invited to offer a tender for public projects. Often, this tender system is restricted in that not every foreign company is allowed to subscribe. Some countries accept tenders only from "qualified firms" appearing in a special list. As regards private projects foreign companies may themselves sometimes take the initiative. For them to benefit from the favourable legislation they must prove that the project is one of public interest and inform the authorities in detail about feasibility, marketing aspects, local participation and the like.

Company law

The company law of several countries is based on the civil law system. The types of companies are generally those known in Western European, particularly French law. Usually they are legal entities with the exception of joint ventures which are considered as an undisclosed agreement of association between two or more parties. This is especially the situation in **Saudi Arabia.** In the **United Arab Emirates** the formation of companies is effected through a charter system, i.e. by Decree of the Ruler.

When does trading attract tax?

Foreign firms have to be very careful if they do not wish to become liable to income tax. Taxation of business profits is based upon the principle of territoriality which is rather sharply defined. Trading *with* a country — i.e. the selling of goods *to* a Middle East country — does not usually attract tax, but only to the extent that the goods are delivered at a port. As soon as they are delivered directly to the ultimate customer, the foreign firm will be deemed to carry on business *within* the country and become taxable. In other words, even in the absence of any sales office or business agent, Middle East tax liability may arise because of the simple fact that delivery takes place within the country.
This is an important feature in connection with construction operations, especially those concerning the construction and installation of industrial or similar plants. Where a foreign company applies machinery and other equipment manufactured in its own country for installation in a Middle East country, it is often worth its while for it to conclude two separate contracts: one to deliver the machinery and equipment at a port and the other to assemble or construct. Thus, only profit resulting from the latter will be taxable in the host country.

Head office expenses

Most Middle East tax laws are not very detailed on the subject of the computation of taxable profit. Generally accepted methods of commercial accounting play an important role. As a consequence of the principle of territoriality, business expenses are only deductible if connected with taxable activities within the countries concerned. Head office expenses may constitute a problem in this respect. Charges for direct services related to operations in the Middle East are generally deductible if such services contribute to the profitability of the operations. Overhead cost of the head office would not as such be allowed. Often, the solution seems to be to take such cost into account in computing the fee charged for direct services.

Interest and royalties

Another problem arising from the principle of territoriality is the somewhat ambiguous position of interest and royalties payable by the Middle East activities. While such payments are deductible expenses in computing the profits from such activities they are at the same time income from local sources. The problem then is what part of the interest and royalties constitutes taxable profit. In such cases the general rule is applied that the profit is estimated if no proper accounts are kept. **Saudi Arabia** for instance assumes that at least 15 percent of such payments constitute taxable profit, which then is taxed at normal rates.

Depreciation, capital gains, losses

Depreciation of assets is deductible. Where depreciable assets are sold at a gain, such capital gains are included in ordinary profit and taxable as such.
As regards losses different rules apply in the various countries. Within two extremes, losses incurred in previous accounting periods are carried forward. In **Kuwait** this is allowed for an unlimited number of years. On the other end, **Qatar** and **Saudi Arabia** do not allow any loss carry-over.

Special rules and incentives

Most countries apply special taxes or rules to oil companies.
In all cases, approved or qualifying foreign investments may benefit from the incentives provided for in special investment laws.



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Rate structure

Where companies are taxed, two different rate structures apply. There are graduated rates on a per bracket basis, where for each bracket a percentage is imposed irrespective of the total profit. In some countries the rates are graduated as well but each percentage applies then to *total* profit not exceeding a certain bracket. In the following table, these two methods are indicated as "graduated rates" and "flat graduated rates" respectively.

General evaluation

Although at first sight the attitude towards foreign investors seems to be restrictive, foreign companies in many cases are not only allowed but even welcomed to operate in most Middle East countries. The only problem that may arise for a particular company is to come into the picture. Even though this is not always required, it is to be recommended to get in touch with a local partner or sponsor who can facilitate the contacts with the various authorities and who takes care of compliance with the provisions of the various laws, decrees and regulations. This is particularly desirable in connection with the drawing up of contracts and other legal documents which must always be submitted in the Arabic language.

THE FACTS:

The conference was held in Amsterdam, 27-29 October, 1976

Subject:
Tax and Legal Aspects of Trade and Investment in Oil Countries and Financial Centres of the Middle East.

The eleven countries covered:

Bahrain - Egypt - Iran - Iraq - Jordan - Kuwait - Oman - Qatar - Saudi Arabia - Syria - United Arab Emirates

The ten speakers:

Issa El-Ayouty
Partner of Issa El-Ayouty & Co., Accountants & Auditors, Jeddah
D. Bennetts
Partner of Peat, Marwick, Mitchell & Co., Dubai
George Ghali
Partner of Saba & Co., Jeddah
Sayed Habib
First Under Secretary of Ministry of Finance, Cairo
D. Fletcher
Partner of Whinney, Murray & Co. in the Middle East, Deira — Dubai
P. Nabavi
Partner of Coopers & Lybrand, Tehran
Khalid Issa Taha
Lawyer, Baghdad
Kamen Troller
Lawyer, President of the Arab-Swiss Chamber of Commerce and Industry, Geneva
Usama Tuqan
Partner of Saba & Co., Bahrain
D. Wainman
Partner of Whinney, Murray & Co., London

The Conference Manual

prepared by Mr. J. Mittendorff with the assistance of the speakers contains 11 country chapters, each dealing with the following subjects:
— Selling goods
— Trade agencies
— Construction or assembly activities
— Branches
— Subsidiaries
For each subject, the legal, financial, tax and customs aspects are summarized.

Moreover:

the texts (in English) of:
— the multilateral Arab double tax treaty
— the treaty on Arab Economic Unity
— the existing bilateral treaties between
Egypt — Austria
Egypt — Finland
Egypt — Germany
Egypt — Italy
Egypt — Norway
Egypt — Sweden
Egypt — U.S.A.
Iran — France
Iran — Germany

A limited number of the Conference Manual is still available at the price of 200 Dfl. (by registered airmail: 220 Dfl.). Please use the enclosed order form and enclose your cheque.

	I Local participation	II Corporate income taxes (max.)	More favourable treatment as regards I and II under special law or arrangement	Exchange control limitation
Bahrain	51%	nil, except oil companies	yes	no
Arab Republic of Egypt	51%	undistributed 39.7% distributed 40.55%	yes	yes
Iran	At least majority. 25% foreign holding permitted	foreign company graduated rates up to 60% at Rs 50 M Special construction withholding tax 5.5%	yes	approval, no
Iraq	51%	graduated rates up to 60% at I.D. 15,000	yes	yes
Jordan	51%	38.5%	yes	yes
Kuwait	51%	flat graduated rates up to 50% at KD 375,000	yes	no
Oman	35% up to 66 2/3%	flat graduated rates up to 50% at RO 500,000	yes	no
Qatar	51%	flat graduated rates up to 50% at QD 5 M	yes	approval, no
Saudi Arabia	not, 25% to qualify for incentives	graduated rates up to 45% at S.R. 1 M	yes	no
Syria	No, however authorisation needed	graduates rates up to 66% at £S 700,000	yes	yes
United Arab Emirates	Charter system Abu Dhabi 51%, or 25% Others local sponsor or bank guarantee	graduated rates up to 50% at Rupee Riyal 1 M respectively Dirham 5 M	yes	no

Inflation and Taxation.

At present, almost every country, whether developed or less developed, suffers from inflation. There may be a variety of causes of inflation but the common feature is that crucial problems arise in the area of taxation of business income. In most countries, income tax is based upon the nominalistic principle.

Over the years, several attempts have been made to adjust income tax provisions so as to reflect economic realities. As regards business income a *revaluation of assets* for the purpose of determining depreciation allowances has been admitted or is still being granted. With respect to progressive individual income taxes, rates, allowances as well as brackets have been, or are being, adjusted. These and other measures have not always led to practical results.

Learned societies have put up study committees or devoted special meetings to the problem of inflation and taxation. During its London Congress held in September, 1975, the International Fiscal Association invited a panel of experts to discuss it. At this year's Congress in Vienna (October, 1977) one of the two main subjects is "Inflation and Taxation", on which a large number of national reports is expected, with Prof. Dr. Hans Georg Ruppe from Austria as general reporter. The London based Institute for Fiscal Studies made it a topic for research in depth.

Inflation presents a special problem for developing countries seeking to attract foreign investments. A country facing and suffering particular difficulties in this respect is Israel. The Israeli Government has taken active steps to resolve the matter in a new manner after previous legislation having been rather unsuccessful. Dr. Ernst W. Klimowsky, president of the Israeli branch of the International Fiscal Association and a lawyer in Tel Aviv briefly reports on the measures recommended and now officially proposed in his country.

TAX MEASURES AGAINST INFLATION.

Dr. E. W. Klimowsky

A. The economic and tax problems

With an economy with an annual inflation rate of between 30-35% and nevertheless badly needing foreign investments in order to steep up the growth of its national output above 2%, Israel is looking for a remedy also in the fiscal field.

Attempts for the same reasons and purposes had already been made elsewhere, for instance in France, to allow balance sheet reserves; similar attempts were contemplated in U.K.

The problem had been discussed by a panel of experts at the 29th Congress of the International Fiscal Association 1975 in London. One of these experts had been Shalom Ronel, past president of the Israeli Institute of Public Certified Accountants. He was on November 12th, 1975, appointed by the Ministers of the Treasury, Commerce and Industry to act as chairman of a committee which should examine the effects of devaluation of the Israeli pound (IL) on foreign investments and to propose measures to maintain and encourage such investments in Israel. In its Report of February 2nd, 1976 the committee surveyed the unsatisfactory experience made after previous one-time devaluations of the IL with regard to the maintenance of the value of equity capital in terms of foreign currency; the laws of 1958, 1964 and 1969 granting additional depreciation allowances had proved to be completely inadequate countermeasures. Therefore a permanent and built-in remedy had to be found, especially for enterprises with a high working capital whilst with regard to the investment in fixed assets the problem was not so significant.

The situation of the foreign investor had been deteriorating in two ways: on the one hand he suffered a genuine loss of foreign currency in both real and nominal terms. It is true that the same investor made a profit on loans received in IL. On the other hand, in case of sale of an asset acquired in foreign currency and sold in foreign currency, the Israeli law courts related the purchase and sale's price to IL and held that such an investor had made a profit in IL for which he was liable to income tax or capital profits tax. All these difficulties aggravated by the introduction into Israeli economy of the "creeping devaluation" whereby with an attempt to delay any rise in price level, the rate of the IL to the US dollar was constantly lowered in short intervals, each time at about 2%. The investor was, therefore, interested to postpone the conversion of foreign currency into IL. This withholding tactics caused considerable tension with the Israeli enterprise which had to take costly loans in IL from Israeli banks. Moreover, that enterprise cannot normally take short-term loans in foreign currency, this being against Israeli fiscal policy.

The committee rejected the insurance of the rate of exchange as an alternative remedy which would cost 10.4% annually with a devaluation rate of 30%. In any such case the value of the undivided profits would have to be insured as well in terms of foreign currency, thereby demanding a larger premium than the insurance of share capital because it involves a short period of time and a probably quick withdrawal. The issue of bonus shares will require a complicated adjustment of premiums. Other alternative remedies, such as additional loans with or without convertibility grants, tax credit certificates and the introduction of a special allowance to maintain only the working capital into foreign currency were examined and rejected by the committee.

B. The recommendations by the committee

The committee found that by way of legislation two fundamental positions had to be altered in order to pave the way for the attraction of foreign currency investments:

(a) Relinquishing the nominalistic treatment with regard to those investments, and —

(b) Income tax exemption of any profits arising from the devaluation of the IL.

"No tax will be imposed on profits, where the amount of the provision is negative."

This should be confined to foreign currency earning industrial enterprises.

The particulars of these recommendations are:
1. Companies wholly or partly approved or recognised under the Israeli Law for the Encouragement of Capital Investments (L.E.C.I.) and the Law for the Encouragement of Industries (L.E.I.) and owned by foreign residents or in which foreign residents have more than 25% of the control, may out of their profits make an *Equity Maintenance provision* in IL in order to maintain the approximate value of equity capital, including accumulated profits as measured in terms of foreign currency. This Provision is income tax deductible even in closely-held companies (under the control of not more than five persons) and will be calculated according to the adjustment of depreciation and the amount required for the working capital. Also companies jointly owned by foreign *and* local investors may set up that Provision. The exchange rate differentials due to investors are a deductible expense.

Because the earlier anti-inflationary (not that for excessive wear and tear) depreciation allowance has become superseded, it will now be disallowed.

2. The Equity Maintenance Provision is meant to insure the foreign currency value of the share capital and also, if so desired, the accumulated surplus to be distributed as dividend. For the latter purpose that surplus is to be adjusted to the exchange rate and, after a withholding tax of 25% or in case of Double Taxation Conventions of 15% in terms of foreign currency be transferred to a Dividend Equalization Reserve. Adjustment of depreciation is to be computed once a year only, viz. according to the coefficients to be published once a year by the Income Tax Commissioner. Example: For an asset of IL 100.— the exchange rate was by the end of the first year IL 4.20 and the next rate IL 7.24, the adjusted depreciation of that asset will be IL 172.—.

C. The Equity Maintenance Provision Bill

Now, the Minister of Finance has on November 17th, 1976 issued the first draft of a Bill which is intended to shield foreign investments against inflationary corrosion.

The introduction of the "creeping devaluation" aggravated that corrosion to a perilous degree, inasmuch as these did not take the form of value-preserving fixed assets. The calamity was especially felt by scientifically orientated enterprises where the percentage of working capital is rather high. One of the results was the speedy distribution of dividends for foreign investors. In order to solve these problems the recommendations of the Ronel Committee were adopted and will be presented to the Knesset as a Bill of which the salient features will be as follows:

(a) An industrial company having more than 25% direct or indirect participation by non-residents, shall be entitled to set up a tax-exempt *reserve* as Equity Maintenance Provision (E.M.P.). That investment may give to the non-residents the right to dividends or to voting power or to appoint members of the board of directors. The investment itself may be composed of equity and of shareholders loans. This new proposition is meant for genuine non-residents only and, therefore, a company registered outside Israel but controlled by an Israeli resident is excluded.

(b) The E.M.P. is income-tax deductible and is being adjusted once every year from the year of start of operating to the end of that and every following year. The adjustment is composed of the following particulars: long-term loans and current obligations and payments made to foreign shareholders, even to those who have a controlling interest in the company.

(c) The provisions made are to be registered in a special account to be kept separate in the annual balance sheet as "Capital Maintenance Reserve" and shall serve to maintain the payment of dividend in foreign currency and to cover payments of the "negative provision" (when the amount required exceeds the adjustments of the depreciation and other debts). This negative provision is considered as an income item and shall not exceed the amount of provisions made in the two foregoing years. Has this been, however, the case, then the surplus shall be transferred to the two subsequent years and shall be deducted from the positive provision.

(d) From the E.M.P. the amount necessary for the adjustment of the distributable dividend is to be transferred into a "Dividend Equalisation Reserve" (D.E.F.) which is to be registered in a special account and to be singled out in the annual balance sheet. If the company has overdrawn the E.M.P. it has to pay back the amount of the tax-exempt overdraft with interest.

(e) Because of the grant of the perpetuating anti-inflationary remedy the earlier special depreciation allowances are cancelled.

The new measures are to remain in force for ten years, and from 1980 onward no new such privileges are to be given. The right to those privileges is to be computed on a monthly base beginning from the actual month in which the grant is being given.

It is noteworthy that the currency and tax privilege will be granted to the company as such and not to the foreign investor and that they apply also to such otherwise qualifying companies which are controlled by not more than five persons.

LOOSE-LEAF SERVICES REVIEW

For many years, we have been listing not only loose-leaf publications received for review, but also the updating supplements subsequently received for these publications. This information will continue to be listed in the section: Loose-leaf Services.

As an additional service, however, we are now starting a country-by-country survey, listing bibliographical notations and further information on the contents of these books. The first of these surveys appears in this issue on page 38 and deals with loose-leaf publications covering Australia and Belgium.

From tax haven to fiscal paradise.

H.W.T. Pepper

PART ONE

I. INTRODUCTION *

1. Opinions about tax havens tend to vary from regarding them as the unacceptable face of capitalism to hailing them as sanctuaries from over-oppressive tax levies, depending on whether one is trying to collect taxes or avoid paying them.

2. Since World War II, when many countries' taxes were raised to unprecedented heights, not every country has reverted to more "bearable" tax levels and there has been a brisk business in setting up tax havens and in using their services.

3. Economists may deplore the channelling of highly-skilled private sector man-power into the non-productive tax avoidance industry, with a corresponding diversion of governmental resources into countering avoidance. High tax levels encourage avoidance techniques which tend to reduce the tax base, leading to the need for still higher taxes, which in turn increases the exasperation factor and leads to even more avoidance. Economic waste is also implicit in the diversion of skills and resources from higher-taxed to lower-taxed countries purely on tax considerations intead of on the basis of real economic needs.

Fiscal Losses and Gains

4. The "fiscal wastage" or leakage (or "saving", depending on one's viewpoint) caused by the use of tax havens cannot be estimated accurately but probably runs into thousands of millions of dollars, only a tiny part of which accrues as revenue to the havens.

5. The losers tend to be the highly-industrialized countries, which are usually also highly-taxed, but these are not the sole sufferers, since some developing countries also have high tax rates and are thus at even greater risk (because of limited resources to cope with them) to tax avoidance schemes.

6. The havens themselves are a varied collection of colonies, principalities, and independent states, which by no means, as a body, represent the most needy countries of the world. Some havens achieve comparative affluence for their populations, and sometimes this affluence is, in effect, at the expense of much poorer developing countries whose tax revenue is also eroded by haven activities. Nevertheless, as will be seen later, certain specific requirements govern the question of which countries could be developed as tax havens and these factors have little to do with a country's needs or deserts!

* *For a detailed table of the various tax havens, see page 5.*

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Influence of Fiscal Policy on Propensity to Avoidance

7. When personal tax levels are not regarded as unduly high or oppressive in the light of a country's economic circumstances, tax avoidance by the sharper or shadier characters in a community may be regarded as less than "respectable" and unworthy of emulation. When taxes are generally regarded as unreasonable or oppressive, and particularly when the political party in office appears to use its power to levy taxes at a much higher rate than the opposition party did when it was in office, there may be an erosion of that part of patriotism which has to do with prompt declaration and payment of taxes, and tax avoidance may become a much more general and respectable pursuit.

8. To an extent, therefore, matters are in the hands of a government itself — which if it does not exercise reasonable moderation in taxation may reach the point of diminishing returns.

9. That the feeling against taxation which is regarded as onerous can be very strong is indicated by various historical examples, starting with the Athenian Empire, which fell partly through defection of associated states which were supposed to contribute to the Athenian navy, the fall of the Roman Empire, partly speeded by the exactions of the central government from the provinces to provide bread and circuses for the Roman plebeians.

10. In more recent centuries the revolt in England against a naval tax ("ship money") imposed by a would-be absolute ruler became a civil war in which the King lost his head and England her monarchy; and the tea and stamp taxes imposed by Britain upon the American colonies resulted in the first "colonial war" of the modern era and independence for the erstwhile colonies.

11. Nowadays the strife is carried on in accountants' and lawyers' offices and on the Government side in the chambers of Attorneys General, usually without bloodshed, though the cell-door may occasionally clang shut on the legal avoider who has gone too far and used fraudulent evasion to gain his ends.

12. Like the quest for El Dorado, the avoider's dream is the perfect haven, where he may inherit the family fortune untaxed, enjoy his life-time income untaxed, preferably amid modern conveniences, a blissful climate and cultural environment, and leave his capital untaxed to his heirs when he in turn departs from his earthly haven to a fiscal paradise.

Definition

13. Before going further it is desirable to define a "tax haven" for the purpose of these notes, as being a place offering relief or exemption from taxes, particularly direct taxes on income and wealth, and from exchange control, not merely a place to keep money (whether "black" or "white", "hot" or "cold"). Several countries accept foreign money on bank deposit without attempting to tax the interest or seek disclosure of the foreign depositor's name (examples include Britain and the U.S.A.) but such countries are not necessarily orthodox tax havens, and some plainly are not.

14. Some countries, however, have some "haven" elements in that particular types of income or capital are not taxed and a full-scale haven may then be a place where such exempted income may be imported and held or put to work. (See also "**No tax and Low Tax Havens**" below).

15. Other countries may provide an effective haven for certain classes of individuals although in no sense being tax havens in the ordinary sense. (See "**Individual Taxpayers: Residential Havens**" below.)

16. Some havens specialise in shipping (see "**Shipping Havens**" below) and some of the more "respectable" havens now eschew the use of the phrase "tax haven" preferring to be styled "financial centre".

"RESPECTABLE" USES OF TAX HAVENS

17. A case can no doubt be made out for the use of tax havens as a refuge from "tax tyranny" or oppression, as England, Holland, and in turn the New World were (and are) for long sanctuaries from religious and political persecution. Perhaps the very existence of such havens exercises some check on the rapacity of tax departments and Ministries of Finance.

18. Not all tax-avoidance schemes entail the use of a tax haven, and in fact most "avoidance", or the ordering of one's affairs so as at least not to attract the maximum tax, is done within the taxing country, and havens are most relevant when there is some international element in transactions or investments.

19. Often the effect of using an avoidance scheme based on a foreign tax haven is to **defer** taxation rather than avoid it completely. There may be good commercial reasons for deferment, even though such reasons may not be accepted by the taxing state.

20. One of the more "respectable" devices is the "captive insurance company" referred to below, and some respectability has also attached to the use, in certain circumstances, of flags of convenience. (See "**Shipping Havens. .**" below.)

"Defensive" Uses

21. Where the tax laws of a country contain anomalies which can only be avoided by a person taking himself or his income or capital outside the taxing country, there may be some case to be made in justification, provided no laws are broken.

22. For example, countries with death duty laws usually have abatement provisions to reduce the successive exactions when the same estate passes from one person to another, and then to another because of a succession of deaths, but rarely is the relief adequate to prevent extremely confiscatory levels of taxation.

23. Where capital gains tax exists, some countries have no relief where the proceeds of realisation of assets are promptly re-invested. Then what is supposed to be a tax on realisation at a profit of assets with a view to personal consumption of the gain, becomes an arbitrary levy which e.g., does not usually apply to realisation and reinvestment where this occurs through one company taking over another by a share exchange, or, of course to the investment which increases in value without needing to be switched at all.

24. Several countries have no adjustment for currency depreciation in their gains taxation so that where there is no profit (or even a loss) in real terms on realisation of an asset, the owner may incur substantial tax upon the cash "profit" on realisation.

25. Where an individual owns assets through a company which he controls and is unwise enough to realise his assets by first selling the company's assets and then winding up the company to distribute its assets to himself, he will, under some capital gains tax regimes incur a swingeing "double dose" of capital gains tax on what is really a single capital gain.

26. Where a boxer, baseball or football player, rises to the top of his profession and remains there for a short time only he may incur very heavy "graduated" taxes on his income for that period. The same may apply to a writer, an actor, singer, dancer, etc. Some countries' laws provide for the "spreading" of the exceptional earnings over a longer period for tax purposes, but the period of spread is rarely long enough to equate the "star's" position with that of a man who earns a similar total income over the whole of his working life, which will often be a period of at least 40 years.

27. In such cases it had become almost routine to take "avoiding" action. Possibly it was the prevalence of such avoidance which helped to lead to a major change in the USA's Federal Taxation of earned income. The top rate of Federal income tax fell over a relatively short period of years from more than 91 percent to the present "cut-off" rate of 50 percent of the earnings. The action taken by the USA has incidentally led to a major reduction in the numbers of those entering into tax avoidance schemes concerning exceptional short-term earnings.

28. In many cases an individual may register a haven company, or even a trust, abroad with the idea of eventually retiring to live abroad, or as a precautionary or preparatory measure, but may never actually use the company so that it becomes a sort of "toy", of which he tires in due course, so that it becomes struck off the register.

29. In contrast, of course, some taxpayers, or their advisers on their behalf, concoct schemes of the greatest artificiality in order to avoid tax that is not unduly oppressive, and some taxpayers are of such an extreme nature that they would go out of their way to avoid tax even if it was charged only at 1 percent!!

ATTRIBUTES AND TAX STRUCTURE OF A TAX HAVEN

30. What have been called the "classic" attributes of a tax haven may be summarised as—

(a) Absence of direct taxation (i.e., no income tax, estate, inheritance, or succession taxes, capital gains tax);
(b) Absence of Exchange Control;
(c) Political stability, good law and order, work permits readily available for foreign professionals to operate haven services;
(d) Good air, telex, and telephone communications with developed countries; and
(e) Suitable tax, commercial, corporate, and trust laws to attract overseas business.

31. The "ideal" political situation has been suggested to be that of a long-term "colony" which apparently has no ambition to become independent (the **Caymans, Gibraltar, Bermuda** and **New Hebrides** have been put forward as more or less within that category, while **Switzerland**, a country with a stable currency, a neutral stance in wars, and an absence of political problems is regarded as another type of "natural" haven). [1]

32. Some of these conditions may, of course, be shaded — for example, some havens function not with an absence of direct taxes but having those taxes at low levels. For instance, **Jersey, Guernsey,** and the **Isle of Man,** all off the coasts of Britain have personal income taxes with maximum rates around 20% and so does **Montserrat** in the West Indies, while the **British Virgin Islands** have a 12% maximum income tax on individuals and companies.

33. A country may have exchange control for its resident nationals but accord freedom from control to others in respect of all money originating from outside the country.

34. It is useful for a country to have up-to-date company and trust laws, and to make digests of these laws (as well as full copies) available to those who require them. Company laws should preferably contain model Memorandum and Articles of Association which may be used by persons who wish to register a company quickly and there is also something to be said for establishing model trust instruments which may be adopted in cases where a trust is required for some usual and straightforward purpose. Such models are of great assistance to the "customer" since he knows, without having to incur substantial professional fees to find out, what kind of documents will comply with, and "work" under the law of what, to him, is a foreign country. Where such laws do not exist and it may take a long time to formulate them, an interim solution may be found by allowing the laws of some other country to apply to particular types of transactions relevant to "offshore" customers.

35. Of course a tax haven must raise some taxes to pay for the cost of governing the country, and does not usually wish to raise import duties to exceptional levels because that would hit the poorer people in the country. Revenue is in fact usually derived from initial and annual company registration fees, and similar fees for offshore banks, shipping registration, etc. where these items are within the haven's scope. Where the haven makes it a condition that an offshore company should have an on-shore director or other local representation (which may or may not be a good idea) the effect is to put business in the way of local professionals, who will benefit handsomely if there is no income tax. It may, therefore, be reasonable to make a small percentage levy on professional fees in repect of offshore business as an additional means of raising national revenue.

TYPICAL USES OF TAX HAVENS

36. By far the largest part of tax haven business in pure numbers of transactions is the registration of companies. Usually there are flat initial and annual registration fees and no supervision of the activities of the company if

1. There are, of course, several long-established havens, e.g. **Panama, Andorra, Liberia, Liechtenstein,** which are politically independent, in recent years the **Bahamas** has become independent, and **Singapore** and **Malta** have been added to the ranks of shipping centres.

these are all overseas. Although registration takes place in the haven the actual "residence" of the company, e.g., for tax purposes, may be there or in some other country where the company is actually managed.

37. Local professionals will be involved in helping to set up and register companies, which may include drafting Memoranda and Articles of Association where these are not made on a standard model. Some countries insist on a local director or official being appointed to a company in order to increase local earnings from offshore companies. This measure would probably not be adopted by a newer haven which was seeking to obtain a footing in the haven field, and in any event there might be initial shortages of professionals in law and accountancy available to take on the extra work, given that a swift and efficient service is a sine qua non of a tax haven.

38. Registration of trusts in tax havens is a matter that will certainly involve resident professionals, and in the first instance the employment of outside experts in trust and tax law to provide the necessary services. The Government's task will be to provide suitable trust laws, to relax its labour laws at least to the extent that there is no difficulty in employing foreign lawyers and tax experts for some years until local personnel can be trained. There will in any case be appreciable employment created by the existence of tax haven facilities and customers. Foreign employers can normally be expected not to be slow in employing locals as soon as they are qualified, since the cost in salaries and fringe benefits is normally much less where a man and his family do not have to be brought into the country at high cost in fares and benefits. Benefit may include housing accommodation when a foreign employee is in post as well as education allowances and fares for his children if they have to be educated overseas.

39. Shipping registration and flag-of-convenience facilities tend to be a specialised service provided only by a few havens. If the haven has a "genuine" connection with maritime matters in the shape of good harbours and port installations and a history of handling and chandling ships, there will probably be local skills which can be utilised in respect of registration and "flag" services.

40. By far the largest shipping haven is **Liberia**, which employs agents overseas, notably in New York, to which lawyers and agents acting for North American clients can refer, and in other countries as well. (See below "**Shipping Havens. .**".)

41. Banking services, specialising in handling off-shore funds, including trusts, are likely to involve importing experts even though ordinary banking services already exist in a country. A good example in this respect is the **Caymans** where there are now about 220 banks, of which 25 have registered since the end of 1975, company registrations running at about 1200 per annum, a good deal of trust business, and about 40 solicitors and 40 accountants supplying the expertise to cope with the banking, trust and other work. In the **Caymans** many of the banks are physically present in substantial buildings, although the funds they handle are mostly of overseas origin.

42. Haven countries such as **Caymans, Bermuda, Jersey, Guernsey,** tend to be rather cautious in their registration of banks, since financial institutions, if not properly run, may lose not only their own money but also the savings of others, thus spoiling the image of the country which has allowed them to register. Accordingly it is common to require security checks and references in such cases and to provide laws which also give some measure of security to the depositor.

WHERE USE OF HAVEN INAPPROPRIATE

43. It has been truly said that there is nothing more useless than to have made trading losses in a tax haven. If, therefore, there is any danger of the results of an enterprise going "into the red", even if in the initial stages only, and even if the "loss" is somewhat "artificial" — perhaps being created by generous relief for depreciation etc., possibly in excess of normal commercial provisions — it may still not be desirable to use a tax haven.

44. The point is that if the enterprise is part of a larger concern (or "conglomerate") it will usually be possible to arrange for the losses on one part of the concern to be offset against profits of other sections, thus reducing the total profits of the group. Such an offset will not be permissible if the loss-making activity is based in a tax haven. Accordingly, even in the case (or perhaps particularly in the case) of a shipping concern which is part of a group, where there is a risk of trading losses, or an entitlement to exceptional depreciation allowances, it may be best for the shipping activities to be subjected to orthodox taxation.

REGIONAL CONSIDERATIONS

45. Another limitation on the operation of tax havens is the attitude of their regional neighbours. Britain takes an interest in the activities of its offshore havens (**Jersey, Guernsey, Isle of Man,** etc.) which probably helps to ensure that they do not permit the perpetration of too audacious schemes to avoid British tax, and correspondingly the EEC keeps an eye on the European tax havens. General de Gaulle, when President of France, treated **Monaco** very firmly when there was some question of their extending haven activities so that French nationals would have had more scope to avoid French tax and erode the French revenue. Similarly, Australia is understood to have severed telex connections with one or two would-be havens in the Pacific region in order not in any way to encourage their efforts to provide havens for Australian tax avoiders. Britain ended the double taxation agreement with the **British Virgin Islands** (which was in any case due for revision) and renegotiation has not yet been completed as far as is known, although the double tax treaty with the USA still stands.

46. Although practitioners are always on the look-out for a haven which is geographically convenient to the countries whose taxes may be avoided, in the interests of good neighbourly relations, havens often pay regard to the susceptibilities of their neighbours, perhaps because of the realisation that excessive avoidance zeal might stir up a hornets' nest, whereas a moderate amount of avoidance might be tolerated!

"IMAGE"

47. It is important for a haven, or would-be haven, to achieve and maintain a good "image" if it wants to attract optimum business. On the positive side it is important that there should be no delays in answering queries connected with the services provided, whether by telex, cable, or post, and that "literature" including forms and copies of the laws, digests thereof, and explanatory notes about the laws and other services should be immediately available on reasonable payment. So much is plain common sense. A haven will try to keep out of the news, or at least out of the bad news, such as having its ships behave badly, its banks going bankrupt, or its institutions involving subscribers or depositors in losses. This means good "vetting" (see below) and constant vigilance, all of which is worth while, since if a haven attracts bad press notices and thus focusses attention upon itself, it is also more likely than others to provoke counter-action by the countries whose revenues suffer from avoidance depredations.

TAX HAVENS AND TOURISM

48. There is no necessary link between tax havens and tourism, but it is noteworthy that in some cases places were recognised tourist resorts before they became important tax havens — this is true of Britain's offshore islands all of which are pleasant places, still "unspoilt" as far as scenic beauty is concerned. It is also true of the Caribbean resorts such as the **Bahamas, Montserrat,** the **British Virgin Island,** and **St. Vincent,** and of **Bermuda** further north, while in Europe, **Andorra, Gibraltar, Malta, Cyprus, Monaco,** and **Switzerland** have their attractions.

49. The **Cayman Islands** are a haven where tourists followed the tax avoiders, good communications with neighbouring territories have grown up to meet both "trades". It has been noted that there is a tendency, when an individual has set up an offshore company or perhaps a family trust in a haven, even if there is no actual need for him to visit the place, that he will at some time or other go there in person. He may not become wildly excited at the sight of the brass plate of his own company but may perhaps generate a sentimental attachment which will result in his remaining an occasional tourist long after all tax havens have been wiped off the face of the earth by international "sanctions"!!

50. At any rate, it does seem that wherever a haven is reasonably accessible, and has something to offer the tourist there may be useful inter-action whereby one activity encourages the other.

Individual Taxpayers: Residential Havens

51. In the ancient world, exile was sometimes used as a punishment, sometimes resorted to as an escape from the consequences of crime or political disfavour. In modern times dictatorships of the right and the left have both resorted to the reverse policy of not allowing the disaffected to leave the country. Fortunately, in democracies, an individual is still free to travel and emigrate outside his own country, and a new category, the "tax exile" has arisen, who sometimes "votes with his feet" when he finds the tax regime at home altogether too onerous.

52. Exile is not to be too lightly resorted to since the conditions of life in the chosen haven, while no doubt pleasant, are unlikely to be so stimulating, or the amenities quite so comprehensive as in the industrialised country from which he comes, and he may miss the social contacts with friends and relatives to which he has become accustomed.

53. Sometimes exile is resorted to more for health reasons than tax considerations, sometimes there are elements of both factors in the decision to retire overseas, perhaps to a warmer or drier climate. Where there is a choice of possible havens, tax considerations may swing the decision one way or the other.

54. Although it would sometimes make sense to do so, few countries indeed offer a special tax "deal" for potential settlers (an exception is Malta — see below) but some do not need to because their tax climate is in any event favourable. For example, **Bermuda, Bahamas,** and **Caymans** have no income tax or death duties, **Monaco** has no income tax, some **Swiss cantons** no death duties, the **British Virgin Islands** have a top tax rate of individual income tax of 12%, and a top rate of around 20% prevails in **Montserrat, Jersey, Guernsey,** and **Isle of Man.** In **Malta** the normal top rate of income tax is 65%, but new residents may be accorded a maximum rate of 32½% if they satisfy certain minimum income and capital requirements and pay not less than M£1,000 per year in income tax. The minimum tax payment requirement in **Jersey** is incidentally now £17,000 although the maximum rate is 20%, so that new arrivals, other than those who set up businesses, have to be more or less in the millionaire class. Further afield the **Seychelles** have a top rate of 35% and the **Solomon Islands** a cut-off top rate of 25% on personal incomes— all of these islands have attractions for residence in retirement. An important factor to consider is whether income tax extends to the whole of a person's world income or merely to the part that is brought into the country for living expenses. The rules vary and cannot be briefly summarised.

55. It is, however, important to clear this point before deciding to go to settle in an island paradise, i.e., one must first make sure that even if it is not a fiscal paradise, the tax charge will be a reasonable one. Some tax regimes, though appearing rather harsh on the surface, may prove to be more favourable if foreign income is not taxed, and if double taxation treaties or unilateral relief for foreign tax provide abatement where the income brought into the country has already been taxed overseas.

56. It is nowadays usual for a would-be settler to be asked to give evidence of adequate means before being permitted to settle in a country. This is reasonable enough because many pleasant parts of the world have populations with low income levels and the countries often have economic problems such that they have no wish for an influx of impoverished beachcombers.

"Artistic" Havens

57A. An interesting idea for encouraging settlement in a kind of "artistic" haven, or modern Athens, has been developed in **Eire** (Republic of Ireland). An individual who is an established novelist, playwright, composer, artist, sculptor, etc., may set up residence in Eire and be completely free of income tax on his artistic earnings including any royalties, etc., from his past artistic work. The only stipulation is that he should be an established and successful member of his profession and not a mere dilettante.

57B. Apart from raising the cultural image of the country, the concession is not likely to be costly since artists, writers, etc. are often somewhat nomadic, being able to exercise their professions almost anywhere in the world which they may visit to seek "local colour". They are also able, on occasion, to arrange their affairs so that they minimise their tax liability even without the benefit of specific exemption. The welcoming State, however, is likely to receive economic benefits from the advent of a class of reasonably affluent persons, whose demand for housing and other requirements should give a minor stimulus to the economy.

58. Tax "exile" is probably the most respectable form of tax avoidance, and if the individual has skills which he does not want to atrophy in retirement, he may be able to help his adopted country (especially if he keeps out of local politics) by placing his skills at the government's disposal; the exile, moreover, makes a real sacrifice by severance of old friendships and amenities.

NO TAX AND LOW TAX HAVENS

59. Although a complete absence of direct taxation has obvious attractions, sometimes a moderate tax regime in the country of adoption for corporate or individual residence may prove in the event to be equally attractive. The effect of a network of double taxation agreements between a country selected as suitable for residence, and some of the industrialised countries whence the new resident may come is often to provide exemptions for certain types of income, such as pensions and annuities, in the source country if these are remitted to and taxed in the residence country. Where other income is doubly-taxed the effect of the treaty may be that there is no net addition to the tax jointly imposed by the two countries, because of the relief granted by one or the other.

60. Some countries exempt foreign income from tax provided it has borne tax in the foreign country and in some cases the rather token tax applied to **International Business Companies** (see later) has been sufficient to qualify.

EXCHANGE CONTROL

61. It goes almost without saying that a tax haven must not even contemplate applying exchange control to its customers, and should allow them to maintain bank accounts in any currency that the banks operating in the haven are prepared to allow. It is legitimate to desire to keep one's monetary assets in whichever currency or currencies one thinks will prove strongest over a period and reasonable for a haven to allow this facility for anyone who wants to use it.

62. Absence of exchange control is not of course confined to tax havens but is the rule in many countries where there is no pressure on the balance of payments. Exchange control should in any event be a temporary expedient, whever adopted, since it is arguable that it may have the opposite effect from that desired if persons in a position to bring money into the country, hesitate to do so for fear of difficulty in taking it out again.

63. Hence, in countries which have had exchange control for long periods, such as Britain, although control is strict on residents, non-residents may freely transfer money in and out. They are encouraged to send money to Britain by high interest rates, which, however, make it expensive to attract such funds.

64. Where exchange control exists, it must be admitted that it may help the Tax Department to cope with cases where income is fraudulently understated and the money sent out of the country to avoid detection, but on the whole an economy is healthier if such control can be given up and foreign investment attracted by the economic climate in general rather than by "artificially high interest."

65. As far as by-products, such as the making of greater difficulties for tax evaders are concerned, it is better to deal with such evasion by other methods. Moreover, since exchange control itself will usually generate a new quota of control-evaders, this may in turn lead to new types of tax evasion, since there may then be a "need" to evade tax in order not to provide evidence which on a cross-check could help the exchange control authorities to establish a prima facie case for evasion of their controls through evidence of income declared and taxed, but not accounted for by bank balances within the control country!!

GEOGRAPHICAL "ZONING" OF TAX HAVENS

66. There is a clear tendency for taxpayers to use the services of tax havens which are physically near to, or at least well-connected by air, sea or land travel, and by telephone, telex, or cable. Geographical distance may be overcome by the haven establishing agencies in the countries it serves (see also "**Shipping Havens. .**") but there are obvious advantages to the **Bahamas** and **Caymans** in having the excellent air connections they enjoy with North America, and to the British "off-shore islands" and the various European havens (e.g., **Andorra, Monaco, Liechtenstein, Switzerland, Malta,** and **Gibraltar**) in being so well connected to European industrial centres. The inter-action of financial services and tourism (see **"Tax Havens and Tourism"** above) is also obviously greatest when there are good travel links between customer and haven.

67. On the other hand, the physical nearness of a haven to the countries it seeks to "serve" (the Finance Ministries of those countries might choose another verb!) may make it easier for the latter to put pressure upon a haven and limit its activities (see below **"Tax-Avoidance and Counter-Tax-Avoidance"** and **"Shipping Havens.."**).

TAX-AVOIDANCE AND COUNTER-TAX-AVOIDANCE: RESTRICTIONS ON HAVENS

68. It is a misfortune for mankind that so much good brainpower is devoted on the one side to extra turns for the tax screw and on the other to new twists in avoidance spirals!

69. The more experienced havens seem to exercise self-discipline by refraining from bringing wrath upon them by allowing too outrageous schemes to be set up which would seriously erode tax revenue in another country. Others, by stringent vetting of would-be operators and their schemes, endeavour to avoid financial scandals and

other abuses which would damage their "image". For example, **Bermuda** does not accept offshore banks at all, and **Jersey, Guernsey**, and the **Isle of Man** all exercise restraint in the interests of neighbouring Britain, the **Caymans** accept banks with offshore activities but take great care to check the bona fides of the promoters.

70. By now it must be clear to havens, even if it is not always clear to the more enthusiastic of tax advisers, that any scheme which is too esoteric, convoluted, or "artificial", particularly if it offers a serious threat to the operation of an important tax law in an industrial country, is going to provoke reaction. The reaction may not only set aside the scheme, involving the perpetrator perhaps in additional expense instead of a tax saving, but may go much further in a wing-clipping exercise.

71. For example, the Australian Government, reacting from avoidance schemes which in particular used **Norfolk Island, Nauru,** and the **New Hebrides,** enacted at the end of 1974 a revision of the Banking Act, which imposed a requirement that an Australian had to obtain a tax clearance certificate and exchange control permission before undertaking transactions with a number of tax havens (in addition to the **New Hebrides,** for which the requirement already existed). The prescribed list of 19 countries makes interesting reading, viz.:

Bahamas		
Bermuda	*Grenada*	*Nauru*
Solomon Islands	*Hong Kong*	*Netherlands Antilles*
British Channel Islands	*Isle of Man*	*New Hebrides*
British Virgin Islands	*Liberia*	*Panama*
Cayman Islands	*Liechtenstein*	*Switzerland*
Gibraltar	*Luxembourg*	*Tonga*

72. The U.K., in introducing Capital Transfer Tax in succession to Estate Duty included a provision which ruled that a Briton who "emigrated" to Jersey, Guernsey, or the Isle of Man, offshore islands one of whose attractions had hitherto been the absence of death taxes, would remain liable to British Capital Transfer Tax for the first 3 years after emigration. Similar provisions exist elsewhere, e.g. Austria subjects its non-resident citizens to death duty as if they were resident during a period of two years after they have left the country, Germany does so for a period of five years (10 years under certain circumstances), while the Netherlands only recognize the acquisition of a foreign domicile by its citizens after 10 years have elapsed. The United States is currently looking into the whole matter of tax avoidance, and if anything, efforts are likely to be stepped up on the forthcoming change of President. The U.S. is already noteworthy for the interest it takes in taxing its passport-holders when the latter are working or resident outside the country, and seems likely to take an increasing interest in the activities of offshore banks in so far as U.S. nationals do business with them. Belgium, Canada, and West Germany are other countries to take anti-avoidance action in recent years.

COMPETITION BETWEEN HAVENS

73. **Fees.** In general it seems that there is comparatively little competition between havens, solely on the grounds of fees, say, for ordinary company registration. For one thing fees tend to be broadly in line, since new havens have adopted practices from the older havens whose success they have emulated! Another point is that there is usually no guarantee that the fees of one haven, which are currently below average, will not be increased next year to an above-average level!

74. Accordingly, provided the fees are not inordinately high, customers are more likely to look into matters such as accessibility, efficiency of services, availability of professional advice and so on. A new haven, attempting to jump on the bandwaggon would, therefore, be better advised to look to its services than to try to gain an entry by undercutting prices!

75. Legal, financial and tax practitioners in other countries who already have to keep au fait with the laws and practices of a fairly large number of havens, are unlikely to be too enthusiastic about the arrival of a new haven, except to the extent that the extra competition with the old havens will keep them "on their toes" and perhaps also discourage them from attempting to increase their fees.

76. **Services.** The types of service commonly provided by financial and tax havens have already been alluded to. In general it is efficiency and promptness which most impress customers and potential customers, and these factors cover the availability of all relevant laws, and digests and translations of them, the explaining of all that is actually required to set up companies, trusts, etc. and, of course swift replies to enquiries by letter, preferably in the customer's own language.

77. **Work Permits.** The importance of granting labour permits to expatriates without undue delay can hardly be overstressed. In fact the countries in the developing world which give most attention to this simple point are usually the ones that attract the most technical aid and private investment, and incidentally achieve the greatest increase in employment opportunities for their own citizens in all fields of human endeavour.

78. **Laws.** As already mentioned, it is useful to have up-to-date company and trust laws, but until they are adopted it is possible to make do with the laws of other countries by making them applicable to the instances which are appropriate. The main requisite is that it should be absolutely clear what law applies, and that copies should be readily available.

PRE-REQUISITES FOR A TAX HAVEN

79. These have already been summarised in the Introduction to these notes. It might be mentioned, however, that where a new haven is to be set up, which has the requisite history of political stability and civil order, it is also useful, where the ruling government is likely to change from time to time with the varying outcome of elections, that there should be reasonable assurance that the party out of power does not intend to reverse the policy of the party in power when its turn to govern comes, i.e., there should be bilateral consensus of views on the matter.

COUNTRY BY COUNTRY SURVEY OF LOOSE-LEAF PUBLICATIONS...

AUSTRALIA

AUSTRALIAN INCOME TAX; LAW AND PRACTICE

11th edition; by E.P. Mannix and D.W. Harris.
— Replacement pages
— Bulletin
— Cases.
Sydney, Butterworths, 1975.
Supplemented: fortnightly.

Loose-leaf publication consisting of 7 volumes. The full text of the Income Assessment Act is set out section by section, and each section is followed by annotations prepared by the editors.
The annotations consist of an analysis of the section, notes on all the decided cases which have a bearing on the section, worked examples and relevant departmental announcements. The Income Tax Regulations and related legislation including double taxation treaties are appended.
The material in this work is updated by a special loose-leaf service: Replacement pages.
In addition, the publishers supply supplementary services for information on tax developments and on case law in Bulletin and Cases, respectively, to be filed in loose-leaf binders entitled Australian Income Tax-Law and Practice — Bulletin, and Australian Income Tax-Law and Practice — Cases.

SALES TAX; EXEMPTIONS AND CLASSIFICATIONS

Canberra, Commonwealth Taxation Office, 1971.
Supplemented: periodically.

Publication gives details of current official rulings on the classification of goods under items in the Schedule to the Sales Tax (Exemptions and Classifications) Act.
The material will be kept up to date by the issue of replacement pages.
A comprehensive index is appended.

BELGIUM

BTW-HANDLEIDING

Ministère des Finances, Masuiplein 13, 1000 Brussels.
Supplemented: annually.

Loose-leaf publication prepared by the Ministry of Finance designed as a guide for quick information on tax on value added. The publication provides a well organised comment on the tax on value added per subject matter with reference to findings in the law and to administrative circulars.
The material is kept up to date by the issue of supplementary pages.

CODE DES IMPOTS SUR LES REVENUS/WETBOEK VAN DE INKOMSTENBELASTINGEN

Commentaire du Code des impôts sur les revenus / Commentaar op het Wetboek van de inkomstenbelasting.
Ministère des Finances, rue d'Arlon 80, Brussels; 8 volumes.
Supplemented: regularly.

Loose-leaf publication containing the official text of, and comment to the Belgian Income Tax Code, available in the French and Dutch languages. The full text of the Code is published. In addition, an annotated text of the Royal Decree implementing the Code is appended. The comment to the Code covers the individual income tax, the corporate income tax, the income tax on legal entities and the tax on non-residents. Tax collection, distribution of income to provinces and municipalities, cadastral income from real estate, temporary provisions, prepayment on business income, the enforcement of the law and penalties for non-compliance are dealt with.
The material is kept up to date by the issue of replacement pages and supplementary pages.

GUIDE PRATIQUE DE FISCALITE

CED/Samsom, 7 rue Philippe de Champagne, 1000 Brussels. 6 volumes.
Supplemented: regularly.

Loose-leaf publication divided into 8 chapters.
Chapter I consists of two parts. Part I contains the official text of the Belgian Income Tax Code in the French and English languages. It covers the individual income tax, the corporate tax, the tax on legal entities and the tax on non-residents. The Royal Decrees implementing the income tax are appended.
Part II contains the official text of the other parts of the Belgian Fiscal Code. It deals with the tax on value added, registration duties, death and gift duties, stamp duties and duties connected therewith.
Chapters II to VIII contain a commentary on the different tax items mentioned under Part I and Part II of Chapter I.

TRAITE DES IMPOTS SUR LES REVENUS/HANDLEIDING DER INKOMSTENBELASTINGEN

CED/Samsom, 7 rue Philippe de Champagne, 1000 Brussels.
Supplemented: monthly.

Loose-leaf publication containing the official text of, and commentary on, the Belgian Income Tax Code, available in the French and Dutch languages. The full text of the Code and the implementing Royal Decrees, ministerial decrees and circulars are printed. The comment of the Code covers the individual income tax, the corporate income tax, the income tax on legal entities and the tax on non-residents.
Tax collection, system of prepayments, worked examples, enforcement of the law and penalties for non-compliance, tax appeal procedures and double taxation treaty provisions are dealt with.

WETBOEK VAN DE BELASTING OVER DE TOEGEVOEGDE WAARDE

Ministère des Finances, Masuiplein 13, 1000 Brussels.
Supplemented: two times a year.
Loose-leaf publication containing the text of the Belgian tax on value added act of 3 July, 1969. The Royal Decrees and ministerial orders, implementing the law, are included. Supplements have been issued in the months February and July during the last years.

FISCALE DOCUMENTATIE VANDEWINCKELE

CED/Samsom, Philippe de Champagnestraat 7, 1000 Brussels; 15 volumes.
Supplemented: twice or three times per year.

Loose-leaf publication containing official text of, and commentary on, the Belgian taxes in the Dutch language. The series consists of 15 volumes. Each volume can be bought separately. The contents of this work, briefly summarised, are the full text of the tax law, the royal and ministerial decrees implementing the law, case law and official regulations, comment, tax tables and worked examples. Designed as a quick reference guide it covers taxes such as the personal income tax, the corporate income tax, the income tax on legal entities, the tax on non-residents, tax on value added, stamp duties, death duties. System of prepayments, tax collection, the enforcement of the law and penalties for non-compliance are dealt with. The material is kept up to date by the issue of supplementary pages.

GUIDE FISCAL PERMANENT

Editions Service, Boulevard Emile Bockstael 252, 1020 Brussels.
Supplemented: monthly.

Loose-leaf publication containing the official text of, and comment to the Belgian Income Tax Code in the French language. The full text of the Code and connected decrees implementing the Code is followed by comment to the taxes in the Code, i.e. the individual income tax, the corporate income tax, the income tax on legal entities and the tax on non-residents. The comment consists of an analysis of the above taxes in connection with tax collection, cadastral income from immovable property, system of prepayments, the enforcement of the law and penalties for non-compliance, temporary provisions, distribution of income to provinces and municipalities, worked examples and references to statute and case law.
The material is kept up to date by the issue of supplementary pages.

VAKCURSUSSEN

Inkomstenbelastingen en ermede gelijkgestelde belastingen, BTW. Ministère des Finances, rue d'Arlon 801, Brussels. 3 volumes.
Supplemented: regularly.

Loose-leaf publication in three volumes explaining the income tax and related taxes. The work is primarily designed as study material for purposes of young officials in the administration of direct taxes. No references therefore are made in the explanations to sections of the law, decrees, circular dates, case law. Taxes cover the personal income tax, the corporate income tax, the income tax on legal entities, the tax on non-residents, the tax on motor vehicles and the taxes on lucky winnings. The major principle of the tax on value added is only dealt with in connection with the direct taxes explained. Tax collection, system of prepayments, enforcement of the law and penalties for non-compliance and tax appeal procedure are dealt with. Explanation on double taxation treaties is forthcoming.

TAXATION AND THE BRITISH RECOVERY PROGRAMME

The Chancellor of the Exchequer, Mr. Denis Healey, cannot possibly have read Mr. Qureshi's article at page 7 of this issue when he gave his New Year Message on Britain's economic situation and the strategy planned by the British Government. After having stated that "the necessary measures have now been taken," Mr. Healey said:

> "The Government also hopes to provide better financial incentives for the necessary improvement in our industrial performance. I have already decided to improve the tax treatment of those working abroad at the sharp end of exporting.
> I am also concerned to create the conditions in which it will be possible to reduce income tax in the next Budget, particularly at both ends of the earnings scale. But I can give no commitment in this field before I know what agreement can be reached on the next round of pay policy — I hope in good time for the Spring Budget.
> The recent economic measures should be seen as one element in a three-year recovery programme to which the developing industrial strategy and new policies on pay and taxation will make equally important contributions. But the key to its sucess will lie, as always, with management and work-force at the level of the individual firm."

See for Mr. Healey's view on tax policy his article Taxation Policy in Britain: The Government's Objectives, *in: European Taxation, Vol. 15, No. 11, November 1975, pages 363-367.*

FOREIGN INVESTMENT AND TAX ADMINISTRATION

Under this title the United Nations Economic and Social Commission for Asia and the Pacific (ESCAP) held a second Seminar in Tokyo (September/October, 1976), the first having been held in Manila at the end of 1974. Both Seminars were sponsored by the Government of the Netherlands and both were chaired by the Bureau's managing director. The Governments of, respectively, the Philippines and Japan hosted the Seminars. A report on the Manila Seminar, with a synopsis of country reports, is available from ESCAP, Division of Industry, Housing and Technology, United Nations Building, Rajdamnern Avenue, Bangkok 2, Thailand.

The Tokyo Seminar was attended by top level officials from fifteen countries. In addition to the chairman, the following discussion leaders were in charge:

S. Ambalavaner, B. Sc., LL.B.
Member of Sri Lanka, United Kingdom and India Bar,
Colombo

Joseph P. Bourdrez
International Development Consultant
New York

Prof. R. Hirono
Chief, Development Planning Division,
ESCAP, Bangkok

Dr. Suresh Kumar Sahgal IAS
Principal Administrator,
Int.l Crops Research Institute for Semi-Arid Tropics (ICRISAT)
Hyderabad

Subject Areas Discussed

Foreign investment and tax policies
Tax systems in Asia and the Pacific
Foreign investment incentives
Foreign investment- and tax administration
Problems of foreign investment negotiations
Approach to international co-operation
- transnational enterprises
- tax and non-tax policies
- strengthening of regional co-operation and complementation

Incentives specific to domestic and international re-location of industries

These subjects were prepared by four working groups and further discussed in plenary sessions.

Conclusions reached

I. The working group on *Foreign Investment Policy* identified several problem areas and suggested remedies therefore:

Widening gap between the rich and the poor

Remedies:
- Progressive increase in local content
- Preferential treatment to employment-oriented projects
- Encouragement to foreign as well as domestic small and medium size investors
- Encouragement of competition, also with domestic enterprises
- Promotion of regional development and dispersion
- Creation of widely held investment companies mobilizing small savings
- Involvement by public sector enterprises in joint ventures

Overdependence upon foreign countries

Remedies:
- Diversification of foreign capital sources
- Ceiling on foreign equity investment in individual projects
- Legislation on restrictive trade practices
- Development of domestic managerial and technical skills

Harmful competition among countries with respect to foreign investment

Remedies:
- Greater exchange of information among developing countries
- Co-ordination of project planning at sub-regional level
- Mutual consultation among countries of the region for rationalization and, where necessary, limitation and reduction in tax and other incentives
- Voluntary code of conduct on the part of foreign investors

Adverse effects on domestic enterprise and technological development

Remedies:
- Encouragement of domestic participation in joint enterprises
- Majority equity participation by nationals of host countries
- Restrictive entry into sectors which are adequately serviced by or reserved for domestic enterprises
- Planned phase-out programmes
- Entrusting nationals with progressively increasing management responsibilities
- Progressive transfer of technology and establishment of research and development facilities

Adverse impact on balance of payments

Remedies:
- Preferential treatment for export-oriented and import-substituting projects
- Regulation of outflow of foreign exchange for services performed by foreign investors
- Regulations against the misuse of transfer pricing mechanisms
- Relaxation of capital outflow of developed countries

● *Several general measures for policy improvement*

Having reviewed these major problems associated with foreign investment and having considered certain possible remedial measures, the Working Group emphasized that *foreign investment in its wider connotation encompassing technology transfer should be recognized as a significant contributing element in the development efforts of developing countries.* Policies need to be oriented so as to enhance foreign investment and direct it into desired areas. Among the major policy options to that end, the Working Group considered the following:

- A well-defined, stable and coordinated foreign investment policy
- Clear identification and publication of investment opportunities for foreign investors
- Dissemination of information on laws and regulations relevant to foreign investment, such as taxes and incentives, labour and immigration, foreign exchange control, etc.
- Adequate provision of infrastructure facilities
- Establishment of an integrated machinery for foreign investment promotion, evaluation, approvals and monitoring procedures
- Evolution of procedures conducive to speedy decision making
- Provision of selective tax and non-tax incentives for attracting foreign investment
- Facilities for repatriation of capital and remittances of profits and dividends
- Special arrangements, such as production sharing and work contracts, for oil and other extractive industries
- Greater flow of capital and technology among the developing countries of the region
- Bilateral agreements on investment guarantees and multilateral procedures on investment dispute settlements

II. The working group on *Foreign Investment Administration* very much worked along the lines of the last-mentioned proposals. The main points emphasized by it were:

● The institution of a high level government body as a centralized machinery for all aspects of investment administration with authority to issue the necessary permits and approvals.

● Active promotion activities, such as
- clearly written and attractive publications on investment opportunities, as well as advertising and broadcasting abroad
- the use of embassies and consulates abroad with clear instructions and an adequate promotional training
- sending investment missions abroad
- establishing promotional offices in foreign countries.

● Prompt handling and evaluation of enquiries. The supply of information should be prompt, accurate and complete. Industrial projects as well as matters of technology should be thoroughly examined, evaluated and cross-checked against prevailing laws and regulations with discretionary decision-making kept within narrow limits if at all necessary.

● Administrative expertise was felt to be mandatory, requiring extensive training of responsible officials.

III. Two working groups dealt with *Tax Policy* and *Tax Administration*. Their conclusions can be summarized as follows:

● **Tax policy** should aim at influencing the pattern of consumption, savings, investment, capital formation, production, proper development of natural resources, international trade, prices, employment, as well as income and wealth distribution.

● **Tax climate**. Domestic and foreign investment require a good tax climate. The following requirements should be satisfied:
- stability in the tax system
- comparable tax rates and bases in the region
- reduction of tax rates, since high taxes are to be considered as a disincentive to investment, as leading to tax evasion and, consequently, as having counter-productive effects
- simplification of the complex tax laws
- avoidance of retroactive legislation or administrative interpretation.

● **Assessment procedures** should be improved. A scheme of withholding taxes on wages and salaries, as well as on dividends, interest and royalties, and a self-assessment system should be considered. The latter would require appropriate education of taxpayers.

● **Tax holidays** were deemed to play only a marginal role in attracting foreign investments, also because in several capital exporting countries their effect would be nullified.

The following alternatives were unanimously recommended:
- Capital allowances in the form of accelerated depreciation for the purpose of enabling industry to recoup its capital investment in a short span of time
- Realistic depreciation allowances or other similar capital allowances in respect of initial as well as additional investments
- Other provisions in the law taking into account the economic conditions under which investments are made.

Whereas depreciation not exceeding 100 percent of the cost is not by itself a tax advantage, there was general agreement that accelerated depreciation eases the liquidity position and is, therefore, useful as an incentive to foreign and local investment.

● **Loss carry-over and depreciation allowances.** Depreciation allowances (normal as well as accelerated) and other economically oriented devices should be accompanied by a mechanism for the carry-over not only of ordinary business losses but also of losses resulting from such allowances and other devices. *Depreciation losses at least should be carried forward without any time limitation. The same should apply to operating losses incurred during the first few years after the operations start.*

● **Other tax recommendations**
- Royalties, technical service fees or fees for the provision of know how are to be allowed as deductible current expenditure.
- Where corporate profits are exempt under a tax incentive scheme, dividends whether paid to local or foreign investors, should not *ipso facto* be exempt as well, unless the law so specifically provides.
- Capital gains taxation is acceptable. The capital of foreign investors to be repatriated should include such gains.
- The role of direct taxes in a development economy should be strengthened.
- Indirect taxes should serve as a tool to achieve tax policy goals. Wherever possible, their burden should be shifted so as not to become too heavy for people in the lowest income brackets. Consequently, the prime necessities of life should be exempted.
- The countries of the region should conclude double taxation treaties.

Reference was made in this connection to the work of the United Nations Expert Group on tax treaties between developed and less developed countries.

— Tax avoidance and evasion ought to be combated by a regular exchange of information.

These and other recommendations made by the second ESCAP Seminar will be formulated in more detail in a report shortly to be published by ESCAP. It is noteworthy that they are not just the result of wishful thinking of a group of academics. The people who attended the seminar are high ranking officials who, in their respective countries, are involved in the formulation of development and tax policies.

Moreover, in several respects certain delegates could report on actual positive experiences with measures already introduced in their countries. In this connection, particular attention is drawn to the article by Mr. N.M. Qureshi elsewhere in this issue. As the Chairman of the Central Board of Revenue of Pakistan, Mr. Qureshi is to be considered as an expert in matters of tax policy and administrative implementation of tax laws.

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FOR FURTHER INFORMATION PLEASE WRITE TO:

International Fiscal Association (I.F.A.): General Secretariat, Woudestein, Burg. Oudlaan 50, P.O. Box 1738, Rotterdam (Netherlands).

British Branch of I.F.A.: Secretary of British Branch of I.F.A., Williams and Glynn's Bank Ltd., P.O. Box 448, London EC3P 3DP (United Kingdom).

Associated Business Programmes Ltd.: 17 Buckingham Gate, London SW1E 6LN (United Kingdom).

Seminar Services International: Rue de Livourne 9, 1050 Brussels (Belgium); 31 Sussex Place, London W22 TH (United Kingdom); Passage Perdonnet, 1000 Lausanne 4 (Switzerland); OFIC, 6, rue Soyer, 92200 Neuilly (France).

Internationale Steuer- Fachschule Dr. Endriss: Schaafenstr. 10, D 5000 Köln (German Federal Republic).

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THE NETHERLANDS

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Federatie voor de Nederlandse Export (Federation for the Netherlands Export): Koopovereenkomsten bij levering uit Nederland naar de Bondsrepubliek Duitsland, vervoer en inklaring (Sales from the Netherlands to the Federal Republic of Germany, transport and clearance (including customs duties, excise, turnover tax at importation, levies on Community goods)). Rotterdam (The Netherlands) March 8 (Dutch, German).

British Chamber of Commerce for Belgium and Luxembourg (Cosponsor the American Chamber of Commerce in Belgium). Accounting and tax harmonization in the European Communities. Brussels (Belgium) March 8 (English).

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APRIL 1977

British Branch of I.F.A.: Anglo-Swiss Tax Seminar (cont.). London (United Kingdom) April 1 (English, German).

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Seminar Services International: Fiscal Sovereignty and Multinational Corporations. Paris (France) April 20-21 (French).

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MAY 1977

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Tax Planning International: International Tax Planning (including double taxation agreements, tax planning techniques, the Far East & the Middle East, pharmaceutical industry, retirement, doing business "in and with" Australia). Geneva (Switzerland) May 18-20 (English).

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JANUARY 1978

Associated Business Programmes Ltd.: Tax Planning and International Trade; Taxation of Personal Wealth of Individuals; Sales Taxes, Value Added Taxes and Double Taxation Conventions. Honolulu (Hawai) January 22-27 (English).

FOR FURTHER INFORMATION PLEASE WRITE TO:

International Fiscal Association (I.F.A.): General Secretariat, Woudestein, Burg. Oudlaan 50, P.O. Box 1738, Rotterdam (Netherlands).

British Branch of I.F.A.: Secretary of British Branch of I.F.A., Williams and Glynn's Bank Ltd., P.O. Box 448, London EC3P 3DP (United Kingdom).

U.S. Branch of I.F.A.: Secretary of U.S. Branch of I.F.A., Suite 44-27, 345 Park Avenue, New York, N.Y. 10022 (U.S.A.).

Canadian Branch of I.F.A. Secretary of Canadian Branch of I.F.A., Stikeman Elliot Tamaki Mercier & Robb, 1155 Dorchester Blvd W, Montreal, Quebec H3B 3V2.

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Internationale Steuer-Fachschule Dr. Endriss: Schaafenstr. 10, D 5000 Köln (German Federal Republic).

Management Centre Europe: Avenue des Arts 4, B-1040 Brussels (Belgium).

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Business International Institute: c/o Business International Corporation, One Dag Hammarskjold Plaza, New York (U.S.A.); 12-14, Chemin Rieu, 12-11 Geneva 17 (Switzerland); 301-3 Asian House, 1 Hennessy Road, Hong Kong; 5th Floor, Pola Building, 5, 2-chome, Minami Aoyama, Minato-ku, Tokyo (Japan).

Practising Law Institute: 810 Seventh Avenue, New York, N.Y. 10019 (U.S.A.).

British Chamber of Commerce for Belgium and Luxembourg: Rue Joseph II, 30, 1040 Brussels (Belgium).

U.S. Tax Reform Act of 1976 - Congress chases the foreign dollar.

J. H. Dobson* & V. M. Tarris**

On October 4, 1976, President Ford signed into effect the Tax Reform Act of 1976. This Act makes sweeping changes in many facets of U.S. tax law including a number of changes in the treatment of various types of foreign income and foreign entities. It is the purpose of this article to provide a discussion of the provisions of the Tax Reform Act which have international significance.

Because of the breadth of the changes and the complexity of U.S. tax law it is not possible to provide a detailed explanation of the treatment of international transactions under the Act in a single article. Instead, the authors have attempted to give a general view of the types of transactions affected by the Act and the manner in which they have been affected. This is done by explaining how each of the transactions was treated prior to the Tax Reform Act, with a brief explanation of the practical consequences, followed by an explanation of the changes enacted by the Act. This will not provide the reader with a complete description of the laws and regulations restricting these transactions, but it is hoped that it will enable him to recognize situations where U.S. tax laws should be considered.

This article will be presented in two segments, in consecutive issues of the Bulletin for International Fiscal Documentation. In this segment, four areas will be discussed: the taxation of individuals living abroad, the taxation of foreign trusts, the taxation of controlled foreign corporations, and the credit for foreign taxes. In the following segment the discussion will focus on money and property moving out of the United States, special categories of taxpayers, bribes and boycotts and the domestic international sales corporation.

I. FOREIGN TAX PROVISIONS AFFECTING INDIVIDUALS ABROAD

1. Foreign income of U.S. citizens resident outside the United States

A. Prior law

In the United States, international double taxation can arise in the following situations:

(a) a resident U.S. citizen receives foreign-source income;
(b) a resident alien receives foreign-source income;
(c) a non-resident alien receives U.S.-source income; or
(d) a non-resident U.S. citizen receives foreign-source income.

The present section deals with the last-mentioned situation.

Unlike almost every other country in the world, the United States taxes its non-resident citizens on their world-wide income in a manner which is basically the same as in the case of resident citizens. Since the country where a U.S. citizen is resident generally taxes its residents on world-wide income as well, a special case of international double taxation may easily arise.

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  - A. Prior law
  - B. The Tax Reform Act
- 2. Non-resident aliens
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II. TAXATION OF FOREIGN TRUSTS
- A. General description
- B. The Tax Reform Act
  - 1. Foreign trust with U.S. grantor
  - 2. Capital gains of a foreign trust
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- C. Summary

III. CONTROLLED FOREIGN CORPORATIONS
- A. Prior law
- B. The Tax Reform Act
  - 1. Investments in U.S. property
  - 2. Gains from the disposition of shares in foreign corporations
    - a. Less developed country corporations
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  - 3. Income from foreign insurance companies
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IV. THE FOREIGN TAX CREDIT
- A. Prior law
- B. The Tax Reform Act
  - 1. Elimination of "per country" limitation
  - 2. Recapture of foreign losses
  - 3. Controlled foreign corporation credit
  - 4. Oil and gas extraction income credit
  - 5. Foreign capital gains
  - 6. Underwriting income
  - 7. Dividends from less developed country corporations

Subject to special provisions which may be contained in a double taxation treaty it may have concluded with the United States, a foreign country where a U.S. citizen is resident can hardly be expected to provide any relief from double taxation in the case referred to above. It is the United States, therefore, that should provide such relief.

As will be seen from the brief survey that follows, the United States actually grants double taxation relief to its non-resident citizens. This relief is rather limited in scope. Nevertheless, it may result in a few special advantages. Under the former legislation, two forms of relief were available, namely:

1) a tax credit; and
2) an exemption.

A special disadvantage resulted from the disallowance of the use of certain deductions.

The *tax credit* is the general form in which the United States, unilaterally and in treaties, grants double taxation relief to its residents, both citizens and aliens, and to its non-resident citizens. The credit is for foreign taxes paid in respect of foreign-source income. In the case of U.S. citizens residing abroad, the foreign tax credit does *not* apply to foreign tax on U.S.-source income of the U.S. citizens resident in the foreign country. Thus, this relief method does not solve the double taxation problem to the extent that the taxpayer receives U.S.-source income.

The United States granted an *exemption* from U.S. tax for a limited amount of foreign-source income derived by a non-resident U.S. citizen. A U.S. citizen is permitted to exclude from U.S. taxation a limited amount of the income earned abroad. Any U.S. citizen who was a *bona fide* resident of a foreign country for an uninterrupted period including an entire taxable year, or any U.S. citizen who was present in a foreign country for 17 out of 18 months, was allowed to exclude $20,000 from his taxable income in the United States. A citizen who was a *bona fide* resident of a foreign country for at least 3 consecutive years was allowed to exclude $25,000 of his foreign-source income from his taxable income in the United States. The exemption was a definite one, in the sense that any income in excess of the excluded sums was taxable in the United States as if it was the only income. Thus, this form of relief was an exemption *without* progression.

One would expect that taxes on these sums which were already fully exempt from U.S. tax would not be available for the tax credit. This was not the case. Any foreign tax imposed on foreign-source income *including* the exempt amount would be credited against the U.S. tax on the non-exempt income, within the usual limitations. See Part IV below.

One disadvantage did result from the use of the tax credit. Normally a U.S. taxpayer may determine his taxable income in one of two ways. He could include income from all sources and deduct all actual expenses in the manner prescribed by law. Or he could determine his income by deducting a lump-sum amount fixed by law (the so-called "*standard deduction*"), even if this sum exceeded the actual expenses incurred. A non-resident U.S. citizen who chose to obtain relief from double taxation by the use of the tax credit was not permitted to use the standard deduction to determine his taxable income.

Finally, mention should be made of the fact that certain countries impose their taxes only on income actually received in the country. U.S. citizens residing in such countries could avoid paying foreign taxes altogether by having their income paid to an account in another country, generally a country which would not impose tax on such income. Although this income was not, therefore, taxed abroad at all, it nevertheless qualified for the exclusion from U.S. tax to the maximum amount mentioned above.

The situation existing until the enactment of the Tax Reform Act of 1976 can thus be summarized as follows:

a. Exclusions

(i) A U.S. citizen residing abroad was exempt from U.S. tax with respect to certain amounts determined by law.

(ii) This exemption applied irrespective of whether or not the income was subject to foreign tax.

b. Tax credit

(iii) Any foreign tax paid on the exempt income could be credited against U.S. tax on the non-exempt portion of the income.

(iv) No credit was available for foreign taxes paid on U.S.-source income.

c. Deductions

(v) The taxpayer could only deduct sums actually expensed by him; he could not use the standard deduction available to other, resident, U.S. taxpayers.

(vi) An expense paid on excluded income was completely unavailable as a deduction to the taxpayer.

d. Tax rate

(vii) U.S. tax on the non-exempted income was determined at the rate applicable if the taxpayer had no other income.

B. The Tax Reform Act

Section 1011 of the Tax Reform Act was passed in an attempt to eliminate some of the advantages and minimize the disadvantage described above.

a. *Exclusions*

(i) Effective December 31, 1975, the maximum exemption available for foreign-source earned income is $15,000. [1]

(ii) Income earned abroad which is received outside the country in which it is earned is ineligible for the exclusion if one of the purposes (not necessarily the principal purpose) of receiving the income outside that country is to avoid paying tax in the country in which it was earned. The fact that the country in which the income was earned did not tax it will probably be sufficient to show the existence of a tax avoidance motive.

1. In limited circumstances, i.e. if an individual performs qualified charitable work during the taxable year, this exemption increases to $20,000. If an individual works for both a charity and a non-charitable organization, a special rule applies

b. *Tax credit*

(iii) The taxpayer is no longer allowed a deduction or a credit for the foreign income taxes paid on the amount excluded from gross income under the earned income exclusion.

(iv) The credit is still not available for foreign taxes paid on U.S.-source income.

c. *Deductions*

(v) The tax law was amended to permit taxpayers who avail themselves of the foreign tax credit to also take the lump sum deduction rather than being limited to deducting only actual expenses.

(vi) Expenses related to the excluded income are still not deductible from taxable income. They are considered, however, when computing the tax rate on taxable income under the exemption with progression system.

d. *Tax rate*

(vii) Any additional income in excess of the exclusion is taxed at the higher tax rate that would apply if there were no foreign earned income exclusion (exemption *with* progression).

An individual who would be eligible for this exclusion may elect to have it not apply. Such an election might be made if the country in which the income was earned imposes a high tax rate. In this case, the taxpayer would want to use all the foreign tax credit available to him. Once this election is made, however, it cannot be revoked except with the consent of the Secretary of the Treasury.

2. Non-resident aliens

A. Prior law

Under U.S. tax law, a husband and wife are allowed to file a joint tax return. This may have a great advantage because the total income, irrespective of which of the two spouses received it, is split into two equal parts and each part is taxed according to the tax rate schedule established by law. In other words, the effect of the progressive rate structure is considerably reduced. However, the use of the joint return was not available to a husband and wife if one spouse was a non-resident alien. Not filing a joint return had both advantages and disadvantages for taxpayers.

a. *Disadvantages*

1) Tax rates

U.S. tax law has 4 tax rates: one for single taxpayers, one for heads of households, one for married individuals filing joint tax returns, and one for married individuals filing separate tax returns. The highest tax rate for a specific amount of income exists for those married individuals filing separate tax returns.

2) Maximum tax rate

The section of the tax law imposing a maximum rate of 50 percent on earned income was available to married individuals only if they filed a joint return. The maximum rate which could be imposed otherwise is 70 percent.

b. *Advantages*

1) Foreign-source income of non-resident alien spouse

The foreign-source income of a non-resident alien spouse was not subject to any U.S. tax.

2) Community property laws

In countries recognizing community property income, one half of the income of one spouse is attributable to the other spouse. Thus, the non-resident alien's half of the income, although earned by a U.S. citizen, was not taxable in the United States.

In addition, although a non-resident alien filing a tax return was not required to do so until June 15 of the year following the tax year, he was required to file a declaration of estimated income tax by April 15. The estimated return determined the quarterly payments of tax which must be paid to the government in advance of the actual filing of the tax return the following year.

B. The Tax Reform Act

Section 1012 of the Act permits a citizen and his or her non-resident alien spouse to file joint tax returns by permitting the non-resident alien to be treated as a resident of the United States for tax purposes. This is accomplished by an election for such treatment. Both the husband and wife must make such an election. It is effective until terminated.

Once an election is terminated, it may not be made again by either spouse at any subsequent time. Thus, a non-resident wife who divorces her U.S. citizen husband and later remarries another U.S. citizen cannot elect to be treated as a U.S. resident for tax purposes with this second husband.

The Tax Reform Act attempts to minimize both the disadvantages and the advantages of not being able to file a joint return with a non-resident alien spouse.

a. *Disadvantages*

1) Tax rates

By filing a joint return the U.S. citizen and his or her non-resident alien spouse may use the more favorable tax rates available for married individuals filing a joint return.

2) Maximum tax rate

The maximum tax rate which can now be imposed on the earned income of the U.S. citizen and his or her non-resident alien spouse is 50 percent.

b. *Advantages*

1) Foreign-source income of non-resident alien spouse

By electing to have the non-resident alien spouse treated as a U.S. resident for tax purposes, the spouse and his or her husband are liable for tax on their world-wide income.

2) Community property

The former section of the tax law dealing with community property of a resident or citizen married to a non-resident alien individual has been repealed. A new section has been added. It attempts to properly allocate income for U.S. tax purposes to the person who in fact earned or received it and thus to deny to the non-resident alien spouse the right to a tax-free one half of the spouse's income otherwise taxable in the United States.

Section 1012 of the Act also amended the date for the filing of the estimated tax return by a non-resident alien to coincide with the date on which the tax return is due.

The joint return election is effective for taxable years ending on or after December 31, 1975. The community property rules and the estimated tax return date will apply to taxable years beginning after December 31, 1976.

II. TAXATION OF FOREIGN TRUSTS [2]

A. General description

Because U.S. tax law accepts that a trust has legal personality, it recognizes that a foreign trust may be taxed as a non-resident legal entity that is not a citizen of the United States. As such, it would not be subject to U.S. tax on its income and capital gains. Such gains would be taxable only when received by a U.S. beneficiary. Therefore the two principal questions concerning the taxation of foreign trust income and other gains are: when is the trust to be treated as a separate personality and what taxation should apply to payments to beneficiaries. The new Tax Reform Act deals with both of these questions and in each case the law is expanded to give the U.S. tax administration greater powers.

To understand the motivation for and the effects of the new Act, one must first consider the purposes for which a trust may be employed. Simply stated, there are two basic types of tax advantages that a person (grantor) may be seeking when he contributes property to a trust. The first, "income splitting", is based entirely on internal tax law. Since a trust is recognized as a separate taxpayer, and since there is progressive taxation on individual income, a taxpayer in a high tax bracket might want to put some of his income-producing property in a trust. The trust is taxed on the income according to the rates applying to an individual. Thus, the grantor's income is divided between two taxpayers, himself and the trust, each of whom is taxed at a lower rate than if the income had been aggregated. This is the income splitting effect offered by trusts: by increasing the number of taxpayers through which income is received, the grantor can avoid much of the burden of a progressive rate structure.

The Congress recognized that the income splitting aspect of a trust could potentially circumvent the aims of the Congress in establishing a system of progressive taxation. The response was to put conditions on the separate taxation of trusts so that transfers which were no more than tax maneuvers would not give rise to separate taxation. Under the law certain circumstances, which indicate that the grantor has forfeited control [3] over the property and most future benefits from the property [4], must exist before the trust income is taxed to the trust or the trust beneficiary rather than to the grantor. Of course, these provisions only restrict, and do not prevent, the avoidance of the progressive tax rates. For instance, a grantor can split his income while retaining the right to have the property returned from the trust to him at a later time [5]. What these provisions do determine is how much of the rights of ownership of the property the grantor must be willing to give up to gain the benefits of income splitting. The placement of that balance is the central question in this first area of trust-related tax benefits.

The second major potential advantage of trusts arises from the perception by the U.S. tax administration of a foreign trust as a legal person having a non-resident alien status. If one gives one's property to a foreign trust, and if the transfer-of-effective-control conditions are satisfied, then the property is now owned by a foreign person. Income produced by the property is received by a foreign person and is not automatically subject to U.S. tax [6]. Thus, one can see the potential of using a foreign trust as a receptacle for accumulating income free of tax. Similarly, the foreign trust could sell the property without being subject to U.S. taxation. Since the United States taxes capital gains, a grantor might wish to use a foreign trust as a vehicle for selling property which had appreciated in value without the grantor being taxed on the gain. In other words, the foreign trust, if unrestricted, would give the U.S. grantor a base for accumulating income and realizing appreciation gains without current U.S. taxation. This deferral of tax liability until distribution is the second type of benefit one can perceive in the U.S. trust concept.

B. The Tax Reform Act

1. *Foreign trust with a U.S. grantor*

The Tax Reform Act of 1976 eliminates both income splitting and tax deferral for most transfers to foreign trusts. This is done through three provisions in the Act. The first of these, Act Section 1013, has several effects. It prohibits a U.S. grantor from gaining the advantage of income splitting from transfers during his lifetime to a foreign trust which has a U.S. beneficiary. That is, if a foreign trust has any U.S. beneficiary the U.S. grantor will be taxed on *all* income earned by the trust from the ownership of his property. The law defines a U.S. beneficiary as any U.S. person (U.S. citizen or resident or domestic legal entity) to whom or for whose benefit any income or corpus of the trust may be paid or accumulated, either by normal operation of the trust or by its termination during the tax year. A trust is also considered to have a U.S. beneficiary if benefit flows from the trust to a foreign corporation which for more than 50 percent is owned by U.S. shareholders, to a foreign partnership with a U.S. partner or to a foreign trust with a U.S. beneficiary. The burden of reporting a trust with a U.S. beneficiary falls on the U.S. grantor. Failure to report such a trust subjects him to criminal sanctions and a penalty of 5 percent of the corpus [7] of the trust.

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2. Since many countries do not recognize the legal existence of a trust, some readers may have little experience with this type of legal entity. To provide background information which should help clarify this Subchapter for those readers a short explanation of the trust concept is provided in an appendix at the end of this article.
3. Effective control will not have been transferred, and hence separate taxation will be denied, if the grantor retains the right to choose how the income or property will be disposed of, if he retains administrative control over the trust, or if he has the power to revoke the trust.
4. Sufficient benefits will not have been surrendered if the grantor will receive income or property from the trust within 10 years of its creation or if income from the trust is used for the benefit of the grantor or his spouse.
5. Provided that the property is in trust for at least 10 years.
6. Like any other foreign person, a foreign trust will be subject to tax on income derived from the United States unless exempted by treaty.
7. The term "corpus" refers to the principal sum of the trust.

The law applies for tax years ending after December 31, 1975, but only in the case of foreign trusts created after May 21, 1974, and transfers to foreign trusts after May 21, 1974. These provisions will not apply, however, where the transfer is made by the U.S. grantor upon his death or where the transfer to the trust is in a taxable exchange for money or property equal in value to the transferred property. The trust is recognized as owner of the property for tax purposes in these situations.

2. *Capital gains of a foreign trust*

Besides reducing the availability of income splitting where a foreign trust is involved, Act Section 1013 prohibits U.S. beneficiaries of any foreign trust from enjoying a tax measure which benefits U.S. beneficiaries of U.S. trusts. That measure is the special tax rate applied to capital gains. Normally a trust is allowed to deduct half of its net capital gains in computing taxable income, which in effect produces taxation of capital gains at half the normal rate. Previous legislation had denied this benefit to foreign trusts established by a U.S. grantor. Under the Act income received by U.S. beneficiaries attributable to capital gains earned by a foreign trust not established by a U.S. grantor in the first tax year beginning on or after January 1, 1976, will no longer be allowed the 50 percent deduction.

Obviously, this measure and the measure discussed immediately previously are not intended to harmonize the treatment of domestic and foreign trusts. The purpose seems, rather, to penalize the transfer of property to foreign trusts where the purpose of the transfer may be tax avoidance. The use of a foreign trust where both the grantor and beneficiary are U.S. persons suggests a motive of tax-free accumulation. Capital gains earned by a foreign trust and distributed to U.S. beneficiaries suggest a transfer of appreciated property to a trust to allow tax-free accumulation of the gain.

3. *Tax-free accumulations*

The second Section of the new Act dealing with foreign trusts is directly concerned with tax-free accumulations. A new Section is added to the Internal Revenue Code providing for an interest charge where a foreign trust is distributing income which has been accumulated free of U.S. tax (e.g. income retained by a trust having either no U.S. grantor or no U.S. beneficiary). The interest charge is imposed by increasing the tax on the distribution by 6 percent for each year that the tax has been deferred. The general provision providing for the deduction of interest expenses does not apply to this charge. This interest charge will not apply where the trust income was taxed to the grantor under Act Sec. 1013 discussed above, since in that case there will not have been a tax-free accumulation of the income. Where a trust beneficiary is subject to the charge upon distribution, the impact of this Section is reduced by a provision which provides that the tax on income accumulated before or during 1976 will only be subject to the interest charge from the first tax year beginning after 1976. Thus the new Act will not retroactively reduce the tax deferral benefits provided by a foreign trust through this interest charge.

4. *Transfers of appreciated property abroad*

The third Section of the Act concerning foreign trusts, Section 1015, deals with transfers of appreciated property abroad to avoid U.S. tax on the gain. This section is not restricted in its application to transfers to foreign trusts, but includes transfers to any foreign person. An excise tax is imposed on such transfers. The purpose of such an excise tax is to counterbalance the tax avoidance potential of such a transfer with an equivalent tax liability. Prior to the Tax Reform Act an excise tax provision already existed, imposing a tax of 27½ percent on the amount of untaxed appreciation in value of the transferred shares and securities. The tax applied except where the recipient was an organization exempt from income tax, where the taxpayer had established that tax avoidance was not one of the principal purposes for the transfer, or where the transfer was one to which Section 367 applied [8].

This excise tax is made stronger in two ways by the Act. First, the tax is no longer limited to the transfer of shares and securities. Under the new provision all property transferred after October 2, 1976 which has appreciated in value is subject to the tax. All transfers intended to allow tax-free realization of capital gains will fail under the new law. Second, the rate of the excise tax is raised to 35 percent for all transfers occurring after October 2, 1976. This rate corresponds to the maximum rate of U.S. tax on capital gains received by an individual (i.e. one half of the maximum marginal rate of 70 percent) meaning that the advantage of a tax-free sale is nullified for even the wealthiest taxpayers. For taxpayers whose income is not taxed at the maximum rate, the excise tax on the transfer of property will be greater than the tax that would be due upon its sale. A new provision allows these taxpayers to escape this extra taxation. A taxpayer may elect to have a transfer treated as a sale, with the excess of the property's value over the taxpayer's basis in the property treated as capital gains. If such an election is made the taxpayer is not subject to the excise tax. The result of this provision and the two changes mentioned above is that while a taxpayer can no longer gain a tax advantage by having appreciated property transferred abroad before its sale, he can make such a transfer without paying more tax than would result from a sale, provided he elects taxation as a sale.

C. Summary

Briefly summarized, the new Act has had four major effects in the area of foreign trusts, one of which also applies to other foreign persons. The measure which has the broader applicability taxes transfers of appreciated property to any foreign person. It eliminates any tax advantage from the U.S. standpoint for sales of appreciated property through a foreign intermediary rather than by the U.S. owner. A second measure counters the tax deferral advantages of realization of capital gains by a foreign trust before distribution to a U.S. beneficiary by denying the beneficiary a 50 percent deduction for the gains that he would be allowed for a similar distribution from a U.S. trust. The third measure denies tax

8. For an explanation of the application of Section 367 see Part V.B. below.

deferral for a U.S. grantor who transfers property to a foreign trust with a U.S. beneficiary by refusing to recognize the legal personality of the trust and by taxing the income from the property to the grantor. The fourth measure limits the tax deferral possibilities for income on property received by a foreign trust nor from a U.S. grantor but with a U.S. beneficiary. Six percent interest will be charged on the tax on such income for each year that distribution is deferred. The end result of these measures is that foreign trusts no longer offer more tax advantages than U.S. trusts, and in many cases they are less advantageous.

III. CONTROLLED FOREIGN CORPORATIONS [9]

A. Prior law

As was mentioned in the discussion of trusts, a U.S. taxpayer might wish to defer U.S. taxation on his income by having the income accumulated by a foreign entity not subject to U.S. tax. Recognition of the tax avoidance potential of such an action led Congress to establish special provisions for the taxation of "controlled foreign corporations" (CFCs). In theory these provisions simply prevent a U.S. taxpayer from deferring tax on income received by a foreign business which the taxpayer effectively controls In practice the rules provided by these provisions are far from simple.

The rules fall into two groups: those defining a controlled foreign corporation, and those determining the additional amount to be included in the taxable income of the U.S. shareholder of a CFC. According to the first group of rules a controlled foreign corporation is a corporation more than 50 percent of whose voting power is owned, directly or indirectly [10], by certain persons misleadingly referred to as "U.S. shareholders". A "U.S. shareholder" for the purposes of this law is a U.S. citizen, resident, partnership, corporation, estate or trust which owns at least 10 percent of the voting power of the foreign corporation. (This means that the existence of U.S. portfolio shareholders in a foreign corporation will not result in a CFC status.) Thus a controlled foreign corporation is a corporation a controlling portion of whose voting rights is held by a group of U.S. persons, each of whom individually holds a substantial amount of control.

If a company is determined to be a controlled foreign corporation, special taxing provisions apply which are intended to eliminate the tax deferral arising from the use of a foreign company by a U.S. person. These provisions require that a "U.S. shareholder" of a CFC must include in his taxable income his pro rata share of certain types of income earned by the corporation during the tax year. The types of income that were to be currently taxed to the shareholder under the existing law were:

(a) the corporation's increase in earnings invested in U.S. property;
(b) the reduction in the corporation's qualified investments in less developed countries, to the extent that income has been excluded from tax in previous years because of an increase in qualified investments;
(c) the reduction in the corporation's investments in foreign base shipping companies, to the extent that income has been excluded from tax in previous years because of reinvestment;
(d) income from the insurance of U.S. risks;
(e) foreign personal holding company income, i.e. income flowing to the person who owns certain property (rents, royalties, interest, dividends, etc.);
(f) income from the sale of personal property previously purchased from a related person [11], or from the purchase of personal property for sale to a related person;
(g) income from the providing of services to a third party for or on behalf of a related person [12];
(h) income from a foreign base shipping company to the extent that such income is not reinvested.

The term "subpart F income" was used to refer to income items (d) — (h) of a CFC.

Income item (a) is included with the intention of limiting the transfer without a taxable dividend of the benefits of the company's earnings to the shareholder. That is, a controlling shareholder might wish to use dividends from a CFC to purchase property, e.g. securities, but not wishing to be taxed on the dividend, he might have the CFC purchase the property with the money that would have been paid as a dividend. Income item (a) means that for purchases by a CFC of certain property the value of the property will be treated as income to the shareholder. Under the prior law "U.S. property" included tangible property located in the United States, stock of any domestic corporation, an obligation of a U.S. person (except when arising out of a banking transaction or a normal business transaction) and rights such as patents, copyrights and secret processes.

Income items (b) and (c) are included to insure that income which is excluded from tax because of reinvestment in certain qualified investments will be taxed when subsequently regained by the corporation.

Income items (d) — (h) are included with an eye toward the prevention of the use of the corporation by the shareholder as an alter ego existing solely to receive and hold the shareholder's income. Transfers of income-producing property to the corporation by the shareholder with the intention of tax-free accumulation of the income is prevented by item (e). Items (f) and (g) prevent the use of

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9. For a more complete discussion of this area of U.S. taxation see ALAN R. RADO, UNITED STATES TAXATION OF FOREIGN INCOME, A NEW APPROACH (Publications of the International Bureau of Fiscal Documentation, Vol. 18, 1963).
10. So-called "attribution rules" treat a taxpayer as owning some or all of the stock that is owned by certain relatives, partnerships in which he is a partner, estates in which he is an heir, trusts of which he is a beneficiary, and corporations in which he has a controlling shareholding.
11. For purposes of this provision a related person is any individual, partnership, trust, or estate which controls the CFC, a corporation which controls or is controlled by the CFC, or a corporation which is controlled by the same persons which control the CFC.
12. For this income item and for income item (f) no amounts are included which are income earned through the conduct of a trade or business in the United States the U.S. tax on which is not reduced nor eliminated by a treaty.

a CFC by a person "related" to that corporation as an income-accumulating intermediary in the transactions of the related person. That is, income shifting to the CFC through transfer pricing is prevented. Income items (d) and (h) serve to prevent tax-free earnings from "situs-free" activities, that is, activities which do not take place in a particular location. For tax purposes such activities are normally considered to occur in the jurisdiction in which the entity engaged in the activity is located. However, the inclusion of income items (d) and (h) attributes a U.S. situs to such activities performed by a CFC.

These eight income items do not, of course, include all types of income that could be received by the foreign corporation. They do, however, seek to cause current taxation of all of the corporation's income which has sufficient connection with the United States or with a U.S. shareholder to justify treatment as U.S. income. Income earned by the corporation from genuinely foreign sources will not be currently taxed in the United States, and the corporation can accumulate such income free from U.S. tax. This is reasonable, since the accumulation is income earned by a foreign entity from foreign sources. However, this situation offered possibilities of tax reduction that were unacceptable to the Congress. The possibilities focus on the use of a CFC as an intermediary for a U.S. person's business activities abroad. Income from the business activities would be accumulated by the corporation. This would increase the value of the corporation, a gain that could be passed on to the shareholder in three ways. The first, the dividend, would be taxed to the shareholder at normal tax rates, but the other two, gain on the sale of the shareholder's shares or gain upon the liquidation of the company, would normally be taxed as capital gains at one half the normal rate [13]. Thus, a U.S. person might substantially reduce his tax on foreign source income by the use of a CFC. To prevent such a tax dodge a provision was included in the Code which required that gains from the sale of shares and from certain liquidations of a CFC generally would be treated as dividend income. An exception existed in the case where the foreign corporation qualified as a less-developed country corporation (LDCC). If shares in an LDCC had been held for at least ten years, the shareholder would be allowed capital gain treatment for gains on the sale of his shares. If the shareholder was a corporation that had been a CFC at any time during the 10 year period, capital gain treatment would be allowed only if 50 percent of the voting power of the shareholder corporation's stock was owned by the same U.S. persons during the entire 10 year period.

There are three categories of foreign corporations which qualify as LDCCs. Each category is based on the corporation's income and assets. The first category requires that the corporation engage in a trade or business and derive at least 80 percent of its gross income from sources within less developed countries (LDCs). At least 80 percent of the corporation's assets must be property used in a trade or business located in an LDC, an investment required by an LDC, and assets which are not "U.S. property" as defined above. The second category consists of corporations which own at least 10 percent of the voting power of a category 1 LDCC and which meet the category 1 income and asset tests. The third category consists of corporations who derive at least 80 percent of their income from the use in foreign commerce of aircraft or vessels registered in an LDC or from the performance of services directly related to such use, from the sale or exchange of such assets, from dividends and interest of LDCCs at least 10 percent owned by the corporation, and from the sale of LDCC stock obligations. At least 80 percent of the corporation's assets must be aircraft and vessels and assets not "U.S. property".

A second exception existed where the CFC was involved in certain reorganizations. U.S. tax law permits certain corporate reorganizations between domestic corporations with no current taxation of the shareholders of the corporations involved for gains received because of the reorganization. Normally, when one of the corporations involved was a foreign corporation, Section 367 would apply, requiring a favorable ruling by the tax administration before the shareholders' gains would be excluded from current income. (This section is discussed in detail in Part V.B. below.) The administration could deny such a ruling where the foreign corporation involved was a CFC being used for tax avoidance purposes. For certain transactions, however, Section 367 did not apply and it was possible to transfer CFC gains to U.S. persons without any taxation to the U.S. shareholder of the CFC. Three of these situations existed, each one concerning a U.S. shareholder which was a domestic corporation. The first was the situation in which the U.S. shareholder distributed its CFC stock to its own shareholders as a dividend. The whole value of the stock was taxed to the shareholder-recipients at normal rates, but the distributing corporation was not taxed on the amount that the CFC stock has appreciated in value while being held by the corporation. The second situation was where the U.S. shareholder-corporation distributed the CFC stock to its own shareholders in the course of a liquidation of the shareholder-corporation. In the third situation the shareholder-corporation would sell the CFC stock in the course of its own liquidation and would distribute the money to its shareholders. In both of these cases the shareholder-recipients were taxed at capital gains rates, if at all, for the value of the shares or money received, and the corporation was not taxed at all. Thus, these latter two situations in particular allowed U.S. persons to use a CFC as a receptacle for foreign income which they then later receive as capital gains.

B. The Tax Reform Act

The Tax Reform Act of 1976 does not change the essential nature of the tax treatment of controlled foreign corporations. It does, however, provide new rules which modify the treatment of income earned by a CFC in specific instances.

These rules make adjustments in the tax treatment of:

(a) Certain investments in U.S. property;

13. For corporations the capital gains tax is at the fixed rate of 30 percent.

(b) Gains from the disposition of shares in foreign corporations;
(c) Income from foreign insurance companies;
(d) Income from foreign base shipping companies;
(e) Foreign taxes paid by certain subsidiaries of domestic corporations controlling foreign corporations (for a discussion of this change, see Part IV below on the foreign tax credit);
(f) Bribes and boycott income effected through a CFC (see Part VII below).

1. *Investments in U.S. property*

The new Act has added two exceptions to the types of investments which will be treated as investments in U.S. property. A controlled foreign corporation may now invest in certain domestic companies and in certain property for mineral exploration without an effect on the amount of income to be currently taxed to the U.S. shareholders. The first measure should make it easier for a domestic corporation to find financing and new capital. It is quite broad in scope, as the CFC can purchase shares or obligations of domestic corporations without detriment except in two instances. The first is where the shares or obligations are issued by a U.S. shareholder of the CFC. The second is where 25 percent of the voting stock of the issuing corporation is owned, directly or indirectly [14], by the U.S. shareholders of the CFC. Thse two exceptions are clearly aimed at attempts to return a CFC's earnings to the U.S. shareholders without declaring a dividend under the guise of a loan or capital investment.

The second measure is designed to encourage the exploration for and the exploitation of oil, gas and minerals found in and under the Continental Shelf waters of the United States. The law excludes from U.S. property all movable property except for vessels and aircraft used for "exploring for, developing, removing, or transporting resources" from the Continental Shelf and its waters.

These measures apply to CFCs for tax years beginning after December 31, 1975, and to U.S. shareholders for their tax years which end with or after the first qualifying tax year of the CFC.

2. *Gains from the disposition of shares in foreign corporations*

The Act also changes the treatment given to the gain from the disposition of certain shares in foreign corporations. Act Section 1022 changed the treatment of shares in so-called "less developed country corporations". Act Section 1042(b),(c) and (d) added certain transactions to the list of transactions on which gain on CFC shares must be recognized.

a. Less developed country corporations

Under the new law a shareholder in a LDCC loses some of the advantage of having the corporation accumulate income. If the shareholder sells his stock and the corporation has undistributed profits earned in a tax year beginning after December 31, 1975, he will be treated as having received a dividend if he makes a gain on the sale. Any gain he realizes will be treated as a dividend, taxed at normal rates instead of the preferable capital gains rate, to the extent of his share of post-1975 undistributed profits. If the gain is attributable to pre-1976 undistributed dividends, however, it will still qualify for capital gains treatment. This capital gains treatment is available, under the new law, to all LDCC shareholders without regard to the length of time the stock has been held.

This law takes effect for the first tax year beginning after December 31, 1975.

b. Gains on shares distributed, sold or exchanged by a U.S. corporate shareholder

To prevent the possibility of permanent tax avoidance, Act Section 1042 (b) amends Section 1248 to require that corporations meeting the stock ownership requirements for CFCs which distribute, sell, or exchange stock of that CFC in one of the transactions discussed above recognize as a dividend (thus subject to taxation as ordinary income) the gain realized on such distributions or exchanges to the extent of the earnings and profits of the corporation in the same manner as for other sales or exchanges discussed in Section 1248. This new provision is to apply notwithstanding any other provision of the tax law (i.e. the exceptions which the law was designed to eliminate).

There is an exception to this recognition requirement for certain distributions to shareholders who are domestic corporations, if the distribution is to a domestic corporation which will have the same holding period for the stock as the distributing corporation and the domestic corporation has held more than 10 percent of the stock of the foreign corporation for 5 years. No gain need be recognized, since the future application of this section is still possible. A later distribution of the stock where gain was recognized would "recapture" all the deferred gain.

In addition, CFC stock which is part of a partnership interest which is sold or exchanged must now be included in the transaction items receiving ordinary income treatment on such sale or exchange. There was previously no provision for the treatment of CFC stock in such a transaction.

The above amendments apply to all sales, exchanges, and distributions taking place after October 9, 1975.

3. *Income from foreign insurance companies*

As mentioned above in Part IIIA, Subpart F income includes foreign personal holding company income. Such income is passive investment income, such as dividends, interest, royalties and rents. However, certain income derived from the active conduct of a trade or business is excluded from foreign personal holding company income. This income includes rents and royalties from the active conduct of a trade or business which are received from a non-related person (defined in footnote 11) (with limitations), and dividends, interest, or gains derived from the conduct of a banking, financing or similar business or derived from the investments made by an insurance company of its unearned premiums or reserves ordinary and necessary for the proper

14. The attribution rules here are similar to those described in footnote 10 but with attribution from foreign persons which are not included in the CFC attribution rules.

conduct of its insurance business if they are received from a non-related person. The insurance company is thus not liable to Subpart F taxation on dividends, interest, and capital gains on reserves held to meet the laws of the country where the insurance company is incorporated or the jurisdiction where the property or person is insured. Income on its other premium reserves, however, is treated as Subpart F income.

Some foreign jurisdictions require that foreign insurance companies participating in a reinsurance pool composed principally of companies doing business in the United States maintain a fairly substantial ratio of surplus to earned premiums. The assets held to meet this ratio are of necessity in the form of investments which generate passive income, such as dividends and interest. Under the prior law, such surpluses maintained by foreign insurance companies generated Subpart F income. The same type of surpluses in the United States, maintained in a 1 to 3 ratio, are considered ordinary and necessary to the proper conduct of casualty insurance businesses even though they are not required by law.

To coordinate the treatment of U.S. and foreign insurance companies, Act Section 1034 adds a new exception to the Subpart F definition of foreign personal holding company income. Effective December 31, 1975, foreign personal holding company income will not include dividends, interest, and gains from the sale or exchange of stock or securities derived from investments of up to one third of the premiums earned on insurance contracts (other than life insurance or annuity contracts). To be excludable, the income must be received from a person other than a related person. The premiums on which such income is earned cannot be attributable, directly or indirectly, to the insurance or reinsurance of related persons.

Thus this exclusion eliminates any penalizing treatment which was imposed on a shareholder for income from "necessary and proper" investments and amends the section to tax only that passive investment which is intentionally invested abroad with a view to accumulating tax-free passive income.

4. *Income from foreign base shipping companies*

Prior to the enactment of the Tax Reform Act of 1976 all profits from a foreign base shipping company received by a controlled foreign corporation which were not reinvested in the shipping company were currently taxed to the U.S. shareholders of the CFC. Under the new law an exception is created to this rule. Income will not be currently taxed to the U.S. shareholders if the income was derived from the use or hiring or leasing for use of an aircraft or vessel between two points within the country in which the CFC is created or organized and in which the aircraft or vessel is registered. This exception is a case where the shipping activity is not situs-free. The country in which the activity takes place is also the country which has the right to tax the CFC which receives the income. This means that the CFC is not gaining any advantage over other shipping companies operating in its home country, so there is no reason to treat this as a tax avoidance scheme. By exempting this income from current taxation to the U.S. shareholders the Tax Reform Act refines the scope of "Subpart F income" to make it more closely coincide with income from the use of a foreign corporation for tax avoidance. This provision applies to CFCs for tax years beginning after 1975 and to U.S. shareholders for their tax years which end with or after the first qualifying tax year of the CFC.

IV. THE FOREIGN TAX CREDIT

A. Prior law

Under the U.S. tax system the principal means of unilateral relief from double taxation of income earned abroad is through the providing of a tax credit for foreign income, war profits and excess profits taxes paid or accrued during the tax year. The amount of credit allowed is limited to the lesser of the amount of foreign tax paid or accrued and the amount of U.S. tax attributed to the foreign income. The second amount is calculated according to the following formula:

$$\text{limit} = \frac{A}{B} \times C$$

where A represents foreign source income,
B represents world-wide income
C represents U.S. tax on world-wide income

Prior to the enactment of the Tax Reform Act a taxpayer could usually choose between two methods of applying the above formula. He could always choose to combine all foreign income (except certain interest income, DISC dividends, and oil and

THE TRUST CONCEPT

The trust concept in the United States is based on the principle that ownership of property may be divided into two parts: legal ownership and beneficial ownership. Legal ownership grants the owner title to the property, the right to control the property and the right to sell the property. However, all benefits that are produced by the ownership of the property belong to the person who has the beneficial ownership of the property. Normally, the legal owner of property is also the beneficial owner. In a trust, however, the ownership is divided. Property is transferred to one person, the trustee, for the benefit of other persons, the beneficiaries. (The transferor is known as the grantor or settlor.) The trustee controls and manages the property and is required to exercise reasonable business judgment in conserving and enlarging the assets which have been given to him. Any gains produced by the property belong to the beneficiaries. They may be distributed to the beneficiaries in the year in which they arise or they may be accumulated by the trust and distributed in a later year. It should be emphasized here that while the legal title to the property has been given to the trustee, a separate legal entity has been formed, a trust. The income is received by this entity, not by the trustee, and the property forms the trust's net worth, and does not become part of the trustee's net worth. The trust terminates according to the provisions set down by the grantor at the time of the transfer. Both legal and beneficial ownership of the trust property then is transferred to the beneficiary designated by the grantor or designated by some other person specified by the grantor.

gas income, see below) and losses and apply the formula, using the resulting limit as a limit of all foreign taxes paid and accrued during the tax year which could be credited against U.S. tax. This was called the "overall" limitation. In the alternative the taxpayer could choose to apply the formula to the income from each foreign country separately [15]. Each resulting limit served as a restriction of the amount of taxes paid to the country in which the income was earned which could be credited against U.S. taxes. This was called the "per country" limitation.

The overall method of computation offered a greater amount of credit in certain circumstances where the U.S. taxpayer had some of his foreign income taxed at a higher rate than would be applicable in the United States and some of his income taxed at a lower rate. For example, assume that the taxpayer is a corporation subject to U.S. tax at the rate of 48 percent. It received income of 100 from country A taxed in A at 60 percent and income of 100 from country B taxed in B at 30 percent. Under the overall method the taxpayer has foreign income of 200 and foreign taxes of 90, or a foreign tax rate of 45 percent. Since this is lower than the U.S. tax rate the taxpayer may credit all of his foreign tax against his U.S. tax liability. This allows him to credit taxes paid in A that exceed the U.S. taxes due on the income earned in A. Thus, the overall method could create a sort of foreign tax credit "bonus".

The per country method could also create a sort of bonus under certain circumstances. The bonus arose from the fact that all foreign losses reduced only U.S. income, allowing a disproportionate amount of foreign tax credit. For example, suppose that a U.S. corporation had income of 100 in each of four countries, A, B, C and the United States, all of which countries tax income at 48 percent. The taxpayer had losses of 100 in country D. His world-wide income is 300 and his U.S. tax liability is 144. However, according to the limit formula given above, each of A, B and C have contributed one third of the world-wide income. Foreign tax credit of one third of the U.S. tax liability is allowed to each. Thus, foreign taxes satisfy entirely the U.S. tax liability. Even though the taxpayer earned one third of his world-wide income in the United States, he pays no taxes to the United States Treasury. The per country limitation offered a method for a corporation with both profitable and unprofitable activities abroad to minimize its U.S. tax liability.

The reduction of U.S. income because of foreign losses was particularly advantageous to the taxpayer because of the treatment of future profits from the "loss countries". Full foreign tax credit was allowed for taxes on those profits. Suppose that in the above example the taxpayer had received income of 100 from D and from the United States in the following year, each country imposing a tax of 48 percent. The tax paid to D would be creditable and would satisfy the U.S. tax liability on the D source income. Thus, a loss in D would reduce U.S. taxes in year 1 but an equivalent gain in D in year 2 would not increase U.S. taxes. This situation did not allow a taxpayer to pay less than the U.S. rate on his world-wide income, but it did permit him to pay a smaller percentage of the tax to the United States Treasury than the pro rata share of U.S. income of the world-wide income. As indicated in the example, this might mean a reduction of the taxpayer's total tax liability by increasing the available foreign tax credit. A similar advantage would occur under the overall method where a year of net loss from foreign sources was followed by a year of net gain. Under the existing law this advantage was available for all foreign losses except on oil and gas extraction income.

Note:
Similar to the "bonus" from averaging incomes from low tax and high tax countries, an advantage might be gained from averaging income taxed at a lower rate with income taxed at a higher rate. For example, many countries tax interest payments to non-residents at a much lower rate than they tax business income. Averaging interest income taxed at, say, 10 percent with business income taxed at 60 percent would mean an increase in the amount of the tax on business income that was allowable as a foreign tax credit without an increase in total taxable income. To restrict this advantage, separate foreign tax credits are computed for each of four categories of foreign income. The categories are (i) interest income earned abroad other than through business-related activities, (ii) income received from a DISC or former DISC, (iii) foreign oil and gas related income, and (iv) general foreign income (all foreign income except that in categories (i) — (iii)). Under the existing law a second restriction was added on oil and gas extraction income. Taxes paid on such income in excess of 50 percent of the income were not eligible for the foreign tax credit [16].

The availability of the tax credit was entirely restricted to the entity which paid the foreign tax. If a U.S. corporation received a dividend on which income a foreign tax had been paid by a foreign "first tier subsidiary" [17], "second tier subsidiary" [18], or "third tier subsidiary" [19], the U.S. corporation could take a credit for its pro rata share of the foreign tax paid or accrued on the profits from which the dividend was paid. (This indirect tax credit was treated as income received by the parent.) This permitted a U.S. corporation to do business abroad either through a branch or through a subsidiary structure with equal availability of credit for foreign taxes paid on the activities abroad. Slightly different rules applied in this area to amounts of income deemed received by a U.S. corporation because of its status as a U.S. shareholder of a CFC [20] and to dividends received from a LDCC. In the first situation,

15. In the case of oil and gas income the formula could only be applied overall and not to each separate country.
16. The excess taxes could, however, be deducted from taxable income.
17. A foreign corporation, 10 percent or more of whose voting stock is owned by the U.S. corporation.
18. A foreign corporation, 10 percent or more of whose voting stock is owned by a first tier subsidiary of the U.S. corporation.
19. A foreign corporation, 10 percent or more of whose voting stock is owned by a second tier subsidiary of the U.S. corporation.
20. For definitions of CFC and U.S. shareholder see footnote 10 and accompanying text.

credit was allowed the U.S. corporation only for foreign taxes paid by the CFC or by a foreign corporation 50 percent owned by the CFC (rather than a 10-percent-owned second tier subsidiary). No credit was allowed for taxes paid by a third tier subsidiary.

In the situation of a dividend from an LDCC, the recipient included only the amount of the dividend in his income. The indirect credit was not treated as income. His foreign tax was reduced, however, by the ratio of the foreign taxes paid by the LDCC to its pretax profits.

The following example illustrates the results:

Foreign country A: 30 percent corporate tax rate; Corporation B earnings: $1000.

	LDCC		*Non-LDCC*	
Earnings	$1000		$1000	
A tax	300		300	
Paid as dividend	700		700	
U.S. corporation				
Dividend income	700		1000	
48% tax	336		480	
Foreign tax credit	210	$(300 - (300 \times \frac{300}{1000}))$	300	$(300 \times \frac{700}{700})$
U.S. taxes paid	126		180	
Total taxes	426		480	

Thus the domestic corporate shareholder of an LDCC was in effect given both a deduction and a foreign tax credit for the foreign taxes paid. If, however, the foreign tax rate exceeded the U.S. rate of 48 percent, the foreign tax credit carry-over available for future years was reduced, since the corporation was not allowed credit for all the taxes paid to the foreign country on the dividend income.

B. The Tax Reform Act

The new law substantially alters the application of the foreign tax credit in 8 areas:

(a) Elimination of the "per country" limitation of the credit;
(b) Recapture of foreign losses;
(c) Controlled foreign corporation credit;
(d) Further limitation of oil and gas extraction income credit;
(e) Special treatment of foreign capital gains;
(f) Underwriting income;
(g) Dividends from less developed country corporations;
(h) Reduction of credit because of participation in certain boycotts (for a discussion of the provision see Part VII).

1. *Elimination of the "per country" limitation of the credit*

Perhaps the greatest change enacted by the new law is the elimination of the "per country" method of calculating the allowable tax credit. For tax years beginning after 1975 only the "overall" method of computing the limitation will be permitted. This means that losses from operations in a foreign country no longer may be used to reduce U.S. income while the taxpayer takes a credit for taxes paid in other foreign countries.

2. *Recapture of foreign losses*

The new law contains a set of provisions which insure that foreign gains achieved after a year in which net foreign losses have reduced U.S. taxes will increase U.S. taxes in the year or years of gain. These provisions apply for foreign losses sustained in tax years beginning after 1975. In years of gain after such a loss year 50 percent of the foreign source income will be treated as U.S. source income until U.S. source income has been increased by an amount equal to the previous loss deduction. Foreign source income will, of course, be reduced by the amount of the increase of U.S. source income. For purposes of this rule losses due to foreign expropriation losses and casualty losses (losses arising from unexpected and unusual events) will not be treated as losses subject to recapture.

Where there has been a foreign loss in a previous year, U.S. income will also be increased by the deemed income from the disposition of property used predominantly outside the United States in trade or business. The "deemed income" is the excess of the fair market value of the property over the property's tax basis, irrespective of what amount is actually received by the taxpayer. This income will be added to U.S. income without the 50 percent limitation that applies to other foreign income until total recapture of the prior foreign loss has taken place.

An important element of these new rules is that the foreign taxes paid on the foreign income which is treated as U.S. income will not qualify for the foreign tax credit. The logic is that they are not taxes paid on foreign source income. The necessity of such a rule is that otherwise these taxes could be attributed to other foreign income under the overall method of computation. The United States Treasury would lose tax revenues on that income and the taxpayer would still have available the advantage of foreign loss years. Thus foreign taxes paid on income deemed to come from U.S. sources are not eligible for the foreign tax credit in the year of payment and may not be carried back or carried over to be credited in a different tax year.

3. *Controlled foreign corporation credit*

The Tax Reform Act has greatly enlarged the availability of the foreign tax credit for a U.S. corporation which is taxed on income received by a controlled foreign corporation of which it is a U.S. shareholder. The U.S. corporation can take a tax credit, for tax years beginning after 1976, for its pro rata share of the taxes which have been paid on that income by a first tier subsidiary (i.e. the CFC), a second tier subsidiary and a third tier subsidiary. As is the case of the deemed foreign tax credit

for a U.S. corporation actually receiving a foreign dividend [21], 10 percent ownership of the voting stock of a corporation normally creates the subsidiary relationship. However, there is an added rule in the CFC situation that the domestic corporation must own, directly or indirectly, at least 5 percent of the voting stock of a second or third tier corporation to take a credit for its foreign taxes. Thus, the new law puts the treatment of CFC income on a much similar footing with dividends actually received for purposes of the foreign tax credit, but it does not completely eliminate the distinction.

4. *Oil and gas extraction income credit*

The new law has further limited the allowable credit for foreign taxes paid on oil and gas extraction income. The 50 percent of income limit on the amount of tax that may be credited or deducted in a tax year has been changed. For corporations this limit is now 48 percent of the oil and gas extraction income for tax years ending after 1976. For individuals the limit is their average U.S. effective rate of tax on oil and gas extraction income. This limit applies for tax years ending after 1974.

5. *Foreign capital gains*

Prior to the passage of the Tax Reform Act of 1976 no special provisions applied to capital gains received abroad. Such gains were simply treated as general foreign source income for purposes of calculating the foreign tax credit. However, for purposes of computing U.S. tax liability, foreign capital gains were combined with domestic capital gains and losses and the net amount of gain, if any, was taxed at a special rate [22]. Also, foreign capital gains in some countries were not subject to tax. Thus, the U.S. taxpayer might gain three advantages from foreign capital gains. First, foreign capital gains would increase the amount of foreign tax that could be credited even if no foreign tax had been paid on the gain. This is the type of "bonus" that was intended to be prevented by separate credit limits for interest income, etc. discussed above. Second, a foreign gain which increased the foreign tax credit might be offset by domestic capital losses and hence produce no U.S. tax liability. Third, even if the foreign capital gains were fully taxed in the United States, they would be taxed at 30 percent or less [23]. However, in computing the amount of U.S. tax attributable to foreign sources the gains would be given equal weight with U.S. income taxed at 48 percent for corporations or at progressive rates up to 70 percent for individuals.

The new law reduces or eliminates all three advantages. In applying the tax credit formula, foreign source capital gains for tax years beginning after 1975 will only be considered foreign taxable income to the extent that the gains exceed domestic capital losses. For corporate tax payers if foreign capital gains are to be considered foreign taxable income the "foreign taxable income" in the tax credit formula will be increased by only five-eights of the amount of the gains (reflecting the ratio of capital gains taxation to taxation of other income, 30:48). Thus, the amount of foreign capital gains included in the foreign tax credit formula now more nearly reflects the amount of U.S. tax attributable to those gains.

The "bonus" from averaging untaxed or lightly taxed income with highly taxed income is limited by treating certain capital gains as U.S. source income. Gains from the sale of stock abroad by a corporation after 1975 will only be foreign income if the gain is subject to foreign income tax at a rate of at least 10 percent or if the sale is made in the country in which the corporation issuing the stock earned more than 50 percent of its gross income for the three tax years prior to the year of the sale. Gains from sale of stock by an individual after 1975 will be foreign gain only if the sale occurs in the taxpayer's country of residence. Gains from the sale of personal property other than shares by any taxpayer after November 12, 1975 will only be foreign source income if the gain is subject to foreign income tax at a rate of at least 10 percent, if the property is sold in he country in which it was used in a trade or business of the taxpayer, or if the property is sold in a country in which the taxpayer derived more than 50 percent of his income for the three years preceding the tax year of the sale. Thus, while foreign capital gains may still increase the amount of taxes paid on other income which is eligible for the foreign tax credit, a taxpayer may not increase his foreign tax credit by having a sale producing capital gains take place in a foreign country unrelated to the property sold unless the gain is subject to at least a 10 percent tax.

6. *Underwriting income*

A foreign tax credit is available only for taxes paid to foreign countries on taxable income from sources without the United States. The tax law specifies to a large extent the types of income which are considered income from sources within and without the United States. Underwriting income (the premiums earned on insurance contracts during the taxable year less losses and expenses incurred) was not included under either definition. Under prior law the source of such income was determined on the basis of where the incidents of the transaction producing the income occur (e.g. where the contract was signed). Thus the taxability of such risks could be easily manipulated by insurers and the insured by changing the location where the contract was signed. It could also result in double taxation if, for example, a contract was executed in the United States and covered overseas operations. If issued in the foreign country in which the risk is located, it might be subject to foreign tax in addition to the U.S. tax imposed because the contract was signed in the United States. Since it was income from U.S. sources, taxes paid on such income to a foreign country would not be available for the foreign tax credit.

For this reason, new subsections were added to the sections of the tax law which define income from

21. See footnotes 16, 17 and 18 and accompanying text.
22. For an individual capital gains are normally taxed at one half the rate of his other income, but the taxpayer may choose instead to have the first $50,000 of capital gains taxed at the flat rate of 25 percent. For corporations capital gains are taxed at the flat rate of 30 percent.
23. See footnote 21.

sources within and without the United States. Act Section 1036 designates underwriting income derived from the insurance of U.S. risks as income from sources within the United States. "U.S. risks" are defined elsewhere as risks in connection with property in, or liabilities arising out of activities in, or in connection with the lives or health of residents of the United States, or where another company receives premiums for substantially the same type of risks. All other underwriting income is income derived from sources without the United States.

This section is applicable to taxable years beginning after December 31, 1976. Thus the new law clarifies the tax treatment of income from offshore insurance companies. It both eliminates the adverse foreign tax credit consequences of certain insurance transactions and prevents the manipulation of the availability of the foreign tax credit.

7. *Dividends from LDCCs*

Act Section 1033 amends the tax law dealing with the credit for taxes paid and eliminates the special treatment given to LDCCs. All dividends received from foreign subsidiaries, whether LDCCs or not, must be grossed up by the underlying taxes, if an indirect tax credit is taken.

Section 1033 also amends other sections of the tax law to eliminate the distinctions which were made between LDCCs and non-LDCCs.

Act Section 1033 is generally effective for any distribution received by a domestic corporation after December 31, 1977 and for distributions made out of current income in taxable years beginning after December 31, 1975. Corporations making distributions in taxable years beginning after December 31, 1975 and received before January 1, 1978 are effected only to the extent that the distribution is made out of the accumulated profits of a foreign corporation for a taxable year of the foreign corporation beginning after December 31, 1975.

[To be concluded in the next issue]

In next issue:

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  - 1. Prior law
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- B. Ruling requirement for certain exchanges involving foreign corporations
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VI. SPECIAL CATEGORIES OF FOREIGN TAX TREATMENT
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VII. ANTI-BRIBE AND ANTI-BOYCOTT MEASURES
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VIII. THE DOMESTIC INTERNATIONAL SALES CORPORATION
- A. General description and prior law
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U.S. Tax Forecast: More Reform

President Carter spoke during his campaign of the need for a comprehensive tax reform. Now he is in a position to propose such a reform. It is expected that he will present a complete tax reform package to the Congress in 1978. However, although President Carter's tax package is in its infancy, it is not too early to anticipate some of its contents. Based on statements by the President, one can expect measures concerning

- the double taxation of corporate profits. President Carter has said that this income should be taxed only once, indicating that he favors some form of imputation system of taxation.
- taxation of capital gains. President Carter has indicated that he favors full taxation of capital gains rather than the present system of excluding from three eights to one half of the gain from tax.
- the Domestic International Sales Corporation. President Carter favors the abolition of the DISC.
- individual taxpayers. The President favors a reduction in the deductions and exclusions available to individuals. He also supports a change from a deduction to a tax credit for dependents, a change which would benefit the poor taxpayers more than the well-to-do.

Though the exact form that these measures will take is uncertain, and though President Carter's proposals will have no effect unless passed by Congress, it can be concluded that the prevailing current in the Carter Administration is toward tax change and reform.

Interrelationship of corporation tax and income tax of shareholders.



National and International Tax Aspects

by Martin J. van Rooijen

The International Bureau of Fiscal Documentation is pleased to present the following — slightly adapted and updated version — of a paper submitted by Mr. Martin J. van Rooijen, Dutch Vice-Minister of Finance, on October 15, 1976 before a meeting of the U.S.A. Branch Northeastern Regional Committee of the International Fiscal Association.
The subject of his paper is the proposed E.E.C. Directive on a common system of corporation and shareholder taxation which advocates the introduction of the "imputation system" which has already been adopted by a number of E.E.C. member countries. Mr. Van Rooijen shows that the imputation system as proposed by the E.E.C. Commission contains a number of built-in deficiencies which should not be underestimated, in particular in the the relationship between E.E.C. member countries and non-member countries.

I very much appreciate your invitation to exchange ideas with you today about part of the tax harmonisation in the European Communities, namely the imputation system as proposed by the European Commission for the structure of company taxation for the whole Community.

Tax matters have always aroused great interest and in the present year in which the United States of America is celebrating its bicentennial it should not pass unnoticed here that it was a fiscal matter, the well-known Boston Teaparty, which sparked off the American War of Independence. Other examples may be found to prove that taxes are far from being mere marginal phenomena in society. One tax which has often been, and still is the centre of interest, particularly in the European Community, is corporation tax.

A particular question which has caused profound controversy is whether there is room for a tax on the profits made by legal entities in addition to a tax on the income of natural persons. The protagonists of an independent corporation tax maintain that a joint-stock company is a social entity in which management, capital and labour cooperate productively, and that it would not be realistic to identify the company with those who provide the capital. The company is an independent body and as such it should be taxed independently of the shareholders. The taxation system based on this opinion in which corporation tax is levied completely independently of the income tax on the shareholders is known as the classical system and it is applied in the U.S.A., Italy and the Netherlands as well as elsewhere.

The opposite view holds that the joint-stock company is no more than a form of cooperation of natural persons which is subject to certain norms. Seen in this light there is no reason to levy a separate corporation tax and if the profit of the company is taxed at all then such tax can only constitute an advance payment of the income tax owed by the persons entitled to the profits, namely the shareholders. The tax systems of most Western countries do not carry this view to its extreme but on the other hand a number of countries such as Belgium, Denmark, England, France, Germany and Ireland have opted for a partial integration of corporation and income tax in their fiscal legislation with regard to distributed profits. In this context we refer to the avoidance of what is known as economic double taxation. Economic double taxation means that the total profits of a joint-stock company are subject to corporation tax first and that subsequently the part of those profits which is distributed in the form of dividends is taxed again when received by the shareholders.

Economic double taxation may be wholly or partially avoided by taking measures with regard to either corporation tax or income tax. The differentiated rate system and the deduction of dividend are measures for the relief of corporation tax.

The *differentiated rate*, which was applied in Germany up to January 1, 1977, means that the profits made by a legal entity are not taxed according to a uniform rate but that a lower rate is applied to distributed profits. The lower rate in Germany was 15% while non-distributed profits were taxed at a rate of 51%.

The deduction of dividend allows the company to deduct the whole or part of the distributed profits from the taxable gains.

A variation of this system, namely the deduction of primary dividend, has been repeatedly discussed. The deduction of primary dividend means that that part of the dividend which may be deemed to be a primary remuneration for the capital provided by the shareholders, may be deducted from the taxable profit. Such a system has existed in Denmark and though limited to certain forms of providing new capital, was in force temporarily in Belgium some time ago. [1]

It is also possible to provide relief for double taxation on distributed profits by taking measures with regard to income tax. This possibility is applied in what is called the imputation system which is what I want to talk to you about today.

The imputation system allows the tax which the distributing corporation paid on the distributed profits to be wholly or partially deducted from the tax owed by the shareholder on the dividend received.

Currently in Belgium, Denmark, France, Ireland and Great Britain a partial imputation system is in force. On 1 January 1977 Germany introduced a system of total imputation with regard to distributed profits. The system introduced in Germany is a mixed form of the imputation system and the differentiated rate system. Corporation tax which may be wholly set off against the tax owed by the shareholder on dividends received, will be levied on distributed profits at a reduced rate. The Commission of the European Community is also in favour of an imputation system and has submitted a proposal for such a system to be adopted in all the Member States. According to the Commission's proposal the profits of corporations will be subject to a corporation tax at a rate which may not be lower than 45% or higher than 55% in any Member State. A shareholder may set off part of the corporation tax levied on the dividends received by him against the tax which he himself owes on the dividend.

For that purpose the deductible part of the tax levied on the distributing corporation, that is, the tax credit, is added to the taxable income or the taxable profit of the shareholder and subsequently deducted from the tax owed by the shareholder on the total amount of income and tax credit. The Member States may not grant a tax credit of less than 45% or more than 55% of the corporation tax levied on the dividends.

Where the shareholder is not liable to pay tax on the dividends received there is no reason to grant him a tax credit. This is particularly the case when the shareholder is a legal entity. In the Netherlands, for example, there is a substantial holding privilege according to which a company which holds more than 5% of the shares of another company is exempted from paying tax on the dividend received from that other company. In such cases there is no economic double taxation so that there is no reason to grant the shareholding company a tax credit. In other words parent companies are not entitled to tax credits on the dividends received from their subsidiaries.

The United States has another system for inter-corporporate dividends, which is known as the "credit system", about which I hope to say more when dealing with the relationship between the European Community and third party countries.

Where a parent corporation passes on the dividend received to its own shareholders there are two possibilities: either the shareholder is liable to pay tax on the dividends received or he is not taxed. In the first case, economic double taxation occurs and consequently the shareholder is entitled to a tax credit. In the second case, if, for example, the parent corporation passes on the dividends to its own parent corporation economic double taxation does not occur and its own parent corporation would not be entitled to claim a tax credit.

At the purely national level the proposed imputation system is still feasible but applying the system in an international setting is altogether different. It should be pointed out that in the Commission's proposal the intra-community dividends, i.e. the dividends flowing from one Member State to another, are treated differently from those distributed to shareholders outside the European Community.

The Commission proposes a very complicated system for dealing with intra-community dividends. For example if a Belgian subsidiary pays dividends to a Dutch parent corporation which in turn passes them on to its own shareholders, the Belgin tax credit must be transferred to the Netherlands so that it may be taken into account in assessing the Dutch income tax owed by the shareholder. Because of the substantial holding privilege the Dutch parent corporation itself is not entitled to the tax credit. For technical reasons the transfer of the Belgian tax credit to the Dutch shareholder has been organised as follows: when the Dutch parent corporation passes on the Belgian dividend to its shareholders a compensatory levy (précompte) which is sufficient to cover the costs of granting the tax credit to the shareholder is imposed on the corporation. The Belgian tax credit may be deducted from the "précompte" or compensatory levy. If no further measures were taken the setting off of the Belgian tax credit would be a charge on the Netherlands treasury. Howevēr the intention is that the burden of the imputation should be borne by the country of the subsidiary corporation. Consequently there is the need for a settlement between the Dutch and Belgian treasuries.

That is the position regarding intra-community dividends. What happers, however, when dividends leave the European Community. The answer to this question will have to be provided by the Conventions for the avoidance of double taxation between the European

1. In order to stimulate its economy France recently adopted the deductibility of dividends for companies created in 1977-1979 on increasing their capital during those years. The deduction is accorded for a period of 5 years and the maximum annual deductible amount is 7.5 percent of the capital contributed.

Community and third party states. That this is far from easy may best be demonstrated by means of an example. A corporation resident in one of the Member States of the European Community pays a dividend to a shareholder resident in the United States. The shareholder is a natural person and so there is economic double taxation and the shareholder is in principle entitled to a tax credit. The question arises how the shareholder's right should be exercised. The American tax authorities will not be prepared simply to set off part of the corporation tax levied in the European Community from the American income tax and so it seems likely that the tax credit will result in direct payment to the American shareholder by the Member State. Nevertheless I would like to query this solution. Is it right that the costs of the tax credit should be entirely chargeable to the state in which the distributing corporation is resident? In our example economic double taxation is caused just as much by American income tax as by the corporation tax levied in the E.E.C. State and it would be equally correct to say that the American Treasury should bear the burden of the tax credit. The direct payment of the tax credit to the shareholder I have just mentioned will require certain international measures to be taken. It stands to reason that the Member State of the European Community will only be prepared to pay if it is quite certain that the American shareholder is liable to pay tax on the dividend received. If the shareholder is exempt from tax on his dividends or if he does not declare the dividend to the American tax authorities then economic double taxation will not occur and no tax credit need be paid. Thus the shareholder will have to present evidence of his tax liability in respect of dividends received in the United States when claiming the payment of a tax credit.

The situation is even more complicated when a corporation resident in one of the Member States pays dividends to an American parent corporation. The American parent corporation may set off corporation tax paid on the profit distributed in the E.E.C. State against the American corporation tax for which it is liable. The consequence of setting off one tax against the other is that as long as the profit derived from the E.E.C. country remains in the corporation it should not be subject to a higher tax than that which results from the highest rate of corporation tax applicable in the U.S.A. and in the E.E.C. country. In this way the accumulation of tax liabilities within the corporation is avoided and there is no reason to grant a tax credit to the parent corporation. However, when the shareholders of the parent corporation finally receive the dividend and are taxed on it, the need to grant a tax credit arises again, but the manner in which it is to be effected is far from clear. After all, the shareholder cannot claim directly from the tax authorities of the E.E.C. Member State, as can the direct shareholder, because his dividend is not an E.E.C. dividend but is the dividend of an American corporation. Moreover, a procedure by which the parent corporation claims the tax credit and passes it on to its shareholders is not feasible either since the parent corporation cannot prove that the shareholders are liable to pay tax or not.

In the new Convention between England and America a lump sum solution to the problem has been found. According to Article 10 of the Convention an American parent corporation receiving dividends from a British subsidiary is entitled to half the tax credit which would have been granted to a shareholder who is not a legal entity. This provision has been made on the assumption that the parent corporation will redistribute about half of the dividends received to shareholders who are liable to pay tax.

If all the difficulties attached to the proposed imputation system are considered, and particularly those arising at international level, the classical system seems to be perfectly simple. The way this system operates is clear; it does not discriminate against foreign shareholders and does not impede international cooperation by companies. The imputation system on the other hand is to a large extent obscure and particularly where it touches on international shareholding relationships the granting of tax credits causes many problems which can lead to discrimination against foreign shareholders. In order to implement the system properly at international level the existing conventions for the avoidance of double taxation need to be extended by a number of extremely difficult provisions regarding the granting of the credit which can be understood only by very experienced tax experts. Looking at the conventions signed by France and the United Kingdom it becomes clear that France is not prepared to grant inter-corporate tax credits while England has only a partial solution for these. What Germany will do once it has introduced the imputation system cannot be predicted.

It is very doubtful whether the advantages of the imputation system outweigh the complications at international level which have just been referred to. In its Explanatory Memorandum to the proposal to introduce an imputation system in the E.E.C. the Commission puts forward the following advantages:

a) In comparison to the classical system the imputation system is more neutral with regard to various forms of company financing. The classical system favours self-financing and discourages the distribution of profit to the shareholders, while the imputation system is said to encourage equity financing and the distribution of dividend.

b) The imputation system favours fairness of taxation, while the classical system favours the ploughing back of profits which benefits the major shareholders but not the small shareholders who are interested only in obtaining a reasonable dividend.

c) The imputation system is said to make tax evasion and tax avoidance less attractive. Under this system it would be less appropriate to transform unincorporated enterprises into joint-stock companies; large shareholders would be less inclined to have dividends paid into a company set up for the purpose. These arguments are based on the assumption that the introduction of the imputation system will go hand in hand with an increase of the corporation tax rate which would bring it closer to the marginal rate of income tax.

The Commission's arguments are not always convincing. They are based on the premise that the imputation system will promote the inclination to distribute profits and considerably lessen the gap between the marginal income tax rate and the corporation tax rate. It is questionable whether these two consequences of the imputation system will bear out the arguments of the Commission.

Moreover, I am struck by the fact that the Commission stresses arguments based on the national tax policy of the Member States while it devotes scarcely any attention to various international aspects. This is all the more strange since the "Van den Tempel Report" which was commissioned by the European Community in 1969, drew its strongest arguments against the imputation system from precisely those international aspects. In its Double Taxation Memorandum of 1970 the Netherlands Government arrived at a similar conclusion.

Furthermore, it remains to be seen whether, particularly from the financing point of view, the transition from the classical system to the imputation system is really so attractive economically to corporations which distribute little or no dividend since, assuming that the aggregate yield of corporation tax and income tax remains unchanged, such corporations will after all be faced with a higher rate of corporation tax without having the benefits of the relief of economic double taxation. The imputation system favours especially those companies which usually distribute very satisfactory dividends. While it is true that the Commission's proposal is of a structural nature so that arguments pertaining to cyclical financing problems should not be advanced against it, such aspects should certainly be considered where the financial position of certain corporations is weak for a prolonged period.

It may be expected that the examination of these and other questions will be very time-consuming so that it will be a good while before a harmonised company taxation system is introduced.

The proposal of the European Commission contains a suggestion to harmonise the withholding tax on dividends at a rate of 25%. It may be questioned whether there is any place in the imputation system for a withholding tax since the tax credit already has a similar function. Neither France nor England make use of a withholding tax in domestic taxation. On the other hand the new Anglo-American Tax Convention does provide for a withholding tax to be levied in the United Kingdom on dividends flowing to the United States.

In this respect it should not be forgotten that in 1973 the Commission still intended to submit to the Council within a short time guidelines for a withholding tax on interest. According to the Commission a harmonised withholding tax could be an important instrument in the struggle against tax fraud and in this I fully concur. From the very start, however, the Commission has rightly pointed out that, simultaneously with the harmonised levy on interest, measures to control the movement of capital would have to be introduced; otherwise the withholding tax on interest might provoke a flight

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DENMARK. INTRODUCTION OF AN IMPUTATION SYSTEM

By P. Dyhr. *European Taxation*. Amsterdam. October 1976 at 342.

FEDERAL REPUBLIC OF GERMANY: INTRODUCTION OF A TOTAL IMPUTATION SYSTEM

European Taxation. October 1976 at 348.

of capital to third party countries. Moreover, the control measures were to contain provisions guaranteeing a large measure of freedom for the movement of capital within the Community. The Commission has not yet proposed a measure of this kind and it is therefore not surprising that in July 1975 it declared that no proposal for a harmonised withholding tax would be submitted to the Council for the time being.

In conclusion I should like to say a few words about the framework in which tax harmonisation in the European Community is to be seen, that is, the Common Market. The Common Market implies that in many areas and matters the Member States are growing closer to each other. In different areas such as the customs union and agricultural policy much progress has been made, but in other areas it has been slower.

The harmonisation of taxes is but a part of the considerable work which still has to be done before the aims of the Common Market have been fully realised. Tax harmonisation therefore cannot be seen in isolation from work proceeding in other Community matters such as common transport policy, common energy policy and common industrial policy. There is no point in allowing tax harmonisation to run on ahead of developments in other areas; only a coordinated approach can lead to satisfactory results.

Furthermore, as the process of tax harmonisation progresses, more attention should be given to a rational division of fiscal authority between the Community and the Member States. Irrespective of its structure, every State has to deal with the problem of dividing fiscal authority between the central government and other authorities. There are two aspects to the problem. The first of these is that of deciding which taxes should be levied by the government and which can be left to the local authorities. The second is that of deciding the share of the national taxes to be assigned to the other authorities. The key to this problem will usually be found in the division of responsibilities between the various public bodies and the extent to which some of these bodies are unable to finance expenditure from their own tax revenue.

The Europe of the Nine faces the same problem. Although the sovereign right of the individual Member States to levy taxes has scarcely been affected, as more development takes place more taxes will be levied by the Community, which in turn will distribute funds to the Member States according to need (for example in the form of subsidies).

This is why tax harmonisation lies in the force field between two poles, one of which is the responsibility of the Member States which will still retain a good deal of autonomy and will therefore need considerable financial leeway, while the other pole consists of the requirements of a well-organised Community and the extent to which economic and social policies become a Community responsibility.

Whatever happens, a uniform tax structure under the central authority of the European Community cannot be achieved without the cooperation of the national parliaments, and the corresponding formulation and implementation of a common tax policy will have to go hand in hand with a strengthening of the position of the European Parliament. After all as long ago as the eighteenth century the slogan "no taxation without representation" made the citizens of the American colonies rebel and furthered the cause of democracy.

I hope that now, during the last quarter of the 20th century, this same slogan will provide much food for thought to the Eurocrats of the New Europe.

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TURNOVER TAX IN THE U.S.S.R.

by E.H. de Jong *

Turnover tax is one of the most important sources of income for the Soviet State budget. Although its proceeds have proportionally declined (as compared with the total income of the Soviet budget) since 1965, the year of the economic reforms, more than 30 percent of the total income of the Soviet budget was derived from this source during the last few years.

The following are subject to U.S.S.R. turnover tax:
- State enterprises;
- cooperative enterprises;
- so-called "enterprises of social organizations" (i.e. all kinds of associations, such as trade unions, sporting clubs, etc.).

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It must be common knowledge that private enterprises have not existed in the Soviet-Union since the 1930's. All enterprises are owned either by the State or by a cooperative or by social organizations. The vast majority is owned by the State. In addition to the turnover tax, the enterprises pay several levies and taxes on profits, social security premiums and other levies and taxes (e.g. customs duties). More than 90% of the total income of the Soviet budget consists of the sum of the turnover tax and the other levies and taxes due by enterprises. The other revenues come from the wage and income tax.

Since the tax reforms of 1930, taxation of enterprises in the U.S.S.R. is effected through two main channels:
1. turnover tax;
2. profits taxes.

Different laws exist for the taxes on profits due by State enterprises, cooperative enterprises or enterprises of social organizations respectively. As regards the turnover tax, however, there exists one uniform law which is effective for all categories of enterprises.

Since the vast majority of enterprises is owned by the State, taxes on profits of State enterprises also constitute an important source of income for the Soviet budget, in addition to the turnover tax. Just like turnover tax, their share of total income of the Soviet budget has exceeded 30 percent during the last few years.

The following charts may illustrate this:

A. In 1000 Million of Rubles [1]

	1940	*1950*	*1960*	*1965*	*1970*	*1973*	*1975*	*1976* a)	*1977* b)
total income	18.0	42.3	77.1	102.3	156.7	187.8	218.7	223.6	238.8
income from enterprises	16.0	35.4	70.1	93.9	142.9	170.9	199.0	202.9	216.6
turnover tax	10.6	23.6	31.3	38.7	49.4	59.1	66.6	69.9	73.2
taxes on profits of State-enterprises	2.2	4.0	18.6	30.9	54.2	60.0	69.7	69.9	78.4

B. In percentages of total income [1]

	1940	*1950*	*1960*	*1965*	*1970*	*1973*	*1975*	*1976* a)	*1977* b)
total income	100	100	100	100	100	100	100	100	100
income from enterprises	88.8	83.7	91.0	91.8	91.2	91.0	90.9	90.7	90.7
turnover tax	58.7	55.8	40.7	37.8	31.5	31.5	30.5	31.3	30.7
taxes on profits of State-enterprises	12.1	9.5	24.2	30.2	34.6	32.0	31.9	31.3	32.8

a) Proposal of law (as approved).
b) Proposal of law (not yet approved).

1. The following sources were used for these surveys:
- *Narodnoe khoziaĭstvo SSSR, v 1965 godu, statisticheskiĭ ezhegodnik* (The national economy of the U.S.S.R. in 1965, statistical yearbook), Moscow 1966, page 781-782.
- *Narodnoe khoziaĭstvo SSSR, v. 1973 godu, statisticheskiĭ ezhegodnik* (The national economy of the U.S.S.R. in 1973, statistical yearbook), Moscow 1974, page 778-779.
- *SSSR v tsifrakh v 1975 godu* (The U.S.S.R. in figures in 1975), Moscow, page 10.
- *Ekonomicheskaia Gazeta* (The economic newspaper) 1976, No. 45, page 10.

Legal Sources

The turnover tax has been reformed in 1975 by the Decree on the Turnover Tax as approved by the Council of Ministers of the U.S.S.R. [2]

As a part of this Decree, the Ministry of Finance of the U.S.S.R. issued a "General Instruction on the Turnover Tax" which contains a large number of regulatory provisions [3]. The old "Ordinance to the Turnover Tax on Enterprises in the Socialized Sector", dating from 1930 [4] and a large number of additional regulations and instructions were substituted by the Decree and the General Instruction.

Taxpayers

As explained above, the taxpayers for the turnover tax are State enterprises, cooperative enterprises and enterprises of social organizations. However, enterprises owned by agricultural or fishing cooperatives (kolchozes) are excluded from tax liability.
Both production and commercial enterprises can be liable to the turnover tax. The only thing which is subject to turnover tax is sale or other disposition of goods manufactured or purchased by the enterprise. Services are not taxed. Goods which are taxed are mainly consumer goods, i.e. goods which are sold to individuals. Goods used in the course of production (e.g. machinery and equipment) are, in general, not taxed with turnover tax, except for, inter alia, petroleum products, natural gas, energy, motorcars.

System of Soviet Turnover Tax

The 1930 Soviet turnover tax was based on the principle of one-time imposition of turnover tax for each product, however, with the restriction that the product itself does not undergo a change which makes another product of it. If the finished product was processed to one or more other products, turnover tax could be levied on the newly manufactured products, even if the processed product was taxed with turnover tax in an earlier stage. In that case, it had to be a question of the manufacturing of completely new products (e.g. the manufacturing of confectioner's products from products which were subject to turnover tax in an earlier stage, such as flour, sugar, fats, etc.) Processes which have the purpose to protect certain products against deterioration or damage or to facilitate the sale of the products (e.g. packing) were not considered to turn them into new products.

This principle which was laid down in article 1 of the legislation of 1930 is no longer provided for by the new Ordinance on the Turnover Tax of 1975.

Although the principle of a single stage turnover tax cannot explicitly be found in the new Ordinance on the Turnover Tax, it plays a role in the background, i.e. for the way of determination of the tax rates. The former principle, that turnover tax will only become due if the goods are sold by the enterprise to customers outside the enterprise, also disappeared in the new Ordinance on the Turnover Tax. Transfers within the enterprise (e.g. from one department to another) against retail trade or industrial wholesale prices are now subject to turnover tax.

Tax Base

In determining the rates of the turnover tax, one must consider that almost all prices of goods are determined by the State. In the Soviet Union the following three different price concepts exist:
— enterprise's wholesale price;
— industrial wholesale price;
— retail trade price.

The enterprise's wholesale price of a certain product consists of the production costs increased by the margin of profits of the enterprise.
The industrial wholesale price for a certain product consists of the enterprise's wholesale price increased by the turnover tax.
The retail trade price for a certain product, finally, is composed of the enterprise's wholesale price increased by the turnover tax and the margin of profit of the retail trade. See the chart at the bottom of this page.

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2. Ordinance on the Turnover Tax, approved by the Decree of the Council of Ministers of the U.S.S.R., June 30, 1975; *Sobranie Postanovleniĭ Pravitel'stva SSSR* (Collection of decisions of the Government of the U.S.S.R.), 1975, No. 17 item 108.

3. General Instruction on the Turnover Tax, Instruction of the Ministry of Finance of the U.S.S.R., December 31, 1975; *Biulleten' normativnykh aktov ministerstv i vedomostv SSSR* (Bulletin of normative statements of the ministries and departments of the U.S.S.R.) 1976, No. 9, page 12-32.

4. Ordinance on the Turnover Tax of enterprises in the socialized sector, approved by the Decree of the Central Executive Committee and the Council of People's Commissars of the U.S.S.R., September 2, 1930; *Sobranie zakonov i rasporiazheniĭ Rabochekrest'ianskogo Pravitel'stva SSSR* (Collection of laws and decrees of the Workers' and Peasants' Government of the U.S.S.R.) 1930, No. 46 item 477.

production costs	+	margin of profits of the enterprise					=	enterprise's wholesale price
production costs	+	margin of profits of the enterprise	+	turnover tax			=	industrial wholesale price
production costs	+	margin of profits of the enterprise	+	turnover tax	+	margin of profits of retail trade	=	retail trade price

The product can be taxed either on the level of the productive enterprise or on the level of the trading enterprise (one-time imposition). The rates of the turnover tax are determined either on the basis of the difference between retail trade price less the margin of profit of retail trade and the enterprise's wholesale price or on the basis of the difference between the industrial wholesale price and the enterprise's wholesale price. In the first case the trading-enterprise pays the turnover tax due; in the second case the productive enterprise.

The rates can also be determined on the basis of percentages of turnover or in fixed amounts per product-unit. During the last years more than 80% of the revenue of the turnover tax has been computed as the difference between retail trade price (less the margin of profit of retail trade) and the enterprise's wholesale price or as the difference between the industrial wholesale price and the enterprise's wholesale price. Approximately 6% of the revenues of turnover has been computed in percentages of turnover and approximately 14% in fixed amounts per product-unit.

The Government determines not only the prices of the products, but also the production and the turnover of the products, which are fixed in a plan (annual plan, divided in quarterly plans, if any, monthly plans, etc.). The revenue of the turnover tax can be easily computed from these plans because of the existing fixed prices. Therefore, revenue of turnover is also planned. The revenue of the turnover tax depends on the realization of the production plan and the plan concerning sale of the products. Thus, an important additional effect of the collection of the turnover tax is the possibility to control the realization of the plans of the enterprise concerning the production and the sale of the products via the Ministry of Finance. If an enterprise's plan concerning production or sale of products is not realized, this will immediately result in a reduced turnover tax revenue. Since the turnover tax revenue is also laid down in a plan, the non-realization of a plan concerning production or sale of product, if any, makes the enterprise fail to meet the standards set by the authorities. The attention of the Ministry of Finance (i.e. the Ministry of Finance of the U.S.S.R., the ministries of finance of the separate Union Republics and the financial departments of the lower territorial governments (provinces, regions, cities etc.)), therefore, is immediately drawn to circumstances upsetting the production or the sale of products.

The Government can influence the earning capacity (i.e. percentage of profits as compared with full costs of production) of a certain product by determining the turnover tax rate for that product. In determining the turnover tax rate for new products an earning capacity with a minimum of 15% and a maximum of 30% must be guaranteed for the enterprise according to the Ordinance on the Turnover Tax. The determination of the turnover tax rates for other products must result in an earning capacity of 15 to 17% for the enterprise, or in the case of groups of similar products up to 20%, if any. Anyhow, a minimum earning capacity of 15% for a certain product must always be guaranteed for the enterprise in determining the turnover tax rates. Thus, the production of new products is stimulated within the limits of the Government plans by guaranteeing a high earning capacity on these goods. If, in the case of the effective turnover tax rate, the production of certain goods results in a loss or a failure to make a profit, temporary reductions of the turnover tax rates are granted with respect to these goods (in most cases for one year). On the other hand, however, the enterprises which produce hardly profitable goods or goods which involve a loss can be obliged to pay higher turnover tax on other goods produced by them which have a relatively high earning capacity, as a compensation for reductions of turnover tax. The rates are always determined by the Ministry of Finance of the U.S.S.R., the ministries of finance of the Union Republics, or the financial departments of the lower territorial governments (provinces, regions, cities, etc.).

Dates of Payment

The duty to pay the turnover tax exists for the enterprise directly after the receipt of the money from the sale of its products. The terms within which the turnover tax due must be paid range from a payment directly after each transaction, a daily payment, a payment per five days, a payment per ten days, a monthly payment to a quarterly payment. However, a payment once per ten days is the most usual term. For enterprises which pay the turnover tax due once per 10 days, the turnover tax due amounts to more than 3,000 Rubles per month [5]. If the average turnover tax due amounts to less than 3,000 Rubles per month, the tax is paid monthly or quarterly. These quick, continuing payments of turnover tax provide the State budget with a constantly flowing source of income.

Computation and Returns

The enterprises which are subject to tax must compute the turnover tax due themselves. They also must render an account of this with the Ministry of Finance within the required terms and in accordance with the forms which are issued by this ministry. The director and the chief accountant of the enterprise are responsible in

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5. According to the official exchange rate 1 Ruble equals 3.40 Dfl. (November 1976).

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this respect. Enterprises which are subject to the Ministry of the Interior of the U.S.S.R. and the Committee for State Security with the Council of Ministers of the U.S.S.R. (better known as K.G.B.) are excepted from this duty. Enterprises which fail to render an account of the turnover tax to be paid by them are obliged to pay 110% of the turnover tax paid over the preceding period of time, until an account is rendered. Enterprises which do not pay the turnover tax due within the required terms, must pay a fine at an amount of 0.05% per day of the outstanding tax due. On the other hand, however, the taxpayers also have right of appeal against wrong decisions of officials at the Ministry of Finance.

Exemptions

The Ordinance on the Turnover Tax lists a number of groups of enterprises which are completely or partially exempt from the payment of turnover tax.

First, it concerns newly founded or reorganized enterprises which produce consumer goods from locally available raw materials or by-products (with the exception of vodka, other drinks and cosmetics containing alcohol, as well as tobacco), however, under the condition that the consumer goods are at least 75% made from locally available raw materials or by-products. The same exemption is granted to newly founded or reorganized enterprises which produce articles of popular art. These enterprises are exempt from the payment of the turnover tax during the first two years after the foundation or the reorganization.

The second group consists of enterprises and institutions which employ disabled workers. Here, it concerns products which are manufactured by workplaces of educational institutions, educational and workcentres for minors, medical-therapeutical workplaces of psychiatrical and other institutions, workplaces for handicapped and blind persons, etc. All products manufactured by such institutions are partially exempt from turnover tax. The conditions for the granting of this exemption is that the number of partly disabled persons amounts to 75 percent or more of the total number of employees (except in the case of blind persons, where the percentage of 75 is reduced and instead a percentage of 50 is applied).

The third group of enterprises and institutions which are exempt from the payment of turnover tax, consists of various branches and enterprises which produce all sorts of goods, e.g. medicines and vitamins, bread and flour products, potatoes, vegetables and fruit, milk and milk products, meat and meat products, books, newspapers and periodicals, coal, peat and firewood, clothes, toys, etc. It was the legislature's intention to exempt from turnover tax the necessities of life as much as possible.

In addition to the exemptions granted by the Ordinance on the Turnover Tax and the annexed Instruction, partial or complete exemptions from tax can also be granted by the Ministry of Finance.

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PROVINCIAL TAXATION SERVICE

Richard De Boo Ltd., 151 Wellington Street, Toronto 1, Ontario, Canada.
Supplemented: regularly

Loose-leaf publication service providing continuously updated information on the increasingly important and fast changing areas of provincial taxes of Alberta, Saskatchewan, Manitoba, New Brunswick, Nova Scotia, Prince Edward Island and Newfoundland. This service presents the texts of all provincial income, corporation, property, commodity and other tax acts and regulations, orders-in-council, bulletins — indexes and introductory notes. Tables of principal licence and registration fees of the Provinces are also included. The material is kept up-to-date by the issuance of supplementary and replacement pages.
Complementary to Provincial Taxation Service are in separate volumes:
1. British Columbia Taxation Service.
2. Ontario Taxation Service.
3. Quebec Taxation Service.
The provincial taxes of which are not dealt with in Provincial Taxation Service itself.

PROVINCIAL SUCCESSION DUTY AND GIFT TAX SERVICE
(formerly Canada Estate Tax Service)

Editor-in-Chief H. Heward Stikeman. Richard De Boo Ltd., 151 Wellington Street, Toronto, Ontario, Canada.
Supplemented: regularly.

Loose-leaf publication service to provide in one Binder the texts of and comment on the provincial succession duty and gift tax legislation. Special chapters on situs and valuation are appended. The material is kept up-to-date by the issuance of supplementary and replacement pages.

CANADA INCOME TAX GUIDE

CCH Canadian Ltd., 6 Garamond Court, Don Mills, Ontario 1974 (second edition started 1974), Canada.
Supplemented: 18 supplements per year.

Loose-leaf publication service to reflect the Canadian Income Tax Act as revised under the federal income tax reform effective January 1, 1972. Volume 1 contains an explanation of federal income tax law based on the Income Tax Act, Income Tax Regulations, decisions of the Tax Review Board and the courts, and administrative rulings with reference to the Law and illustrated by worked examples. Volumes 2 and 3 (optional) contain the full texts of the Income Tax Act and Regulations, Information Circulars, Interpretation Bulletins and Advance Rulings.

CANADIAN TAX REPORTER
(second edition started 1973)

CCH Canadian Ltd., 6 Garamond Court, Don Mills, Ontario, Canada.
Supplemented: weekly.

Loose-leaf publication service in six binders. The full text of the Federal Income Tax Act is set out section-by-section, and each section is followed by editorial comment, text of income tax regulations, tax review cases, interpretation bulletins, information circulars, memoranda, advance rulings and other tax-related regulations. In addition the compilations contain reproduction of text of double taxation treaties and forms. The material is thoroughtly indexed and is kept up-to-date by the issue of supplementary pages.

CANADIAN SALES TAX REPORTER

CCH Canadian Ltd., 6 Garamond Court, Don Mills, Ontario, Canada.
Supplemented: monthly.

Loose-leaf publication service dealing with the taxes imposed by the Federal Excise Tax Act, i.e., the sales tax, the excise tax and the tax on certain insurance premiums. It explains the provision of the Excise Tax Act and Memoranda. The text of the statute and where appropriate departmental circulars or memoranda are reproduced in full. The material is kept up-to-date by the issue of supplementary pages at least once a month. New court decisions and other current developments are reported in the New Matters division of this work. A comprehensive index is appended.

DOMINION TAX CASES

CCH Canadian Ltd., 6 Garamond Court, Don Mills, Ontario, Canada.
Supplemented: 3 reports per month.

Loose-leaf publication service which reports in full the text of all federal tax cases heard by the Tax Review Board, The Supreme and Federal Courts of Canada and the higher courts of the provinces. New cases will be reported as and when they are released by the Board or the courts. A regular service will report on new developments. All decisions are cumulatively indexed by subject in the Topical Index, by section number of the Acts in the Citator, and by case name in the Case Table.

FOREIGN INVESTMENT IN CANADA
A guide to the law by Peter R. Hayden, Jeffrey H. Burns and Irwin Schwartz.

Prentice-Hall of Canada, Ltd., 1870 Birchmount Rd, Scarborough, Ontario M.P. 237, Canada. 1975.
Supplemented: monthly.

Loose-leaf publication service on foreign investment law in Canada. The service covers a full comment on the Foreign Investment Review Act and the complete text of the Foreign Investment Review Act, the Regulations and Guidelines thereto. Provincial, as well as federal, legislation that restricts foreign investment in Canada is dealt with. The service brings the material up-to-date by monthly releases which are of three types entitled: Current Matter; New Ideas and Report Bulletins. A comprehensive index is appended.

FRANCE

DICTIONNAIRE PERMANENT — DROIT DES AFFAIRES

Editions Législatives et Administratives, 3 Rue Jean-Ferrandi, Paris.
Supplemented: regularly (at least four times a year).

Loose-leaf publication service providing explanation of the French business entities. Each kind of major business entity is dealt with in extenso. Minor business entities are also considered. At present the work contains three binders. The material is kept up-to-date by the issue of replacement pages and supplementary pages.

DICTONNAIRE PERMANENT — FISCAL

Editions Législatives et Administratives, 3 Rue Jean-Ferrandi, Paris.
Supplemented: regularly (at least four times a year).

Loose-leaf publication service providing explanation of the French tax system. Each kind of tax is dealt with. References are made to the basic statute, case law, administrative notifications and circulars. Double taxation treaties are considered. At present the work contains two binders. The material is kept up-to-date by the issue of replacement pages and supplementary pages.

FEUILLETS DE DOCUMENTATION PRATIQUE FRANCIS LEFEBVRE

Editions Francis Lefebvre, 44 Rue de Villiers, Levallois-Perret.
Supplemented: every three months.

Encyclopedia in loose-leaf form dealing with taxation, social and labour law in France divided into six basic collections contained in various binders. The six basic collections are classified under the following subject headings: DIRECT TAXES, REGISTRATION AND STAMP DUTIES, INDIRECT TAXES, TAXES ON IMMOVABLES, SOCIAL SECURITY AND LABOUR LAW. Each collection covers the text of statutes pertaining to the subject concerned and includes the relevant text of the law, circulars, case law and administrative instructions. Double taxation treaties are considered. The material in each collection is kept up-to-date by the issue of monthly BULLETINS and LOOSE-LEAF SUPPLEMENTS, every three months. In addition, the issue of RAPID DOCUMENTATION PAGES (FEUILLETS DE DOCUMENTATION RAPIDE) published at least once a week reports on new developments in the field of taxation, social and labour law.

JURIS CLASSEUR: DROIT FISCAL CODE FISCAL — COMMENTAIRES

Editions Techniques, 123 Rue d'Alésia, Paris.
Supplemented: 2-3 times a year.

Loose-leaf service on taxation in France in various binders. The work covers the consolidated text of the tax laws and comments thereon. It deals with all taxes such as individual income tax, corporate income tax, business tax, tax on value added, taxes on immovable property, and other miscellaneous taxes on income, capital, payroll and local taxes. Avoidance of double taxation both by unilateral measures and by double taxation treaties, is considered. The material is kept up-to-date by the issue of replacement pages and supplementary pages.

LA TAXE PROFESSIONNELLE

Express — Documents
61 Rue de Malte, Paris.
Supplemented: regularly.

Loose-leaf publication containing full text of the business tax (taxe professionnelle) and explanation thereof. The material is kept up-to-date by the issue of replacement pages and supplementary pages.

FROM TAX HAVEN TO FISCAL PARADISE.

H.W.T. Pepper

PART TWO *

PERMISSIBLE AND DESIRABLE ON-SHORE ACTIVITIES: BENEFITS TO HAVEN

80. Some types of tax haven have relatively high direct taxes but give exemption therefrom to companies registered there under special legislation which have their business transacted overseas. In such cases it is essential that the exempted companies should have no operations in the country as otherwise they could compete with other local companies which are subjected to normal taxation.

81. Nevertheless, it is sometimes required that one of the directors of such offshore companies should be a local resident, or that a local should act in some other capacity in the company, obviously in order to generate some more local employment. Even if the duties are purely nominal, if a substantial number of companies register, the total quantity of "work" to be done may be appreciable, and where some legal or accounting knowledge is required, the result may be to create openings for local persons to acquire professional qualifications and raise their status and earning capacity.

82. Often an offshore company will arrange to have its directors' meetings outside the country of registration, the residence of the company then being in the country where the meetings take place. That place may be a "no tax" haven so that no income tax arises in either country.

83. Another variation is to allow the offshore company to have an office in the country of registration, in fact to encourage this, provided that its actual functions are concerned solely with persons not resident in the country.

84. In the case of a "no tax" haven, there is usually no economic objection to an offshore company carrying on its work in the haven so long as its functions are entirely outside those of the existing trades and businesses carried on by locals in the haven. The functions of the offshore company will usually be of a legal and financial character connected with the overseas owners of the company.

85. In either type of haven there should be a clear gain in employment opportunities for nationals of the haven, which will range from professional (legal, accounting, and banking) services, clerical work, and of course there will be demands on the construction industry, and on utilities, including telephone, telex, and postal services.

* Part One has been published in January 1977 issue of the Bulletin.

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OTHER ECONOMIC ACTIVITIES

86. Goods, such as consumer durables, are not uncommonly manufactured in one country and sold to consumers in another which may be at the other end of the world. Some large corporations interpose a subsidiary in a third country actually or ostensibly to process selling orders and production demands so as to ensure an even flow of the goods from factory to market. Where the distribution country is in a tax haven the profits from that level of activity will no doubt be tax-free or lightly taxed, at least in the first instance. Sometimes no doubt the ostensible distribution company may be little more than a brass plate, but with the growing pressure on tax havens there must be more reasons than ever to have a "real" operation in the haven.

87. Nowadays, when data can be taped and flown rapidly from place to place, processed by computer and transmitted by telex, it could well make sense to set up intermediary corporate activities in tax havens (for that matter in other developing countries that offer fiscal inducements) involving the use of data-processing equipment for which local staff could be trained. There would of course also be scope for setting up much simpler operations. Such a course would not only commend itself to the host haven but make the whole operation less vulnerable to counter-tax-avoidance legislation.

CAPTIVE INSURANCE COMPANIES

88. The kind of risks which a corporation might wish to insure against range from the cataclysmic (such as the entire destruction of buildings, plant and stocks by earthquake, tidal wave, or fire), to the fairly frequently recurring, run-of-the-mill losses. In between there are risks which may involve substantial losses which are less than cataclysmic and less predictable than the small losses.

89. A large corporation may insure the first category of risks, and perhaps not insure the second category, but bear the risks itself. As regards the intermediate type of risks, it may decide to set up a subsidiary or affiliated company (therefore a "captive" company) to handle the insurance.

90. If the main company had merely put some of its profits aside as reserves to cover the contingency of the intermediate type of risks, no tax deduction would be due for the sums reserved. In contrast, premiums to an insurance company against recognised risks would be deductible — hence the need to set up a separate company in a haven so that untaxed reserves may accumulate to meet future losses.

91. Sometimes the intermediate risks may include some peculiar to the industry which are not commercially insurable, or not readily insurable except at unreasonably high premiums.

92. Once it has a captive insurance operation, the main company may also transfer other types of insurance to the new company, using re-insurance to hedge against cataclysmic risks.

93. Establishing a captive insurance company may have other advantages besides a tax saving. Where risks are insured with a commercial company there may be complacency as regards accident prevention because of the very fact that the risk is covered by a third party who will meet all costs of restitution in the event of loss. When the insurer is within the "group", the loss will come back home and there will be an incentive to take all possible preventive measures to limit losses, making for a more healthy corporate performance in general.

94. Although as will be obvious from the above, a good case can be made out for the creation of captive insurance companies, it is also true that there can be abuses in their use, e.g., as a vehicle for sending excessive sums of money overseas in the form of "premiums". In the U.S.A. the Internal Revenue Department has banned the deduction of premiums to captive insurance companies because of abuses, though it seems that a better, though less simple approach would be to allow deductions subject to close checks on the operation including the level of premiums charged.

95. The tax haven "specialising" in captive insurance management is Bermuda, estimated to have about 400 such companies registered, but some business in this field is also done in the Bahamas, Caymans, the Irish Republic (Shannon Free Port area), New Hebrides, and Panama.

INTERNATIONAL BUSINESS COMPANIES

96. Laws to permit the registration of "International Business Companies", normally having all their business operations abroad have been enacted in Antigua, Barbados, and Jamaica, in each of which the rate of tax applicable to world profits of such companies is 2½%, and in St. Vincent, where the rate of tax is 2%. All 4 countries have relatively high rates of direct taxation, except for the special IBC rate, and for the long-term exemption of tax on the profits of new enterprises operating inside the territories.

97. The originator of the "IBC" idea perhaps thought that the industrialised countries would accept tax rates at 2 or 2½% as qualifying for relief in double tax treaties, where one country gives up its right to tax income if the income is taxed in the other country. At any rate, only St. Vincent seems to have attracted a reasonable number of such registrations, and this country is now considering the extension of its financial and haven services. The IBC legislation in St. Vincent, however, is to be repealed and replaced by a similar law, the exercise being done to weed out undesirable companies which were registered under the old laws. It may be assumed that this will put an end to the notorious off-the-peg off-shore banks. The two new laws to be introduced (designed by a firm of Swiss lawyers) are the more usual income tax-free companies which pay registration fees only, and trust law which will enable income tax-free trusts to be set up.

OFF-SHORE COMPANIES

Directors' Meetings: Local Directors

98. Reference has already been made to the general lines of requirements of laws and facilities for the registrations of companies. In the early stages of a haven's existence it probably should not insist, e.g., on meetings being held in the country, on a local person (such as a lawyer) being appointed to the Board. If the welcome the haven gives to its customers is a friendly and helpful one it may well be that the company may decide to make greater use of local facilities without being pressed to do so. Moreover it is not unknown for a company's officials to make excuses to come to the country of registration of their own freewill in order to enjoy a peaceful interlude from the rat-race back home!

99. Sometimes it suits the company's purpose better to arrange directors' meetings in another country, and if ruled about such matters are too stringent in one haven the customer may choose another. Where operations are carried on within the tax haven, of source, it may well be reasonable to seek more of an actual "presence" of the company in the haven, but these matters can be worked out in the light of experience of customers' needs and the responsibility of the haven to preserve a good image.

Revenue to Haven Government

100. A haven will usually charge somewhere in the region of the going rate for offshore companies, which ranges upwards from about £200 sterling for initial and also for annual registration. For a new haven substantial revenue should not be looked for in the early stages, it

will be more important to establish a name for efficiency and service and let the future take care of itself. There is a great deal of competition and loopholes are being closed all the time in tax legislation, sometimes faster than the experts can find new ones. It has to be borne in mind that some of the advantages of haven business may be measured in employment opportunities rather than in tax revenue. (See also "**Attributes and Tax Structure of a Tax Haven**" above.)

OFF-SHORE TRUSTS AND FUNDS

Family Trusts

101. One type of "offshore" trust is that created by a taxpayer, usually for the benefit of his heirs, whereby he divests himself of certain assets, which can then earn or accumulate income tax-free in the haven he has chosen so as to increase the benefit to the beneficiaries, in addition to reducing the tax liability of the originator of the trust. The greatest flexibility in setting up trusts occurs under a common law regime such as that prevailing in the Bahamas, Bermuda, Caymans, Hong Kong, the Isle of Man, and New Hebrides. There is provision for civil law trusts in several havens, including Liechtenstein, Switzerland, Panama, and the Netherlands Antilles.

Investment Trusts and Funds

102. Offshore investment funds, which may either be in the form of a trust or company are clearly matters which require careful consideration by the haven authorities, particularly in view of scandals that have arisen over the last few years through bad or even fraudulent management of customers' investments. The general idea is that an offshore investment operation has advantages in that there is less tax applying to the income arising from the "group" investments than if the operation were not in a tax haven. Where the individual investor resides in a country which taxes foreign income there may only be a marginal advantage in obtaining a slightly larger gross distribution, or in some element of tax-deferral.

103. Apart from making security checks on the persons who are to operate the funds, the haven may decide to enact security laws governing the rights of investment managers to invest, as is common in the Trustee Laws of many countries. Although there was great interest in haven-based funds during the 1960-1970 decade, there has been a considerable slackening of interest in recent years.

Banks

104. Interest on deposits of cash in Banks in No-Tax Havens does not, of course, attract income tax, but the same is also true of deposit interest accruing on deposits from overseas invested in banks in non-tax-free financial centres such as Guernsey, Isle of Man, Jersey, Liechtenstein, Luxembourg, Netherlands, Netherlands Antilles, Singapore, the U.K. and the U.S.A. Offshore banks are, however, more often situated in the No-Tax Havens, especially Bahamas with nearly 400, and the Caymans with about 220. Guernsey and Jersey are also offshore banking centres although these havens have more or less reached saturation point as regards banks.

105. Some offshore banks have been set up by large international banks to perform various functions which are more easily accomplished in conditions of freedom from exchange control, and fewer banking formalities. Such banks are able to pay interest without deduction of tax and take part in international underwriting syndicates, and of course assist customers in forming foreign companies and trusts.

106. In some cases "captive" banks have been set up by large international trading concerns which may be of service, not only to their parent companies, but also to customers of those concerns. The offshore bank may operate as a merchant bank and provide financial facilities additional to those obtainable in commercial banks at home. The offshore bank is often able to handle foreign exchange business more smoothly than the local banks.

107. The fees charged by havens for offshore banks which wish to register and operate under the havens' laws are very substantially higher than those for ordinary companies, and there is usually a licensing procedure, besides the ordinary registration process, which prescribes what a bank can do under the law. During the processing period the haven will normally check the credentials of the promoters in a very thorough manner (see "**Vetting of Developers, Promotors, etc.**" below).

"SECRET" OR "NUMBERED" BANK ACCOUNTS

108. All bank accounts are "secret" as between the account-holder and the bank to the exclusion of all other persons. Some countries, however, have enacted rules demanding the disclosure by the bank to Government (Inland Revenue, Exchange Control, Police) in certain circumstances of details of a customer's affairs.

109. Where secrecy is more or less untrammelled by any disclosure laws, it is probably almost as effective whether the customer's name, or an anonymous number identifies the account, especially if the account is kept in a distant tax haven.

110. Nevertheless, there is some demand for numbered accounts, partly no doubt because of the mystery or aura of glamour which seems to surround such accounts. In some cases, in these days of industrial espionage when large corporations try to obtain the industrial secrets of their competitors, there may well be a reasonable commercial case for using an anonymous account to do certain dealings where secrecy from competitors is essential. It seems that not even numbered accounts are completely proof against penetration by Government agents working for the Treasury or perhaps the Fraud or Bunco Squad, but these notes are concerned with legal transactions only, where there should be nothing to hide from one's Government!

SHIPPING HAVENS "FLAGS OF CONVENIENCE"

General

111. The popular view of "flag of convenience" tends to range at one extreme from the notion of a rusting hulk limping into harbour with a drunken crew and officers having only correspondence course qualifications. Some-

times the picture is of a ship going the wrong way in a busy traffic lane, or running ashore and spilling its oil cargo on to neighbouring beaches. At the other extreme, and to an increasing extent, haven registrations include some of the newest and most modern of ships whose owners maintain a high standard of maintenance of the vessels, and of facilities for the crew.

112. Both images are factual, but the former may be on the way out as haven countries themselves raise standards of compliance. Recent initiatives by the International Labour Organisation Maritime Conference (13-29 October 1976) will further improve matters when countries ratify and act upon the latest proposals for checking the condition of ships that call at the harbours of signatory countries, and at the same time examining the conditions of service of the crew for compliance with I.L.O. standards.

113. Although it has been estimated that less than one-third of ships' crews belong to trade unions, there is probably higher union membership among dock-workers, and there have been examples of dock-workers or longshoremen "blacking" (i.e., refusing to handle) ships which too flagrantly ill-treat their crews. Accordingly there are limits beyond which owners cannot go in attempts to make undue profits by underpaying crews and undermaintaining ships.

114. Since havens commonly offer income tax exemption on shipping profits (but impose registration and tonnage fees), many shipowners are attracted by that factor alone. In high-wage countries, however, where there are strong maritime trade unions, shipping companies have sometimes found it impossible to make any profit at all except by registering under a foreign flag (usually also registering a shipping company in the flag country) so as to bring themselves outside the too-onerous labour requirements in the home country. Such action has been lent a measure of "respectability" by some governments, notably the U.S.A., condoning the use of a foreign flag, so that its nationals will have some shipping interests in case of war or other emergency, when the home government might otherwise have to depend entirely on foreigners for shipping services.

Factors other than Taxation

115. To what extent maritime countries lose revenue from income tax on shipping profits by the activities of havens must be somewhat conjectural. Shipping tends to suffer more than average economic vicissitudes, ranging from under-capacity when the Suez Canal is closed, to over-capacity when the canal re-opens. Passenger ships have lost most of their business to the airlines, and private sector shipping has suffered from subsidised competition by State or para-statal shipping lines, and sometimes from attempts of importing or exporting countries to insist that their cargoes be carried by their own ships.

116. Moreover, shipping is often given preferential fiscal treatment. Britain has at different times granted depreciation on sums larger than the actual cost of a ship to its owners and given substantial grants towards the cost of new ships. The U.S.A. has given favourable treatment to American shipowners even though they have registered their ships under flags of convenience. Greece, whose nationals own a large proportion of the world's shipping, has recently tried, with some success to "bring the ships back home" by matching the treatment afforded to Greek owners by the tax havens where the ships were formerly registered.

117. It is in fact generally recognised that matters such as over-restrictive practices by maritime trade unions in some industrialised countries, and the occasional unpopularity of some of these countries in the developing world, which can cause difficulties for those flying the flag of the unpopular country, may figure more largely than tax alone in deciding where to register one's ships.

Shipping Havens and Centres

118. Although many countries may aspire to become shipping havens by offering flag-of-convenience terms for registration, most of the business is done by a handful of havens the "leaders of the table" having been in the business for a long time. At the end of 1974 Liberia was the leading "maritime nation" being credited with 55.3 million tons gross of registered shipping (out of a world total of 311.3 million gross registered tons), followed by Panama with 11 million tons. Of other havens, Cyprus with 3.4 million tons and Singapore with 2.8 million have risen rapidly, although it seems that the position of Cyprus may have been eroded partly by the war in that country and the possibility of its partition, and partly by the competition of Greece itself in trying to bring its shipowners home.

119. Singapore clearly has a long lead in Asia and since Singapore is of growing importance as a financial centre and also has a key geographical position as a port and entrepot, and considerable dockyard facilities, it seems to be soundly based as a centre for ship registration. Panama, which is strategically placed on the canal between the Atlantic and Pacific Oceans, is a natural haven for Latin America which is also widely used by North Americans.

120. A shipping centre in the new style is Malta, which enacted its Mercantile Shipping Law in 1973, and is well situated geographically between Europe, Africa, and Asia, athwart the shipping route between Suez and the Straits of Gibraltar. Malta is an independent, non-aligned country with excellent harbour and dockyard facilities, currently being expanded by the building of a supertanker repair dock. Shipbuilding facilities are also being substantially extended, and a new development is that of entrepot/transhipment services. Cargoes carried on east-west shipping services are landed in Malta for re-distribution by ships plying north and south to the southern coasts of Europe and to the northern coasts of Africa.

121. The intention is to be selective in accepting ship registrations so as to preserve a good image in the maritime world. Consular services have been set up in various parts of the world and there is the usual exemption from income tax for shipping profits, with registration fees broadly in line with those of shipping havens.

"FREE PORTS" AND "DUTY-FREE ZONES"

Entrepot Trade and Processing Industries

122. Freeports occur more commonly in the world than is generally thought, and in fact virtually all large ports allow the import and re-export of goods, by way of

entrepot trade without seeking to impose customs duties. The goods may be stored in bonded warehouses or there may be an enclosed area of the port where goods may be held pending import or re-export.

123. Sometimes, however, a country may set up an area large enough to contain industries which will process imported raw materials into goods for export, at a seaport or airport (e.g., Shannon in Eire). Such arrangements may be convenient more from the physical ease of handling materials with an absolute minimum with no hauls from port to factory and back by road or rail, than from the tax viewpoint. Even where the factory is well outside the port or airport area, customs duty and sales taxation on the materials and products that are exported, are in principle exempted and it is merely a matter of arranging either not to charge such duties at all or to make rapid refunds where duties are charged initially.

Income Tax on Export Industries

124. Some countries, in conjunction with port or airport development, establish industrial zones or "estates" in the port area and in order to encourage use of the facilities for manufacturing industry which is export-oriented, grant income tax exemption on the profits from the industry for a period of years. Where part of the product is sold in the country itself the exemption would normally be reduced proportionately.

Tax-Sparing of Exempted Profits

125. Where a company set up to manufacture goods for export under tax exemption incentives is the subsidiary of a larger company subjected to tax in some industrialised country, the effect of the exemption may be partly nullified if dividends paid out of the exempted profits to the parent company are taxed in the recipient company's assessment. The remedy is for the investing country to grant "tax-sparing" relief in respect of the exempted profits, by recognising the profits as "taxed" at the normal rate in the country of origin for relief purposes. Such provisions may be found in many of the tax treaties between developed and developing countries, but some countries, notably the U.S.A. refuse to give such relief.

126. Where no sparing relief is given, some deferment at least of the tax which would otherwise be imposed on the exempted profits may be possible by judicious use of a tax haven. This would be another rather respectable use of a haven — to avoid the original intention of the exemption being frustrated by the action of the investing country!

Death, Succession, Inheritance, and Gift Taxes

127. Most full-fledged tax havens do not seek to impose any of the above taxes, but such levies are often a factor to consider in the more limited havens, where there is either an orthodox tax system with moderate tax rates which applies to everyone, or where some special more favourable regime is granted to a new settler in a country where high personal taxation prevails generally.

128. A country may have natural advantages in providing congenial living conditions for the affluent retired of other countries. It would make sense for it to offer a special regime in respect of death duties etc., since the odds are on retirees making substantial contributions in this field because their average life expectancy is so much less than that of the population as a whole. There is no sign that apart from some Swiss cantons, any country has so far implemented such an incentive, though of course "havens" such as Bahamas, Bermuda, Caymans, Isle of Man, Jersey, Guernsey, Andorra, Monaco have no death duties at all. Some countries have very low rates such as the Falkland Islands (maximum rate 10 percent).

129. One factor in favour of an attractive residential haven country instituting a special "deal" for new retiree settlers is that some revenue could then be assured, whereas it is often possible for an affluent person, coming from a more sophisticated country where he will have the advice of tax specialists, so to arrange his affairs that little death duty liability will arise in the new country. A small country with limited resources will obviously have even greater difficulty in coping with avoidance than the more industrialised, who with all their legal resources still themselves have difficulty in coping.

130. A retired person, seeking a peaceful life, with as few as possible areas of uncertainty, and knowing that "there are no pockets in shrouds" or that he cannot take his wealth with him when he dies, may be quite pleased to settle for a certain guaranteed level of tax on his remaining estate to apply when he goes into his final exile.

"VETTING" OF DEVELOPERS, PROMOTERS, BANKERS AND OTHERS

131. While it is not usual to run security checks on the ordinary routine offshore companies that are registered in their hundreds in the main tax havens, experience has shewn, even if the point was not already obvious, that much more care is needed if the concern which it is proposed to register is to go in for banking, investment trust operations, insurance or other financial matters.

132. A country newly entering the haven field would, therefore, be well advised to establish from the outset more stringent rules for the types of operation mentioned above. In addition it is a simple, but necessary precaution to prohibit the use in the title of a newly-registered ordinary company, any term such as "bank", "trust", "finance", "insurance" or the grammatical derivatives of those words, plus the translation into any other language of the words. If this is not done there is always the possibility that an unscrupulous promoter will use such words in the title of his offshore company to hoodwink investors in some far-off country.

133. Moreover, where a model set of Memoranda and Articles of Association for a company are embodied as a table or schedule in the Company Laws, it is as well to exclude activities such as banking and insurance operations from the permitted activities, which, otherwise, may be as wide as possible.

134. Where the promoters of a company are to run banking, trust, or insurance operations, it is now usual to make stringent security checks starting with asking for bankers' and other references from the applicants. In

addition reference will usually be made to organisations such as Dun & Bradstreet in the U.S. and the National Credit Bureau in Britain and other organisations which specialise in providing credit and other "credentials" (or lack of them) to enquirers. Where the promoter claims to be a barrister or member of some other professional association, lists of members may be consulted or enquiries made of the association concerned.

135. Since the Police Departments of major countries, and in particular their Fraud Sections have a keen interest in keeping informed about the activities of swindlers and fraudulent promoters who may have passed through their hands, it is mutually useful to keep in touch with such Departments, with whom it is often possible to establish rapport because of the common interest in preventing scandal and fraud, and the older tax havens have usually made such valuable contacts.

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IFA INTERNATIONAL FISCAL ASSOCIATION NEWS

U.S. BRANCH

On January 14, 1977 the President of the U.S.A. Branch of I.F.A. sent a circular letter to the members containing much information which is also of interest to members of other national groups and to our readership in general. The most significant parts of the letter are reproduced below.

U.S.A. BRANCH ACTIVITIES

National meeting

For the first time, the U.S.A. Branch held a National Meeting ("U.S. Congress") in San Francisco on November 17-18, 1976. The West Coast Regional Committee, under the leadership of Harry Horrow, undertook the organization of the meeting and did an outstanding job. The calibre of the program and speakers was exceptional. By reason of competition from other meetings (particularly those dealing with the then newly enacted Tax Reform Act of 1976), the attendance (about 75) was not up to our hopes or expectations. Nonetheless, we plan to give the National meeting concept another try and have tentatively scheduled for November 3-4, 1977 in New York, to be organized by the Northeast Regional Committee under Walter O'Connor's leadership. We all owe Harry Horrow, Frank Walsh and the other members of the West Coast Regional Committee our gratitude for a magnificent effort.

Regional committee activities

All the regional committees were extremely active this past year, each one mounting its share of technical meetings on various subjects of interest to the membership. The subjects ran the range from sensitive payments to integration of corporate and shareholder taxation.

Canadian — U.S. meeting

In addition, the West Coast Regional Committee and the Canadian branch jointly sponsored an all-day session on taxation of natural resources, held in Calgary. My compliments to the regional committee chairmen for a job well done!

Speech of Dutch Undersecretary *

I might also point out that one of the programs sponsored by the Northeast Regional Committee featured as speaker Dr. Martin J. van Rooijen, the Dutch Parliamentary Undersecretary of Finance. This again demonstrates our unique position, as a constituent of the only truly international tax organization in existence, to call upon tax experts from abroad to appear at U.S.A. Branch programs. I hope in future we will take more advantage of this capability.

German — U.S. meeting

We are planning to conduct a joint meeting with the German branch in New York, April 21-22, 1977. The program is being designed under the able guidance of Paul Farber in conjunction with representatives of the German branch. The basic thrust of the program will be to exchange views and ideas on tax problems of U.S. businesses operating in Germany and German businesses operating in the U.S.A. With recent overhaul of the German tax system, the session will be extremely timely.

Functional committees

The functional committees continue to operate at full steam. With the size of our branch and the many activities undertaken, these committees are essential to our continued efficient operation. My thanks to Jim O'Brien for his able efforts in connection with the committee operations.

Tax treaty committee

I might point out that as at January 1, 1977, we have formed a new functional committee, a Tax Treaty Committee. I have asked Bob Patrick, fresh from his position as the U.S. Treasury's International Tax Counsel (where treaties were a major portion of his responsibility), to chair this new committee. As we envisage it, the major purpose of such a committee would be to provide business and professional input to Treasury in connection with their ongoing and future treaty negotiations. We believe that there is a real need for such an activity and that I.F.A. is the ideal organization to undertake it.

MEMBERSHIP

Net growth of our individual membership is relatively negligible, as new memberships virtually offset loss of memberships through attrition. We wish to continue to confine our membership to persons with a real interest in the area, but our membership among academicians and economists is relatively small and could use strengthening.

Corporate and firm sponsoring memberships continue to decline (31 at latest count). Within the next month or so, each council member whose firm is not represented among the sponsoring members will receive a letter from me requesting that he or she make a determined effort to enlist their firm as a sponsoring member. Perhaps later we will make such a solicitation from other than council members. In this endeavor, I expect to lean heavily on the Membership Committee and the regional

* See page 64.

liaison membership representatives. It is essential for our continued financial health that we substantially increase our sponsoring memberships (at $100 per annum).

Gordon Nicholson, who has chaired the Membership Committee for the last two years will be stepping down from this post. Gordon was appointed as his firm's National Director of Tax Services and will no longer be in a position to devote substantial time to I.F.A. activities. I offer our congratulations and gratitude to Gordon. Mark Cohen has graciously agreed to assume this position for the coming year.

PROCEDURAL MANUAL

I am pleased to report that the branch procedural manual, outlining the duties, functions and responsibilities of the officers, the council, the executive committee and the committee chairmen, was issued in May 1976. Although important contributions were made by many individuals, Julian Phelps spearheaded the project and deserves a vote of thanks from all of us. It is incumbent upon all of us to strive to keep the manual up to date.

FINANCES

Our financial position remains solid despite a very tight 1976, under the diligent stewardship of our Treasurer, David Bertrand. Inflationary pressures have caused Central I.F.A.'s portion of our dues to continue to increase, although our dues have not risen in several years to keep pace. With this in mind, we have been forced to consider a dues increase (to $35) for 1977. This will be discussed at the forthcoming annual meeting.

ANNUAL MEETING

The 1977 annual meeting will be held on February 11, 1977 at the Plaza Hotel in New York. David Foster, International Tax Counsel, will be our featured speaker. By now, I trust that you all have received the notice, and I hope to see many of you there.

UNITED KINGDOM BRANCH

During the coming months, the British I.F.A. Branch will hold a number of meetings on subjects of topical interest.

Development Land Tax is the subject of a meeting to be held on March 9. Topical Tax Questions will be discussed on March 30. On March 31 and April 1, the second Anglo-Swiss Tax Seminar will be held in London.

CANADIAN BRANCH

The next meeting of the Canadian Branch of I.F.A. will be held on April 1, 1977 in Toronto. A summary of the proposed agenda which is entirely devoted to the interpretation of tax treaties, follows:

Morning sessions

— General principles of interpretation (speaker: Mr. David A. Ward).

— Definitions: residence of individuals and corporations, enterprises and permanent establishments (speaker: Mr. Geatan Drolet).

Luncheon Speaker

Mr. Gerard Coulombe on "The work of the Fiscal Committee of the O.E.C.D."

Afternoon sessions

— Gains on alienation of property (speaker will be indicated later).

— Property income (speaker will be indicated later).

JOINT BRANCH MEETINGS

In addition to local activities, several branches of I.F.A. have organised in the past and are to organise in the future joint seminars with other branches.

In recent years, inter alia the following meetings were held:

Anglo-Dutch Seminars, in Amsterdam and London

Anglo-German Seminars, in Hamburg and London

Anglo-Belgian Seminars, in Brussels and London

Benelux Tax Seminars, in Luxembourg and Amsterdam

The following meetings are scheduled in 1977:

Second Anglo-Swiss Seminar, London, March 31/April 1

U.S. German Tax Seminar, New York, April 21-22 (dealing with the taxation of businesses in the U.S.A. and Germany).

NIGERIA

The Employment Implications of the 1976/77 Federal Government Budget: A Comment.

by F. Akin Olaloku *

I. Introduction

The Federal Government budget for the fiscal year 1976/77 completely conforms to the now familiar pattern of the post-civil war budgets, with the battle against inflation being the most important single feature. Once more, the nation has been treated to the same barrage of measures (as in past years) all aimed at increasing the supply of essential goods and services (food, housing and transportation), which have been identified as the most important cause of the current inflation in the economy.

In encouraging the increased supply of the above essential goods and services, the specific fiscal measures adopted include considerable reduction in the cost of their inputs. For example, import duties on all categories of machinery for food production have been abolished, while the duties on a wide range of imported food items as well as excise duties on certain locally processed foods have been reduced to the barest minimum. In addition to these, the government has also slashed and in some cases maintained the existing policy of outright abolition of duties on imported raw materials with the aim of aiding the increased output of some locally based industries. In this connection, attention has been focused particularly on imported raw materials for the building and construction industry such as cement and iron rods as well as for some consumer goods industries like textiles, foot wear, electronics and household utensils. In order to increase the supply of transportation facilities and thus aid an easier and freer flow of goods and people, the Government, in addition to liberalizing the importation of medium-sized cars, has also brought down the import duties on some categories of commercial vehicles and their spare parts. Finally, one further fiscal measure adopted by the Government to curb the current inflation in the economy is the restriction placed on the rate of government spending. This measure is particularly significant in the sense that the rapid rate of public spending which has characterised the last few years has constituted an important factor in the inflationary pressures being presently experienced in the economy.

Year after year since the civil war, or more specifically, at least since 1972, the Federal Government has adopted specific anti-inflationary measures directed at solving the problem of supply shortages in the economy. But in retrospect, the inflationary situation against which this solution is ultimately directed, has worsened from year to year. This inability on the part of the Government to grapple very effectively with the problem of inflation is either due to the failure to diagnose the problem correctly or the failure to adopt real and effective measures. But to my mind, with the existing flood of evidence about the causes of inflation in the Nigerian economy, it appears that the Government's difficulties are more related to the latter factor.

The problem of inflation is a world-wide phenomenon and in an increasingly economically interdependent world, finding solutions to the problem is a formidable task. This fact is attested to by the current experience in other countries of the world. It may therefore appear to be asking the Federal Government too much to provide a final solution to the problem all at a go. But certainly, the measure of achievement so far, leaves very much to be desired, considering the fact that the war against inflation has raged continuously for about five years. Although the present budget appears to be more articulate in its emphasis on the problem, the degree of achievement will greatly depend on the effectiveness with which the announced measures are pursued.

II. Level of Employment

In this comment, I am less concerned with the analysis of the likely impact of the fiscal measures on the task of decelerating the rate of inflation, but rather more with the implications of the budget for another economic policy objective, namely, the level of employment. In other words, I am trying to examine the extent to which the measures announced in the budget will provide increased scope for the creation of more job opportunities.

The world-wide problem of inflation has unfortunately and inevitably become coupled with another problem which has arisen mainly from the conflict of the objectives of maintaining stable price levels (i.e. controlling inflation within acceptable bounds) on the one hand, and full employment on the other. This development has created another dimension to the task of finding solutions to the inflation problem in the sense that policy makers have had to operate policy instruments for controlling inflation under the big constraint that unemployment must be maintained at an acceptably prescribed level. Thus, by and large, in almost, if not all the developed countries, the militant fight against inflation has taken place against the background of the possibility of unacceptably high rates of unemployment,

* Senior Lecturer, Department of Economics, University of Lagos.

with the result that achievements about the control of inflation have been very limited. This indicates a dilemma between the two policy objectives — a dilemma that can only be resolved by a trade-off of one policy objective (low rate of inflation) for the other (high rate of unemployment).

According to economic theory, prices and wages are negatively related to the rate of unemployment. Thus, rising wages and prices are usually accompanied by very low rates of unemployment. But in practice, the experience in many countries, not the least in the developing countries, has been different: high rates of unemployment have co-existed with high rates of inflation, thereby leading to a worsening of the trade-off between the two and making much more difficult a reasonably acceptable simultaneous achievement of the twin objectives.

III. Inflation and Unemployment

The current inflationary situation in the Nigerian economy can be described to have reached the crisis proportion and hence, the government's great concern to do something about it. But in the absence of any reliable figure of its rate, one cannot as yet say the same about the situation with unemployment, although according to the records in the Federal Ministry of Labour's register, its level has risen considerably since the civil war. Given this fact, it will appear that the inflation — unemployment dilemma is not yet as critical in Nigeria as in the developed countries. But this does not mean that the Government should lose complete sight of the unemployment problem. Looking over the Federal Government budgets for the last couple of years, there is ample evidence to support the view that unemployment has not been recognised as a serious issue of government economic policy. Despite the Government's explicit expression of a definite commitment in its development plans to reduce the level of unemployment, nowhere in any of the budgets of the past few years was it emphasised explicitly as an objective of economic policy, towards the achievement of which fiscal measures are specifically directed. However, a good many of the fiscal measures adopted in these past few years, while heavily anti-inflationary in their purpose and direction, have had implications for the level of employment in the economy one way or the other, especially to the extent that such measures affect the production process in the various industries concerned. The measures adopted in the present budget are no exceptions to this trend.

Many of the anti-inflationary measures in the present budget, especially those that aim at increasing the supply of certain essential goods and services the shortages of which have occasioned rising prices, have implications for employment. For example, the shortages of three most essential goods and services have been identified as the major cause of the present inflationary pressure in the economy. These are food, housing and transportation. Government measures to bring down inflation are therefore directed towards increasing very substantially the supply of these goods and services. Some of these measures would exert short-run effects while the effects of some others are of a long-term nature. While the former category consists of those measures aimed at easing imports, particularly of certain food items in order to supplement domestic supply, in the latter category are measures designed to increase the level of output in those industries producing the essential goods and services which are in short supply.

In terms of their implications for employment, the long-term measures which are designed to exert direct impact on the level of domestic output of the goods and services in short supply is of greater relevance. All things being equal, the considerable encouragement which the output of food will receive from the measures for implementing the government's programme of "operation feed the nation" is likely to increase employment opportunities not only in agriculture, but also in all food processing and food-related industries, although the extent of employment generation will depend on the capital/labour ratios or factor-intensities in the relevant industries. This becomes particularly significant considering the fact that one of the important measures for encouraging the production of food is the complete abolition of import duty on all types of machinery used for food production. If anything, this measure, by making the employment of capital relatively cheaper than that of labour, is likely to encourage the substitution of the former for the latter, with a consequent adverse effect on the level of employment. One would also tend to think that the measure to protect some domestic industries by the imposition of import quotas as well as an outright ban on imports in certain cases, by encouraging expansion in domestic industries, should have the effect of creating more job opportunities. But again, the extent to which this will happen, will depend on the rate of labour utilization in the industries concerned.

The measure to increase the target of the government housing programme from 60,000 to 200,000 units during the current plan period should result in a considerable expansion in the construction industry as well as in all construction-related industries. Furthermore, the

TAXATION IN NIGERIA

Nigeria currently consists of nineteen states which to a certain extent have their own tax systems. However, most individuals and companies are subject to a uniform income tax. Customs duties are also uniform throughout the country.

Individual Income Tax: rates range from 10-50% (on incomes over ₦ 30,000).

Company Tax : 40% on all income exceeding ₦ 6,000.

A summary description of the Nigerian tax system is to be found in *African Tax Systems*, a loose-leaf publication of the International Bureau of Fiscal Documentation.

Government's decision to rely as much as possible on the use of building materials locally produced for the implementation of its relatively gigantic housing programme should provide an added boost to the level of output and thus to the level of employment in the industries specializing in the production of building materials. These industries are quite wide-ranging and they include quarrying, wood, glass, metal, asbestos, cement, brick ceramics and paint among others.

The effect on the level of employment of the resulting expansion of the level of economic activity in the above industries will, as we noted before, depend on their labour absorptive capacity. For example construction itself in this country has become, by and large, a relatively capital-intensive industry, with the result that any expansion in the industry can at best have a marginal effect on the level of employment. On the other hand, the induced expansion in the construction-related industries is likely to produce more positive results with respect to the level of employment, given the fact that these other industries are relatively much less capital-intensive.

Finally, there are some other measures in the present budget which are not limited to particular industries, but have some implications for the overall level of employment in the economy. One such measure is the introduction of a new interest rate structure designed to implement the Government's policy of the discriminatory treatment of investment in the private sector of the economy. For example, the decision to make relatively cheaper credit available to stimulate investment in the productive sectors of the economy should also stimulate employment in these sectors. But again, as in the many other cases already considered above, the ultimate result will depend on the nature and condition of technology in the relevant sectors.

IV. Conclusion

In conclusion, although the measures in the 1976/77 Federal Government Budget, like the measures in the budgets of the past few years, are mainly and specifically directed towards the solution of the acute inflation in the Nigerian economy, they have some implications for the level of employment in the economy. A good many of the measures that aim at easing supply shortages in the economy by increasing the level of output should also increase the level of employment. Also, measures that are designed to encourage private investment in certain sectors of the economy should exert similar effects. On the face of it, however, the effects on employment will ultimately depend on the labour absorptive capacity in the industries or sectors of the economy where the Government measures are likely to lead to expansion in the level of economic activity.

While the severity of the inflation now being experienced in the economy has certainly made its control economic policy objective "number one", the Government in its pursuit of this objective should be careful not to sacrifice the other objectives of economic policy, especially the employment objective. Thus, in adopting specific measures for the control of inflation in future budgets, the Government is urged not to lose sight of their implications for other economic policy objectives. Additionally, for more positive results, measures specifically designed to reduce the level of unemployment should also be adopted in future budgets.

BUDGETARY PROCEDURE

The normal budgetary procedure in Nigeria is that proposals are first discussed in the highest policy making body, i.e. the Supreme Military Council. After approval by this body they are announced over the radio and television by the Head of State. Subsequently the Commissioner for Finance gives a greater detail and a further breakdown of the announced measures, usually at a press conference. So far as the measures of the 1976-77 Budget are concerned they became effective on April 1, 1976. The Budget measures are usually later formally enacted in an Appropriation Decree.

The Nigerian Budget 1976/77*

On March 31, 1976 His Excellency Lieutenant General Olusegun Obasanjo, Head of the Federal Military Government of the Federal Republic of Nigeria outlined the government's budget proposals of the fiscal year 1976-77 in the annual Budget Speech. This was later followed by a press statement on the budget, delivered by the Federal Commissioner for Finance, which went into considerably more detail as to the measures proposed in the budget itself. Extracts of this statement — being mainly the highlights relating to fiscal matters — are shown here below.

The Commissioner first outlined the objectives to be attained by the budgetary measures as follows:

(i) increase of food production and supply;
(ii) establishment of new industries particularly in rural areas in line with Government policy of industrial dispersal;
(iii) construction of more houses;
(iv) containing and then reducing the existing high price levels, and the expansion of local plant capacities to produce more manufactured goods;
(v) the decongestion of the ports in order to speed up the inflow of essential goods and commodities;
(vi) continued protection of local industries;
(vii) reasonable importation of essential commodities to make up for shortfalls in local production and as a check against continued inflation.

He also pointed out that the Government was aware that artificial shortages are often created by manufacturers and trade associations so as to push up prices. Government is, therefore, taking measures during fiscal 1976-77 to counter such manoeuvres.

The main fiscal proposals deemed necessary in the light of the above then followed viz.:

* Extracts are reproduced from Recurrent and Capital Estimates of the Government of the Federal Republic of Nigeria 1976-77 published by Federal Ministry of Information Printing Division, Lagos.

Agriculture

In addition to the existing duty free importation of agricultural machinery for soil preparation, import duty has also been abolished for all types of machinery imported for food production. Import duties on food items have been considerably reduced. The duty on groundnut oil, cotton seed oil, and all cooking oils, is reduced from 33 1/3 percent to 20 percent; sardines from 10 percent to 5 percent; the duty on stockfish has been abolished; while that on groundnut for local processing has also been abolished but placed under approved user schemes to check possible abuses. Duty has also been abolished for local processors of baby food, while other forms of baby foods import duty has been reduced to 5 percent.

Transportation has direct influence on the cost of food. The steep increase in the cost of imported vehicles and spare parts has raised transportation cost. In order to reduce this or at least keep it at its current level import duties on trucks and lorries have been reduced from 15 percent to 10 percent; while duties on motor spare parts have been reduced from 33 1/3 percent to 10 percent. Furthermore, special purpose motor lorries and vans are now to be dutied at 15 percent instead of 33 1/3 percent while the import duty on river craft has been reduced from 50 percent to 33 1/3 percent. Import duty on tyres for trucks has also been reduced from 55k to 35k per kilogram.

Building Industry

The abolition of import duty on cement has been maintained while import duty on semi-finished iron rods has been reduced from 15 to 10 percent. The duty on glass which is an important material in building industry has also been reduced from 33 1/3 to 20 percent. A new Tariff item for plastic ceiling tiles has been introduced, and the duty reduced from 66 2/3 to 33 1/3 percent. Import duty on raw materials for pipe manufacturing has been abolished, while the duty on pozzolana has been reduced from 33 1/3 percent to 10 percent.

In addition, the Federal Government, in order to encourage more housing constructions has decided to give special assistance to housing estates built by companies or organisations provided Government or local authority will be involved in the fixing of rents to be charged. The types of assistance to be given include: enhanced capital allowance of a total of 30 percent in the first year and 10 percent annual allowance thereafter will be given on expenditure relating to construction of Housing Estates. To qualify for these benefits, an estate must contain at least 50 housing units.

Other Local Industries

As a further assistance to local manufacturers, duty on a wide range of imported raw materials has been considerably reduced in favour of the following:

(a) *Textile Industry*
Import duty on dyeing chemicals has been reduced from 10 to 5 percent.

(b) *Car Assembly*
The local car assemblies will continue to enjoy the protection accorded them through quota restriction on the importation of the range of cars assembled locally. However, because Nigerian assembly plants cannot as yet fill the gap in the supply of these classes of cars, there will be an increase in the quota of the small and medium size cars that will be imported in fiscal 1976-77. The Federal Commissioner for Trade will announce the new quotas. The permissible quotas will decline as the capacities of assembly plants increase.

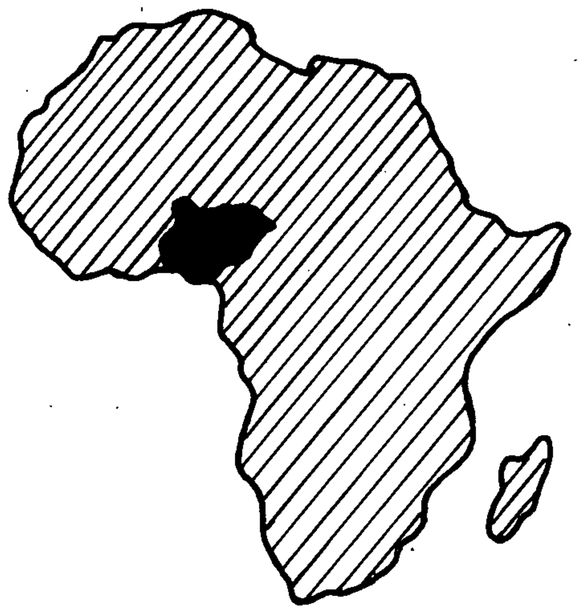
(c) *Footwear Industry*
The duty on the various categories of imported material for the manufacture of footwear has been reduced from 66 2/3 percent to 20 percent.

(d) Exemption from duties on imported raw materials has also been granted to the electronics, metal fabrication and kitchen utensils and equipments manufacturing industries.

Import Prohibition

The present policy of unrestricted imports has contributed immensely to the congestion at our ports and consequently the inflationary pressure. While effort is continuing to decongest Nigerian ports there is need to hold off the importation of certain goods which would only add to the problems at the ports. Accordingly the importation of a number of commodities which can either be easily produced locally or already have local substitutes or are in ships at the ports and on the high sea in large quantities have been banned for six months with effect from today. Government is aware that for most of the items banned there are sufficient stocks at Nigerian ports to last for the duration of the ban. No undue hardship on the public is anticipated. Some items have been placed under licence. The items banned or placed on licence are contained in the Import Prohibition Amendment Order.

The prohibition of the importation of these commodities will also make it possible for local industries producing similar goods to expand and increase their profit margins. In the light of the prohibitions, the Government has decided to reintroduce



excise duties ranging generally from 2 to 5 percent on these goods. At this juncture the need is stressed for all local manufacturers to normalize their relations with the Department of Customs and Excise by paying the excise taxes.

Other Fiscal Measures

(i) *Company Tax*
Under the existing law, the first ₦ 6,000 profit made by any company is exempted from tax while any profit in excess of this amount is taxed at a flat rate of 40 percent. It has now been decided to revert to the pre-1975-76 Budget rate of 45 percent. However, the first ₦ 6,000 profit made by any company still remains tax-free.

(ii) *Claim for Losses*
Under Decree No. 47 of 1972, companies can claim a deduction for losses which they have sustained in any trade or business during any preceding year of assessment in respect of income tax. There is no limit to the number of years that this can be done, with the result that some companies have taken it upon themselves to keep on accumulating so-called losses over the years. Henceforth the period for the carry forward of unabsorbed losses will be limited to 4 years. After such period any unabsorbed losses will lapse.

(iii) *Capital Gains Tax Act, etc.*
It is common knowledge that properties, assets, etc. have changed hands in recent years yet no appreciable revenue has accrued to the Federal Government as a result of the Capital Gains Tax Decree, mainly because necessary information, etc. does not come through when properties change hands with handsome capital gains therefrom. It has therefore become necessary to amend section 44 of the Capital Gains Tax Decree to make it obligatory for the Commissioner of Stamp Duties to demand tax clearance certificates when checking documents on sale by companies of properties and other assets before the

documents are accepted for stamping and registration. This will ensure that the Federal Board of Inland Revenue has the opportunity of collecting revenue from capital gains tax during the process of the assets changing hands from the vendor to the purchaser. The transaction will only be finalised after this has been done. Tax clearance certificates will also be obtained before change of title or ownership of assets or properties is made by the Registrar of Lands.

Exchange Control Measures

In connection with exchange control the Commissioner made the following comments relating to management, technical and royalty fees:

"The present policy of allowing a fixed fee only in the first five years of establishment and thereafter a percentage of gross profit for deserving cases will continue. Fees based on turnover or net sales will however apply to royalties only. In the present economic situation when the speed of development could render management techniques, licences and patent rights obsolete under five years, it is necessary to review the whole policy. This will be done after proper consultation in the interest of all parties. Other factors to be taken into account are the state of technology of the industry concerned, research and development efforts and the speed of transfer of technology and know-how to Nigeria."

Before ending his statement the Commissioner issued a warning to the business community to co-operate in holding down and reducing prices and outlined the measures which he would be obliged to take in the case of non-co-operation:

"Ladies and gentlemen, I suspect the question uppermost in your minds, as almost in the mind of every Nigerian is how the fiscal measures will benefit the common people of this country. The doubt is justified from past ineffectiveness of similar measures. I want to assure you that this Administration is very much concerned with this problem. The fact is that the Government gives, but some other interest groups take it away and keep it for themselves. In fact prices are raised on the very goods for which duties and excise taxes are reduced by Government. However, this Administration is determined to see that those who control the supply of goods and services pass on these concessions to the consumers. For this purpose, I wish to take this opportunity to inform the public that this Government does not have set dates for changes in fiscal measures. We shall keep a very watchful eye on price movements. Our company income tax measures will be reviewed on a continuing basis. We shall impose retroactive excess profit tax in step with the rate of price increases. If the general price level should rise 20 percent, that would be the tax rate. If it should rise by 60 percent, excess profit tax for the year of this price rise would also be 60 percent. We will also adopt other measures in our arsenal to make unearned profit very unprofitable. It is my personal hope that the business community will co-operate to hold down and reduce prices so that Government will not be compelled to take such measures."

WHAT TO EXPECT IN THE MARCH ISSUE

The U.S. Tax reform Act of 1976: Congress chases the foreign dollar (Part II)
(see table of contents at page 63)

by James H. Dobson and Virginia M. Tarris

The recent fiscal situation in Japan

by Prof. Dr. Kazuo Kinoshita

The Israeli experience of using the *tachshiv* for estimating the taxable income

by Prof. Arye Lapidoth

The Fiscal and Economic Studies Center in Madrid

by Prof. Pedro Massone

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A complete study on accountancy rules for agricultural enterprises containing general rules and special rules for different kinds of agricultural activities. (B. 15.595)

ASIA

BUSINESS STRATEGIES FOR DEVELOPING ASIA, 1975-1985

A business International Asian Research Report. Hong Kong, Business International Asia, 1975. 217 pp.
Study on business activities in some Asian countries with market economies. The countries focussed are Burma, Brunei, India, Indonesia, South Korea, Malaysia, Pakistan, Philippines, Singapore, Taiwan, Thailand. (B. 50.630)

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Text of the third Seminar on East-West Trade Promotion, Marketing and Business Contacts, organized by the Committee on the Development of Trade of the United Nations Economic Commission for Europe (ECE)

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BELASTINGHARMONISATIE IN DE EUROPESE GEMEENSCHAPPEN

By M.J. van Rooijen. Brussels, Dutch Chamber of Commerce for Belgium and Luxembourg, 1976. 19 pp.
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COMPANY POLICY FOR THE E.E.C.

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Guide designed to provide information concerning taxation, social and legal aspects arising in agricultural operations in France. The material is up-dated as of November 1975. Supplements will up-date the basic bound volume until a new bound edition is published. A yellow paper supplement updates the material as of July 1, 1976. (B. 9999)

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TAXES IN FRANCE

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CTT — DLT — VAT, 1976-77. London, Butterworths, 1976. 994 pp., £ 7.—.
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Fourth edition of monograph designed to explain the setting up of trusts and the appointment of trustees. It deals with the situation which ordinary trustees are likely to meet, including taxation aspects. The main feature of this 4th edition is the inclusion in the book of chapters on capital transfer tax and development land tax. The law is stated as of 31 July 1976. (B. 100.001)

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Second edition. By P.G. Whiteman and D.C. Milne. London, Sweet & Maxwell, 1976. 1008 pp., £ 30.—.
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THE PAYROLL TAX FOR SOCIAL SECURITY

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THE ISRAELI EXPERIENCE OF USING THE TACHSHIV FOR ESTIMATING THE TAXABLE INCOME.

by Prof. Arye Lapidoth*

Modelled on British law, the Israeli Income Tax ordinance originally presupposed the keeping of books of account by all "self employed" taxpayers, although there was no express statutory obligation to keep books. Following the British practice, each tax return was supposed to be audited and an assessment made of the actual taxable income. Where no account books were kept, or where those kept were found inadequate, the taxpayer's income was assessed "to the best of the Inspector's judgment". The "best judgment assessments" were meant to be made in exceptional cases.

However, since its establishment, in 1948, Israel has encountered widespread non-compliance, and the tax administration has been confronted with great difficulties in attempting to determine and tax the actual income of the "self employed" taxpayers. It has therefore experimented various methods of estimating income; at the same time the declared policy has always been that of encouraging bookkeeping.

This article deals with the tachshiv, *which is a peculiar method of estimating income experimented by the Israel tax system.* Tachshiv *(plural* tachshivim*) is a modern Hebrew word. It has been translated by A. Morag as "standard calculation charts".* [1] *Wilkenfeld has used the term "standard assessment guides".* [2] *In the English translation of Sharef's Report, the* tachshivim *are referred to as "standard estimates".* [3] *One may also describe the* tachshiv *as "economic directions". The basic idea of* tachshiv *is to provide the inspector who must estimate the taxable income derived from a certain source of income "to the best of his judgment" with useful tools which will help him better arrive at the taxpayer's income, in the absence of comprehensive, reliable information, such as that provided by proper bookkeeping.*

General Concept of the Tachshiv

The *tachshiv* normally contains a general economic survey of the trade, business or profession dealt with for a given tax year. The *tachshiv* further gives a general idea of the nature of the economic activity involved. It then attempts to sort out the factors, obtainable from independent reliable source of information, which could be used as indicators of the profit. Once those indicative factors are ascertained the inspector is shown how to use them to compute the taxable income. For example, a *tachshiv* for ice production would be based on the annual amount of water consumption by the taxpayer. Given that the amount of water consumed by the ice factory may be obtained from the water bills paid by the taxpayer, the inspector may get an idea of the amount of ice produced. If the inspector is further provided with data concerning ice prices and the average rates of either gross or net profits, he may pursue to estimate the profits of the taxpayer with reasonable approximation.

A *tachshiv* may also be used as a supplement to incomplete bookkeeping. Thus, where the Israeli *kibbutzim* do maintain bookkeeping but do not differentiate between deductible revenue expenses and expenses for capital purposes or domestic use, which are not deductible, a *tachshiv* is prepared which specifies the normal operational and maintenance costs of the various branches; the amount of these costs is allowed as a deductible expenditure. [4]

The actual application of the *tachshiv* to the assessment of the taxable income of a *kibbutz* has not been challenged in any reported case.

The *tachshivim* are prepared and constantly brought up to date by the economists of the Revenue Administration. The economists base the various types of *tachshivim* on economic studies and research aiming at finding simple factors, such as consumption of water or electricity, the type of machinery used by taxpayer, the number of employees and the location of the business. Preference is given to "factors" that can be used, without too complicated calculations, to arrive at a fairly close estimation of the taxpayer's profit. The "factors" should further be of such a nature that the information about them can be ascertained by the Assessing Officer with reasonable accuracy. A good *tachshiv* should have more than one indication of income. The *tachshiv* is not rigid; it is flexible enough to make it adjustable to the special circumstances of the taxpayer to whom it is applied.

A further feature of the *tachshiv* is that before it is issued it is, as a rule, negotiated with the various representatives of the various groups of taxpayers in an attempt to reach an "agreed *tachshiv*". Where no agreement is reached, the *tachshiv* would nevertheless be issued as an "unagreed *tachshiv*". Both agreed and unagreed *tachshivim* are accessible to the public. It should further be mentioned that the economists who prepare the *tachshiv* use, among other sources of information, data obtained from a taxpayer in the same line of business who happened to maintain proper bookkeeping.

The taxable income under a *tachshiv* is commonly determined in the following three stages:

1. The Assessing Officer is first guided as to how to estimate the taxpayer's total amount of trading receipts, sometimes also referred to as "the turnover" of the business.
2. The next stage is to determine the "gross rate of profit", thus arriving at the taxpayer's "gross profit".

> It should be noted that the estimated "gross profit" contemplated by the *tachshiv* does not, as a rule, take into account any estimated labour expenses. Since the payment of employment income is subject to withholding of tax under the Pay-As-You-Earn basis, the *tachshiv* normally allows only for de-

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1. See A. Morag, "Some Economic Aspects of Two Administrative Methods of Estimating Taxable income", National Tax Journal, Vol. 10 (1957), p. 176.
2. See H.G. Wilkenfeld, *Taxes and People in Israel*, Harvard University Press (1973) p. 144, n. 7.
3. Report of the Commission for examining the Methods of Assessment and Collection of the Income Tax, Jerusalem, Ministry of Justice, 1954. English Translation, Cambridge, Harvard International Tax Program, 1962 (mimeo), Martin Norr, ed.
4. See Y. Tsur, "The Taxation of the Kibbutzim", *Quarterly Tax Journal*, 1974, p. 214. (In Hebrew).

duction of the *actual* labor expenses incurred by the taxpayer. The taxpayer must prove those expenses by producing the documents relating to the tax which he deducted at source from payments which he made to his employees.

3. The third stage is that of determining the "net profit". This is done by further allowing the taxpayer to deduct certain expenses, specified by the *tachshiv*, provided that he can support the claimed expenses by proper receipts. The expenses specified by the *tachshiv* include items such as property tax, municipal business rate, rent, water and electricity bills.

In certain types of business the turnover can be fairly accurately ascertained. For example, it is fairly easy to ascertain the turnover of taxpayers who distribute, at a fixed price, a product which is supplied by a well known supplier. A *tachshiv* made for such types of business is mainly concerned with estimation of the deductible expenses. The expenses may be estimated at a fixed percentage of the turnover. *Tachshivim* of this type, also referred to as "*tachshiv* of expenses", have been prepared, for example, for distributors of dairy products supplied by leading producers. As has been shown, the *tachshiv* prepared for the *kibbutzim* also has the nature of a "*tachshiv* of expenses".
A variation of the same method may be the determination of a fixed gross profit presumably derived by the taxpayer. Thus the *tachshiv* for butchers presumes a fixed profit for each pound of meat.
In fact, the first *tachshivim*, which were prepared for farm and plantation income, were "*tachshivim* expenses". For example, citrus, which is one of the main exports of Israel, is exported as well as sold within the country through the Citrus Marketing Board, which is a body corporate constituted by a special statute enacted to regulate the export and marketing of citrus. Hence, the Revenue is in a position to get a reasonably accurate information about the gross income received by the owner of the plantation for his products. The *tachshiv* for citrus plantations was mainly aimed at estimating the average expenses and expenditures incurred by the taxpayer in growing the fruit, thus enabling the Assessing Officer to estimate the taxable income. Similar "*tachshivim* of expenses" were prepared for other farm products which are marketed through marketing boards which maintain sophisticated books of account.

The *tachshiv* for citrus plantations, like indeed other *tachshivim*, does not as a rule contemplate any loss. However, a taxpayer who claims to have sustained a loss is not precluded from claiming such a loss, provided he can support his claim by proper books and records.

Where the turnover cannot readily be ascertained, the main problem of the *tachshiv* is to determine the factors from which the turnover may be deducted. Here are some illustrations of such factors as have been used by various *tachshivim*.

The number of employees and the location of the business are the main indicators of the turnover of businesses such as groceries, restaurants, barber shops and cafés.
In a *tachshiv* for a business such as a carpenter's workshop or a garage, account is also taken of the skill of the workers. In certain types of business, such as sub-contractors employed by builders, the number of employees in itself cannot be reasonably indicative of the estimated profits. Hence, the Assessing Officer is urged by the *tachshiv* to look for more relevant information.
Another major indicator of income is the type of equipment used by the taxpayer. That indicator is used, for example, by *tachshivim* prepared for the taxation of truck drivers and taxi drivers.
The *tachshiv* may be based on both the equipment and the number of employees as, for example, the *tachshiv* for printing houses.
Where the goods sold are subject to sales tax, the amount of sales tax paid by the taxpayer may be indicative of the taxpayer's turnover. Such a factor is used, for example, for jewellers.

In theory, the *tachshivim* should not be used for the estimation of some kind of average income in lieu of the actual income. They should rather be used as a useful economic guide for the Assessing Officer, who is bound, lacking more accurate data, to assess the actual taxable income of the taxpayer "to the best of his judgment". However, the Assessing Officers soon realized that if they departed from the directions of a *tachshiv* they would be in an awkward position: although in principle the onus of proof lies with the taxpayer to show that an assessment is excessive, in fact the Assessing Officers must show grounds for their deviation from the *tachshiv*, in order to rebut an allegation of arbitrariness. Consequently, the Assessing Officers would normally follow the *tachshiv* and assess the taxpayers accordingly.

As a result, rather than making "best judgment" assessments of the actual income, the Assessing Officers in effect taxed the taxpayer's estimated income, computed on the basis of averages. Thus, although legally the *tachshivim* were never regarded as substitutes for assessments of the real taxable income, in practice that is what they amounted to.

Arguments pro and contra the Tachshiv

One of the main criticisms of the *tachshiv* is that its use has the effect, not of taxing income, but of taxing the various factors which are indicative of the taxable income according to the *tachshiv*.
For example, if the number of employees of a grocery is indicative of the grocery's turnover, then the assessed tax will assume the nature of an employment tax.

It is further argued that the extensive use of the *tachshiv* may also lead to schemes of tax evasion and tax avoidance. One form of circumventing the *tachshiv* may be that of managing the business in such a way as to be in a more favorable position from the *tachshiv* point of view. Such arrangements may range from schemes which may be regarded as tax avoidance to schemes of evasion in which actual cheating is involved. Some of such schemes may also result in a distortion of the normal economic behavior.

For example, when the *tachshiv* for groceries used to be based largely on the number of customers officially attached to the grocery to get their rations of food, shopkeepers would prefer to open "delicatessen shops", to which only few customers were officially attached. Other examples include the reluctance of taxpayers to replace their machinery when the model and year of production of the machinery was an indicator of income under the *tachshiv*. In some cases, taxpayers tried to get around the *tachshiv* by giving false information about factors which were relevant to the computation of taxable income according to the *tachshiv*. Thus an ice factory whose production and, consequently, the taxable income was determined in accordance with the consumption of water, would try to get part of the water from a secret, disguised source of supply.

Similarly, a workshop might get some of its electricity in a disguised form, in order to artificially reduce the amount of electrical consumption which would be indicative of machine work carried out in the workshop. A fairly typical device for decreasing an estimated assessment based on a *tachshiv*, which takes into consideration the number of employees, is to reduce the number of employees either genuinely, in which case the device might assume the nature of tax avoidance, or by fraudulent failure to report some of the employees, which scheme amounts to tax evasion.

Those who defend the *tachshiv* point of that a good *tachshiv* is not based on o single "indication" of income. Efforts a made to construct the *tachshiv* on mo than one "indication", thus reducing t room for tax avoidance, as well as reta ing the nature of a tax on income, which good *tachshiv* should have.

[Continued at page 102]

The 'tachshiv' in other countries.

A fair distribution of the tax burden among taxpayers presupposes a correct application of a country's tax laws. However, this will only be possible if the taxpayers are able to declare their taxable income in the prescribed manner. In practice, it appears that in particular small businessmen, farmers, traders etc. who have received little training in this field are not equipped to meet the obligations which the law imposes. This problem is encountered not only in Israel but in other countries as well and many of them have resorted to solutions in which the taxpayer's income is determined in relation to certain criteria which are easily ascertained such as the surface area of an agricultural enterprise, the raw material purchased, the gross receipts etc.

For comparison the Editors have selected a number of European countries in which legal provisions exist which allow the tax administration and the taxpayers to agree on a certain lump sum income tax assessment.

Belgium

Article 248 of the Belgian Income Tax Code authorizes the Belgian tax administration to estimate the income of a taxpayer if he fails to submit sufficient proof as to the correctness of his tax return. In such a case the tax administration will compare the taxpayer's income with that of three other taxpayers which are in approximately the same financial position and it will take into account the capital invested, the turnover, the number of employees, the power used, the annual rental value of the land exploited etc. The tax administration is also authorized to negotiate with taxpayers which belong to the same business group the basis on which a lump sum assessment will be made. If an agreement is reached such agreement will be valid for three consecutive assessment years. The agreements usually provide that no lump sum assessment will be made (i) if the taxpayer keeps proper financial records or if he is in a position to prove the amount of his income and (ii) if the tax administration can prove that the taxpayer's real income is substantially higher than the income which would be computed under the lump sum procedure. The lump sum tax assessment usually relates to a number of physical facts which are inherent to the business, such as the quantities of flour, butter and sugar used by a bakery, the quantities of alcoholic beverages purchased and the prices charged by cafes, the weight of meat purchased by butchers etc.

Germany

Section 13a of the Individual Income Tax Act provides for lump sum assessment of agricultural and mixed agricultural and forestry enterprises which are not obliged to keep regular accounts. Lump sum assessment is made annually and it is the sum of a basis amount, the value of work of the entrepreneur and his family, the rentals received, a certain amount representing the annual rental value of the residence of the entrepreneur and certain additional amounts. The basis amount (Grundbetrag) equals one-twelfth of the "Ausgangswert" which is the sum of the estimated values of the land used by the entrepreneur.

France

In France various lump sum assessment systems exist for taxpayers who carry on business, agricultural or professional activities.

Small businesses which are carried on by individuals may benefit from lump sum assessment if their turnover does not exceed 500,000 Fr.Frs. in case of trading or hotel business and 150,000 Fr.Frs. in all other cases (mainly the rendering of services). The main purpose of lump sum assessment in this case is to determine the income which the business would normally produce thus eliminating exceptional profits or losses. Criteria which may be used are the quality of the technical equipment, the number of clients, local conditions and the personal qualifications and qualities of the taxpayer. The lump sum assessment is determined for a period of two years at the end of the first year.

Lump sum assessment for agriculture is available to those taxpayers whose receipts do not exceed 500,000 Fr.Frs. per year. The assessment is collectively determined per region and it is based on the average yield per hectare (2.47 acres) by the Commission départementale des impôts. In some cases also other criteria are used such as the number of animals or of fruit trees, the quantity of grapes harvested etc. In case of calamities such as flood, hail storms, frost etc. the taxpayer may request a reduction of the taxable base. Special rules exist for forestry exploitation whose income is deemed to equal the so-called "cadastral income" for purposes of the land tax. Lump sum tax assessment is also accorded to taxpayers who derived income from so-called non-commercial activities such as professions and other activities which are neither a business nor an employment, provided that their annual receipts do not exceed 175,000 Fr.Frs. The tax assessment is based on taxpayer's gross receipts, the number of his employees and the salaries paid as well as fees paid to third persons.

Spain

Certain taxpayers may benefit from lump sum tax assessment under the so-called "Estimación objectiva" system in which case they are not subject to tax on their real income but are taxed on an income which is attributed to them. For this purpose a committee ("Junta") is set up with representatives of the Ministry of Finance and taxpayers as members. The Committee determines the total profit made within a year of all enterprises within a certain district which are engaged in similar activities. The total profit is then allocated to each individual enterprise. Factors which influence the allocation are gross sales proceeds, the quantity of raw materials used, social charges paid etc. Certain industrial enterprises and enterprises whose capital or turnover exceeds a certain amount are excluded from benefiting from lump sum taxation.

An argument against the tachshiv is that, being based on averages, it may tend to be more favorable for the more efficient taxpayer and less favorable for the less successful. Whereas it may not necessarily be wrong, from an economics point of view, to discourage the less efficient enterprises by taxing them more heavily, clearly it is not equitable and violates the common notion of a just tax which is imposed on the principle of the ability to pay. Admittedly, the principle of the ability to pay is by no means universally accepted as a guide for equity in taxes. However, if the Revenue wishes to adopt a tax policy which encourages the more efficient, such objective should be made clear, so that full consideration should be given to the question of which type of economic activity is to be encouraged, rather than being an obscure, unmeasured consequence of the use of *tachshiv*.

The taxation of the average income may also have the effect of mitigating the progression of income tax rates. A taxpayer who files a return of his actual income will normally report less income in the first five years of his business and more income when the business has developed. He will thus reach a higher income bracket when his profits grow. On the other hand, the taxation of average income will normally not take full account of the development of the business. Hence, the taxpayer's income may be overestimated in the first years and under-estimated in a later period. The effect may thus be a spreading of income over time, which commonly results in paying less tax.

On the other hand, assessments based on averages do not as a rule recognize losses, unless the taxpayer keeps books of account.

Another criticism of the *tachshiv* relates to the "negotiated *tachshivim*". Originally, the *tachshivim* were intended for the best judgment assessment of small income taxpayers who did not, and could not be expected to keep sophisticated books of account. The assessment of those taxpayers usually involved tedious bargaining. After the *tachshivim* were introduced, the bargaining between the taxpayer and the Revenue, though not entirely eliminated, has undoubtedly declined. The *tachshivim* were mostly negotiated between the Revenue and the representatives of the various sectors to which they applied, such as taxi drivers, craftsmen, farmers, etc. They were not kept secret but were made known to the individual taxpayers. Consequently, the notorious bargaining with each taxpayer was limited to bargaining of the various factors indicative of income, within the framework of the *tachshiv*.

To do justice to the *tachshiv* one should also mention one more advantage to this method. Before the *tachshiv* was introduced, the "best judgment" assessments of income derived from the same line of business had greatly differed from one office to another. The use of the *tachshiv* brought about more uniformity in the "best judgment" assessments of similar sources of income all over the country.

However, the *tachshivim* have grown in number, covering about 100 sectors of the economy. They have not been limited to small income taxpayers but have been extended to pressure groups of taxpayers who were under a legal obligation to keep books. Instead of reporting their actual income, based on proper bookkeeping, these taxpayers were assessed to tax in accordance with *tachshivim*.

Since the preparation of the *tachshiv* was based, among other things, on discussions with experienced tax inspectors as well as on economic research, the *tachshiv* has further been advantageous in another way. It has enabled the inspectors of the various income tax offices to benefit from the experience gained by senior inspectors, as well as from the economic data and analyses prepared by the conomists of the head office.

The Revenue maintains that were it not for the negotiated *tachshivim*, many taxpayers would have escaped tax altogether. The Revenue further maintains that the proper use of the *tachshivim* should have resulted in the assessments of the actual or more than the actual income, thus serving as a deterrent to taxpayers who did not keep books.

In fact, however, the "negotiated *tachshivim*" have been used long after the taxpayers grew accustomed to the idea that they had to pay income tax. Moreover, the use of *tachshivim* has apparently resulted in underestimation, since the pressure-group taxpayers insisted on being assessed in accordance with "a negotiated *tachshiv*" rather than keep books.
Indeed, some of the "negotiated *tachshivim*" were strongly criticized for being much too favorable to certain pressure groups and thus discriminative against other groups of taxpayers.

A common technique of preparing a *tachshiv* for a certain sector was to find taxpayers who did keep adequate books and records and attempt to draw conclusions from the analysis of their books of account in respect to factors which may be relevant to a *tachshiv*, such as the amount of basic materials needed for production, the percentage of gross or net profit, etc. The taxpayers who were selected for the model were commonly well-established firms which kept sophisticated books; it has been questioned whether such firms could be used as a guide for the assessment of the productivity and profitability of the common firm which did not keep adequate books of account.
The Revenue maintains that every effort is made to find a small business which keeps books and to use such a business as a model for the *tachshiv*.

A serious problem related to taxpayers who did maintain some bookkeeping and yet preferred to conceal them and rely upon the *tachshiv* in the hope that the resulting assessment will be more favorable to them. Indeed, such tactics were employed also where the taxpayer anticipated a more favorable estimated assessment which was a "best judgment" assessment not based on a *tachshiv*. If the "estimated assessment" proved to be excessive, the taxpayer would surprise the Assessing Officer by producing his books and records for the first time when the assessment was reviewed, either administratively at a hearing of an "objection", or in the District Court sitting as a court of income tax appeals. The admissibility in evidence of such documents for the first time in court was raised in *Soslik v. Assessing Officers*. [5]

It was decided by the Supreme Court that the taxpayer is not precluded from producing for the first time in court evidence which he had not brought before the Assessing Officer; but this, of course, may greatly affect his credibility.

The *Soslik* case, which the taxpayer eventually lost, disclosed a typical case of a taxpayer, in this instance a builder, whose tactics were to refrain from submitting any tax return, although he presumably did keep some sort of books of account. He would then get an estimated assessment, to which he would object, and finally reach a settlement. Clearly, where a *tachshiv* is used and the taxpayer may have an idea of what the estimated assessment is likely to be, such tactics may be even more readily used by him.

Legal Nature of the Tachshiv

Having considered the technique of the *tachshiv* and some of the economic as well as administrative problems which are involved in its extensive use, the legal nature of the *tachshiv* may now be more closely examined. [6]

5. C.A. 204/53, *Soslik* v. *Assessing Officer*, *Piskei Din* 1037.
6. For further details of the development of *tachshiv* techniques, the reader is referred to the thorough study of H.C. Wilkenfeld, *op. cit.* pp. 144-150.

The Report of the Commission for the Examination of the Methods of Assessing and Collecting of Income Tax in the State of Israel, 1954 (Sharef's Report) recommended the use of the *tachshiv* as the best means of assessment where bookkeeping could not be made obligatory. It was recommended by the Report that tax returns declaring an amount of taxable income, which is not less than the amount which would have been arrived at by the aid of the *tachshiv*, should be accepted without audit unless the Assessing Officer had some information that the taxpayer underdeclared his income.

Only where the declared income was less than the *tachshiv*, or where the Assessing Officer had information indicating that the real income was more than the *tachshiv*, should the tax return be audited.

In order to understand the recommendation one has to bear in mind that the Israeli tax system has not yet adopted the "self assessment" method. Subject to relatively few exceptions (mainly of small income employees), most of the returns are audited. The idea of the recommendation was apparently that the Assessing Officers should not waste their efforts on a thorough auditing of small income taxpayers; instead, they should concentrate on the big earners. It is not clear to what extent that goal was achieved. One thing seems clear. It is submitted that as a result of the extensive use of the *tachshiv*, and the acceptance of returns which more or less amount to the figures envisaged by the *tachshiv*, the "best judgment" assessment of the real income has in effect been replaced by the taxation of estimated income.

It should be noted that the introduction of the *tachshiv* was not accompanied by any legislation. Thus, taxpayers have not been given any statutory right to submit estimated tax returns. Nor have the Assessing Officers been legally empowered to substitute any estimated assessments for the original "best judgment assessment" envisaged by the Income Tax Ordinance.

Theoretically, the *tachshiv* did not relieve the taxpayers of their duty to declare their actual, rather than estimated, income. However, the taxpayers soon realized that, where the *tachshiv* is used, its effect could be that of underestimating income. Hence, instead of challenging the right of the Revenue to apply the *tachshiv*, taxpayers would argue that the *tachshiv* was not properly applied under the circumstances. Thus, they would try to establish special circumstances to which the lower scale of the *tachshiv* should be applied. Clearly, allowing the taxpayers to scrutinize the detailed process of the *tachshiv* assessments and to find fault with a certain item makes those assessments very vulnerable and the task of the Courts reviewing them difficult.

An early case which dealt with the weight which should be attached to an estimated assessment based on a *tachshiv* was *Attorney General* v. *Leviter*. [7] In that case the Supreme Court reversed the decision of the Haifa District Court, which interfered with an estimated assessment based on a *tachshiv*, substituting for that assessment an assessment which the Court thought to be more appropriate having regard to the same *tachshiv*.

That case may be compared with the more recent decision of *Yahalomei Keren Or, Ltd.* v. *Assessing Officer*. [8] (hereafter referred to as the diamond case). The taxpayer, a cutter and exporter of diamonds, submitted a return which was not based on proper books of account. Therefore the assessment was made on the basis of a *tachshiv*, which was agreed upon by the Revenue and the Diamond Dealers Association. The taxpayer did not challenge the *tachshiv*, neither did he argue that the *tachshiv* was not properly applied, except for one point. The taxpayer proved that a certain debt owed to him by his Japanese customer, amounting to $56,000, had proved to be a bad debt which could not be recovered. The amount of the bad debt was more than the entire taxable income of the taxpayer for the year in question. The *tachshiv* failed to make any reference to bad debts and did not indicate how they should be treated. The taxpayer argued that when applying the *tachshiv* the loss resulting from the bad debt should be taken into consideration. The Revenue rejected that claim, maintaining that refraining from making any reference to bad debts in each *tachshiv* should be interpreted as an indication that a deduction for bad debts should not be allowed when a *tachshiv* is used as the basis for the assessment. The Tel Aviv District Court was of the opinion that the Revenue's interpretation of the *tachshiv* was correct and accordingly upheld the assessment and dismissed the taxpayer's appeal. On appeal, the Supreme Court overruled the decision of the District Court, holding that under the circumstances the deduction in respect to the bad debt should be allowed.

The Supreme Court first dealt with the argument put up by the Revenue, namely, that under Section 33 of the Income Tax Ordinance, no deduction should be allowed in respect of any trading expenses (including bad debts), otherwise deductible, unless proper books of accounts were kept. The Court dismissed that argument, holding that when dealing with a *tachshiv*, which, in principle, takes into consideration the normal expenses of the business anyway, it would not be proper to ignore so significant an item of expense as a bad debt which amounts to more than the whole profit. Admittedly, the court continued, the *tachshiv* is based on estimates of averages and, hence, a taxpayer who did not keep books of account should not be allowed to argue that in his special case the Revenue should deviate from the *tachshiv*. However, like any other "best judgment" assessment, an estimated assessment based on a *tachshiv* may be reviewed and interfered with if it is found to be arbitrary. The court agreed that the *tachshiv* should generally be regarded as exhaustive, with regard to all regular items of trading expenses which are normally incurred in the production of the income. Such expenses were presumably taken into account by the *tachshiv*. However, disregarding an exceptional bad debt, the court held, was unreasonable and arbitrary.

Before making an attempt to evaluate the decision of the Supreme Court, it should be mentioned that the Court was also influenced by the following special circumstances of the case, to which it referred in the second part of its judgment.

It has been established, the Court stressed, that in the special branch of industry in question, namely, diamonds, it is very common to make assessments based on *tachshiv* rather than to require the taxpayers to keep books of account. A witness for the taxpayer, whose testimony was not contradicted, testified that, as far as he knew, there were only one or two companies in the diamond industry which kept books of account. It appears, the Court added, that regarding all taxpayers in the country, there is a reluctant putting up with a situation in which the taxpayer in effect has the option either to submit books of account or to refrain from submitting books of account and request an assessment based on a *tachshiv*. Furthermore, the Court added, it has been established by the taxpayer that in the diamond industry the Revenue has positively agreed to accept the method of assessments based on *tachshiv*. Regarding bad debts, there was evidence that the Revenue has allowed the deduction of bad debts when applying the *tachshiv* to diamond dealers in more than eight cases. The taxpayer further submitted to the court a letter signed by the Income Tax Commissioner, authorizing the Assessing Officers to allow the deduction of bad debts at their descretion, where they are satisfied that the bad debts should be allowed in a particular case. Hence, the Court concluded, the *tachshiv* should be read in the light of the Commissioner's letter and genuine bad debts be allowed. The denial of the right to deduct a bad debt to one taxpayer while, at the same time, allowing a similar deduction to other taxpayers, without any reason, also amounts to discrimination.

Theoretically, the diamond case can be reconciled with previous decisions, such as the *Leviter* case, [9] which was decided in 1957. Indeed, the Court in the diamond case appears to have been anxious to stress that, although an estimated assessment would not, as a rule, be interfered with, the taxpayer is still entitled to show that the estimated assessment was arbitrary. The

7. C.A. 98/56, 11 *Piskei Din* 465.
8. C.A. 110/72 27 *Piskei Din*. (Part 1), p. 446.
9. C.A. 98/56, *Attorney General* v. *Leviter*, 11 *Piskei Din* 465.

contention of the taxpayer that he should not be taxed for the year in question was further supported by the special circumstances which have been established by him in that particular case.

However, in fact the attitude of the Supreme Court towards estimated assessments based on *tachshiv*, as reflected in the diamond case, is definitely different from its attitude in the *Leviter* case. The *Leviter* case was decided in the beginning of 1957, shortly after the use of *tachshiv* as a base for estimated assessments had begun. At that time there was still some hope that the use of estimated assessments would be only transitional, and that eventually most taxpayers would be made to keep books of account, thus limiting the use of estimated assessments to those taxpayers, such as small businesses, who could not be reasonably expected to maintain elaborate books and records. At that time the Supreme Court showed reluctance to interfere with estimated assessments which were made in the absence of reliable books and records, stressing that a taxpayer who did not keep books of account did so at his peril. Indeed, that principle was again stressed in the diamond case. Yet it seems that now the Court was more ready to interfere with estimated assessment. As a result, its decision may have the effect of prolonging the non use of accounts. Indeed, the decision in the diamond case expressly confirmed what is common knowledge, namely that in practice the level and scope of bookkeeping, though substantially improved, still leaves much to be desired.

Problems Resulting from the Tachshiv System

The decision in the diamond case, although given in very special circumstances, raises some important questions regarding bookkeeping and the nature of estimated assessments, particularly those based on a *tachshiv*. The first question relates to the effect of Section 33 of the Income Tax Ordinance, (originally numbered as Section 18). That provision categorically disallowed any deductions and allowances unless the taxpayer produced proper accounts. It was introduced in 1943 and was amended only in 1975. Now, if that provision is not applicable where a *tachshiv* is used, because it would be improper to disregard so important an expense item as a bad debt, it is difficult to imagine any circumstances in which it would not be improper to invoke Sec. 33. One of the main purposes of making bookkeeping compulsory is that the verification and audit of the receipts and expenses may more easily be made where the taxpayer has maintained proper accounts and records. The mere fact that the estimated assessment is based on a *tachshiv* which does allow the deduction of normal expenses, it is submitted, does not make it improper to apply Sec. 33. On the contrary, the *tachshiv* is also used for the next year, and if the taxpayer recovers the debt which was thought bad, the taxpayer will not feel obliged to disclose that fact. It follows that when *tachshiv* is used Sec. 33 may be quite properly invoked. Furthermore, the wording of Sec. 33 is explicit; indeed, it is mandatory. It does not empower the Assessing Officer to disallow the deduction of expenses, otherwise deductible, at his decretion; it is phrased in mandatory words, namely, it disallows the deduction unless books of account are propperly maintained. The narrow construction which was given to Sec. 33 by the Supreme Court has greatly limited its effectiveness as an instrument to encourage bookkeeping. Apparently the only effect of Sec. 33 will now be that of conferring upon the Revenue the discretion to disallow expenses in the absence of bookkeeping, which decretion should be exercised only in proper cases. The interpretation which the Supreme Court has given Sec. 33, it is submitted, is a further acknowledgment of the view that Sec. 33 has failed to make taxpayers keep books of account. It has shown that the court would prefer not to give full effect to an express statutory provision, although it may agree with the object of the Legislature, if it appears to the Court that the literal application of the statute would, in its opinion, cause great injustice. The decision of the Supreme Court, it is submitted, shows that the Courts, to use the Court's phraseology, have reluctantly put up with the situation in which bookkeeping is, in practice, regarded as optional.

It should be noted that after the decision in the diamond case the Income Tax Administration issued a circular (No. 19/27 of February 10th 1974), which gave the court's decision a narrow interpretation. It directed the Assessing Officers to follow the court's decision, and allow the bad debt, only where the amount of the bad debt exceeded the amount of the taxable income based on the *tachshiv*, as was the case in the diamond case. Otherwise, the bad debt should not be recognized, unless specifically allowed by the *tachshiv*. In any case, the circular added, under Sec. 33 no set off of losses, resulting from allowing the bad debt, should be allowed.

It should further be noted that in 1975, after the decision in the diamond case, Section 33 was redrafted. It now refers to "unacceptable books" and deals with the following three situations:

Subsection (a) generally empowers the Assessing Officer to deny the taxpayer who did not keep "acceptable books" the right to deduct expenses.

Subsection (b) deals with a taxpayer whose books have been found to be "unacceptable in aggravating circumstances". Such a taxpayer shall not have any right to set off losses, neither shall he be allowed to make any deduction for bad debts.

Subsection (c) deals with a taxpayer who did not comply with the obligation to keep books at all. Such a taxpayer shall not be entitled to set off any losses; he shall not be allowed to deduct bad debts; he has further been denied the right to deduct any sum in respect of interest and depreciation allowance.

"Acceptable books" have been statutorily defined as books of account which the Assessing Officer neither refused to accept nor rejected, or books which the assessing officer decided either not to accept or to reject but his decision was overruled by the "committee for acceptability of books" or the court.

In its new form Sec. 33 is interpreted by the Revenue as counteracting the effect of the court's decision in the diamond case.

Another problem which the decision in the diamond case raises relates to the nature of the "best judgment assessments" which are based on a *tachshiv*. Here the decision is, at the same time, clarifying and confusing. The decision clarifies the issue of the nature of the *tachshiv* by demonstrating that the *tachshiv* must be regarded as a "best judgment" assessment rather than the "normal" or "average" or any other type of estimated assessments which do not purport to be assessments of actual income, but rather serve as substitution for the real income (like the French *forfait* or the Japanese "White Return" system). The Supreme Court has made it quite clear that, although the *tachshiv* makes use of "averages", the final assessment based on the *tachshiv* remains a "best judgment" assessment which aims at assessing the actual income. As such it can be set aside if it is proved to be arbitrary.

On the other hand, the effect of the Court's decision is that of making the "best judgment" assessment more vulnerable. Hitherto the courts were very reluctant to enter a discussion of the details of the computation of the taxable income where the assessing officer was justified in making use of the *tachshiv*. Now it seems that the taxpayer will feel free to argue that an extraordinary expense has been improperly disregarded by the Revenue when a *tachshiv* has been rightly applied. In other words, the Courts may have to decide not only whether a certain expense is deductible in principle, but also whether it is an unusual expense which, although incidental to the trade and hence deductible, is still unusual and hence not included in the *tachshiv*

Once that point is decided, the next point for the Court to decide is whether the amount of the alleged expense is great enough to make it improper to disregard the expense and thus establish that the assessment was arbitrary. Finally, the Court will have to decide whether to believe that the taxpayer has genuinely incurred the expense, even though no proper books of account were kept. As a result, it is submitted, the *tachshiv* assessment may assume a different nature from that of a regular "best judgment" assessment. Admittedly, the Court has emphasized that the assessment, although based on a *tachshiv*, should nevertheless be regarded as a regular "best judgment" assessment which could and should be set aside if it is found to be arbitrary. However, it is submitted, the decision in effect amounts to an approval of the taxpayer's failure to comply with the statutory obligation to keep satisfactory books and records and declare his actual income accordingly. Instead, the effect of the decision is that of giving the taxpayer the option to be taxed on his estimated income, computed in accordance with a *tachshiv*, in lieu of his actual income based on proper books and records. He may further show fault with the way in which the *tachshiv* was applied to his special case. The court did not go so far as to suggest that the *tachshiv* was a method of estimation alternative to "best judgement" assessment of the actual income. And yet, once the taxpayer is allowed to elect to be taxed on a *tachshiv* basis and show that the Revenue improperly disregarded a specific item of expense, it looks as though the question is no longer what the taxpayer's actual income was, but rather how the "average income" should be best adjusted to his own special case.

The decision in the diamond case is confusing in yet another way. It appears that it may have the undesirable effect of putting a taxpayer, who did not keep any books of account whatever, in a highly favored position; he can prove higher actual deductions but the Revenue cannot prove higher actual income.

The decision in the diamond case tends to prolong non-use of accounts. A different decision which may have a similar effect, though indirectly, is that given by the Supreme Court some ten years earlier, concerning the deductibility of a usurious interest paid by a builder. [10] In that case a builder who kept proper books of account claimed a deduction for usurious interest which he allegedly paid. The dealer did not disclose the names of the money-lenders, though requested to do so, arguing that the money-lenders gave loans only to clients who would not disclose their names. Any disclosures would ruin the builder's credit and have the effect of cutting him off from any source of financing (except the banks, which gave only limited loans). The Assessing Officer did not find any fault with the books of account and hence accepted them. However, he refused to allow the deduction of usurious interest for two reasons: first, the relatively low rate of profit reported by the taxpayer; and sesondly, the refusal to disclose the names of the money-lenders.

Subject to certain adjustments, the Supreme Court in principle decided in favor of the Revenue (as did the District Court in the first instance). It should be added that the practice which the taxpayer alleged to have existed was common knowledge; in fact, it was not at all disputed. It appears that the court was mainly concerned with the public policy aspect of the case, as well as the difficulty involved in verifying a payment of usurious interest where the name of the payer would not be disclosed.

Reading the decision delivered by the court in the diamond case, one cannot help wondering: given that the payment of high rates of interest by builders is common knowledge, would the builder not have been better off if he refrained from maintaining bookkeeping altogether and was consequently taxed on a *tachshiv* basis? Clearly, a standard *tachshiv*, which is based on "averages", would have taken into account the high rates of interest which are commonly paid by builders.

One may also pose the question: why should a taxpayer who failed to keep books be allowed to deduct a special expense, as in the diamond case, whilst his fellow-man who maintained perfect bookkeeping be denied the right to deduct an expense which he admittedly incurred only because he would not disclose the names of the persons to whom he had paid the money?

Another legal problem involved in the use of a *tachshiv* method relates to the possible taxation of the income which has escaped the underestimated assessments based on a *tachshiv* and is subsequently reflected in growth of the taxpayer's "net worth". Such a "growth" may indicate some unreported taxable income; however, the estimated assessments based on *tachshiv* are basically "best judgment" assessments which are presumably aimed at the actual income. Hence, the "growth" of the taxpayer's "net worth" may, at the most, indicate that the previous *tachshiv* assessments had been based on underestimation.

In the absence of a specific legislation authorizing the Assessing Officer to tax the income which escaped the tax, such income, it is submitted, cannot be legally taxed at all, unless the power of "review" vested in the Commissioner of Income Tax by Sec. 147 of the I.T.O., is invoked. Admittedly, the Commissioner of Income Tax may review previous assessments and increase the assessment. Furthermore, for the exercise of that power of "revision", and increasing the assessment, "discovery" of *new facts* is not essential; a conviction that the assessment under review was based on a mistake of the law would suffice to establish the right of "revision". Thus, in C.A. 264/64, [11] the Assessing Officer originally decided not to impose income tax on a profit derived from a sale of land. A few years later the Commissioner of Income Tax reviewed the case and, although no new facts were discovered, decided that the transaction involved amounted to an "adventure in the nature of trade" which was subject to income tax. The taxpayers were assessed accordingly; the assessment was affirmed by the Court. Nevertheless, it is thought, the power of "revision" is not suitable for the correction *ex post facto* of the underestimation caused by *tachshiv* assessments. Besides the more complicated procedure of revision and the period of limitation during which it may be exercised, one should also bear in mind that in the absence of a discovery of new facts, the power of revision, as has been rightly observed by the Courts, should be exercised carefully and in exceptional cases only.

The legal difficulty involved in the eventual taxation of untaxed income resulting from underestimation lends further support to the suggestion that the exact nature and use of the *tachshiv* should be defined by appropriate legislation. Indeed, it is suggested that some thought should be given to whether it may not be more advisable to admit that the use of the *tachshiv* in fact amounts to an assessment of an average "estimated income", which should be treated as such, with all the consequences that follow, rather than to continue to treat the *tachshiv* as if it serves as a basis for the "best judgment" assessment of the *actual income.*

The Tachshiv leads to Tax Evasion

The "best judgment" assessments based on the *tachshiv* have been strongly criticized in Israel recently. The main criticism has been that the use of *tachshiv* has resulted in gross underestimation of taxable income. It has been further argued that since large amounts of income have thus escaped the tax, the *tachshiv*, among other factors, might have accounted for the widespread tax evasion in the country. Some economists in the Revenue Service who prepared the *tachshivim* maintain that the *tachshiv*

10. *Beit Zakay Co. Ltd.* v. *Assessing Officer* (C.A. 522/63), *Piskei Din*, Vol. 18 (Part Two), p. 548.
11. *Ben-Zion* and *Meron* v. *Assessing Officer*, 19 *Piskei Din* (Vol. 1), p. 245.

method is basically a good one. They admit that the assessments based on the *tachshiv* in effect tax only part of the actual income; in their opinion, however, the fault does not lie with the *tachshiv* but rather with the way in which it is applied. The Assessing Officers who apply the *tachshiv*, they maintain, tend to be too lenient with the taxpayers.

Erosion of the Tax Base

The *tachshiv* was also one of the issues examined by the Tax Reform Commission, headed by Professor Ch. Ben Shachar, which was appointed on 15th December 1974. In its report, submitted to the Minister of Finance on 12th March 1975, the Commission notes that the use of the *tachshiv* brings about a considerable erosion of the tax base. Taxpayers whose income is above the standard *tachshiv* benefit from the use of the *tachshiv*, whereas those whose income falls short of the *tachshiv* succeed in getting assessments which are lower than the *tachshiv*. They do so either by keeping books and records or through public pressure. The Commission, however, is aware of the fact that the *tachshiv* may be useful as a guidance for estimation of income.

Recommendations for Improvement

With a view to preventing the erosion of the tax base as well as encouraging bookkeeping, the Commission made the following recommendations. The *tachshiv* should not be negotiated with the representatives of the groups of taxpayers. The *tachshiv* should be issued before the end of the tax year. The *tachshiv* should not have the effect of shifting the burden of proof from the taxpayer who does not keep books onto the Assessing Officer. On the other hand, the *tachshiv per se* should not constitute sufficient grounds for rejecting the books kept by the taxpayer. In addition to the *tachshiv*, the Assessing Officer should be provided with indices and indicators concerning the development of prices and economic activity during the tax year in question; these may guide the Assessing Officer in auditing the returns, especially in the absence of bookkeeping.

Apparently the Commission recommends that the use of the *tachshiv* be limited and that the assessments based on bookkeeping be extended. Indeed, the Report stresses the importance of bookkeeping and recommends that it should be obligatory for all taxpayers who derive income from business or profession, including small-income taxpayers. The Report makes it quite clear that assessments based on bookkeeping, even though they may be unsophisticated, are preferable to assessments not based on bookkeeping. Hence, the Report recommends the introduction of incentives to taxpayers who keep accounts and disincentives to those who do not.

The recommendations regarding the use of the *tachshiv*, however, are vague; it is not clear how the Commission envisages the role of the *tachshiv* when the reform is implemented. The Revenue Service too is puzzled; it does not understand exactly what it is supposed to do with the *tachshiv* once the recommendation of the Commission is accepted.

Nor do the taxpayers seem to be happy with the recommendation to insist on bookkeeping. The diamond sector, for example, has already protested. It claims that the obligation to keep accounts will ruin its business, which is allegedly based on non-use of accounts world-wide. There are also other sectors who seem to regard the assessments based on a *tachshiv* rather than on accounts as their "vested right". It remains to be seen what changes, if any, the *tachshiv* will undergo.

To date the experience of using the *tachshiv* in Israel may be summed up as follows. It was very useful at the beginning. It has eventually reached an impasse, presumably for the following reasons. Its use was not confined to unsophisticated small income taxpayers; it was too widely applied, including sophisticated taxpayers who could and should have been expected to keep books and records. It was not used provisionally until all taxpayers were made to keep some sort of accounts, whether sophisticated or unsophisticated; it was practised for too long, until regarded as a "vested right". Its use resulted in underestimation and hence encouraged taxpayers to refrain from keeping books and records.

Finally, the application of the *tachshiv* caused some confusion because its objectives and nature were not properly defined. Furthermore, the introduction of the *tachshiv* was not accompanied by any legislation whatever.

The Income Tax Ordinance (Amendment) Law (No. 22), 5735-1975, added a series of provisions encouraging taxpayers who keep books and discouraging those who do not. The amendment demonstrates that the Revenue is determined to change-over to assessments of actual income based on proper tax records. It does not, however, mention the *tachshivim*. Thus one of the most outstanding features of the Israeli income tax system has remained conspicuously absent from any statutory provisions of the law.

On December 6, 1976, a Bill was published for a further amendment of the Income Tax Ordinance.[12] Three provisions of the Bill (Secs. 19-22) propose the introduction of a new type of assessment, termed "an assessment according to the highest income obtainable in a business or profession similar to that of the taxpayer". The issues that can be raised in an appeal against such an assessment have also been limited.

The proposed amendment fits in the series of statutory provisions aimed at ensuring compliance with the legal obligation to keep books. It is assumed that taxpayers who fail to comply with the legal obligation to keep books of account do so because they prefer to be taxed on the basis of a *tachshiv* or other "average" income. The object of the amendment is to empower the Revenue to assess the taxpayer's income according to the highest obtainable income, thus making the non-keeping of books not worthwhile.

Under the proposed Sec. 145A of the Income Tax Ordinance where a taxpayer failed to keep books as required by law or failed to base his tax return on such books the Assessing Officer may assess his income according to the highest amount of income obtainable in a similar business or profession.

The taxpayer is not deprived of his right of appeal against such an assessment. The grounds of appeal, however, have been limited. Under the proposed Sec. 153(c) where the assessment was based on a *tachshiv* the taxpayer may only disprove the facts which served as a basis for the application of the *tachshiv*. It follows that the taxpayer is not entitled to challenge the correctness of the *tachshiv* itself; nor may he challenge the computation of the income according to the *tachshiv*.

The proposed law further stipulates that where the assessment was not based on the *tachshiv* the taxpayer may only show that the "highest obtainable income" fell short of the assessment made upon him.
The taxpayer has been retained the right to argue that he is not legally bound to keep books.

The proposed amendment, if passed as law, will be the first statutory provision expressly referring to the *tachshiv*. Unfortunately, it only deals with one aspect of the *tachshiv*. It proposes to use the maximum averages of the *tachshiv* as a further measure to ensure compliance with the legal obligation to keep books. It does not refer to the question what nature the *tachshiv* will assume and how it is going to be used, if at all, not as a punitive assessment for not keeping books. It appears that more comprehensive legislation of the nature and use of the *tachshiv* is long overdue.

12. Income Tax Amendment Law (No. 25), 5736-1976. The Bill was published in *Hatzaot Chok* No. 1268 of 14th *Kislev* 5737 (Dec. 6, 1976) p. 38.

A View of Tax Reform.

by Ross Parsons

Professor of Law in the University of Sydney, Australia.

May I say that I am honoured by the University's invitation to give this lecture and most impressed by the interest in tax reform, reflected in your willingness to listen to me. When I was in London in 1966, you had just introduced a "separate" system of corporation tax and a capital gains tax, and you were having some difficulty in adjusting to the new taxes. There was talk of an unusual incidence of suicides among accountants and tax lawyers. In the years between you have replaced purchase tax and selective employment tax by a value added tax and turned back to an imputation system of taxing company profits — I am not sure how finally. You have introduced a gift tax and integrated it with your estate duty under the name of capital transfer tax. You have had a development gains tax and now have a development land tax. And I believe your are again considering a wealth tax. I would have thought that by now all passion for reform would have been spent.

The *Asprey Committee* (The Commonwealth of Australia Taxation Review Committee) to which the Chairman has referred was established late in 1972 to review the whole Federal tax system. It was established, and its members appointed, by the McMahon Government — a coalition of the liberal and country parties, which you might call the conservative parties in Australian politics. Its chairman was a judge — Mr. Justice Asprey of the New South Wales Supreme Court. Its members were an economist, an accountant, a business executive and myself. There was a change of Government very soon after the members of the Committee were appointed. The new Government — a Labor Government with Mr. Whitlam as Prime Minister — confirmed the establishment of the Committee and made no change in its membership.

The Committee received and considered more than 600 submissions — a demanding, sometimes tedious, but instructive exercise — and it conferred with a number of experts, some of them from the United Kingdom. It presented a Preliminary Report [1] in June 1974, and a Full Report [2] in January 1975, both of them, of course, to the Labor Government. The Full Report was made public in May 1975, along with the Report of another Committee [3], the *Mathews Committee*, which had been set up to consider the effects of inflation in relation to the personal income tax scale and the calculation of taxable business income. I will refer to the *Mathews Committee* again in the course of this lecture. Since the publication of the Full Report of the *Asprey Committee* we have had another change of Government, assisted by the action of the Queen's representative in dismissing Mr. Whitlam. The new Government is again a coalition of the conservative parties, this time with Mr. Fraser as Prime Minister.

Some months ago I spoke to an audience at Marysville in Victoria. My subject then was the *Asprey Committee's* proposals in regard to company tax. I made some observations about the United Kingdom experience — how you adopted a "separate" system under a Labour Government and returned to an imputation system under a Conservative Government. I suggested that one's

TAX REFORMS

— Is not all tax reform an expression of policy?

— Is not the formulating and implementing of policy a matter for politicians?

— Was not the Australian Asprey Committee therefore a waste of time?

To the first two of these questions, Professor Parsons answers "Yes". In his following paper, he attempts to answer the third question.

At present, several countries find themselves in the need of tax reform. In his lecture at the opening session of the I.F.A. Congress in Madrid (1972), Professor Amoros Rica referred to the "continuing process of the reform" (see his article "Some Reflections on Permanent Tributary Reform" in XXVIII Bull. 179 (May 1973)). Taxes have long ceased to be a means to cover public expenditure. More and more taxation has become one of the main tools of government policy in a wide socio-economic perspective. Taxes on income and consumption have become very high and, consequently, complicated.

Should a tax reform aim at a simplification of the tax system, at a reduction of the tax burden on the individual citizen, or at an increase of public revenue? Complicated and high taxes easily lead to tax avoidance and tax evasion. The interests of the individual and of the society to which he belongs do not always seem to be the same.

In this issue, we have the great pleasure of publishing the text of a lecture on Australian tax reform proposals delivered by Professor Parsons at Queen Mary College, University of London, which was attended by "all the cognoscente of the tax world in London", as one of the good Bureau friends put it.

The next issue will contain a detailed paper dealing with the report of the Tax Reform Committee of Hong Kong.

The aspect of tax avoidance and tax evasion is touched upon in this issue in the from of a selective bibliography, see page 117.

* Lecture delivered at Queen Mary College, University of London, on 20th January 1977.

1. Taxation Review Committee, Preliminary Report, June 1974, Australian Government Publishing Service, Canberra 1974.
2. Taxation Review Committee, Full Report, January 1975, Australian Government Publishing Service, Canberra 1975.
3. Report of the Committee of Enquiry into Inflation and Taxation, May 1975, Australian Government Publishing Service, Canberra 1975.

politics may have a bearing on the choice one makes between a separate system and an imputation system. At the end of the discussion that followed one questioner, in the manner of an aggressive television interviewer, put this to me: Is not all tax reform an expression of policy? Is not the formulating and implementing of policy a matter for politicians? Was not the *Asprey Committee* therefore a waste of time? The present lecture is in some respects an attempt to answer that third question. The answer to the first two questions is clearly "yes". I should say that the Chairman at Marysville kindly released me from an obligation to answer my questioner — it was time to close the session — but I confess I was somewhat shattered.

Scope of Australian Tax Reform

By its terms of reference, as you might have guessed, the Committee was commanded to carry out its review *in the light of the need to ensure a flow of revenue sufficient to meet the revenue requirements of the Commonwealth*. We were denied the opportunity to recommend that very popular kind of reform which would relieve us of our tax burdens. There were other commands in the terms of reference: to have regarded to the equity, the simplicity and the efficiency of the tax system. The Committee added other values to the list — that incentives to work, to save and to invest should not be destroyed, and that large inherited fortunes are undesirable — values which it judged the Australian community thinks important. The Committee was invited to formulate proposals for reform *either by way of making changes in the present system, abolishing any existing forms of taxation or introducing any new forms of taxation*. One could not ask for wider scope.

In fact, the Report did not propose that we should tear down the existing structure and begin afresh, as did the Carter Report in Canada. The recommendations of the Committee could all be described as modifications of the existing system.

Many of the changes recommended are obvious ones. Equity requires that the base of the income tax should be extended to include capital gains. Efficiency (which generally the Committee equated with neutrality) requires the replacement of the present narrow-based sales tax by a broad-based tax on goods and services. Equity requires an integration of the death and gift taxes, and reforms to the bases which will make those taxes effective. Equity and neutrality require an integration of the company tax and personal income tax.

Equity in a Tax System

All of these changes were recommended by the Committee. But the more important recommendations relate to the significance to be given to particular taxes. These may not be so obvious because they depend on judgments as to relative weightings to be given to different values where they give contradictory directions as to changes in the law. Let me assume that equity in a tax system can best be served by an income tax, because income is the best measure of how much tax an individual should pay and only a direct tax on income can be closely related to the individual's income. This involves a notion of equity which has become an article of faith — a faith of which economists since Haig and Simons have been high priests. I confess that I find some of the details of the faith more confounding than the doctrine of the trinity: I am thinking of the Carter Commission conception of discretionary economic power. But it is a faith which is generally accepted by the Australian community, and it is not relevant that I might prefer a different measure of how much tax an individual should pay. My own choice, in company with Kaldor would, in fact, be expenditure as the measure of tax liability.

Let me then make the assumption. Yet this notion of equity will be served by an income tax only if the base of the tax has been expanded to include capital gains and the base has been refined in other respects which must make it ever more complex. Some of this refining will seek to take count of inflation. When this is done, if it can ever be done in any thoroughgoing way, an income tax must become desperately complex. And the greater the amount of distributional equity one seeks to achieve through an income tax, the greater will be the damage the tax does to incentives.

The weighting to be given to equity is thus the basal question for the tax reformer to answer.

On the answer depends the significance to be given to income tax and the attendant cost to simplicity and incentives. The Committee sought to make a judgment of the emphasis the Australian community would give to equity. Such a judgment must be the underpinning of any proposals for reform a committee may make. The personal views of members of the committee are clearly not appropriate. Economists, of course, offer a lot of statistics, and lawyers offer a good deal of comparative tax law. But statistics and comparative law cannot yield values. The judgment of my Committee could, I suppose, be described as a guess, but it was informed by the submissions that had been considered. And I think could be said to be supported by experiences with tax changes which Governments have had in recent years and to which I will make reference later in this lecture.

The Committee's judgment was this. The community expects the tax system to be progressive in relation to income at the upper end of the scale of incomes. Over the middle band of incomes the community will accept as fair a system which is roughly proportional in relation to income. In this band distributive equity is not thought important. At the lower end of the scale of incomes there should be no tax, so far as this can be achieved, and situations of special need should be assisted by transfer payments.

Flowing from this judgment, the Committee sought to draw conclusions as to the role of the income tax in the Australian tax system. At the lower end of the scale

incomes there should be no positive direct tax on income. Equity should be served by social service expenditure, by social service grants and adjustments to minimum wages. Eligibility for grants should be determined by objective tests of need — old age, sickness, unemployment, having children — and no means tests should be applied. Grants should be subject to income tax if, when added to other income, they come within the range of the income tax. Equity will be served in these ways at the lower end of the scale of incomes without the disincentives which attend a negative income tax. In the middle band of incomes, there is no need for a direct tax on incomes. Equity will be served by a tax on goods and services, operating on income spent, and by effective death and gift taxes operating on income saved. At the higher end of the scale of incomes there is a continuing need for a direct tax on incomes. But the cost to incentives will be lessened by lower marginal rates. The rates will be lower because of the general shift away from income tax and because the redistribution function of the income tax will be reinforced by effective death and gift taxes.

Diminishing Role of Income Tax

The Committee's judgment of the emphasis the community would give to equity is thus the primary explanation of the most important recommendation of the Committee — that there should be a movement away from income tax towards a broad based tax on goods and services levied at a uniform rate. I say it is the primary explanation. The Committee entertained some skepticism about the assumption that a refined income tax is necessarily an effective instrument for achieving equity. In recent years there have been offers by both Labor and Conservative Governments in Australia to trade a decrease in income tax for restraint by employees in making wage demands. I believe that offers to trade in this way have been within your experience. And we have recently had a good deal of industrial action by employees in support of a claim that the employer should pay his employees' medibank levies — in effect that the employee should have one part of his direct tax on income paid for him. Such offers to trade and such claims suggest that wages are fixed in net-of-tax terms — that the direct tax on income is passed on, in which case its function in serving equity must be defeated. But the Committee did not press its skepticism too far. There is room for a like skepticism about the incidence of tax on goods and services.

If one becomes too skeptical about the general assumptions that the incidence of income tax is on the taxpayer and that the incidence of tax on goods and services is on the consumer, it becomes nearly impossible to hold any views about tax policy.

Not more than a dozen years ago personal income tax accounted for a little more than one third of Australian Federal revenue. The fraction is now well over one half. The recommendation of the Committee is that we should reverse the trend. But reversing the trend will not be easily achieved, even if Government comes to be persuaded that it should be done. One perhaps hopeful development is the indexation of the personal rate scale introduced by legislation passed in May 1976.

Indexation

Indexation was a recommendation of the *Mathews Committee*, the Committee to which I made some reference at the outset of this lecture. The *Asprey Committee* devoted a good deal of attention to tax drift — to the way in which a progressive income tax, in conditions of inflation, will, in real terms, take an ever increasing amount in tax, unless the scale is adjusted. But the Committee preferred to leave the protection of the subject against this so-called "taxation-by-stealth" to regular action by Government. It was content to recommend that an indexed scale should be published each year with the budget papers so that comparisons might be drawn with the actual scale imposed. Mathews, however, recommended formal statutory indexing. In the 1975 election campaign which followed the tumultuous event of November 11th, 1975, Mr. Fraser promised indexation of the personal rate scale. He made good his promise in legislation enacted in May last year. The legislation provides for automatic indexation of the scale, to take effect at the commencement of each year of tax on 1st July, on the basis of the increase in the consumer price index in the twelve months to the previous 31st March, less any part of that increase due to indirect taxes. The scale, as so indexed, has been imposed for 1977-78, but not, as yet, for any subsequent year of tax. It is true that Mr. Fraser's action fitted rather well into a pattern of economic measures which did not include increases in tax. But what he has done may prove to be more significant than a declaration of rates of tax for 1977-78 and subsequent years, and an imposing of the rates declared for 1977-1978. Indexation involves some kind of legislated promise to cut income tax back once a year to the level in real terms which prevailed a year previously. Unmaking indexation is likely to be looked on as a breach of faith by the present Government, unless it is unmade in order to reduce income tax in real terms, and I rather think that a Labor Government will feel inhibited about allowing income tax to increase in real terms. Stabilising the share of gross national product taken by the income tax is not of course to reduce the emphasis on income tax unless a general increase in tax occurs. But this much can be said: if one is to retreat, one must first stop advancing, and this we seem to have done.

Centralisation or Federalism?

If indexation of the rate scale is a hopeful development, there is another which is not so hopeful, because it could lead to an increase in the significance of income taxes in the total system of Federal and State taxes. Mr. Fraser and the coalition parties are Federalists and want the States to raise more of the revenue they spend. At present the States rely heavily on reimbursements from the Federal income tax and grants from the Federal Government. Mr. Fraser is seeking to restore

income taxing powers to the States. As a practical matter, they lost the power to impose income taxes in 1940 — a war-time development which has been with us ever since. Mr. Fraser is not finding the going easy. The States are not so very anxious to have responsibility for raising revenue, at any rate through income taxation. State politicians know that electorates are persuaded that it is more blessed to receive than to give, and the way to popularity is to spend money that has been raised by someone else. The conservative parties lost office in the New South Wales elections last year. One explanation is that Labor scared the electorate into believing that a vote for the conservatives, allied as they are to the parties that make up Mr. Fraser's Government, was a vote for the "double taxation" of income. I am not sure that there isn't a lesson in this for a United Kingdom Government that might seek to implement the *Layfield Report*.

My own view is that the cause of federalism would be best served by giving the States powers to impose sales tax, which I think could be administered jointly with Federal sales tax. But this would require constitutional amendment which is extraordinarily difficult to achieve in Australia.

Increased Taxation of Goods and Services

The movement from income tax to taxation of goods and services will require skilful management, so that the gradual increase in taxes on goods and services is matched by a decrease in income tax, and increases in social service grants and in wages at and near the minimum. Wages will need to be increased at levels where income tax relief will not cover increases in taxes on goods and services. If wages continue to be indexed by the *Arbitration Commission*, it will be necessary to exclude increases in the cost of living due to increases in taxes on goods and services from the index that is used.

The Committee devoted a good deal of attention to the form of the tax on goods and services. It sought to monitor what was happening in the United Kingdom in the operation of value added tax and concluded that a value added tax was the appropriate form.

Integrated Death and Gift Taxes

The other important proposal by the Committee concerned with the significance of a tax in the tax system relates to death and gift taxes. The Committee proposed an integration of the present Federal taxes and reforms in each case of the tax base so as to make them effective taxes, which at the moment they are most certainly not. Integration and reforms to the tax base will increase the significance of the integrated taxes in the tax system. The present Federal death duty, in the Committee's view, is paid *principally from the estate of those who (die) unexpectedly, or who (have) failed to attend to their affairs with proper skill.*

Integration as proposed by the Committee would produce a tax very much like your capital transfer tax. My Committee's proposal was made to the Government in the preliminary report about the time your Green Paper was published and was made without knowledge of what was proposed in the United Kingdom. In fact there is a common origin for our proposals and for your tax in the writings of American scholars and of your Professor Wheatcroft. There are nonetheless some differences between our proposals and your tax, for example we would cumulate gifts by reference to their present values, you would cumulate by reference to historical amounts. Given continuing inflation, cumulation by reference to historical amounts will, I suggest, frustrate the purpose of your capital transfer tax.

The Committee saw the objectives of the integrated taxes as serving to restore some of the achievement of redistribution which would be lost by the movement away from income taxation to taxes on goods and services, and as limiting the growth of large inherited fortunes, which might otherwise be a consequence of that movement. I should say that the Committee did not attempt to translate its judgment on what was the community demand for redistribution and the value of preventing large inherited fortunes into any rate structure for the integrated taxes. I would express my own view however that the Australian community would not ask for a rate scale even approaching what you have adopted. A lower rate scale lessens the problems of payment of duty by an illiquid estate — the estate of a small businessman or primary producer — to a point where it should be possible to solve them by provisions for payment by instalments and for deferral of tax. The problems of payment of duty by an illiquid estate which is otherwise a viable economic entity are the most commonly asserted argument against death taxes in Australia.

The Committee rejected an annual wealth tax, as an alternative or as a supplement to the integrated death and gift taxes. There are some disincentives to work, save and invest to the integrated death and gift taxes, but the Committee saw the disincentives associated with an annual wealth tax as more damaging. There are greater problems in framing the base of an annual wealth tax only too evident from your Parliamentary Committee report. I cannot see how one can tax the wealth of a man who saves for his retirement and at the same time exempt the wealth comprised in another man's pension scheme. If one taxes the wealth in a pension scheme should not one tax the potential wealth of another man who may confidently expect a golden handshake? And a wealth tax involves much greater administrative and compliance costs.

The Committee rejected the idea of an inheritance tax or an accessions tax, being unconvinced that the burden of such a tax falls on the beneficiary (which is said to be one of its virtues) and unconvinced that in Australia there is need to encourage the wider dispersion of bequests (which is said to be another of its virtues).

There are difficulties in the way of achieving integrated death and gift taxes in Australia. The States, as well as the Commonwealth, impose such taxes and achieving a rational system for the whole of Australia will require either the co-operation of the States in enacting uniform

legislation or that they agree to be displaced. Experience in fields other than tax indicates that the first alternative is not practical politics. The second alternative may not be so unlikely. Of late the States have been competing with one another in promises of relief from death duties. Mr. Bjelke-Petersen in Queensland has now outbid them all, and since 1st January 1977 State death and gift taxes have been abolished in Queensland. Already the estate agents handling Gold Coast developments are proclaiming Queensland as the world's most desirable death tax haven: warmth and golden sands to prolong your life and no tax to trouble your dying. The establishment of a tax haven in Queensland will make it extremely difficult for the other States to maintain effective taxes, and all the State taxes, I think, are likely to disappear.

Corporation Tax: Return to Imputation System

I would like now to make special reference to some changes in the income tax proposed by the Committee. These concern changes in the system of company tax and the adoption of capital gains tax. Since 1940 we have had a "separate" or "classical" system of company tax. The Committee has proposed that we should return to an imputation system, a more rational imputation system, however, than our pre-1940 system. The Committee recommended that in the long-term we should have full imputation — a credit available to the shareholder for all the tax paid by the company on the profits whence his dividend has been paid. Immediately, a partial imputation system was recommended involving a dividend tax credit of one-third to one-half, on the assumption of a 50 percent company tax rate. The partial imputation would not adopt the advance corporation tax procedures which are part of your system. For the present the credit procedures would follow the Canadian model. The Committee thought that when the long-term objective of full imputation comes to be implemented it will be necessary to look hard at your advance corporation tax procedures. I should say that I am not personally persuaded that those procedures are consistent with what the Committee thought were the values which an imputation system serves — the equity and neutrality of the tax system. If it is thought appropriate that the company should have credit for foreign tax or relief from tax by an initial capital allowance, the shareholder should have it too. I concede that the operation of the imputation system should not require the Revenue to apply a credit against tax on other income, or refund tax to the shareholder, when the Revenue has not in fact received tax from the company. But the advance corporation tax system may result in tax being paid which would not have been paid had the business been carried on in a partnership of the shareholders.

The object of an imputation system should be to assimilate, as far as possible, the tax treatment of company and partnership. In addition to the imputation system the Committee proposed that Australia should follow the United States Sub-chapter "S" model, and allow shareholders in a restricted class of companies an election to have the company's profits taxed in a manner such as applies in taxing partnership profits.

I should say that the Committee was not prepared to accept an argument that company tax is not borne by the shareholders — that it is passed on by the company — and it may therefore be ignored in judging the equity of the tax on dividends.

If our present company tax is passed on, the indication must be that we should repeal it and replace it with sales tax which does not discriminate against the more efficient production. But the repeal would expose what would then be seen to be a gross inequity — an immunity from income tax of the undistributed profits of companies which, on the hypothesis, they have all along enjoyed. The assertion that company tax is passed on is not an argument against the adoption of an imputation system. It is an argument against any income tax at the company level and the person who makes the assertion is surely bound to tell us how, as a matter of a regime of general application, to tax company profits without imposing a tax at the company level. If he cannot, the assertion that company tax is passed on becomes an argument against income tax at large: it demonstrates that in an important area of its operation, an income tax cannot achieve the equity which is its sole justification.

I would think that there is a good deal of support in Australia for an imputation system. It promises some income tax relief and that is always popular. I suspect that the Revenue may not, however, be too happy about it. If Australia adopts an imputation system it will face pressure from other countries, especially the United States, to extend the imputation credit to non-residents. Australia is presently renegotiating its treaty with the United States. Yet it seems to me that what comes of these negotiations will reflect the relative bargaining powers of the two countries and the skills of the negotiators. If we have to surrender tax to the United States we will have to surrender it whether we do or do not have an imputation system.

Capital Gains

May I turn now to the Committee's proposals in regard to the taxing of capital gains. An income tax, I have said, is justified only by its claim to serve equity; it should be true to that claim. This is the whole case for a capital gains tax. It is a case which the majority of the Committee accepted, though with obvious misgivings about whether the extension of the base of the income tax which is involved can be fairly defined. The distortions in the operation of a tax to which inflation can give rise are nowhere more evident than here. The corrective which the Committee, by a majority of the majority, proposed is that a fraction only of capital gains should be included in the base of the income tax and that this fraction should vary with the rate of inflation. As a minority of the majority, I rejected this proposal — the implication is that the fraction will be increased when a period of high inflation has passed and the consequence will be that a taxpayer who has held an asset during the period of high inflation, but has realised the asset after that period has passed, will be denied the

special relief. If relief to deal with a period of high inflation is contemplated, it should, in my view, be provided by an indexation of costs of property held during the period. It will be necessary to prescribe an indexation factor for each year of the period. Such special relief will of course be rough and ready. It should not be applied so as to give rise to a loss, and it will be subject to the criticism that it will give an advantage to a taxpayer who acquired his asset with borrowed funds.

Current Value Accounting

All the members of the Committee were persuaded that a method of indexing gains which seeks to identify the taxpayer's net investment in the assets realised and to index the cost of that net investment is simply beyond the limits of effective legal and administrative action. The Committee's conclusion on this issue may be taken also as a conclusion in regard to the income tax generally, though it had left to the *Mathews Committee* the task of proposing what should be done in regard to the effects of inflation in distorting the base of the present income tax. This was the other matter specially assigned to that Committee. Mathews proposed that a modified current value accounting should be applied in determining profits subject to tax where a business holds trading stock — opening stock should be written up to a value as determined by the replacement costs of closing stock. Mathews also recommended that the amount of annual depreciation allowable on plant should be determined by reference to the replacement cost of that plant, though in this case replacement cost would be determined by simply applying an index to the cost of that plant.

Mathews gained some support from the recommendations of your *Sandilands Committee* which, curiously, makes no reference to Mathews. But Sandilands recommends only a temporary expedient to replace you

Taxation in Australia.

A SYNOPSIS

Taxes may be levied either by the Commonwealth or by the States (New South Wales, Victoria, Queensland, South Australia, Western Australia and Tasmania) or the two internal Territories (the Australian Capital Territory and the Northern Territory). In addition "rates" are imposed by the local governments and similar authorities on the value of land within their jurisdicton.

A – COMMONWEALTH TAXES

1. Income tax — The Commonwealth is the sole income taxing authority. The tax is imposed on individuals and companies.

Individuals

A system of steeply graduated rates applies. The minimum taxable income is $1,040. Rates range from 20% to 65%.

A provision is made for adjustments in the schedule of rates to account for inflation.

Companies (resident and non-resident)

Public companies

On all taxable income — 42½ percent.

Private companies

On all taxable income — 42½ percent.
"Undistributed profits" — 50 percent additional tax.

2. Payroll tax — This is levied by the Commonwealth on wages paid by an employer in the two internal territories: the Australian Capital Territory and the Northern Territory. The rate is 5 percent of the gross wages paid or payable, subject to certain exemptions if total wages paid by an employer do not exceed a certain level.

3. Estate duty — The estate duty rates vary from 3 percent to 27.9 percent. Death duties imposed by the States may be deducted from the estate. A rebate is allowed for the lesser of the duty paid outside Australia on personal property situated outside Australia or the Commonwealth duty payable on such property.

4. Gift duty — Gift duty is imposed at rates ranging from 3 percent to 27.9 percent.

5. Sales tax — It is payable generally at the wholesale level, on the sale value of non-exempt goods or commodities. It is a single point tax. The general tax rate is 15 percent. Special tax rates of 2.5 percent (for household goods) and 27.5 percent (for goods such as jewellery, television receivers, watches, passenger cars etc.

6. Customs duties — The rates vary according to the type of goods and their country of origin. Ad valorem duties and specific duties are in use. In addition, "primage duties" are imposed on some importers.

7. Excise duties — They are imposed on the wholesale value of certain classes of locally produced goods e.g. tobacco, spirits, etc.

8. Special industry taxes — e.g. Wool tax.

B – STATE TAXES

1. Payroll tax — It is levied by all the states on wages paid or payable by an employer in their respective jurisdictions. The rate is 5 percent of the gross wages, subject to certain exemptions.

2. Land tax — Land tax is imposed on all the states on the unimproved capital value of land owned.

3. Death duties — They are imposed in all the States other than Queensland and the Northern Territory. The rates are based in some states in the dutiable value of the estate as a whole and in others on the amount received by each individual beneficiary.

4. Gift duties — They are imposed in Victoria and South Australia. Stamp duties paid in such States on deeds of gift or settlement are credited against the gift duties.
In New South Wales, Queensland, Tasmania and Western Australia, stamp duties are imposed on deeds of gift or settlement.

5. Stamp duties — They are imposed in all States and the internal "territories".

6. Other taxes — e.g. tax on motor vehicles, betting etc.

emporary expedient of 12 November 1974. A perma-
nent solution is to be found by a Royal Commission.

The Mathews recommendations drew a good deal of cri-
icism from our Tax Department, some of it on equity
grounds. They will give special treatment to businesses
holding trading stock and will favour those businesses
hat are highly geared. After after a first blaze of enthu-
iasm support for the Mathews recommendations has
vaned somewhat in the business community. Recently
he chairman of our largest company, Broken Hill
Proprietary Limited, observed rather plaintively that the
Mathews recommendations in regard to trading stock
vill not be very helpful to his company because it does
ot hold stocks of steel; it manufactures to order.

But Mr. Fraser included the implementing of the
Mathews recommendations in his election promises in
November-December 1975 after the dismissal of Mr.
Whitlam, and he is now about to take some action to
onour his promise. We are told that legislation will be
ntroduced in the autumn session of Parliament which
vill have some affinity with the Mathews recommen-
ation in regard to stock. A deduction in determining
axable income will be allowed of the amount which
esults from the application of one half of the increase
n the "goods" element in the consumer price index to
he value of opening stock. The application of an index
o the value of opening stock of course abandons the
heory of current value accounting without adopting the
ompeting theory of current purchasing power account-
ng. And the Government proposals, again no doubt in
he interests of simplicity, differ from Mathews in con-
emplating a permanent relief and not merely a defer-
al of tax. We have been told that the Government
roposals will apply to most kinds of trading stock but
ot to land or to shares and other securities.

Meanwhile the Australian accounting bodies have issued
rovisional recommendations requiring the application
f current value accounting — or current cost account-
g as their version is called — in computing business
rofits. The Australian bodies got their provisional re-
ommendations out just ahead of your accounting
ody. The Australian business community has shown
ery little enthusiasm for the recommendations. They
ill no doubt accept them if this is necessary to ob-
in the Government's tax concession, but there is no
ggestion as yet that the two will be linked. A deflat-
g of published profits is not something to be wel-
omed for its own sake. Calculations that have been
ade suggest that the deflating will be dramatic.

have no faith in the application of current value ac-
unting, in any form, in determining the amount of
usiness profits to be subject to income tax. Current
lue accounting may be helpful in judging the perform-
ce of a business considered as an entity distinct from
proprietors and creditors. But it has no place in de-
rmining the base for a tax whose only claim to exist-
ce is that it serves equity between individuals. I know
at the suggestion I made a moment ago about index-
g of costs for capital gains tax purposes, which has
parallel in the Government's proposals in regard to business profits, is equally vulnerable. But it is offered only as a rough and ready corrective, and I readily concede that it will produce almost as much inequity as it will cure. The Mathews recommendations seek to attract some validity from accounting theory which is distinctly irrelevant.

The whole debate about correctives for the distortions caused by inflation only demonstrates that the measure of equity that can be achieved by an income tax is indeed limited.

The *Asprey Committee* thought that the tax on capital gains should extend to gains deemed to be realised on gift and death — the income tax should be true to its claim to serve equity. It considered, however, that some compromise was necessary in order to mitigate the effects of a tax on capital gains on incentives to save and invest. It proposed that there be an exemption from the tax of a specified amount of gains, not less than $40,000, deemed to be realised on death or realised after attaining the age of 65, or upon permanent incapacity.

Prospects of Capital Gains Tax in Australia

You may perhaps be interested in the prospects of a tax on capital gains in Australia. We almost had one two years ago. Following the preliminary report of the Committee the Labor Government announced the introduction of a capital gains tax on 17th September 1974, with effect from that date. But this proved to be a false start. A period of high inflation is not the most propitious time to introduce a capital gains tax which, as it was proposed on 17th September 1974, would not have had any provisions to deal with the distortions caused by inflation. On 29th January 1975 (four months later) it was announced that the Government's plans for the introduction of the capital gains tax had been postponed. The withdrawal of the tax was explained as a contribution to the restoring of business confidence. We have, of course, had a change of Government and I doubt that Mr. Fraser has in mind a capital gains tax, at least during the life of the present Parliament.

May I now mention two experiences of the Labor Government in attempting to change the tax law, which I think have a bearing on the emphasis the Australian community would give to equity. The first relates to the taxing of fringe benefits; the second relates to a surcharge on investment income.

Taxation of Fringe Benefits

The Committee Report deals at some length with the strengthening of the law and its administration in regard to the taxing of fringe benefits. In advance of the Full Report, the Labor Government had, as part of the September 1974 Budget, introduced legislation to tax the value of the private use by an employee of a motor vehicle provided by his employer — more popularly described as "company car" provisions. These provisions owed much to the Canadian model. The company car provisions were greeted by howls of protest indicating just how widely this fringe benefit is enjoyed throughout the electorate. The motor car manufacturers claimed that the provisions would affect continuing purchases by companies of fleet vehicles and this, in turn, would be damaging to the economy. As part of the package of measures to restore business confidence, which included the withdrawal of the capital gains tax at the beginning of 1975, it was announced that the legislation would be repealed. The company car provisions died without having produced a dollar of tax. The moral in all this is, I suppose, that the majority of electors are not as persuaded of the need for equity in the tax system as the Labor Government thought they should be, or indeed, as the *Asprey Committee* judged they were.

Investment Income Surcharge

The second experience relates to investment income surcharge. As part of the September 1974 Budget the Labor Government introduced an investment income surcharge. As first announced it was to be a surcharge at 10 percent of the taxpayer's average rate of tax and would be applied to all taxpayers. It was then modified to become a surcharge operating only when the taxpayer's taxable income exceeded $5,000. Like the company car provisions, the investment income surcharge was not well received. The *Asprey Committee* in its Full Report drew attention to the bias against saving already involved in the income tax — it limits what can be saved and diminishes the rewards for saving. There may be a case for taxing investment income derived from inherited wealth if one could identify such wealth, but I fail to see the case for an investment income surcharge of general application. The Committee also drew attention to the fact that in conditions of inflation some forms of investment income may be unreal. Indeed most members of the Australian community have in the past several years enjoyed a negative real return on their investments. The Committee recommended the repeal of the investment income surcharge. In the August Budget 1975, the last before it lost office in December, the Labor Government announced the repeal of the surcharge but offered no explanation for the repeal. The tax died without even a whimper. I suspect that the Government had decided that the experiment with the surcharge was electorally damaging. The moral of this story may be that the electorate is more concerned about incentives to save and invest than the Labor Government imagined they were.

Role of Tax Review Committee

It is time to return to my questioner at Marysville. Was the *Asprey Committee's* work a waste of time? One measure of usefulness would be the amount of change in the law the Committee has inspired. The Committee's recommendations have had an influence on the shape of the personal income tax scale and on the method of dependents' allowances and allowances for personal expenses. I have not dealt with those recommendations in this lecture. The recommendations of the Committee in another area not dealt with in this lecture — income taxation and the mining industry — have for the most part been endorsed by the *Industries Assistance Commission* and have led to changes in the law.

Parliament has been told recently that the Committee's Report is "under active consideration" by Government. But the economy is in a less than happy state and now may not be the time for other changes such as the adoption of the recommendation in regard to an imputation system of taxing company profits, or the adoption of other recommendations which I have not mentioned, such as those relating to the taxing of the income of trusts or to the ways of taxing foreign source income and the income of non-residents. In any case the most important of the Committee's proposals — for a shift from income tax to taxation of goods and services, and for an increase in the significance of death and gift taxes — are long term proposals. Indeed a sudden and radical shift from income taxation to taxes on goods and services would be most unfair to those who had saved under an income tax and now, on retirement, come to spend under a tax on goods and services.

I have the impression that no political party in the United Kingdom supports the idea of a *Royal Commission on Taxation* recently proposed by the *Sandiland Committee*. The preference seems to be for Parliamentary Committees. Judged by the amount of changes in the law, they may appear to be more useful. But then they deal with proposals which have already received some Government support. Your Parliamentary Committee on the system of taxing company profits — split rate or imputation — was useful in influencing the choice that was made. I am not sure how one should assess your Committee on the wealth tax. In Australia we have had one Parliamentary Committee on taxation in recent times. Its terms of reference were confined to death taxes in Australia. By a majority it recommended that we should continue to have such taxes and that they should be more effective and at higher rates. The minority recommended the abolition of death taxes. The majority consisted of all the members of the Committee who were members of the Labor Party. The minority members consisted of all those who were not members of the Labor Party. I am sure there is a lesson in that.

A tax review committee has, of course, a technical role. It may be able to show how the law can be made a better expression of the values it already seeks to express. But I would put its principal claim to usefulness in this way: the submissions it considers, its report and the discussion which should follow are a valuable means of communication between the electorate and government. This communication is not confined by the limits set by a Government proposal for changes in the law, and the communication is not filtered through the preconceptions of persons who are members of political parties and each committed to his party's platform.

At the very least a tax review committee might hope to deflect a politician from pursuing one or other of the dogmas of his party's platform — by, for example, the introduction of an investment income surcharge — at the cost of values which the community thinks important, and, even more sadly for the politician, at the cost of his electoral support. And a politician might be brought to see that some values he seeks to express are already adequately expressed in the tax system — that a wealth tax added to death and gift taxes may not redistribute wealth, but simply inhibit the creation of wealth. The tax may serve no more than an expression of corrosive envy.

At the highest a tax review committee may some day inspire a Government to attempt a restructuring of a tax system on the basis of contemporary community values and not the dogmas, most often the shibboleths, of the party platform. Whether or not the *Asprey Committee* was a waste of time is of course for others to judge. I am content to say that a tax review committee need not be a waste of time.

The Recent Fiscal Situation in Japan.

1) The economic slowdown has brought ith it serious fiscal difficulties for govern- ent both at the national and local level nd the possibility of securing the tax evenue estimated in the original budget or the fiscal year 1976 now mainly relies n business profit prospects. In order to ttain real economic growth of around even percent without relying more on xport boost, it is felt that about a twenty ercent increase in public works expendi- ure over the current year's level will be ecessary in the fiscal year 1977. The Min- try of Finance expects recovery of do- estic demand, especially investment in lant and equipment, to be slow and ex- ansion of public works spending should, herefore, get priority over a reduction in x.

he main problem recently has been to nd appropriate sources of revenue to nance the government deficit. The rev- ue from tax and non-tax sources in the xt fiscal year can be estimated at most as ound ¥ 20 trillion and no considerable crease in revenue can be expected. The inistry will, therefore, be unable to duce the current deficit of ¥ 7.3 trillion ich is 29.9 percent of estimated total venue as shown in the general accounts the national budget. The 1977 budget is kely to exceed ¥ 28 trillion and bond- ues will increase to almost ¥ 8 trillion.

) In the supplementary budget of No- mber 12 the Government decided to opt new measures to stimulate the econ- ny for the current fiscal year; these in- lve an additional increase in public ending and loans. These pump-priming easures, which include revival of a project the two Government-owned corpora- ns — the Japan National Railways and e Nippon Telegraph and Telephone Pub- Corporation — increased financing for all-scale industries and housing, and pro- otion of public works, are expected to ve the economic effect of creating ost a ¥ 1 trillion increase in domestic mand. The monetary policy which is w under examination includes a cut in long-term interest rates as an investment incentive.

There has been a great deal of argument in the Diet and elsewhere concerning compensatory cuts in both individual and corporation income taxes. Opponents of this measure stress the fact that the relative burden of individual income tax here is lower than that in other major advanced countries, that the extra disposable income resulting from such tax cuts will go into savings, and that the Government's enormous budget deficit will not be eliminated in these coming years without proper tax reform. Nevertheless, a promise of cuts in income tax was felt to be an attractive slogan in the campaign for election to the House of Representatives in December 1976, and the Ministry of Finance is likely to be unable to resist these political pressures in preparing the 1977 budget.

Many economists do not expect a small tax cut to result in any increase in consumption and labour groups wish a tax cut to be made, in order to compensate for the loss of real income resulting from price rises, by increasing the tax-free base (at present ¥ 1,830,000 for a family or four). There is also an argument among business management in favour of a substantial tax cut in order to ease labour's wage demands. Moreover, some people recommend a cut in corporation income tax by the introduction of an investment deduction scheme for the promotion of investment in the private sector. Others, however, oppose this because its effect is dubious. In spite of strong public support for income tax cuts, the Ministry of Finance knows well that a tax cut in the fiscal year 1977 will make it even more difficult to raise the burden of income tax in subsequent years in order to deal with the problem of inflation.

(3) The Taxation System Council of the Finance Ministry in the expectation of a huge revenue shortage is considering selective tax increases in the fiscal year 1977. An outline of the reform is reported as including consolidation of numerous tax breaks which are given for a limited length of time and a raising of rates of preferential income taxes such as that levied on income from interest. The abolition of several reserves such as reserves for price fluctuations, for overseas market development, and for overseas investment losses will result in an increase in revenue of about ¥ 100 billion. The total increase in revenue in the next fiscal year as a result of the above mentioned reform can be expected to be around ¥ 300-400 billion.

Because of slow sales of ten year interest-bearing bonds to individuals, the Ministry has decided to issue shortly a new type of bond in order to encourage public subscription and cover revenue shortage. Under the agreement between the Ministry and a consortium of banks and brokerage houses, the yield of the new five year discounted bonds to the subscriber will be 7.781 percent per annum while the interest actually received will amount to 6.643 percent as result of a tax levied at the time of purchase.

(4) The Ministry is intending to revise its decree relating to the system for the legalisation of consolidated corporate financial statements. This system, which aims at publication of the business results of the parent company together with those of its subsidiaries (covered by the new system are those in which the parent company owns equity interests of fifty percent or more), will be started as from the fiscal year 1977 with the purpose of acquainting stockholders with the management performance of the company.

About six hundred out of around twenty-seven hundred corporations will prepare consolidated documents. The Ministry, however, has decided to postpone temporarily enforcement of a consolidated tax system until after the next fiscal year.

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* Note submitted by Prof. Dr. Kazuo Kinoshita, Director of the National Institute of Public Finance, Tokyo.

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FOR FURTHER INFORMATION PLEASE WRITE TO:

International Fiscal Association (I.F.A.): General Secretariat, Woudenstein, Burg. Oudlaan 50, P.O. Box 1738. Rotterdam (Netherlands).

Belgian-Luxembourg Branch of I.F.A.: Secretary, Avenue Louise, 385, Bte 1, 1050 Brussels (Belgium).

British Branch of I.F.A.: Secretary of British Branch of I.F.A., Williams and Glynn's Bank Ltd., P.O. Box 448, London EC3P 3DP (United Kingdom).

U.S. Branch of I.F.A.: Secretary of U.S. Branch of I.F,A., Suite 44-27, 345 Park Avenue, New York, N.Y. 10022 (U.S.A.).

AMR International: 6-10 Frederick Close, Stanhope Place, London W2 2HD (United Kingdom).

Associated Business Programmes Ltd.: 17 Buckingham Gate, London SW1E 6LN (United Kingdom).

Business International Institute: c/o Business International Corporation, One Dag Hammarskjold Plaza, New York (U.S.A.); 12-14 Chemin Rieu, 12-11 Geneva 17 (Switzerland); 301-3 Asian House, 1 Hennessy Road, Hong Kong; 5th Floor, Pola Building, 5, 2-chome, Minanii Aoyama, Minato-ku, Tokyo (Japan).

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A Bibliographical Survey in Geographical and Chronological Order

Over the years, we have received several letters from readers interested in literature concerning tax evasion and tax avoidance, and our librarian has been able to supply them with a bibliographical list of literature likely to be of interest. We are now, for the first time, publishing this list in view of the interest of many readers in the subject. This list is, of course, far from complete; especially as we have excluded books purely on tax havens (a few of which were mentioned in a bibliography on Tax Havens in No. 2, 1977 of the Bulletin). Our librarian welcomes additions to this list from readers.

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J. H. Dobson & V. M. Tarris

PART TWO *

V. MONEY OR PROPERTY MOVING OUT OF THE UNITED STATES

1. Portfolio debt investment

A. *Prior law*

All persons, in whatever capacity, paying money from interest, dividends and other similar types of income from sources within the U.S., to non-resident aliens or foreign corporations were required to withhold a tax equal to 30 percent of the income. The law exempted interest received by a non-resident alien or foreign corporation from deposits in banks, savings institutions, or amounts held by insurance companies, from being considered income from a source within the United States, if such income was not connected with a trade or business. Such an exemption increased the desirability of portfolio investment by foreign corporations and helped provide the United States with foreign capital. The exemption was due to expire on December 31, 1976.

B. *The Tax Reform Act*

Act Section 1041 makes permanent the exemption from withholding tax of interest from banks, savings institutions, or insurance companies if the income is not connected with the conduct of a trade or business in the United States by the foreign lender.

2. Ruling requirements for certain exchanges involving foreign corporations

A. *Prior law*

Domestic corporations involved in organizations, liquidations, and reorganizations normally are not required to recognize (i.e. currently pay tax on) any gain resulting from such transactions. When a foreign corporation was involved in certain of these transactions, however, the Internal Revenue Service would not consider the foreign corporation as a corporation (and thus able to take advantage of the non-recognition provisions) unless the taxpayer had established to the satisfaction of the Secretary of the Treasury that the exchange was not in pursuance of a plan having as one of its principal purposes the avoidance of income tax. The taxpayer was required to obtain a ruling to this effect before the transaction began.

This advance ruling requirement applied to exchanges involving contributions of property to controlled corporations, all tax-free corporate reorganizations,[24] and the liquidation of subsidiary corporations. Without corporate status in these transactions, all the gain realized on the transfer of property would have to be recognized.

Taxpayers desiring corporate status had to obtain the ruling before the transaction could take place. Even if the transaction involved two foreign corporations, such a ruling was required for the non-recognition of gain. If no ruling was obtained, gain had to be recognized by the U.S. taxpayers. There was no means provided for compelling the Revenue Service to issue a ruling, adverse or otherwise, and virtually no means for appealing an adverse decision, since the law required only that the Secretary be satisfied that the transaction was not for tax avoidance purposes.

For many years, the taxpayer had no idea what ruling he could expect to be given on any particular transaction. There were no general criteria

Part One was published in the February 77 issue, p. 51.

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24. These reorganizations are: a statutory merger, a stock-for-stock reorganization, a stock-for-assets exchange, a spin-off or split-off, a recapitalization, and a mere change in identity, form or place of organization.

available to help him determine the possible consequences of a particular transaction. In 1968, however, the Internal Revenue Service issued "Guidelines" which outlined the probable treatment for various transactions. These Guidelines indicated that before the Secretary would give his consent for certain transactions, the taxpayer would have to include in his income a sum of money representing the gain which was being realized in the transaction and which would be recognized if corporations were not involved. This money was called a "toll charge". Since these were Guidelines only, however, the Internal Revenue Service still reserved the right to make an individual ruling in whatever manner it desired. Thus the taxpayer still had no absolute certainty as to the treatment expected.

B. The Tax Reform Act

The amendments in Act Section 1042(a) were designed to provide a taxpayer with some degree of certainty as to the treatment which would be given to a transaction. They also attempt to alleviate the harshness of the rule requiring advance approval of a transaction and restrict the ruling requirement to those transactions where U.S. taxes could be permanently avoided. Finally, the amendments provide for court review of adverse rulings or the non-issuance of a ruling.

The only transfers of property requiring a ruling by the Secretary are those involving transfers of property by a U.S. person to a foreign corporation. No ruling will be required for transfers into the U.S. or for transfers involving only foreign corporations. There are four types of transfers currently recognized as taxable transactions which will now require such a ruling. They are: the transfer of property occuring when a U.S. subsidiary is liquidated into a foreign parent, the transfer of property to a foreign corporation which is controlled by the transferor after the transfer, the acquisition of a U.S. corporation's assets by a foreign corporation, and the acquisition of a U.S. corporation's stock by a foreign corporation. The ruling requirement for these acquisitions is limited as well. When the only property transferred to the foreign corporation is stock or securities of a foreign corporation which is a party to the transfer taking place, no ruling is required. In addition, the Secretary of the Treasury may by Regulations designate situations where property is transferred out of the United States and where no ruling is required. These situations will most likely be where there is no significant tax avoidance possibility or where the Secretary could easily determine a formula for the gain which must be recognized. Under the new law it is no longer required that the ruling be obtained before the transaction. Now the taxpayer has until the close of the 183rd day after the beginning of the transfer to file a request for the ruling.

The fact that certain transfers no longer require a ruling should not be taken to mean that they will no longer be regulated. Act Section 1042(a) requires that the Secretary of the Treasury promulgate Regulations dealing with these transfers. The Regulations must include the circumstances under which 1) gain must be recognized currently or amounts must be included in gross income as a dividend or 2) gain can be deferred, as well as the extent to which adjustments must be made to earnings and profits, or the basis of stock or assets because of such transactions. Foreign corporations will *not* be considered corporations only to the extent necessary to prevent the avoidance of income tax.

One of the more significant changes in the law is that the new section will provide for court review of an adverse determination or for a court ruling on the request in the event of undue delay. In the case of an actual controversy involving a determination or the failure to make a determination, a party to the transaction may request a declaratory judgment dealing with the ruling [25]. This declaratory judgment will be given by the United States Tax Court and will have the force and effect of a Tax Court decision. The Tax Court review may be of the adverse determination, of the failure to make a determination concerning the avoidance of income taxes, or of the terms and conditions under which the favorable ruling was given by the Secretary. The Tax Court also is given the power to make its own reasonable terms and conditions.

This section was effective on October 9, 1975. The Secretary must promulgate the Regulations required under the new law by January 1, 1978. Until that time, however, all transactions require a ruling by the Secretary. For any transaction which took place after December 31, 1962 and before December 31, 1975, solely between foreign corporations, a taxpayer has 183 days after the enactment of the bill to file a ruling request for the non-recognition of gain. Thus, U.S. shareholders of foreign corporations involved in taxable exchanges where the corporation were unaware of the ruling requirement, or where the shareholder were unaware of the exchange until it was too late to obtain a ruling may now request tax-free treatment of such transactions.

3. Contiguous country branches of domestic life insurance companies

A. General description

Domestic life insurance companies like all U.S. corporations, are taxable on their world-wide income. They are of course allowed a foreign tax credit for any taxes paid on their foreign source income to a foreign country in which they do business. If the tax rate of the foreign country is less than that of the United States the domestic corporation's effective tax rate for a business in such foreign country is higher than the rate applicable to its competitors who are corporations of such foreign country. The shareholders of a mutual life insurance company are the policyholders, who receive the benefits of any income earned by the company. Therefore, a tax rate which is higher in the United States than in the foreign country only serves to reduce the distribution to that country's policyholders. The result is that the U.S. companies' policies are le

25. A declaratory judgment is a judgment which declares the rights of the parties or expresses the court's opinion on a question of law, without ordering anything to be done. Thus, a declaratory judgment could rule that a transaction was not subject to tax even before the tax administration has decided whether or not to tax the transaction.

ttractive in that country. Since the earnings of a branch of a mutual ife insurance company selling poli-ies in a foreign country would be available only to the policyholders of the company, who are also resi-dents of that foreign country, dis-tributions of earnings normally would have no effect on U.S. taxa-ion.

B. The Tax Reform Act

To help alleviate any competitive hardship which the current tax law mposes on domestic life insurance ompanies doing business in Canada r Mexico, Act Section 1043 adds ection 819A to the tax law. To be ligible for the benefits under this ew section, the domestic mutual nsurance company must be a life nsurance company, with a contig-ous country life insurance branch. The company must make an election or this special treatment, such elec-ion being effective until revoked vith the consent of the Secretary.

ligible contiguous country life in-urance branches are those branches f domestic life insurance companies hich issue insurance contracts (life, ealth, accident, annuity or reinsur-nce) in connection with the lives or ealth of residents of countries ontiguous to the U.S., have their rincipal place of business in that ountry, and would be a mutual life surance company if they were sep-ate domestic insurance companies. he taxpayer must establish and aintain a separate branch account r such contracts, in accordance ith its regularly employed method accounting if this separates U.S. ems from branch items, and in ac-rdance with Treasury Regulations it does not. When the election is ade, the domestic company must cognize all gain which would have en recognized if the branch assets d been sold.

nce the separate branch is estab-hed, any payments to the domes-life insurance company made m the separate branch account all be treated as if they were re-ived from a third person. Income m the contiguous country branch all be recognized by the domestic mpany only when it is repatriated such domestic life insurance mpany. No taxes paid to the for-n country on separate account items will be allowed as a tax credit or deduction. Income repatriated to the United States is treated as a divi-dend from a foreign subsidiary. The dividend must be grossed-up and a tax credit for such dividends will be allowed.

A domestic stock life insurance company may transfer assets to a contiguous foreign country for the same type of treatment without ob-taining the normally required ruling from the Secretary of the Treasury that such transfer is for purposes other than the avoidance of income tax, and without paying an excise tax on the transfer of appreciated assets. (For a brief discussion of the excise tax, see Part II.B.4.) The do-mestic corporation will have to recognize the gain which would have been realized had the transferred as-sets been sold.

This section is applicable for taxable years beginning after December 31, 1975.

4. Losses on bonds etc. for foreign banks

A. General description

Prior to the enactment of the Tax Reform Act of 1969, U.S. banks could treat gains from the sale of corporate and government bonds and other evidences of indebtedness as capital gains and could deduct losses from such sales as ordinary losses. Corporations which would have been considered banks except for the fact that they were foreign corporations treated such gains and losses as capi-tal gains and losses. As such, the foreign banks could take advantage of the capital loss carryover. Such carryover could be applied only against gains resulting from the same type of transaction that gene-rated the loss. The Tax Reform Act of 1969 revoked this preferential treatment as of July 11, 1969. Thereafter gains and losses on such transactions were treated as ordinary income and losses, subject to the full inclusion in their income of both gains and losses. A transitional rule permitting a limited exception for U.S. banks was enacted [26] There was no transitional rule for foreign banks. They were therefore left with capital carryover which they could not use.

B. The Tax Reform Act

Act Section 1044 adds a subsection to the tax law and establishes a tran-sitional rule for the treatment of bond etc., losses for corporations which would be considered banks ex-cept for the fact that they are for-eign corporations. The section's ef-fectiveness is retroactive to taxable years beginning after July 11, 1969.

This rule allows a foreign bank to use its remaining capital loss carryover. The net gain from sales or exchanges of bonds, etc., shall be considered as gain from the sale or exchange of a capital asset (and thus subject to tax at the preferential capital gain rate) to the extent that this gain does not exceed the capital loss carryover from the same type of sale or ex-change for taxable years beginning before July 12, 1969. The capital loss carryover does not reduce the amount of current gain; it merely provides for the recognition of cer-tain gain as capital rather than or-dinary income. Thus, if a foreign bank with an unused capital loss carryover of $2,000 recognized $10,000 of ordinary income on the sale of bonds, etc., in 1970, it can now amend its tax return to recog-nize ordinary gain of $8,000 and capital gain of $2,000. This will in effect permit the foreign bank to pay taxes on $9,250 rather than on $10,000 of income.

Act Section 1044 also provides that the time limitations for refunds or credits shall not be applicable for this transitional rule if the claim for such creditor refund is filed within 1 year of the date of the enactment of the Act.

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26. Under this transitional rule, if the net long-term capital gains from the sale or exchange of bonds, etc., held by a bank on July 11, 1969, exceeded the net short-term capital loss for the year from the sale of the same type of bonds, etc., the excess is treated as a capital gain to the extent that it does not exceed the net gain on the sale or exchange of all bonds, etc. for the year. Capital gains for bonds, etc., held on July 13, 1969 are determined by multiply-ing the amount of capital gains without applying any special rule by a fraction whose numerator is the number of days prior to July 12, 1969 the security was held, and whose denominator is the total number of days the security was held.

The effect of this section is to give foreign banks the same type of transitional treatment currently being given to domestic banks and to allow them the use of their capital loss carryover available on July 12, 1969.

VI. SPECIAL CATEGORIES OF FOREIGN TAX TREATMENT

1. Possessions corporations

A. General description

As a kind of incentive to investment in U.S. possessions, the United States established special rules for the tax treatment of investment in U.S. possessions. These rules were designed to help induce U.S. corporate investment in active trades and businesses in Puerto Rico and the possessions. Under these rules, individuals or domestic corporations operating a trade or business in a possession of the United States were entitled to exclude from their gross income all income of possessions corporations from sources without the United States, including foreign sources income earned outside the possession in which the corporation conducts a business. They were not permitted the use of the foreign tax credit for any taxes paid to possession governments, however.

To be eligible for the income exclusion, the individuals or corporations had to satisfy 2 conditions: 1) 80 percent or more of their gross income for the 3 year period immediately preceding the close of the taxable year must have been derived from sources within a possession of the United States and 2) 50 percent or more of the gross income for such period of the corporation or of the individual (on his own or as an employee or agent of another) must have been derived from the active conduct of a trade or business within a possession of the United States.

All dividends received in the United States by the corporation or individual were taxable. In addition, domestic corporations were not allowed to take advantage of the 85 percent deduction normally granted for intercorporate dividends [27]. This exclusion resulted in little repatriation of earnings and in the domestic corporations seeking other outlets for their possessions corporation's earnings. Also, because the corporate taxpayers are domestic corporations, the possessions corporation could be liquidated into the parent without the recognition of gain or loss (this advantage is available to all corporations owning 80 percent or more of another corporation it liquidates).

Possessions corporations were permitted to be included in the consolidated return of an affiliated group of corporations in years in which they incurred losses. The result was that domestic corporations paid no taxes on their possessions corporations' income in gain years if it was not repatriated, while they were able to reduce their total tax burden in loss years. In effect, the corporation received a double tax benefit.

B. The Tax Reform Act

The amendments to the possessions corporation law are designed to eliminate some of the potential for abuses of the possessions corporations without eliminating the corporations altogether. Such corporations may still be an important aid to investment in U.S. possessions. The changes continue to exempt trade or business income derived in the possession and investment income earned in the possession, while they result in the elimination of the exemption for income from investments outside the possession. Also, although foreign source investment income from possessions business earnings will be taxed, possessions corporations will be able to repatriate the income to the United States without liquidating and without resulting in the payment of substantial taxes by the domestic corporation.

To achieve the changes outlined above, the sections of the tax law dealing with possessions corporations now have one rule for individual owners of possessions corporations and one rule for corporate owners of possession corporations. Act Section 1051 retained the treatment under the prior law for individuals controlling possessions corporations. It added Section 936 to the possessions corporations rules. Corporations operating possessions corporations will now be taxed on their possessions corporations' world-wide income in the same way that any other U.S. corporation is taxed. However, the corporation is allowed a 48 percent foreign tax credit (called the Section 936 credit) for the business and qualified investment income from possessions. To be eligible for this credit, a corporation must meet the same requirements as were necessary for the original possessions corporation benefits. The credit will be given to the domestic corporation regardless of whether the possessions corporation had paid any taxes to the possession country.

The section denying the intercorporate deduction for dividends has also been amended. The general 85 percent deduction will be allowed in all cases for dividends returning to the United States and the 100 percent deduction will be allowed to corporations which elect to be treated under the new Section 936.

Consolidated returns may be filed only in the case of initial losses. Once the election for the Section 936 credit is made, consolidated returns may not be filed for 10 years. Losses occurring at the beginning of the operation of a possessions corporation must be recaptured if foreign source income is derived in later years (see a discussion of this provision in Part IV.B.2. above).

In determining the amount of tax attributable to the income from the active conduct of a trade or business or to qualified possessions source investment income, losses from other sources must be taken into account. Qualified possessions source investment income is income only from sources within the possession in which the possessions corporation conducts a trade or business. The taxpayer must establish that the funds invested were derived from such activity. This is to prevent the loss of capital to the possessions countries.

27. In the U.S. tax law, corporations receiving dividends from other corporations are permitted to deduct 85 percent of the dividend from their income. The deduction is increased to 100 percent for dividends from a small business investment company and for certain "qualifying dividends" — i.e. dividends from a member of an affiliated group of corporations but only if: 1) an election for such treatment was made; 2) the dividends were distributed out of earnings and profits of a taxable year ending after December 31, 1963; and 3) the distributing company and the receiving company were members of the affiliated group for the same time.

f a corporation is eligible for the Section 936 credit, any taxes paid to a foreign country or possession are not treated as creditable taxes and no deduction for such taxes is allowed. The new tax credit is available only for corporate income tax paid.

This section is effective with taxable years beginning after December 31, 1975.

2. Western Hemisphere Trading Corporations (WHTCs)

A. *Prior law*

Prior to the enactment of the Tax Reform Act, the United States allowed WHTCs a reduction on the corporate income tax payable on their income as a WHTC. A WHTC is defined in the tax law as a domestic corporation, 1) all of whose business (except for incidental purchases) is done in a country or countries in North, Central, or South America, or the West Indies, 2) which derives 95 percent or more of its gross income for the three years immediately preceding the close of the taxable year from sources without the United States and 3) which derives 90 percent of its gross income from that period from the active conduct of a trade or business. Such WHTCs were allowed a reduction of up to 14 percentage points on their corporate income tax. The reduction is determined by multiplying the normal taxable income by a fraction, the numerator of which was 14 and the denominator of which was the sum of the normal tax and the surtax which would have been effective (presently a total of 48).

This provision was intended to provide an incentive to establish corporations in countries in the Western Hemisphere. It was useful for corporations whose business involved operations in other countries in the Western Hemisphere. A lower U.S. tax rate permitted such corporations to operate competitively with foreign corporations established in Western Hemisphere countries with low tax rates, while retaining U.S. ownership of the investments.

B. *The Tax Reform Act*

Beginning with the taxable year 1976, the numerator in the multiplier described above to determine the tax reduction will be reduced. For 1976, the numerator is 11 percent; in 1977 it will be 8 percent. This is further reduced to 5 percent in 1978 and to 2 percent in 1979. For years beginning after 1979, the section is repealed altogether. Act Section 1052 also contains provisions deleting references to the WHTC from other sections of the tax law.

This amendment will help provide general tax equity for income derived from all foregin sources.

3. China Trading Act Corporations

A. *Prior law*

Corporations organized under the China Trading Act (a section of the U.S. civil law) were given special tax benefits. Although subject to the same tax rates as other corporations CTA corporations were entitled to a special deduction against their taxable income. This special deduction was equal to a proportion of the corporation's income derived from sources within Formosa and Hong Kong which was the same as the proportion which the par value of the stock held by residents of Formosa, Hong Kong, the United States or its possessions, or individual citizens of the United State bore to the par value of all outstanding stock of the corporation. Thus, if 100 percent of the corporation's shares were held by the above persons and 100 percent of its income was derived from sources within Formosa and Hong Kong, such a corporation could in principle exclude 100 percent of its income subject to taxation.

There was a further limitation on the deduction, however; the excluded taxable income could not exceed the amount distributed by the corporation to the above shareholders as a special dividend. This dividend was an amount at least equal to the amount of U.S. tax that would be due were it not for the special deduction. Thus, CTA corporations could in effect operate free of tax. In addition, monies distributed as dividends to residents of Formosa and Hong Kong were not included in the shareholders' gross income and were thus exempt from taxation altogether.

There are presently only 3 active CTA corporations, while there are many other corporations trading in Hong Kong and Formosa without the advantage of these tax benefits. Congress felt that there was no present justification for the special tax treatment afforded to CTA corporations.

B. *The Tax Reform Act*

Act Section 1053 repeals the provisions of the law relating to CTA corporations. This is done in a 3 year phaseout period. The special deduction and the exclusion of dividends to residents of Formosa and Hong Kong will be reduced by 33 1/3 percent for the taxable year beginning in 1976 and by 66 2/3 percent for a taxable year beginning in 1977. Effective December 31, 1977, the section of the tax law dealing with the CTA corporations is repealed. At that time also, all references to the CTA in other sections of the tax law are also repealed.

VII. ANTI-BRIBE AND ANTI-BOYCOTT MEASURES

1. Bribes

A. *Prior law*

Under the prior law the only anti-bribery tax measure was a provision that denied a tax deduction for amounts paid to officials or employees of a foreign government if such payments would have been illegal if subject to the laws of the United States. This provision applied only to the question of deductible expenses of a domestic business; it did not apply to foreign subsidiaires. This situation led one publication to advise recently that "the denial of deductions for a questionable payment can be avoided in some cases by having questionable payments made through a foreign company" [28].

B. *The Tax Reform Act*

Under the new law special provisions apply to bribes or similar payments made to a foreign government official or employee after November 3, 1976. If the payment was made

28. INTERNATIONAL TAX REPORT, October 4, 1976, at 3.

by a controlled foreign corporation [29] the payment will be considered Subpart F income. Thus, U.S. shareholders of the CFC will be taxed on the amount of the bribe as if it were a dividend distribution to them. Also, such a payment by a CFC will not reduce the earnings and profits of the CFC. This means that the payment will not be an expense for purposes of reducing the amount of subsequent distributions by the CFC that will be considered dividends. Thus, bribe amounts may be taxed twice.

In the case of an illegal payment to an official or employee of a foreign government made through a DISC [30] the amount of the payment will be deemed a profit distribution and will be currently taxed in the hands of the shareholder. This means that a bribe paid by a DISC not only will not be a deductible expense but also will lose the deferral benefits for the amount of the payment.

2. Boycotts

No anti-boycott tax measures existed prior to the passage of the Tax Reform Act. Now a number of special provisions apply to a taxpayer who participates in or cooperates with an international boycott after November 3, 1976 or, in the case of operations under a contract entered into before September 2, 1976, after December 31, 1977. A person has participated in or complied with an international boycott if:

(a) a condition of doing business with the government or a person of a country is: to refrain from doing business in another country or with the government, companies or nationals of that country; to refrain from doing business with any U.S. person engaged in trade in another country or with the government, companies or nationals of that country; to refrain from doing business with any company whose ownership or management is made up of individuals of a particular nationality, race or religion; or to refrain from hiring or employing individuals of a particular nationality, race or religion;

(b) a condition of sale of a product to the government or a person of a country is: to refrain from shipping or insuring the product with a company which does not participate in an international boycott.

A business who participates in an international boycott is subject to three possible sanctions. First, all such businesses will have part or all of their foreign tax credit disallowed. The amount of credit disallowed is either the actual taxes paid on operations concerning which boycott agreements had been made (if this amount is established by the taxpayer) or a percentage of total foreign taxes based on the "international boycott factor". This factor will reflect the ratio of boycott-related income to total foreign income. (Note, however, that taxes which are not creditable are still allowed as a deduction from taxable income.)

Second, if the business engaged in the boycott is a controlled foreign corporation, boycott income will be treated as Subpart F income and will be subject to current taxation in the hands of the U.S. shareholders. The amount of boycott income to be included in Subpart F income will be either the amount of non-Subpart F income shown by the taxpayer to have been earned from boycott operations or the product of total non-Subpart F income multiplied by the international boycott factor.

Third, if a DISC participates in a boycott the amount of DISC income eligible for deferral will be reduced by either the amount of deferred income shown by the taxpayer to have been earned from boycott operations or the product of the total deferred DISC income multiplied by the international boycott factor.

Thus, the Tax Reform Act penalizes boycott activities of U.S. taxpayers by disallowing credit for taxes paid on income from such activities and by denying the deferral advantages normally available from engaging in foreign activities through a controlled foreign corporation or a domestic international sales corporation.

VIII. THE DOMESTIC INTERNATIONAL SALES CORPORATION

A. General description and prior lau

As an incentive to stimulate expor sales, Congress in 1971 provided fo the tax benefits of a Domestic Inter national Sales Corporation (DISC) [31] It is actually little more than a pape corporation designed to give export ing companies a tax advantage. Th DISC is exempt from most taxes. I is liable for withholding taxes, othe employment taxes, and various othe miscellaneous taxes.

To be eligible for the DISC status a domestic corporation must hav only one class of stock with a mini mum par value of $2,500, elect suc DISC status, and have income, a least 95 percent of which consist of "qualified export of receipts'

Although the DISC itself is not taxe on its income, a DISC shareholde must include in his income a deeme dividend of his share of certain i come items and 50 percent of the e cess of taxable income of the DIS Subsequent distributions of amoun previously taxed as deemed div dends were excluded from the shar holder's gross income.

If the corporation loses its DIS status, a shareholder is deemed receive as a dividend his pro ra share of the DISC income accum lated tax-free during previous yea Such distributions are deemed to received in equal installments in ea of the next 10 years after the term nation or disqualification (limite however, to the number of imm diately preceding years that the c poration was a DISC).

The shareholder must include in income each year amounts actua distributed by the DISC, deem

29. See Part III above for an explanati of controlled foreign corporations and treatment of Subpart F income.
30. See Part VIII for an explanation DISCs.
31. For a more extensive discussion of DISC, see L.S. Ullman, *The Domestic ternational Sales Corporation ("DISC A United States Tax Vehicle to Encour Exports*, 26 BULLETIN FOR INTER TIONAL FISCAL DOCUMENTATION (1972).

dividends, deemed distributions for disqualification, and certain gains.

The Tax Reform Act modified the benefits of the DISC.

B. The Tax Reform Act

Act Section 1101 retains the present deferral benefits, but limits them by requiring that certain additional income be included in the deemed dividend. The Tax Reform Act adds the following new items to those previously considered deemed distributions: 1) 50 percent of the taxable income of a DISC for the year which is attributable to military property; 2) the taxable income for the taxable year attributable to "base period export gross receipts"; and 3) the sums required to be included because of participation in a boycott or because of bribes (discussed in Part VII above).

The "base period export gross receipts" are the basic amount of export receipts fixed by law. They are defined as that portion of the adjusted taxable income in excess of 17 percent of the average export gross receipts for the base period. These receipts are deemed distributed to the shareholders prior to the computation of the present deemed distribution of one-half the DISC taxable income.

In other words the principal tax deferral advantage now accrues to a DISC only if it increases its sales. If its sales remain constant, it would now have only one half of 33 percent, or 16 1/2 percent, of its taxable income available for tax deferral. In contrast with the pervious 50 percent.

The base period for a taxable year beginning before 1980 is the taxable year beginning in 1972-1975. After 1979, it is the taxable years beginning in the 4th, 5th, 6th, and 7th calendar years preceding such calendar year. If the DISC did not have a taxable year beginning in one of the base period years, it is deemed to have a taxable year with receipts of $0.

Obviously it is to the advantage of the shareholder to have low base period export gross receipts, since this increases the amount of current gross receipts which can be deferred. To insure that the base period export gross receipts which are attributable ot a DISC for purposes of deemed distributions are appropriately matched with the current period export receipts, and to prevent the creation of multiple DISC's to reduce base period export gross receipts, Act Section 1101 adds rules dealing with controlled groups and the separation of a DISC from the trade or business giving rise to the DISC income.

If more than one member of a controlled group (all corporations with 50 percent or more common ownership) qualifies as a DISC, the export gross receipts and taxable income, etc, must be aggregated as provided by Regulations of the Secretary, as necessary to prevent circumvention of the new DISC provisions.

When the ownership of a DISC and the trade or business which produced the export gross receipts of the DISC are separated, the new owner of the trade or business is treated as having additional export gross receipts during the period attributable to the business. This provision is designed to prevent the separation of a DISC and the trade or business in order to reduce base period export gross receipts.

Shareholders who own 5 percent or more of the stock of one DISC, and who owned during the base period of such DISC 5 percent or more of the stock of a second DISC, must include in their share of the base period export gross receipts of the first DISC their share of the base period export gross receipts of the second DISC. This is designed to prevent an artificial reduction in the base period export gross receipts (e.g. by creating a new DISC which would have base period receipts of $0 and would now have half the business of the old DISC).

Under the new law, the recapture of accumulated DISC earnings on the disqualification of a DISC is also spread out over a maximum 10 year period but now the actual maximum is equal to twice the number of years the DISC was in existence.

Act Section 1101 also amended the DISC rules to clarify the source of income to be included in a shareholder's income on the disposition of stock of a DISC. This rule will also apply when the corporation disposes of the stock in certain transactions which normally would not require the recognition of gain: i.e. the distribution of stock to a shareholder with respect to his stock; the distribution of such stock as part of a plan of complete or partial liquidation; or the sale of such stock as part of a plan of liquidation completed within 12 months. In these situations, the shareholder must include in his income as a dividend the gain attributable to the accumulated DISC income which was accumulated in taxable years of the corporation when the shareholder held its stock. Gain recognized on DISC stock distributed as a partnership share shall also be considered ordinary income.

The Tax Reduction Act of 1975 terminated DISC benefits for natural resource products subject to cost depletion. Act Section 1011 modifies this to terminate such benefits for natural resource products subject to the allowance for percentage depletion. Taxpayers exporting depletable natural resources pursuant to a contract with fixed price and quantity shall continue to receive the benefits, however.

The Tax Reform Act modified but did not eliminate the DISC benefits. However, the GATT Council, in response to a complaint filed by the E.E.C. Commission, determined that the DISC provision is an export subsidy in violation of the GATT. This determination, although having no effect on Congress, may provide the impetus necessary to repeal the DISC benefits altogether.

Fiscal and Economic Studies Center, Madrid.

The Fiscal and Economic Studies Center (Centro de Estudios Tributarios y Económicos) was created in Madrid during the 1960-1961 academic year by the Madrid Chamber of Commerce (Cámara de Comercio) and the Spanish Fiscal Law Association (Asociación Española de Derecho Financiero).

The Center was founded to completely satisfy the following two social needs:
(i) several professionals wanted to improve their work by means of updating and improving their knowledge acquired during their academic studies, but were not able to find proper centers for that purpose;
(ii) companies expected to have, within their tax and economic technical staff, persons who not only had theoretical and scientific knowledge but were also able to show a command and understanding of that knowledge when applied to the practical reality to which it referred. Companies had concluded that training provided by superior studies was not complete, nor generally useful to the kind of work expected from professionals.

The Fiscal and Economic Studies Center expected to give to these professionals the complementary training that companies and professionals themselves wanted, with a special emphasis on fiscal subjects. Every concept in the Spanish fiscal system was therefore studied, primarily in a practical way. In addition, economic and financial analysis, and general and company accountancy, were also studied.

With similar purposes and in addition to what has already been mentioned, the establishment of a new section of studies was decided; this section was intended specifically for those who already were or wanted to be company lawyers. In this way two branches were established: one of Fiscal Studies and one of Company Lawyers.

Since the beginning, 14 groups have attended the Fiscal Studies Course, and 6 groups have attended the Company Lawyers Course, a total of 430 students (57 of them in the last mentioned branch) belonging to 186 companies which have sponsored most of the students.

The Center's name is widely known, as is proved by increasing applications for entry. Its reputation is based on the guidance from personalities acting within the Board of Directors, on the teachers' staff, and finally, on the courses' comprehensiveness and the program's content.

The teaching staff is composed of approximately 30 prestigious and devoted persons, including university and technical school professors, government lawyers, notaries, inspectors of various agencies of the Finance Ministry, economists, engineers and architects.

Beginning with the 1975-1976 academic year, a close cooperation was established with the Madrid bar association which, in addition to valuable suggestions, has provided the Center with renowned lawyers who have been included on the Professors' Staff.

After 15 years of fruitful work on behalf of professional companies and the Spanish society, a new branch has been established by the Center. The name of this new branch is Financial and Fiscal Accountancy and it is devoted to graduates and non-graduates who have been working in companies as directors or as accountancy chiefs. This new branch has a staff of 20 new professors. During the 1975-1976 period, 207 students divided into the three above-mentioned branches will attend 830 classes developed by more than 40 teachers, all of whom have a well-known prestige.

The subjects covered by each branch and course are the following:

Fiscal Studies Branch, First Course: 1. Written Contracts; 2. Economical and Financial Analysis; 3. General Accountancy; 4. Smuggling; 5. Rural Immovable Tax; 6. Urban Immovable Tax; 7. General Tax Law; 8. Tax on Business Income; Business Licence Fee; 9. Earned Income Tax; 10. Capital Income Tax; 11. Inheritance Tax; 12. Property Transfer Tax; 13. Finance Organization; 14. Tax System; 15. Tax Economic Theory.

Fiscal Studies Branch, Second Course: 16. Company Accountancy; 17. International Tax Law; 18. Tax Administration; 19 Local Finances; 20. Special Taxes; 21. Luxury Tax; 22. Individual Income Tax; 23. Corporation Tax; 24. Sales Tax; 25. Tax Procedures; 26. Special Tax Regimes; 27. Customs Income; 28. Fees and Parafiscal Levies.

Enterprise Lawyers' Branch, First Course: 1. Written Contracts; 2 Foreign Trade; 3. General Accountancy; 4. Rural Immovable Tax; 5. Urban Immovable Tax; 6. Administrative Law; 7. Civil Law; 8. Labor Law; 9. Commercial Law; 10. Penal Law; 11. Procedural Law; 12. Tax on Business Income: Business Licence Fee; 13. Earned Income Tax; 14. Organization System; 15 Property Transfers; 16. Local Taxes

Enterprise Lawyers' Branch, Second Course: 17. Enterprise Accountancy; 18 Smuggling; 19. Administrative Law; 20 Procedural Law; 23. Urban Law; 24. Individual Income Tax; 25. Capital Income Tax; 26. Corporation Tax; 27. Sales Tax 28. Bank Operations; 29. Tax Procedure 30. International Law Relations.

Financial and Fiscal Accountancy Law Single Course: 1. General Accountancy 2. Accountancy and Enterprise; 3. Analytical Accountancy; 4. Accountancy General Plan; 5. Accountancy Law; 6. Market and Financial Sources; 7. Internal Financing; 8. External Financing; 9. Public Aid 10. Corporation Tax; 11. Sales Tax; 12 Property Transfer Tax; 13. Local Taxes

Each course has 166 45-minute classes Classes are scheduled on Monday, Wednesday, and Friday evenings; the first class held from 7:30 to 8:15; and the second class from 8:30 to 9:15.

Tests on the subjects covered in each trimester are taken on scheduled dates. A list of approved students will be submitted to the Director by the Chief of the Study Office. A special test will be given in September for those students who were not approved.

Titles of "Graduated in Fiscal Studies" "Company Lawyer", and "Financial and Fiscal Accountancy" are granted only if at least 75 percent of the classes have been attended. Simple compliance with the above-mentioned minimum, without taking examinations or without being approved makes it possible to obtain, at the end of each course, an "attendance certificate".

There are two kinds of diplomas awarded the "profit diploma" and the "profit and merit diploma". The second diploma will be granted by the Center Director to the students with the best grades who have also prepared a written work, previously submitted to the Director.

FRANCE

On 4th November 1976 the Court of Appeal of Aix-en-Provence sentenced a taxpayer for tax fraud and improper financial records to:

8 months of imprisonment (suspended)
and
a fine of 20,000 Fr.Frs
and
the loss of the right to carry on any industrial or commercial profession during a period of 5 years
and
the suspension of his driving licence during a period of 5 years.

COUNTRY BY COUNTRY SURVEY OF LOOSE-LEAF PUBLICATIONS . . .

AUSTRIA

IE EINKOMMENSTEUER 1972

y Franz Hofstätter and Kurt eichel. Wirtschaftsverlag Dr. Anton rac, Graben 17, Vienna I.
upplemented: regularly twice per ear.

oose-leaf publication in three vol-mes dealing exclusively with in-ome tax in Austria. Volume I con-ains the full consolidated text of the resent income tax law as stated as f July 1976. In addition former ersions of consolidated texts of the ncome tax back through 1954 are ppended (approx. 800 pages). Vol-me II contains condensed texts of levant case law as of May 1976 (62 ages). Volume III contains a de-iled commentary on income tax as f July 1976. The material is kept up date by the issue of supplement-y pages.

EBÜHREN UND VERKEHRSTEUERN, TEMPEL- UND RECHTSGEBÜHREN, RUNDERWERBSTEUER, ERB-HAFTS- UND SCHENKUNGSSTEUER ESETZE, KOMMENTAR MIT ENT-HEIDUNGEN, BEWERTUNG, BILANZ-ND BERECHNUNGSBEISPIELE

K. Fellner and W. Fellner. Avail-le from the authors: Florianerweg , 4470 ENNS.
pplemented: when necessary.

ose-leaf publication in three vol-nes containing the text of and a mmentary on general principles d procedures of tax laws, and the ties levied on various kinds of legal official documents.

INTERNATIONALES STEUERRECHT

Innerstaatliche Vorschriften und zwischenstaatliche Vereinbarungen mit Erläuterungen unter Berücksichtigung der Rechtsprechung, by Robert Pollak and Alfred Philipp. Manzsche Verlags- und Universitätsbuchhandlung, Kohlmarkt 16, A-1014 Vienna.
Supplemented: regularly scheduled.

First release of a loose-leaf publication on Austrian international tax law, containing general explanations (inter alia, the O.E.C.D. Model Tax Convention), texts of and comments on double taxation treaties concluded by Austria, unilateral relief measures, etc. Future supplements will contain remaining texts of tax treaties and treaties to be concluded in future.

KOMMENTAR ZUM BEWERTUNGS-GESETZ

by Alfred Twarock, Rudolf Wittman and Karl Frühwald. Wirtschaftsverlag Dr. Anton Orac, Vienna.
Supplemented: annually.

Second edition of loose-leaf guide containing the text and amendments to the law of 1955 and the commentaries thereto. The material is up-to-date to February 1976. Included in the commentary are the most recent developments in the higher and lower courts after the amendment law of 1972 which has brought legal insecurity by abolishing some valuation prescriptions introduced in the amendment law of 1971. The material is kep up-to-date by new and replacement pages.

KOMMENTAR ZUM GEWERBESTEUER-GESETZ

by Alfred Philipp. Wirtschaftsverlag Dr. Anton Orac, Vienna.
Supplemented: regularly.

Loose-leaf publication containing the text of the Trade Tax Act of 1953, as amended, and implementing laws and regulations thereto. The material is kept up-to-date by the issue of supplementary pages.

KOMMENTAR ZUM GRUNDERWERB-STEUERGESETZ

by Alois Czurda. Wirtschaftsverlag Dr. Anton Orac, Vienna.
Supplemented: regularly.

Loose-leaf publication on the Austrian transfer tax on real property. Full text of the law and implementing statutes are printed. Case law, worked examples illustrate the explanation Civil law in connection with the subject is considered. Great attention is paid to the tax incentives for construction activities. A comprehensive index is appended.

KOMMENTAR ZUR LOHNSTEUER

by Adolf Werner and Wilhelm Schuch. Wirtschaftsverlag Dr. Anton Orac, Vienna.
Supplemented: two or three times per year.

Loose-leaf publication explaining in detail the wage tax. Texts of law and other relevant statutes in connection therewith, as well as case law, are appended. The material is kept up-to-date by the issue of supplementary pages.

KOMMENTAR ZUR MEHRWERT-STEUER

by Alexander Kranich, Hanskarl Siegl, Josef Waba Wirtschaftsverlag Dr. Anton Orac, Vienna.
Supplemented: regularly (at least annually).

Loose-leaf publication containing text of and commentaries on the value added tax in Austria. Worked examples, references to case law elucidate the problems. The material is kept up-to-date by the issue of supplementary pages.

KOMMENTAR ZUM ZOLLGESETZ 1955

By Karl Mathes. Wirtschaftsverlag Dr. Anton Orac, Vienna.
Supplemented: regularly.

Loose-leaf publication containing text of Austrian custom law and implementing regulations as well as connected by-laws; comment and case law are appended. The material is kept up-to-date by the issue of supplementary pages.

DIE KÖRPERSCHAFTSTEUER

by Egon Bauer and Oskar Mayr. Wirtschaftsverlag Dr. Anton Orac, Vienna.
Supplemented: regularly.

Loose-leaf publication on Austrian corporate income tax, text of and comment on the corporate income tax law.

DIE ÖSTERREICHISCHEN ABGABENGESETZE — TEXTAUSGABE

by Paul B. Hassler. Wirtschaftsverlag Dr. Anton Orac. Vienna.
Supplemented: two or three times per year.

Loose-leaf publication in two volumes containing full text of and implementing regulations to major tax laws in force in Austria (e.g. corporate and individual income tax, wage tax, turnover tax, net worth tax). The material is kept up-to-date by the issuance of supplementary pages.

DAS RECHT DER DOPPELBESTEUERUNG IN ÖSTERREICH

By Anton Lager.
Wirtschaftsverlag Dr. Anton Orac, Vienna.
Supplemented: once per year.

Loose-leaf publication in two binders on Austrian international tax law, containing general explanations of terms used in international tax law such as domicile, permanent establishment etc., texts of and comments on double taxation treaties concluded by Austria, case law and regulations. Full text and explanation of the O.E.C.D. model treaties on direct taxes and on death duties are appended. The material is kept up to date by the issue of supplementary pages.

STEUERRECHTLICHE TABELLENSAMMLUNG

Wirtschaftsverlag Dr. Anton Orac, Vienna.
Supplemented: regularly.

Loose-leaf publication containing 450 tables relating to turnover taxes, trade taxes, corporate taxes, individual income taxes, excise taxes, social securities etc. Information of tax rates in previous years has been included.

EUROPE

THE TAXATION OF PATENT ROYALTIES, DIVIDENDS, INTEREST IN EUROPE

Volume I of "Guides to European Taxation".
International Bureau of Fiscal Documentation, Amsterdam, Netherlands.
Supplemented: regularly.

Loose-leaf publication in English containing a summary of all taxes levied on intercorporate patent royalties, dividend and interest, as each type of income flows from one

European country to another, and to Canada and the U.S.A. Each bilateral situation is examined from the point of view of national tax law and takes into account the provisions of relevant double taxation treaties. Each chapter follows the same common outline to facilitate direct comparison. The countries covered are Austria, Belgium, Denmark, Finland, France, German Federal Republic, Greece, Ireland, Italy, Liechtenstein, Luxembourg, Netherlands, Norway, Portugal, Spain, Sweden, Switzerland and the United Kingdom.

THE TAXATION OF COMPANIES IN EUROPE

Volume II of "Guides to European Taxation".
International Bureau of Fiscal Documentation, Amsterdam, Netherlands.
Supplemented: quarterly.

Loose-leaf publication in four binders. A practical, time saving information guide to the practical aspects of all taxes encountered at the different stages in the life of a company. Included are the organizational aspects of the formation of companies, taxation of the formation of capital, taxation of company mergers, corporate tax aspects, other taxes such as value added tax, not worth tax and miscellaneous taxes, such as local, property and land taxes, and stamp duties. Each chapter follows the same common outline to facilitate direct comparison. The present work includes the following countries: Belgium, Denmark, France, German Federal Republic, Ireland, Italy, Luxembourg, Netherlands, United Kingdom, Austria, Spain, Sweden, Switzerland, Greece and Norway. Text of E.E.C. directives and bibliography are appended.

THE TAXATION OF PRIVATE INVESTMENT INCOME

Volume III of "Guides to European Taxation".
International Bureau of Fiscal Documentation, Amsterdam, Netherlands.
Supplemented: regularly.

Loose-leaf publication containing comparative analyses of the effective tax burden on dividends and interest received by individuals in the 11 major countries of Western Europe and the United States of America. It covers the various taxes imposed in each country on dividends, interest and capital gains received by resident individuals. Included are comparative charts illustrating the net dividend received on a corporate pre-tax income of 100 units, and the income a corporation must earn for the shareholder to receive a dividend of 10 units (before individual income tax). The countries covered are Austria, Belgium, Denmark, Finland, France, West Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, United Kingdom and the U.S.A.

VALUE ADDED TAXATION IN EUROPE

Volume IV of "Guides to European Taxation".
International Bureau of Fiscal Documentation, Amsterdam, Netherlands.
Supplemented: quarterly.

Loose-leaf publication containing comparative survey of the system of value added taxation adopted in Western European countries. Each country chapter follows the same common outline to facilitate immediate comparison. The present work in two binders already covers eleven countries: Austria, Belgium, France, West Germany, Ireland, Italy, Luxembourg, Netherlands, Norway, Sweden and the United

Kingdom. A bibliography is appended.

UPPLEMENTARY SERVICE TO UROPEAN TAXATION

nternational Bureau of Fiscal Documentation, Amsterdam, Netherands.

upplemented: monthly.

Loose-leaf publication in 9 binders containing extensive, relevant tax data on the European (including East European) countries. Organized in 5 sections: Section A covers the tax rates on corporations (with tax bases and social security contributions); Section B, the tax rates on individuals; Section C contains the English texts of virtually all major double taxation treaties concluded by European (including East European) countries; Section D covers official documents such as E.E.C. Directives, O.E.C.D. Draft Conventions, etc.; and Section E provides an extensive world-wide bibliography of official documents and of new tax publications (books, periodicals, etc.).

CAPITAL TAXES ENCYCLOPAEDIA

Editorial Board: Sir JOHN FOSTER, K.B.E., Q.C.; E.E. RAY, B. Com., F.C.A.; and B.J. SIMS, LL.B., F.T.I.I., Solicitor. Editor for Scottish Law: W.F. BOWES, W.S. Managing Editor: LESLIE J.P. LIVENS A.T.I.I.

To meet the need for a reference book on Capital Transfer Tax which not only goes beyond the introductory level, but which is also always up to date. Butterworths have published a major new work called *Capital Taxes Encyclopaedia*. In it a team of specialist contributors deal with every aspect of CTT in full detail. Service Issues are published (and charged separately) to keep this loose-leaf work up to date and to expand its subject matter.

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This authoritative volume covers all relevant material to enable the practitioner to assess the relative merits and disadvantages of the various tax havens. The basic principles of the tax haven are set out, followed by chapters on specific tax havens, each written by an expert on that area. The volume is loose-leaf so that information pertaining to a specific area can readily be updated and additional chapters added by means of Service Issues. The work now contains twenty countries.

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List of Tax Treaties. **India**

concerning comprehensive double taxation treaties on income
The list is up to date as of November 30, 1976

ABBREVIATIONS:

BULL = Bulletin for International Fiscal Documentation. International Bureau of Fiscal Documentation, Amsterdam.
DTR (Dominions) Rules = The Income-Tax (Double Taxation Relief) (Dominions) Rules, 1956.
ITJ = The Income Tax Journal, Madras.
ITR = The Income Tax Reports, Madras.
SUPP.SER. Section C = Supplementary Service to European Taxation, Section C.
Kanga/Palkhivala = Kanga and Palkhivala's The Law and Practice of Income Tax, by N.A. Palkhivala and B.A. Palkhivala, Bombay 1976, 7th Edition.
Treaty Series = Treaties and international agreements registered or filed and recorded with the Secretariat of the United Nations. In addition to the official text of each agreement, the publication produces a translation in either English or French as the case may be.
UN = United Nations, Department Economic and Social Affairs. International Tax Agreements. World Guide. Text of tax treaties exists in an English and a French edition. This publication contains several volumes.

Treaty with	Concerning	Concluded	Official Text	Published in the English language
Austria	income	September 24, 1963	English	SUPP. SER. Section C 27 (Bull) 1964 IX UN A (1) 117 Treaty Series, Vol. 545, p. 200 Kanga/Palkhivala, Vol. II, 1976
Belgium	income	February 7, 1974	English, Hindi and French	SUPP. SER. Section C Kanga/Palkhivala, Vol. II, 1976
Denmark	income	September 16, 1959	English	SUPP. SER. Section C IX UN A (1) 74 Kanga/Palkhivala, Vol. II, 1976
Egypt (U.A.R.)	income	February 20, 1969	English	Bull Supplement B, 1971 Kanga/Palkhivala, Vol. II, 1976 ITR, Vol. 2, 1969
Finland	income	June 23, 1961	English	SUPP. SER. Section C IX UN A (1) 80 Kanga/Palkhivala, Vol. II, 1976

reaty with	Concerning	Concluded	Official Text	Published in the English language in
rance	income	March 26, 1969	Hindi and French	SUPP. SER. Section C IX UN A (1) 272 Treaty Series, Vol. 748, p. 55 Kanga/Palkhivala, Vol. II, 1976 ITJ, Vol 1, 1970
erman Federal Republic	income	March 18, 1959	Hindi, English and German	SUPP. SER. Section C IX UN A (1) 28 Kanga/Palkhivala, Vol. II, 1976
reece	income	February 11, 1965	English	SUPP. SER. Section C IX UN A (1) 82 Treaty Series, Vol. 606, p. 10 Kanga/Palkhivala, Vol. II, 1976 ITJ, Vol. 1, 1967
pan	income	January 5, 1960	English	IX UN A (1) 46 Kanga/Palkhivala, Vol. II, 1976
Supp. Protocol	income	April 8, 1969	English	Kanga/Palkhivala, Vol. II, 1976 ITJ, Vol. 1, 1971
exchange of notes	exchange of information	November 30, 1974	English	Kanga/Palkhivala, Vol. II, 1976 ITR, Vol. 98: Part 6 Febr. 10, 1975
alaysia [1]	income	October 25, 1976	xxxx [2]	
orway	income	July 20, 1959	English	IX UN A (1) 42 Kanga/Palkhivala, Vol. II, 1976
erra Leone	income	DTR (Dominions) Rules	English	Kanga/Palkhivala, Vol. II, 1976
Lanka	income	September 10, 1956	English	Kanga/Palkhivala, Vol. II, 1976
eden	income	July 30, 1958	English	Supp. SER. Section C IX UN A (1) 16 Kanga/Palkhivala, Vol. II, 1976

Not yet in force.
Not yet published.

African Budgets.

The recent Afro-Arab summit meeting in Cairo has once more shown the crucial problems which the developing countries of Africa have to face. With the exception of Nigeria, on which country we reported in the previous issue, African countries are bound to suffer from increased oil prices. The UNCTAD meeting in Nairobi has not been satisfactory for the developing countries in general, with their mostly one-sided natural resources. The North-South dialogue will not be concluded in the near future. Meanwhile, the countries of the third world must deal with the current problems of development.

Little is generally known about public finance in Africa, except to a limited group of insiders. We feel that the Bulletin should more regularly report on those countries' economic policies as reflected in their budgets. The following brief notes deal with the budgets of Ghana for 1976/77 and Zambia for 1977.

Details about the tax systems of both countries are published in the Bureau's two volume loose-leaf publication "African Tax Systems", *also available in a French edition* "Systèmes Fiscaux Africains".

The Ghana Budget, 1976-77 *

Reproduced below are the most important of the tax changes proposed in the Ghana Budget for 1976-77 delivered on July 21, 1976

I. DIRECT TAXES

Personal Income Tax

Two years ago when Government introduced a minimum wage of ₵54.00 per month for all workers in the country, the tax-exempt income of individuals was increased from ₵400.00 per annum to ₵648.00 per annum. However, if an individual's chargeable income exceeded ₵648.00 per annum, the only tax-free income he enjoyed was ₵300.00. As the current rates structure which exempts only ₵300.00 per annum appears to be unfair to all individuals whose chargeable incomes exceed ₵648.00 per annum, Government has decided to increase the tax-free income of all individuals who pay tax from ₵300.00 per annum to ₵648.00 per annum. It is estimated that this measure will result in a revenue loss to Government of about ₵3.5 million. It is hoped, however, that with effective collection envisaged in the 1976-77 fiscal year, this loss will be recovered.

Government has also decided to limit the highest rate of income tax for individuals and bodies of persons to 70 pesewas in the Cedi for chargeable incomes in excess of ₵10,728.00 per annum and to introduce a surtax of 10 percent on chargeable incomes exceeding ₵14,400.00 per annum but not exceeding ₵50,400.00 per annum and 15 percent surtax on chargeable incomes exceeding ₵50,400.00 per annum.

Company Tax

It has been decided that companies shall continue to pay company tax at the existing rates.

Deductions allowed for the purpose of ascertaining the income of any person

To ascertain the income of any person for income tax purposes, all outgoings and expenses wholly and exclusively incurred in the production of the income are regarded as allowable deductions. Certain expenses which are considered not necessary in the production of the taxpayer's income are nevertheless charged against profits. To safeguard the revenue position, it has been decided that only outgoings and expenses which are wholly, exclusively and necessarily incurred in the production of the income should qualify as allowable deductions.

Tax-exempt Corporations which pay Dividends

Formerly, before dividends were paid, tax was deducted at the company rate whether or not the company paying the dividends was exempted from tax on its profits, But now, the Income Tax law provides that dividends are no longer taxable in the hands of shareholders. It follows, therefore, that the shareholders of tax-exempt corporations of companies which pay dividends earn more money on their investments than the shareholders of other corporations or companies which are not so exempt. In the interest of equity all corporations which pay dividends to their shareholders should be liable to tax on their profits.

* Note submitted by Mrs. Elizabeth de Brauw, member of the Bureau; research staff.

The new rates strcuture for individuals o bodies of persons is as follows:

Income Tax

Chargeable income	*Rate of Tax %*
For every Cedi of the first ₵648	Nil
For every Cedi of the next ₵240	5
For every Cedi of the next ₵480	7½
For every Cedi of the next ₵480	10
For every Cedi of the next ₵960	12½
For every Cedi of the next ₵960	15
For every Cedi of the next ₵960	25
For every Cedi of the next ₵1,200	35
For every Cedi of the next ₵2,400	45
For every Cedi of the next ₵2,400	60
For every Cedi exceeding ₵10,728	70

Surtax

Chargeable income	*Rate of Tax %*
For every Cedi of the first ₵14,400	Nil
For every Cedi of the next ₵36,000	10
For every Cedi exceeding ₵50,400	15

As a result of these changes the rates stru ture for pensioners will now be as follow

Income Tax

Chargeable income	*Rate o Tax %*
For every Cedi of the first ₵1,020	Nil
For every Cedi of the next ₵480	2½
For every Cedi of the next ₵960	5
For every Cedi of the next ₵960	7½
For every Cedi of the next ₵960	25
For every Cedi of the next ₵1,200	35
For every Cedi of the next ₵2,400	45
For every Cedi of the next ₵2,400	60
For every Cedi of the next ₵10,728	70

Surtax

Chargeable income	*Rate Tax %*
For every Cedi of the first ₵14,400	Ni
For every Cedi of the next ₵36,000	10
For every Cedi exceeding ₵50,400	15

Capital Allowances for Rubber, Oil Palm and other Plantations

In furtherance of the Government's po to promote and encourage investmen agriculture, it has been decided to g

capital allowances to any person (i.e. any company or individual or body of persons) who establishes large-scale rubber, oil palm and other plantations in the country. The initial capital allowance on qualifying plantation expenditure shall be 10 percent and the annual allowance shall be such rate *per centum* as shall be determined by the Commissioner of Income Tax to be just and reasonable having regard to the productive life of the plantation and its estimated value at the end of such productive life.

Capital Gains Tax

It has been realised that the collection of revenue in respect of capital gains is held up because of a provision in the Capital Gains Tax Decree, 1975 (N.R.C.D. 347) which permits an owner who disposes of a chargeable asset in order to use the full sale proceeds to acquire a similar chargeable asset within a period of one year, to avoid payment of the tax. As this provision tends to defeat the purpose of the whole Decree, it has been decided to limit the application of the provisions to transactions affecting dwelling houses only. This amendment shall take effect from the date on which the Capital Gains Tax Decree, 1975 came intro force, that is 22nd August, 1975.

II. INDIRECT TAXES

Minerals Duty

In order to save mining companies producing low grade ores and companies operating on the margin from the burden of the minerals duty is has been decided to amend the rates of mineral duty as follows:

Yield Ratio	*Rate of Duty*
Over 0 and up to 25 percent	5 percent of the value of minerals won (previously 10 percent)
Over 25 and up to 45 percent	10 percent of the value of minerals won
Over 45 and up to 60 percent	15 percent of the value of minerals won
Over 60 and up to 75 percent	20 percent of the value of minerals won
Over 75 and up to 100 percent	25 percent of the value of minerals won

Casino Revenue Tax

It has been decided to abolish the 2½ percent tax on the gross revenue of all casinos with immediate effect. However, the table of tax payable by casinos has been changed as follows:

	Tax per Table at ₵
Casinos in Accra	24,000.00 (previously 10,000)
Casinos outside Accra	12,000.00 (previously 5,000)

SUMMARY OF GHANAIAN TAXATION

Income Tax: is payable on the income of individuals and legal entities accruing in, derived from, brought into or received in Ghana. Non-residents are liable to tax on income accruing in or derived from Ghana. Rates are as follows:

A. *Individuals:*
   (i) residents: at present chargeable income not exceeding 648 Cedi is exempt; income exceeding this amount is chargeable to tax at rates from 5 percent (on the first 240 ₵ over 300 ₵) to 75 percent (on every Cedi exceeding 14,400).
   (ii) non-residents: tax rates are the same as for residents but tax may not be less than 35 percent of total income.
   (iii) pensioners: pension income not remitted out of Ghana is charged at rates between 2½ percent and 70 percent, the first 1,020 ₵ being exempt.
   (iv) income from rent is charged at rates varying between 5 percent (on the first 5,000 ₵) and 30 percent (on income exceeding 50,000 ₵).

B. *Companies:* residents and non-residents alike are liable to tax at the rate of 55 percent for industrial companies and 65 percent for commercial companies. Special rates of 35 percent, 45 percent and 50 percent apply to wholly owned Ghanaian companies whose turnover does not exceed 200,000 ₵.

Deduction at source: tax is deducted at source from employment and pension income, interest and royalties — but not on dividends — at the appropriate rate of company or individual income tax. Dividends are not taxable in the hands of shareholders.

Capital gains tax: levied on the disposition of buildings, business assets, land, stocks and shares at rates between 15 percent and 55 percent.

Gift tax: payable by recipients of gifts *inter vivos* of buildings, securities, land and cash, the value of which exceeds 2,000 ₵, at rates between 5 percent and 15 percent.

Mineral oil profits tax: payable on profits from mineral oil operations at the rate of 50 percent. No income tax is payable on income subject to this tax.

Customs duties: generally ad valorem at rates between 5 percent (reduced rate) and 150 percent (luxury rate).

Excise duties: generally ad valorem between 5 percent and 75 percent on certain locally produced goods e.g. alcohol, tobacco and soap.

Stamp duty: duty varies according to nature and value of deed.

Sales tax: 10 percent sales price or value.

Mineral duty: charged on minerals won in mining operations. For present rates see p. 133.

Import Licences Levy

There is already in existence under the Imports and Exports (Fees) Regulations, 1975 (L.I. 1025) an import licence levy ranging from 5 to 150 percent. In place of the differentiated rates, however, Government has decided to introduce a flat 10 percent levy on the face value of licences issued to importers. This levy shall be paid by the prospective importer to the Commissioner of Income Tax who will issue a receipt for it. Both the serial number and amount of levy paid will be endorsed on the import licence before it is released to the importer, by the Ministry of Trade and Tourism. To facilitate the collection of this levy, Government has decided that henceforth, the Ministry of Trade and Tourism shall furnish the Commissioner of Income Tax with details of all import licences which have been issued to importers.

Companies granted tax exemption under the Capital Investments Decree, 1973 (N.R.C.D. 141), shall not be liable to pay the levy during the period of exemption. Similarly, import licences in respect of agricultural machinery and inputs as well as licences issued to charitable organisations will not attract the levy. The import licence levy shall be allowable as an expense in ascertaining the income of any person or company.

Miscellaneous

The hotel and restaurant proprietor's tax will be abolished and an advertisement tax of 15 percent will be imposed on the cost of every advertisement made through advertising media.

Zambia-The 1977 Budget *

The Budget for 1977 was presented in Parliament on 28th January, 1977 by the Minister of Finance, the Hon. John Mwanakatwe. The reaction of the public to the budget proposals was generally favourable. The consensus of opinion was that the budget was fair and reasonable in the context of the difficult economic situation prevailing in the country.

ECONOMIC CONDITIONS

The Minister of Finance referred to the economic conditions in the country at length. These may be summarised as follows:

(a) the low level of prices fetched for copper, the main income earner of the country
(b) a large deficit in the balance of payments. The overall deficit in 1976 was estimated at K105 million
(c) the large increase in consumer prices mainly attributed to inflationary trends abroad.

ECONOMIC POLICY

The significant features of the economic policy announced by the Minister of Finance are the following:

(a) diversification of the economy with a view to eliminating complete dependence on copper as the mainstay of the economy. Mention was made of the facts that copper is a wasting asset and is subject to erractic fluctuations in price.
(b) the concentration of the bulk of financial and manpower resources on the development of agriculture.
(c) promotion of small scale industries geared towards import substitution and exports.
(d) tight control on the issue of import licences with a view to the control and restriction of imports to essential items.
(e) the encouragement of private enterprise, in particular foreign private investment.

MEASURES TO GIVE EFFECT TO ECONOMIC POLICY

Various measures were announced to give effect to the economic policy. Some of these briefly stated are as follows:

(1) The existing subsidies on fertiliser and maize, the main agricultural product of the country, will be maintained.

(2) The appeal to the managements of parastatal organisations to concentrate more on small scale industries. For this purpose and with a view to making these organisations more viable and enabling them to produce more goods and services they will be allowed to charge economic prices for their products.

(3) In order to encourage exports exporters registered with the Ministry of Commerce will be given priority in the allocation of import licences and priority in the allocation of foreign exchange. These are in addition to the existing incentives such as the exemption of items meant for export from sales tax and excise duty and the repayment of customs duty paid on raw materials used by a large number of industries.

(4) The most significant measures announced are perhaps the exchange control concessions designed to attract foreign private investors and inspire confidence in the business community generally. With effect from the financial year ending 30th June, 1977 private investors will be allowed to remit either 15 percent of the paid up capital of their companies or 50 percent of the profit whichever is less. The corresponding figures at present are 10 percent and 30 percent. Expatriate farmers will be allowed to remit annually 12½ percent of their after tax profits from 1st April, 1977 as against the prevailing 10 percent. A new scheme, under which a reasonable final emigration allowance would be allowed, is to be introduced. The quantum of such allowance would depend on a number of factors such as the age of the applicant, the value of assets and length of stay in the country. A necessary and, perhaps, long overdue proposal is that the application should be supported by tax returns. If implemented properly this measure would effectively serve the dual purpose of checking some of the abuses relating to exchang control and of ensuring that what a perso seeks to take out of the country is consi tent with his earnings and savings over th years.

REVENUE MEASURES

Having forecast an overall budgetary de cit of K152.1 million the Minister a nounced a series of measures designed raise K53.65 million in revenue for t year. Some of these measures are conside ed below.

INCOME TAX

A noteworthy feature in this year's budg is the relatively insignificant changes in i come tax especially in relation to person income tax. The existing rates of person income tax are set out in the followi table:

Chargeable income	*Ra*
First 500	5.0
Next 1,500	10.0
Next 2,000	22.5
Next 2,000	32.5
Next 2,000	45.0
Next 2,000	55.0
Next 2,000	65.0
Exceeds 12,000	75.0

The only change which will come in force on 1st April, 1977 is the increase the existing rates of 22.5 percent and 32 percent to 25 percent and 35 percent. T practical result of the change is that a p son having a chargeable income in excess

SUMMARY OF ZAMBIAN TAXATION

Income Tax: is payable on the income of individuals and legal entities receiving income from a source within or deemed to be within Zambia. Individuals and legal entities ordinarily resident in Zambia are also subject to income tax on dividends and interest from a source outside Zambia. Rates are as follows:

A. *Individuals:* income less exemptions and allowable deductions is subject to a graduated rate of income tax of 5 percent on the first K 500 ranging to 75 percent of the income in excess of K 12,000.

B. *Companies:* current rate 45 percent to be increased to 50 percent.

Death duties: are payable on death on the principal value in excess of K 15,000 of taxable property of which the deceased was at his death competent to dispose. Rates vary from 4 to 10 percent.

Customs duties: there are both ad valorem and specific duties, the rates vary from 5 to 50 percent plus a 10 percent temporary surcharge on all imports.

Excise duties: payable at specific rates on goods indicated in the tariff which are manufactured or produced in Zambia. The rate is charged per pound or per gallon as the case may be.

Stamp duty: payable on legal documents and instruments, the rate varies according to the nature and the value expressed in the document.

Sales taxes: are imposed on imported goods, goods manufactured locally and goods and services provided by hotels and restaurants. The rate is generally 10 percent, but may differ for certain locally manufactured goods.

Levies: Zambia imposes a number of levies on, for instance, dairy produce, agricultural products, African beer, tobacco and entertainment.

* Note submitted by our correspondent Mr. A de Silva, Zambia.

K2,000 for the year will pay more income ax subject to a maximum of K100. The hange is intended to affect only marginal- y the middle and higher income groups.

The present rate of income tax on compa- ies, which has been in force since 1 April 969, is 45 percent. The rate will be in- reased to 50 percent with effect from the ncome tax year ending on 31st March, 977.

ELECTIVE EMPLOYMENT TAX

The tax was originally introduced in 1975 nd was intended to be more an incentive o Zambianisation in the private sector, s evidenced by the exemptions from the ax in the Selective Employment Tax Act, han as a revenue raising measure.

The rate in 1975 was 5 percent and the tax as allowed for income tax purposes. In 976 the rate was increased to 10 percent nd the tax was no longer allowed for in- ome tax purposes. With effect from 1st pril 1977 the rate has been further in- reased to 15 percent and the tax will be llowed for income tax purposes as in 1975.

announcing the new rate the Minister Finance said that there is little evidence at since the tax was introduced the pace Zambianisation has been accelerated. he effectiveness of the tax as an in- rument for stepping up the pace of Zam- anisation was doubtful from the outset d it would appear that the real remedy s elsewhere. This fact was acknowledged by the Minister of Finance when he said that the key to the solution of the problem lies in formulating a massive training programme for local technical and professional personnel in accordance with the country's manpower requirements for the next decade.

EMPLOYMENT PERMIT FEES

Expatriates can be employed in the country only if they possess valid employment permits issued in terms of the Immigration Act. A prescribed fee is charged for the issue of a permit. The present fee of K50 has been increased to K100. The increase is a further measure for encouraging the Zambianisation programme.

EDUCATION LEVY

An education levy estimated to add K1 million to revenue has been proposed from 1st April 1977 on all registered companies whether parastatal or private on the basis that these organisations have benefited from the costly and continuing government programme of education and training.

The Minister of Finance substantiated his views by quoting figures which indicated that the total amount spent by the Ministry of Education had increased from K18.4 million in 1964/65 to K87.6 million in 1974 and K115 million in 1976. The amounts stated include both capital and recurrent expenditure.

CUSTOMS DUTY

A change in the basis of valuation from f.o.b. to c.i.f. for customs duty purposes is being contemplated. The Minister of Finance said he would put forward the new system for approval by Parliament as and when he finds it feasible. Unless there is an adjustment in the rates at which duty is charged and other adequate measures are taken the change could have an adverse effect on the already very high cost of living in the country.

CONCLUSION

In his conclusion the Minister of Finance said that the proposals he has made are intended to balance the requirements of the taxpayer and those of the nation as a whole. He also said that he had deliberately avoided making proposals which would hit the low earners hard and make their lives unbearable. It might be mentioned here that in the sphere of personal income tax the changes in the rates will not, as pointed out by the Minister of Finance, affect in any way an average Zambian family composed of a working husband, wife and three children earning K3,600 or less per year i.e. the chargeable income of K2,000 referred to in the note above on income tax plus the personal allowance of K1,000 and child allowance of K600 at the rate of K200 per child.

Finally the Minister of Finance stated that this year's Budget has been prepared with this main objective in view — that the road to prosperity in Zambia lies in *self-reliance*. Evidance of this is provided inter alia by the measures outlined earlier to give effect to the economic policy.

r. ROY JENKINS ON TAX HARMONIZATION

an address of 8 February, 1977 in which he presented the E.C. Commission's programme for 1977, Mr. Roy Jenkins, esident of the Commission, said the following on the subject tax harmonization in the E.E.C.

lue Added Tax (VAT). The Commission's prime concern at the ginning of this year is to see the proposal for the sixth VAT ective adopted before 1 March 1977, so that the Community be financed entirely from its own resources from 1 January 78. The Commission will carry on implementing the action gramme for taxation — transmitted to the Council on 30 July 75, E.C. Bulletin 7/8-1975, points 1401 to 1404 — taking the ps described below.

ect taxes. In the second half of 1977 the Commission will sent a proposal for extending to *collective investment undertakings* the application of the principles of the proposed directive concerning the harmonization of systems of company taxation and of withholding taxes on dividends. (See for this proposed directive the special issue of "European Taxation", February/March/April, 1976 — *Editor's Note*).

Tax evasion (indirect taxes). In the second half of 1977 the Commission will send the Council a proposal on *mutual assistance and cooperation* between national tax authorities in the field of indirect taxes, similar to the one already presented on direct taxes.

Prior consultation procedure. The Commission will transmit to the Council in the second half of the year a proposal for introducing a prior consultation procedure for important tax measures which national authorities may envisage in areas coming under the tax harmonization process.

Source: Programme of the Commission for 1977.

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Tax Aspects of the Activities of Transnational Corporations and International Double Taxation.



*by A. Atchabahian**

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4. *Legislative criteria relating to taxation on the income of transnational corporations in force in certain countries of the Western Hemisphere.*
5. *From isolation to co-operation.*

1. *TAXATION ON THE INCOME OF TRANSNATIONAL CORPORATIONS AND INTERNATIONAL DOUBLE TAXATION*

Viewed from the aspect of the problem of international double taxation, an analysis of the taxation of the profits of transnational corporations revolves basically around one essential question: how are the different types of income they receive to be allocated, in order to determine the tax base available to each of the tax jurisdictions which considers itself entitled to tax such income?

The desired outcome is that under no circumstances should the total tax on a given portion of the corporations' income be higher than that which would result from the application of the higher of the tax rates in effect in the countries concerned.

The failure of the general criteria for the international allocation of income applied in different countries to coincide may well result in international double taxation, since the tax jurisdictions concerned with a certain portion of income will almost certainly overlap. Accordingly, the total tax required from the enterprise by the different tax authorities may well be so high that the disposable income, or profits after tax, is no longer regarded as a fair return on the investment involved. At all events, the tax factor, *ceteris paribus*, may be a deterrent to the movement of capital.

It is undoubtedly important to identify the jurisdictional principle in force with regard to income tax in each country, so that the effect of its application to activities of an international character can be measured. However, this can do no more than provide the general framework or terms of reference for approaching the subject, in the sense that it makes it possible to define the circumstances in which income is taxable according to the tax law.

The resulting conclusion does not in itself solve the problem of the actual allocation of each type of income, nor does it decide how income related to international activities is to be allocated to the tax jurisdictions concerned.

The generally complex nature of modern large transnational corporations, resulting from their geographical dispersion, the types of activity they undertake, or from their operational modalities, also makes the task of allocating their income to one or other of the tax jurisdictions in which they perform their activities highly complex. Hence it would be advisable, apart from the application of general principles of jurisdiction, for tax legislation to include specific provisions laying down the criteria for determining the source of each kind of income, in order to permit sound income allocations with regard to such enterprises which could serve as a basis for their taxation.

In other words, regarding interest, dividends, royalties, personal services' retribution, fees, sale of personal or real property, capital gains, etc., the tax law should state in what terms it deems that they are income from domestic or from foreign source. Broad technical discrepancies on the criteria can be found in this respect. Thus, for example, in matters related to interest there are at least two approaches toward identifying their source: the country which pays the interest, or the country where the principal is utilized, as different from the former. As to personal services, it can be maintained that income derived from rendering them has its source either in the country where they are performed, or conversely in the country where the income is to be paid, where different from the former. Likewise, concerning royalties it could be argued that their source is to be located in the country where the patent or the trade mark is utilized, or that such a source is in the country where the payment is to be made, if differing from the former.

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Evidently, this is a relevant question whatever the jurisdictional principle adopted as far as income taxation is concerned. It is of no small concern even in the case of countries which tax income world-wide, to determine whether a given income is from domestic or foreign source.

As we shall see later, in commenting upon United States legislation, such a distinction is essential so as to apply the full tax rates in force in the country to income deemed as domestic. If a certain income is regarded as being from a foreign source, in principle it would mean that a foreign tax would be applicable and that eventually a claim for tax credit will be filed against the United States federal income tax.

Furthermore, the treatment of expenses should also be considered in order to define their deductibility, either in allowance of domestic or of foreign source income.

Peggy B. Musgrave points out, in the following clear terms, the advisability of overcoming existing discrepancies in criteria among tax legislations in this matter:

"General international acceptance of basic source rules is needed to prevent overlapping of tax jurisdictions among source countries with possible damaging effects on tax neutrality and internation equity. Furthermore, in the absence of uniformly enforced standards of tax base division, there is an inducement to the multinational corporation to arrange its activities, transactions, and bookkeeping so as to minimize its tax liability, leading to discretionary transfer pricing and profit shifting onto the books of its affiliates in low tax jurisdictions. Tax rate differentials, import duties, and foreign exchange restrictions may all influence the pattern of profit shifting, and inefficiencies together with inequitable loss of tax base among the countries of source are likely to ensue. It thus seems to be desirable that internationally accepted jurisdictional rules be established and enforced." [1]

A report prepared for the fifth meeting of the United Nations Group of Experts on Tax Treaties between Developed and Developing Countries, arrives at similar conclusions, suggesting that it would be

"desirable that procedures be devised to harmonize the views of the countries concerned respecting the principles of allocation and adjustment, and to make possible the effecting of the appropriate correlative adjustments despite possible obstacles under domestic law, so as to protect the taxpayers involved from the problems of inconsistent administrative positions. The accomplishment of those necessary procedures would be more readily made if there could be progress towards internationally acceptable methods and guidelines of allocation."[2]

The Guidelines for Tax Treaties issued as a compendium of the work done by the Group of Experts point out that the adoption of clear principles and techniques for the allocation and apportionment of income at the international level would accomplish two things:

(1) it would reduce the chances that an international business caught between two taxing jurisdictions would be unfairly taxed; (2) at the same time, it would assure that such enterprises would not use their flexibility to slip between the national authorities. [3]

The International Fiscal Association, at its annual congresses of 1971 and 1975, also engaged in extensive discussions of the various aspects of the international allocation of income and expenses, and was able to assemble related information from several countries. [4] The resolution approved during the Congress of 1971 specifically notes, in its first paragraph, "that the reallocation by tax authorities of income or expenses between related entities in different countries often results in economic double taxation". [5]

2. *TRANSFER PRICES AND INTERNATIONAL DOUBLE TAXATION*

Although the tax provisions in force represent the legal background for the international allocation of income obtained by transnational corporations, it may happen that these corporations seek to go beyond these provisions and achieve a different allocation structure, thus altering the amount which each tax jurisdiction can take as its taxable base. This can be done by means of pricing policy for the internal transfer of goods and services, that is, transfers between the parent company and its affiliates or among the affiliates themselves. The result may be an international allocation of the income obtained by transnational corporations quite different from that intended by the tax legislation of the countries involved.

Clearly, the tax consequences of intra-company transfer pricing are of interest to the transnational corporations' home countries and to their host countries as well. A study carried out by the United States Senate Committee on Finance notes:

1. Peggy B. Musgrave, "International Tax Base Division and the Multinational Corporation", *Public Finance*, 1972, pp. 395-396. This idea for the common acceptance of certain technical criteria, as a background for the determination of the source of income, particularly with reference to its application to activities of inter-jurisdictional scope, is also maintained by Charles E. McLure, Jr in "State income taxation of multistate corporations in the United States of America", included in the publication, *The impact of multinational corporations on development and on international relations. Technical papers: Taxation*, United Nations publication, Sales No. E.74.II.A.6), p. 61. See also Eugene F. Corrigan, "Interstate Corporate Income Taxation -- Recent Revolutions and a Modern Response", in *Vanderbilt Law Review*, vol. 29, No. 2 (March 1976), pp. 423-442; it contains ideas that, *mutatis mutandis*, are valid for the determination of the taxable income of transnational corporations, viewed from a new perspective and with innovative proposals.

2. This topic of international income allocation, frequently in conjunction with transfer prices, dealt with in the following section, has been extensively analysed in various reports submitted to the meetings of the Group of Experts. See, in particular the *Fifth Report*, Part II, chaps. II, III and IV (United Nations publication, Sales No. E.75.XVI.1) and the *Sixth Report*, Part One chaps. I and II, and Part Two, chaps. III and IV (United Nations publication, Sales No. E.76.XVI.3). The quotation above is from the Fifth Report, paragraph 104, p.22.

3. *Guidelines for Tax Treaties between Developed and Developing Countries* (United Nations publication, Sales No. E.74.XVI 5), paragraph 51, page 12.

4. International Fiscal Association (IFA), *Cahiers de droit fiscal international*, vols. LVIb and LXb.

5. International Fiscal Association (IFA), *1972 Yearbook* (Rotterdam, 1972), p. 26.

"The chief strategy of tax minimization by multinational companies is manipulation of transfer prices. Subsidiaries can be instructed to set high prices on intra-corporate shipments to high-tax countries, and low prices on those to low-tax countries." 6

The Annex to the Declaration of 21 July 1976 by Governments of OECD Member Countries on International Investment and Multinational Enterprises, contains some guidelines for the enterprises. In one of the two guidelines dealing with taxation it is said:

"Enterprises should refrain from making use of the particular facilities available to them, such as transfer pricing which does not conform to an arm's length standard, for modifying in ways contrary to national laws the tax base on which members of the group are assessed." 7

These views would appear to be confirmed by the fact that transnational corporations with parent companies in certain countries — including the United States — attach great importance to the tax variable in determining their transfer price policy. 8

It might be appropriate, in order to seek an explanation of this manipulation through transfer pricing, to study the structural and operational basis on which transnational corporations function. In this regard, Kopits explains that an affiliated firm established abroad may exhibit various characteristics depending upon its relationship to the parent company, or to the level it occupies in the whole production process: (a) it can be a horizontal extension of the parent company, whose activities it reproduces; (b) it can be vertically integrated forward, in other words, it may operate at a stage in the production process closer to the final product; (c) it can be vertically integrated backward, meaning that its activities precede those of the parent company in the production process, providing the parent with certain inputs, raw materials or intermediate goods; (d) it can be a unit within a conglomerate of diversified economic units, comprehending the total enterprise, devoting itself to the manufacture or trading of goods through activities which may or may not be related to those of the parent company. 9

It may easily be concluded that whatever the modalities of the relationship between the parent company and the affiliate, it is capable of creating an intensive transfer of resources in both directions. This intricate network of intra-company transactions can be used for the transfer of income designed to optimize the total tax burden or liability of the transnational enterprise as a whole.

On the other hand, goods subject to intra-company transfer — particularly in the case of any sort of vertical integration among the units forming the transnational corporation — very often have no equivalents in the market whose prices could be compared with those attributed to the products transferred internally within the framework of the global enterprise.

This peculiarity of goods transferred within a transnational corporation is logically related to the fact that these corporations frequently operate in an oligopolistic market structure. 10 Hence, it may be validly inferred that the transnational corporation is in a position to perform at different degrees of manoeuverability with respect to the abovementioned transfer prices, whether they refer to final products or to intermediate goods.

Clearly, these are all factors that help to render the auditing task of tax administrations very difficult.

It must also be taken into account that in the handling of transfer prices use may even be made of so-called "tax havens" as intermediary bases for the transactions, with a view to minimizing the tax burden for the transnational corporation. "Tax-havens" are utilized for the fictitious transaction of goods and services, as well as to deviate the financial flow resulting from the retribution of capital or the rendering of services (payments for dividends, interest, royalties, fees). This flow too may go to "tax-havens", seeking to reduce the tax obligation.

In connexion with this topic of transfer prices, an international double taxation case may also be created. Let us suppose that in auditing the prices declared by a corporation, the purchasing country reaches the conclusion that they have been too low, and announces a shortfall in the tax paid; the transfer prices resulting from such an adjustment do not coincide with the prices taken into consideration for the tax returns filed by the corporation in the selling country — which we assume is not a "tax-haven". It is easily conceivable that an international double taxation case could be created.

For example: country A, in which the transnational corporation's parent company is located, has agreed that $100 should be the transfer price for an article sent to the corporation's subsidiary in country B, with which country A has no tax treaty; if the latter, once it has investigated the case, finds that the price should be $75, obviously there would be international double taxation on the difference of $25. In other words, if the subsidiary in country B sells the article for $115, the tax adjustment will mean that the tax base will not be $15 — the amount exceeding $100 not taxed by country A — but $40, that is to say the $15, plus $25 which, to some extent, partially or totally, must already have been taxed by country A, when it took into consideration $100 as the selling price for the article.

6. United States Senate, Committee on Finance, *Implications of Multinational Firms for World Trade and Investment and for U.S. Trade and Labor* (Washington, 1973), p. 133. The study notes subsequently: "Transfer-price manipulation can be used for purposes other than tax optimization. When a country prohibits remittance of dividends, the transfer prices can be raised and the dividends taken out that way." (p. 135).
7. Organisation for Economic Co-operation and Development (OECD) *International Investment and Multinational Enterprise* (Paris 1976) p. 16.
8. David K. Eiteman and Arthur T. Stonehill : *Multinational business finance* (Addison-Wesley Publishing Co. Inc., Massachusetts, 1975) p. 366. The other countries whose transnational corporations would follow the same pattern are Canada, France and Italy; corporations based in the Federal Republic of Germany, Scandinavia and the United Kingdom, on the other hand, would attach less importance to the tax variable in establishing their transfer prices.
9. George F. Kopits, "Taxation and Multinational Firm Behaviour: A Critical Survey"; *Staff Papers*, vol. XXIII, no. 3 (November 1976), p. 626. This analysis is based mainly on the one made by Richard E. Caves in "International Corporations: The Industrial Economics of Foreign Investment", *Economica*, vol. 38 (February 1971) pp. 3-11.
10. See Frederick T. Knickerbocker, *Oligopolistic Reaction and Multinational Enterprise* (Boston, Harvard University, 1973).

The enterprise may attempt to remedy the situation before the tax authorities of country A. However, it may encounter centain obstacles for example, the statute of limitations may already be in effect by the time the auditing procedures in country B have finished, or it may even no longer be able to use the amount of additional tax it had to pay in country B as a consequence of the adjustment as a tax credit against the tax in country A.

This situation of international double taxation might perhaps be avoided if a tax treaty were in effect between country A and country B and its provisions contemplated certain measures to solve cases like the one just described.

An idea of the real magnitude of this question of transfer prices for the activities of United States transnational corporations operating in the Western Hemisphere may be gathered from the statistical information published in 1975 by the United States Department of Commerce. This information includes the final data relating to United States direct investments abroad during 1966.

The statistics are based on data supplied by 3,354 parent companies incorporated in the United States; these companies had abroad, in 1966, 20,544 majority-owned affiliates (at least 50 percent of the equity capital belonging to the parent companies); 2,105 (62.7 percent) of the reporting firms had active operations in Canada, through affiliates, and 1,258 (35.5 percent) in Latin America. [11]

The number of affiliates in Canada was 4,102 (approximately 20 percent of the total of 20,544 in the world at large) and in Latin America 4,545 (22.1 percent of the total).

All 20,544 affiliates taken together had total sales of $97.783 million in 1966. Of that total, the existing affiliates in the Western Hemisphere (outside the United States) had sales amounting to $38,140 million (39 percent); $23,876 million (24.4 percent) in Canada, and $14,264 million (14.6 percent) in Latin America. The latter amounts include transactions with the parent company or other affiliates; the corresponding amounts were $2,924 million (12.2 percent of total sales), in the case of Canadian affiliates, and $3,143 million (22 percent of total sales) in the case of affiliates in Latin America. [12]

3. *EXCHANGE OF INFORMATION BETWEEN TAX AUTHORITIES: ITS SCOPE AND OBJECTIVES*

It is virtually axiomatic that in order to cope adequately with problems relating to the international allocation of income and expenses, and to transfer pricing — which can, as we have seen, distort allocations based on the tax legislation — there must be an exchange of information between tax administrations.

In every country, these administrations are empowered, to a greater or lesser extent, to investigate the correctness of the declarations of taxpayers.

However, unlike the case of enterprises whose activities are mainly or exclusively undertaken within national boundaries, and which are not affiliates of foreign enterprises, the thorough implementation of investigative activities regarding the tax liabilities of transnational corporations demands special information which is not always available within the country. With respect to the latter, it is very often necessary to seek information from abroad, that is to say, from the country in which the transnational corporation's parent company is located, or from the countries in which first or second tier affiliates are established.

It is important, therefore, in order to comply with this need for information, that there should be appropriate machinery for making available, or giving access to, the information sought, with special reference to the activities of transnational corporations.

In that sense, the purpose of getting information at the international level used to encounter understandable difficulties, so much so having in mind the confidential nature usually attributed by tax legislation to data connected with the determination of taxpayers' taxable income. At present, the tool on which the countries rely chiefly for gathering data from abroad is exchange of information; a provision agreed upon between the contracting parties to that end occurs regularly in treaties for the avoidance or alleviation of international double taxation.

Actually, it is recognized that this mechanism for the exchange of information does not always function as expeditiously and satisfactorily as would be desirable. Because of this, it is agreed that it should be strengthened in order to effectively achieve the objective of enabling the tax administrations to issue the most correct and incontrovertible assessments for those taxpayers to whom the information refers.

Consequently, the non-existence of a juridical relationship of an international nature, binding each of the signatory Governments to a bilateral treaty to provide the other party with the data that the latter may ask for in conformity with the provisions agreed upon between them, constitutes a marked deficiency. In such circumstances, the possibility of building up, at the international level, an exchange of information about the taxpayers whose tax obligations are under scrutiny depends on contingent and even uncertain factors, whose negative effect could make the effort totally inoperative.

11. There were 1,471 United States parent companies engaged in active operations in developing countries all over the world; the 1,258 parent companies mentioned above represent 85.5 percent of that total.

12. United States Department of Commerce, Bureau of Economic Analysis, *U.S. Direct Investment Abroad, 1966: Final Data* (Washington, D.C., 1975), tables on pp. 197-207.

In the Western Hemisphere there are relatively few developing countries that have in effect comprehensive international tax treaties related to the taxes on income and on capital. Brazil has been the most active country by far in negotiating tax treaties; it has in force treaties with Belgium, the Federal Republic of Germany, Finland, France, Japan, Norway, Portugal, Spain and Sweden. Trinidad and Tobago has in effect treaties with Canada, the United Kingdom and the United States; Peru and Argentina have signed treaties with Sweden; (the treaty signed in 1966 between the Federal Republic of Germany and Argentina, and denounced by the latter in 1972, is partially in force again since 1976);

Barbados and Jamaica have arrangements in regard to the United Kingdom, whose treaties with the United States are applicable to the former two countries; also in force are treaties signed by the Netherlands Antilles with the Netherlands, the United Kingdom and the United States, and Jamaica and Canada have a treaty in effect related to certain kinds of income.

It is clear from the foregoing that machinery for the exchange of tax information, with reference to particular taxpayers and covered by provisions in tax treaties, is not available to the great majority of developing countries in the hemisphere. Their tax authorities are thus prevented from taking advantage of a potentially important means of becoming better acquainted with transnational corporations operating in those countries. The background material that the countries might be able to assemble in such a way would allow them to reach far better-based decisions on taxing the profits of transnational corporations. We do not know whether there is any alternative procedure serving the same purpose, and if so, to what extent it is effective.

Conversely, despite the fact that the developing countries of the Western Hemisphere attract more investment by United States companies than any others in the developing world, the United States tax authorities can get hardly any tax information on the many United States affiliates operating in countries with which the United States has no tax treaty. Canada faces the same situation, though to a lesser extent.

The United States has comprehensive income tax treaties in force at present with 37 countries, whereas Canada with 16 countries. All these treaties include clauses on exchange of information between the competent authorities of the signatory parties. The exchange is made automatically or sometimes at the special request of one of the contracting parties.

The far-reaching effect that may result from the implementation of a request of this sort is indicated by the case of A.L. Burbank and Co. Ltd., decided on 22 October 1975 by the United States Court of Appeals, Second Circuit. According to this decision, there is no impediment to prevent the tax authorities of the United States, in complying with the terms of the treaty signed with Canada, from supplying the latter country with the information requested for a tax investigation which it is undertaking, with respect to a given taxpayer, even though the United States has no immediate fiscal interest in that taxpayer, in the sense of any pending tax debt.

All this suggests the advisability of seeking some solution to this deficiency, perhaps by means of an agreement or understanding of a multilateral character, applicable throughout the hemisphere, whereby the exchange of information would be facilitated, and at the same time encompassed with all the safeguards provided in that regard in bilateral treaties for the avoidance of international double taxation. [13]

In this way it would be possible to form an actual infrastructure with the information received by each country from the other countries, which would be in addition to the information gathered internally.

It could evolve into a valuable tool for tax administrations to use in order to neutralize attempts at tax evasion, which, among other causes, might be influenced by the manipulation of transfer prices in the internal transactions of transnational corporations.

The Fifth Report of the Group of Experts referred to above contains the following remarks on the importance of having a good system for the exchange of information:

"It was recognized that solutions to the problems of allocation were linked to the aspect of exchange of information . . . A considerable part of the difficulties in solving allocation situations lay in the absence of relevant information. For example, countries in which goods were sold desired information as to the costs involved in producing the goods; countries whose companies were being charged for services desired information on the amount and nature of the expenses involved. As a consequence, constructive steps to increase the exchange of information among tax administrations would aid in the appropriate solution of allocation issues. Such adequate information might also be useful in allaying the fear and suspicion of tax authorities that the tax allocations always involved over-reaching or other manipulation by the companies involved. [14]

4. *LEGISLATIVE CRITERIA RELATING TO TAXATION ON THE INCOME OF TRANSNATIONAL CORPORATIONS IN CERTAIN COUNTRIES OF THE WESTERN HEMISPHERE*

For the purposes of this analysis, there are two distinct groups of countries: on the one hand, there is the United States, which is the home country of the great

13. The Scandinavian countries have agreed upon a multilateral convention solely on exchange of fiscal information. *Tax Treaties Between Developed and Developing Countries: Fifth Report*, (United Nations publication, Sales No. E.75.XVI.1) para. 120, p. 20.

14. *Tax Treaties Between Developed and Developing Countries: Fifth Report* (United Nations publication, Sales No. E.75.XVI.1) para. 103, p. 22. The subject of exchange of information between tax authorities has been discussed by the Group of Experts at all its sessions, beginning with the first in December 1968. The corresponding published reports frequently related such an exchange to the aim of combatting various forms of tax fraud, tax evasion and tax avoidance, which could be committed by individual and corporate taxpayers, including among the latter the transnational corporations. In that regard, among other considerations contained in the aforesaid reports by way of conclusion, it is pointed out the uneven situation that the countries face when they do not have signed tax treaties with respect to those which have signed them.

majority of the most important transnational corporations in the world, and Canada, a developed country which, though to a much lesser extent than the former, is also the home country of transnational corporations: on the other there are all the remaining countries, which are at varying stages of development and which chiefly play the role of host countries to the affiliates of these corporations.

In inquiring into the different tax legislations in force in the hemisphere, and trying to extract the adopted criteria, in matters concerning international allocation of transnational corporations' income and expenses — obviously including treatment of transfer pricing of goods and services — the case of the United States will be analysed in the first group of countries, and some of the legislations that contain more specific provisions in that regard in the second group of countries.

I. Along with the fact that in the entire world the United States is the home country for the majority of the largest transnational corporations, the fact that the federal income tax, as a principle, taxes the world-wide income of every taxpayer, be this an individual or a corporation should be taken into account. Hence, American legislation is justifiably one of the most elaborated in taxing the income of these enterprises.

Sections 482 and 861 of the Internal Revenue Code, and their corresponding regulations, are the main provisions concerned with the allocation of income and expenses. Obviously, these provisions apply also to transnational corporations.

Since it was adopted in 1928, Section 482 has not been substantially amended. One of its most important objectives has been and still is to neutralize the legally undesired tax effects resulting from the transfer of profits between economically related enterprises.

Until early in the 1950s, Section 482 and its then existing regulations were very seldom applied by tax authorities to determine the income obtained by taxpayers with operations of international scope.

As the 1960s have experienced the great use of the modern United States transnational corporation with multiple activities all over the world, the need was felt to regulate Section 482 in greater detail. During 1968 and 1969, therefore, new regulations were approved for this Section. They explain its provisions as follows:

"The purpose of section 482 is to place a controlled taxpayer on a tax parity with an uncontrolled taxpayer, by determining, according to the standard of an uncontrolled taxpayer, the true taxable income from the property and business of a controlled taxpayer . . . The standard to be applied in every case is that of an uncontrolled taxpayer dealing at arm's length with another uncontrolled taxpayer" (Income Tax Regulations, Section 1.482-1. (b). Scope and purpose (1).

The criterion of arm's length dealing in the relationship between one taxpayer and another is plain in the context of the regulations and has so far been unequivocally upheld by the courts in the United States.

In the exercise of his tax auditing authority, the Commissioner of the Internal Revenue Service can proceed in one of two ways, as he deems more appropriate: he can adjust each particular transaction which took place between controlled taxpayers, or he can adjust the annual gross income of the taxpayers involved.

The regulations provide specifically for three methods of calculating the price to be regarded as an arm's length price established between uncontrolled taxpayers; they also indicate the cases in which each method should be applied. Among the three methods that follow, the first mentioned is usually given priority, since it accords most closely with the general and basic criterion cited earlier:

(a) the comparable uncontrolled price method, which seeks to compare a merchandise's market price with the price taken into consideration for the transaction between controlled taxpayers;
(b) the resale price method, calculated on the basis of discounting the resale margin or mark-up from the arm's length price at which the merchandise would be sold by an uncontrolled buyer;
(c) the cost-plus method, calculated on the basis of adding the mark-up to the cost of the merchandise, on the assumption that the transaction is carried out by an uncontrolled seller.

On the other hand, the regulations for Section 482 also provide that if none of the three methods can reasonably be applied, owing to the facts and circumstances present in a particular case, the administrative authority may use any other method which it regards as appropriate.[15]

Section 861 of the Internal Revenue Code deals with the determination of sources of different types of income and contains special and quite precise provisions in that regard.

In January 1977, detailed regulatory clauses were approved for Section 861, designed to prevent enterprises like the transnationals from tending to claim their deductions principally or totally with respect to their income from United States sources, their objective being to increase the amount of income tax paid abroad and credited against the United States income tax.

This would be the case, for instance, of transnational corporations making significant research and development expenditures, usually concentrated in the parent company's home country; if it is assumed that the products resulting from that research activity will be sold in the home country and in the countries in which affiliates are located as well, the total deduction for those research expenses should not be claimed against

15. Among other papers and studies reflecting the experience gathered in applying Section 482 and its regulations, at the international level, see: United States Department of the Treasury *Summary Study of International Cases Involving Section 482 of the Internal Revenue Code* (January, 1973); Michael G. Duerr *Tax Allocations and International Business* (New York, The Conference Board, 1972).

the parent company's income in the home country but according to certain criteria for apportionment between domestic and foreign income.

This is the basic idea of the newly approved Section 861 regulations: deductions must be apportioned according to the ratio between domestic gross income and foreign gross income. There are provisions governing the deduction of interest, research and development expenses, and net operating losses. Expenditures by the parent company supposedly in support of foreign affiliates' administrative activities are generally regarded as non-deductible expenses.

II. The prevailing jurisdictional principle in the developing countries of the hemisphere is one that taxes territorial income; therefore, foreign income is, by these terms, excluded from the sphere of taxation.

Several countries' tax legislation — Argentina, [16] Bolivia, [17] Guatemala, [18] Panama [19] — are slanted to the idea that transnational corporations' affiliates are autonomous entities, so to speak, and then state that the base for the tax on their profits be determined on the ground of separate accounting. [20] This separation should be from the accounting of the parent company and from the accounting that belongs to other branches and establishments or affiliates of the aforesaid company, provides the Argentine statute; the Panamanian regulations also demand separation from the accounting of other branches and affiliates existing in other countries. In order to determine the true net income from domestic sources, the necessary rectifications in the outcome resulting from the accounting of the firm have to be made.

For lack of sufficient accounting, or if the net income of domestic source is not accurately reflected, the tax authority will be able to deem that affiliate or branch and parent company form an economic unit and to determine the net taxable income. The Argentinean and Panamanian regulations state that the net income from domestic source will be determined on the basis of the results obtained by independent enterprises devoted to identical or similar activity.

This intended analogy between the income tax treatment of transnational corporations' affiliates and the income tax treatment of independent enterprises that undertake activities similar to them, can be inappropriate, owing to reasons already pointed out previously, that is to say, usually transnational corporations perform, at world level, in a market of oligopolistic structure, and furthermore, in a given country, they might not have for their products any partner in the market.

Still having in mind income determination of transnational corporations' affiliates, for tax purposes, the Argentinean and Panamanian legislations empower their tax authorities to require antecedents, information and data they may deem necessary for clarifying the internal relations between the affiliate operating in the country and the parent company abroad (the requirement may also be extended to define the relationships with affiliates operating in other countries, state the Panamanian regulations), as well as in order to estimate the internal transfer prices of goods.

In the concrete implementation of the provisions commented in the last two sentences is where the insufficiency of available information within each country is much more noticeable. Such a situation perhaps would be possible to overcome by means of the exchange of information between tax authorities of different countries, that is to say, at the international level.

Whenever there exists a marked discrepancy between the market prices and the invoicing prices for the goods exported and imported, the income tax legislation of Guatemala empowers the competent authority to investigate in order to determine the taxable income, to that end following the provisions applicable to exports and imports.

The provisions of the Guatemalan tax legislation in regard to imports and exports are similar to those in force in Argentina, Bolivia, Mexico, Peru and some countries of the hemisphere. In any event, this set of rules is not sufficient to cover the complex gamut of goods transactions engaged in by transnational corporations at the world level, prices for which very often do not depend upon the course of competitive markets.

Although on the one hand the text of the Panamanian regulations quoted is sufficiently clear in recognizing the importance that tax investigation may have in matters relating to transfer prices in intra-company transactions, mention should be made on the other of provisions of the Panamanian Fiscal Code facilitating the re-invoicing operations by transnational corporations.

To that end, Article 694, paragraph 2, section a), of the Fiscal Code provides that "will not be considered as produced within the territory of the Republic of Panama income originating from the following activities: (a) Invoicing, from an office established in Panama, the sale of merchandise or products for an amount higher than that for which such merchandise or products have been

16. Law 20628, (income tax), art. 14, as amended by Law 21481.
17. Decree Law 12853/75, regulations for the tax on enterprises' income, art. 21.
18. Decree on income tax regulations, art. 14.
19. Decree 60/65, income tax regulations, art. 6.
20. Apportionment of the transnational corporations' worldwide total income, based on different factors, would be another technical approach to the international allocation of their income. The resulting taxable base, on the part of each of the countries where an affiliate was established, would be taxed in accordance with the tax rate there in force.
Several countries' tax legislation (Argentina, Bolivia, Brazil, Guatemala, Peru, Venezuela) with regard to certain activities of international scope and performed by enterprises not incorporated in the country, apply a technique which holds similarities with the aforesaid apportionment method for the international allocation of income. These legislations state the legal presumption, without admitting proof to the contrary in most of the cases, that a fixed percentage of the gross income is regarded as net income from domestic source. This solution is applied to business like international transportation, international news agencies insurance and re-insurance operations; foreign movie film distribution.

invoiced to the office established in Panama, provided that the merchandise or products are moved abroad only; . . ."

Mexico is one of the Western Hemisphere's countries which imposes its income tax on world-wide basis, for individuals and corporations as well.

According to the Mexican income tax law, "agencies or branches of foreign enterprises, established in the Republic", as well as domestic enterprises, are taxed on their total taxable income, "whatever be the location of the source their income stems from" (Art. 3, paragraph I, section c).

Thus the principle of taxing income world-wide is established. However, the law does not contain source rules for the different types of income, or any general criteria for allocating them and expenses, which is particularly important for those taxpayers whose activities are international in character, or who are economically related to other taxpayers in the country, or to other enterprises abroad.

The tax authority possesses powers whereby it can adjust the tax declaration of the taxpayer. These powers are established in Article 19, paragraph VI, section b), of the income tax law, which provides that there may be deemed as aggregate income, susceptible of being taxed, *"the difference between the price declared by the taxpayer and the price determined by the Ministry of Finance and Public Credit, when the price used by the taxpayer is not the true market value. In such cases, the Ministry will determine the price, taking into account the invoice price, the official price, or the current price in the domestic or foreign market".*

The regulations provide that branches of foreign enterprises in the Republic must give evidence that the price at which goods are received from their parent company is equivalent to their production cost, plus transportation costs and import duties only. If such evidence is not provided, the taxable income will be presumptively estimated by the tax authorities (Art. 43).

Once again it should be pointed out the limited effectiveness which these kind of provisions may have, if the action they provide for is not enhanced by the possibility of getting additional information from tax authorities of other countries.

5. *FROM ISOLATION TO CO-OPERATION*

To sum up what has been said previously in this paper, we may conclude that the tax treatment of the income of transnational corporations is a topic of interest to home and host countries alike. All of them are understandably anxious to avoid that, at one extreme, any part of that income should go untaxed, "falling between the cracks", or, at the other, any portion of such income should be subjected to international double taxation.

The problem to be solved, then, lies in arriving at appropriate definitions of the facts on which the taxation of the income of transnational corporations depends, so as to allow each country in which these corporations operate to enjoy an appropriate share of the tax base, as required by the corresponding tax laws.

The tax administrations, and particularly those of developing countries, are faced with two sets of considerations: on the one hand, national considerations, and on the other, considerations of an international character, both closely interrelated.

The national considerations have to do with the legislative approach in force in most of these countries. In this regard, the relative paucity of provisions capable of defining the tax base of taxpayers whose activities are international in scope and whose ownership and decision-making processes are controlled by entities located abroad as accurately as possible is noticeable throughout the developing country tax legislation that has been commented upon here as a representative sample of prevailing legislative thought in those countries. The advisability of more precise tax provisions in this respect applies to every country, whatever jurisdictional principle it adopts, whether one based on source or one based on residence, or a combination of varying proportions of both. That kind of standard would facilitate the task of those authorities in exercising their powers to audit and assess the tax liabilities of every taxpayer.

The tax provisions in question should aim at defining, for each characteristic type of income, the terms according to which it would be regarded as having a domestic or a foreign source. The same should be done with regard to expenses, so as to specify under what conditions they are deductible, and from what income, domestic or foreign, as being related respectively to the production of income within the country or outside it.

This degree of precision with respect to the tax treatment of income and expenses cannot be achieved through the existing general statements contained in the legislation in effect. A similar precision should be extended to explicitly regulate on methods and techniques for the readjustment of transfer prices, whenever the tax authorities deemed that the prices taken into account by the corporation are inacceptable.

The considerations of an international character relate mainly to the insufficient knowledge about the activities of transnational corporations, their vast dimensions and their interwoven complexity, that results from information supplied solely by existing affiliates in each developing country. This information must be supplemented by that which the parent company and other affiliates in other countries can provide. Above all, information from the tax authorities of other countries is needed to bring about a better understanding of the subject.

It would be highly desirable, therefore, to devise a suitable machinery to that end, as long as there is no network of comprehensive tax treaties for the avoidance or alleviation of international double taxation between the developing countries of the Western Hemisphere and at least those industrialized countries from which the major transnational corporations come. This should not preclude agreements among the developing countries themselves, also to be recommended.

Any action on only one of these fronts, the domestic or the international, would not adequately solve the tax equation in its entirety.

If the option chosen were simply to prepare legal provsions more specific than those now in existence, which would envisage detailed technical solutions for the problem of allocating taxable income and deductible expenses, clearly the tax administrations would have available a much better juridical basis on which to make their decisions.

However, unless at the same time the foundation was laid for an active exchange of information at the international level, the tax administrations would remain in their present isolation, as far as taxation on the income of transnational corporations was concerned. Co-operative efforts on this place would be of general benefit.

In other words, the interplay of the measures adopted at both levels would serve to assure a revenue distribution among countries in accordance with the true scale upon which each one is affected by the tax events stemming from transnational corporation activities.

Furthermore, while, on the one hand, the decision-making processes of tax administrations would attain a higher degree of objectivity and rationality in their dealings with transnational corporations, on the other, these corporations would enjoy much greater certainty regarding the tax treatment and international allocation of their income and their deductible expenses.

NORTH SEA DIVERS TRAPPED IN THE TAX NET

The British Government is planning to treat divers working for companies operating in the North Sea as salaried employees rather than as self-employed persons. The consequence would be that the employers must deduct income tax under the Pay-as-you-earn provisions.
The Government's decision which is based on Section 38 of the 1973 Finance Act which extended U.K. tax laws to the Continental Shelf will meet with strong opposition from the Divers Action Committee who predicts a reduction of skilled divers available for bringing on stream new oil fields and the inspection and maintenance of off-shore structures.

AFTER THE COFFEE ALSO THE TEA?

The Indian Government in its wish to reserve sufficient tea for home consumption has decided to impose an export levy of Rs 5 per kilogram on tea exports.

It hopes that because of this measure there will be more tea available for the Indian home market and that it may help to reduce prices.

However, the export tax will not be imposed on the export of tea bags containing not more than 2.5 grams net of tea, of tea packed in containers with up to 1 kilogram net of tea and instant tea.

CONFERENCE DIARY

MAY 1977

Business International Institute: Seminar on International Finance (including Taxation of International Financial Operations) Port Chester, New York (U.S.A. May 8-12 and 23-26 (English).

11th General Assembly of CIAT (Centro Interamericano de Administradores Tributarios/Inter-American Center of Tax Administrators): Problems in Tax Administration in the American Countries in 1977. Caracas (Venezuela) May 9-14 (English, Spanish).

AMR International: Project Financing (Including tax implications). London (United Kingdom) May 12-13, 1977 (English).

Tax Planning International: International Tax Planning (including double taxation agreements, tax planning techniques, the Far East & the Middle East, pharmaceutical industry, retirement, doing business "in and with" Australia). Geneva (Switzerland) May 18-20 (English).

European Study Conferences Limited: Tax Planning for Emigration and Working Abroad. Guernsey (Channel Islands) May 26-27 (English).

AMR International: Current strategies and techniques (including tax aspects of structuring mergers and acquisitions). London (United Kingdom) May 31. (English).

JUNE 1977

AMR International: Current strategies and techniques (including tax aspects of structuring mergers and acquisitions). London (United Kingdom) June 1 (cont'd). (English).

Management Centre Europe: International Tax Management (including intercompany pricing, licensing, service fees, valuation of goods for customs duty, VAT and other purposes). London (United Kingdom) June 16-17 (English).

Internationale Steuer-Fachschule Dr. Endriss: Kapitalanlagen in Frankreich (Investment in France). Strassbourg (France) June 17 and 18 (German).

European Investment Research Centre: Seminar on the international taxation of private ("passive") investment. Brussels (Belgium) June 20-22 (English and French).

JULY 1977

Business International Institute: International Seminar (including International Taxation Theory, International Tax Techniques etc.). Port Chester, New York (U.S.A.) July 18-29 (English).

OCTOBER 1977

31st Annual Congress of I.F.A.: I. Inflation and Taxation; II. Determination of the Taxable Profit of Corporations. Vienna (Austria) October 3-8 (English, French, German, Spanish).

Hawaii Tax Institute: The 14th Annual Tax Meeting (including Tax Shelter Review, Doing Business Abroad — Tax Implications etc.). Waikiki (Hawaii) October 23-28 (English).

NOVEMBER 1977

U.S. Branch of I.F.A.: National Meeting. New York (U.S.A.) November 3-4 (tentatively (English).

JANUARY 1978

Associated Business Programmes Ltd.: Tax Planning and International Trade; Taxation of Personal Wealth of Individuals; Sales Taxes, Value Added Taxes and Double Taxation Conventions. Honolulu (Hawaii) January 22-27 (English).

SEPTEMBER 1978

32nd Annual Congress of I.F.A.: The Taxation of Extractive Industries; II. The Differences in the Tax Treatment between Local and Foreign Investors and the Effects of International Treaties. Sydney (Australia) September 17-23 (English, French, German, Spanish).

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Associated Business Programmes Ltd.: 17 Buckingham Gate, London SW1E 6LN (United Kingdom).

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Internationale Steuer-Fachschule Dr. Endriss: Schaafenstr. 10, D 5000 Köln (Federal Republic of Germany).

Investment and Property Studies Ltd. Norwich House, Norwich Street, London EC4 (United Kingdom).

Management Centre Europe: Avenue des Arts 4, B-1040 Brussels (Belgium).

Seminar Services International: Rue de Livourne 9, 1050 Brussels (Belgium); 31 Sussex Place, London W22 TH (United Kingdom); Passage Perdonnet, 1000 Lausanne 4 (Switzerland); OFIC, 6, rue Soyer, 92000 Neuilly (France).

Tax Planning International: Capacity House, 2/6 Rothsay Street, London SE1 4 UD (United Kingdom).

FRANCE INTRODUCES CAPITAL GAINS TAXATION:

A MAJOR BREAKTHROUGH IN CONTINENTAL TAXATION PHILOSOPHY.

The taxation of capital gains has always been a controversial problem in the European countries. Whereas the United States when introducing its first income tax law in 1913 did not make a distinction between "normal" income and capital gains (a more favorable treatment of capital gains was introduced in 1921), European countries have generally excluded capital gains from the scope of their income tax laws. The first European country which took the big step and introduced a general capital gains tax was the United Kingdom, which in 1971 completed its present capital gains tax legislation. The European continental countries, however, continued to consider capital gains as non-income (and thus not taxable), although they allowed major exceptions to this rule. For instance, capital gains derived by an individual or corporate taxpayer engaged in business activities are without exception considered to be part of the taxpayer's business income and subject to tax at normal — or sometimes at reduced — rates. Private individuals may be subject to income tax with respect to the sale of property if there is speculative intent, and in many cases the law assumes such intent if the sale takes place within a specified period of time. In many cases the sale of real property is regarded with a wary eye and the law imposes stricter rules. Another major exception is that many countries subject gains derived from the sale of shares to income tax if the shareholder owns a substantial interest in the company.

Among the Continental countries, France already possessed advanced legislation which brought many capital gains within the scope of income tax. Especially with respect to real property gains, the legislature had taken extensive precautions against certain lucrative real property transactions escaping taxation. For instance, gains derived through the sale of land after it has been subdivided or parcelled by the taxpayer and gains derived through the sale of unimproved real property (generally referred to as "building sites" or *terrains à bâtir*) are taxed. A further measure was to deem the sale of real property within ten years from its purchase a speculative transaction subject to income tax unless the taxpayer could prove that no speculative intent existed. However, gains derived through the sale of personal property were generally not subject to income tax with the exception of gains derived from the sale of shares of a company in which the shareholder (together with his spouse and next of kin) owned an interest of more than 25 percent.

However, the French Government under its President, Mr. Valéry Giscard d'Estaing wished to go one step further and, on February 11, 1975, installed a Committee for the study of the introduction of a general capital gains tax (Commission d'étude d'une imposition généralisée des plus-values) chaired by Mr. Albert Monguilan, president of a division of the Cour de Cassation (Supreme Court) which is generally referred to as the "Monguilan Committee" after its Chairman. This Committee in a remarkably short period of time produced on July 28, 1975 its report containing numerous recommendations. It was the Committee's opinion that the introduction of a general capital gains tax, i.e. the extension of the scope of income tax for private taxpayers, the treatment as income of something which hitherto has been considered to be capital, to go back in the past to trace the origin of the taxpayer's property to ascertain the amount of capital gain, whilst not knowing whether the taxpayer intends to use the proceeds for purposes of consumption or for reinvestment showed more than one bold stroke in the Government's plans. However, the Commission was also of the opinion that the French taxpayers would accept the new concepts, provided that the rates of the capital gains tax would remain moderate and provided that no class of taxpayers would be permitted to evade this tax.

On April 20, 1976, the Government presented the Bill for the introduction of a general capital tax to Parliament and after much debate it was enacted in Law No. 76-660 of July 9, 1976. However, the Government did not come through unscathed since it had to accept numerous amendments before Parliament was prepared to pass the Bill.
In its present form the major features of French capital gains taxation, which became generally effective on January 1, 1977 (with the exception of gains on the sale of securities, which will only become subject to the tax starting from January 1, 1978), can be summarized as follows.

Principle

In principle all gains derived from the disposition of goods and valuable rights by private persons (i.e. persons who do not dispose of such goods and rights in the carrying on of business activities) are subject to normal income tax at graduated rates. The new Law does not introduce a separate capital gains tax.

Real property

A. Sale within two years

Gains derived from the sale or other disposition of real property within two years after its acquisition must be added to taxable income. The taxable gain is the difference between the purchase price increased by costs (see below) and the sales price.

B. Sale within ten years with speculative intent

Since 1963 special rules exist for the sale of real property within ten years after its acquisition (which is presumed to be effected with speculative intent unless non-speculative intent can be proven by the taxpayer). The new Law, however, excluded certain property whose sale is clearly non-speculative, such as inherited real property, real property which is expropriated by the Government, agricultural real property, etc.
The taxable gain is the difference between the sales price and the revalued acquisition price. This revaluation price is determined by adding to the acquisition price 3 percent of the acquisition price for each of the first five years which have elapsed after acquisition and 5 percent for each subsequent year. The taxable gain thus computed is subsequently divided by 5 and the resulting amount is added to the taxable income. The *additional* income tax thus computed is multiplied by 5 to arrive at the income tax due with respect to the capital gain.

C. Other sales

Capital gains realized through the sale or other disposition of real property which does not come under the two preceding categories are subject to tax on the difference between the sales price and the sum of the following amounts:
- purchase price (or value if the property is inherited);
- costs for the acquisition of the property (this may be fixed at 10 percent of the acquisition price);
- costs for construction or enlargement of the property;
- costs for improvement of the property which are sufficiently important not to be considered as costs connected with the rentals;
- costs connected with roads.

The purchase price and the amount by which it may be increased is adjusted for inflation through the use of a so-called "average consumption price index". In order to arrive at the taxable capital gain the resulting amount must be reduced by 5 percent of the acquisition price for each year exceeding the tenth year of possession. For unimproved real property (building sites) the above percentage is reduced to 3.33 percent. This amount is further reduced by a deduction of 6,000 Fr.Frs., increased to 75,000 Fr.Frs. in the case of expropriation.
The tax is also computed by adding one fifth of the taxable capital gain to the taxpayer's income and by multiplying the additional tax by 5 (see the taxation of speculation gains, supra). However, in this case the taxpayer may spread the payment of the tax in equal installments over five consecutive years.

D. Exemptions

Exempt from capital gains taxation are:
- the disposition of the taxpayer's principal residence, provided that the has occupied it for at least five years or from the moment of purchase or that he is forced to sell because of family circumstances;
- the disposition of the taxpayer's secondary residence, provided that he meets the above conditions vis-à-vis his secondary residence and provided that he does not own his principal residence;
- the disposition of real property (improved and unimproved) which the taxpayer has owned for at least 20 years (30 years for so-called "building sites");
- the disposition of real property used for agricultural or forestry purposes which are not exploited by the taxpayer, provided that the sales price per square meter does not exceed certain limits prescribed by the Law;
- real property sold for less than 30,000 Fr.Frs.

In addition, where the value of the total real property owned by the taxpayer is less than 400,000 Fr.Frs. no capital gains tax is imposed (with the exception of building sites or buildings which are sold within ten years after their acquisition). Retired persons whose income is so low that no income tax is due are — with the same exceptions — also exempt from capital gains taxation with respect to the sale of real property.

E. Capital losses

Capital losses may not be deducted from capital gains derived from the sale or disposition of personal property or from ordinary income, with the exception of capital losses incurred by certain persons who have repatriated the losses from overseas.

F. Non-residents

Non-resident persons deriving capital gains from the sale or other disposition of real property situated in France are not subject to the graduated rates of French individual income tax but to a flat 33 1/3 percent rate. However, a residence owned by such taxpayers in France falls outside the scope of capital gains taxation.

G. Secondary residences

Taxpayers subject to capital gains taxation with respect to the sale or other disposition of their secondary residence benefit from the following additional relief:
- the interest of the first ten years paid with respect to loans to finance the purchase of the residence is added to the purchase price (to a maximum amount of 7,000 Fr.Frs. per year increased by 1,000 Fr.Frs. for each dependent child).

Personal property

Capital gains derived from the sale or other disposition of personal property are treated in approximately the same manner as real property gains. However, the fixed cost deduction is 2 percent instead of 10 percent.
Only capital gains with respect to property held for less than *one* year (two years for real property) are treated as ordinary income. Other capital gains must be adjusted for inflation by the average consumption price index and the tax due may be spread over 5 years. Long-term gains (i.e. those derived through the sale or other disposition of personal property held for more than 10 years) do not entitle the taxpayer to further adjustments as is the case for long-term real property gains (5 or 3.33 percent).

Special rules apply to capital gains connected with the sale or other disposition of securities (stocks and bonds). In the first place the new capital gains legislation will only become effective with respect to these gains on January 1, 1978. Secondly, no capital gains tax will be due with respect to securities held for more than 10 years or if the proceeds of their sale in a certain year did not exceed 20,000 Fr.Frs.
In addition certain securities are always exempt, such as:
- State bonds;
- other bonds, unless they have been indexed to take inflation into account, if they are convertible into shares, of if they are profit sharing bonds;
- securities covered by a long-term savings engagement;
- certificates issued by investment funds.

Individual investors may request to be authorized to open an "investment account" (generally with a bank) in which their taxable securities (and also to a certain limit non-taxable bonds) will be placed, provided these securities are quoted on a stock exchange. The advantage offered by this arrangement is that the taxpayer can frequently change the contents of his portfolio without becoming subject to capital gains taxation. Only when he realizes part of the portfolio will he become subject to tax.

Persons owning (together with their spouse and next of kin) an interest of more than 25 percent in a French or foreign company are subject to the normal capital gains tax provisions. However, if the participation has been held for more than 10 years there will be no exemption, but the provisions of the old legislation, under which a 15 percent tax is due on any capital gains derived from the sale or other disposition of such participation or part thereof, are revived.
Taxpayers who derive a capital gain connected with securities may choose the general 6,000 Fr.Frs. deduction or a deduction of 50 percent of the amount of capital gains.

Precious metals, jewels, objets d'art etc.

Special rules apply to the sale of precious metals (gold, silver, platinum etc.), jewels, objets d'art, collector's items and antiques which are subject to a lump sum capital gains tax in the form of a flat rate on the proceeds of the sale, i.e. 4 percent on the sale of precious metals, 3 percent on the sale of other items if not sold at public auctions and 2 percent if the sale is effected through a public auction.

D.A. v. W.

NOUVEAU REGIME D'IMPOSITION DES PLUS-VALUES EN FRANCE

Loi No. 76-660 du 19 juillet 1976 (J.O. du 20 juillet 1976)

par Maître Max-Hubert Brochier & M. Jean-Pierre Allavena

1. INTRODUCTION

Une cession s'entend de toute opération (vente, échange) ayant pour effet de faire sortir un élément de l'actif.
Lorsqu'un élément de l'actif est cédé, pour un prix supérieur à sa valeur comptable résiduelle, la différence représente "une plus-value" qui doit en principe être comprise dans les bénéfices imposables.
La plus-value est, selon la définition du Larousse, l'accroissement de la valeur d'un bien entre deux appréciations successives.
La Loi No. 76-660 du 19 juillet 1976 porte imposition des plus-values en France.
Pour les valeurs mobilières, le nouveau régime entrera en vigueur le 1er janvier 1978.
Pour les autres biens, il entrera en vigueur le 1er janvier 1977.
Cette loi, qui comprend quatorze articles traite:

- de l'imposition à l'impôt sur le revenu des plus-values de cession d'immeubles bâtis et non bâtis, et également de certaines biens meubles;
- de la création d'une taxe sur les ventes d'or, de bijoux, d'objets d'art;
- de l'harmonisation de la taxation des plus-values d'origine professionnelle;
- de la modification des règles de taxation des plus values de cession des charges et offices.

Quelles en sont les dispositions essentielles?

. LES PERSONNES IMPOSABLES

.1. LES PERSONNES PHYSIQUES

ont visées toutes les personnes phyques, quelle que soit leur nationali-, qui ont leur domicile réel en France. es titulaires de pension de vieillesse on imposés sur le revenu en sont exoérés, dans la mesure où elles n'étaient pas xables antérieurement.

Des règles spéciales régissent le cas des français non résidents ou des étrangers ayant leur domicile réel hors de France.

2.2. Les sociétés de personnes

Ce sont essentiellement:

1) les sociétés en nom collectif,
2) les sociétés civiles immobilières qui ne sont pas soumises à l'impôt sur les sociétés,
3) les sociétés immobilières "transparentes" aux yeux du droit fiscal,
4) les sociétés à responsabilité limitée de famille qui ont opté pour le régime fiscal des sociétés de personnes.

3. LES BIENS VISES PAR LA LOI

3.1. LES IMMEUBLES

En règle générale, les plus-values réalisées à l'occasion de cessions d'immeubles sont imposables. Mais les plus-values réalisées à l'occasion de la cession d'immeubles ne sont passibles d'aucune imposition lorsqu'ils sont entrés dans le patrimoine du contribuable:

- depuis au moins trente ans pour les terrains à bâtir;
- depuis au moins vingt ans pour les autres immeubles.

3.1.1. *Les exonérations*

3.1.1.1. *Les cas d'exonération relatifs à la nature du bien*

a) La résidence principale

Est exonérée toute plus-value résultant de la vente d'une habitation principale.
Sont donc considérés comme résidence principale: les immeubles ou partie d'immeuble constituant la résidence habituelle du propriétaire depuis l'achèvement ou l'acquisition, ou pendant au moins cinq ans.
La condition de durée est supprimée lorsque la cession est motivée par des conditions d'ordre familial, ou de changement de résidence, ou par une mise à la retraite.
Pour les Français domiciliés hors de France, il y a exonération dans la limite d'une résidence par contribuable.

b) La résidence secondaire

Sont considérés comme résidence secondaire les autres immeubles ou parties d'immeuble.
Pour être exonéré de l'imposition de la plus-value, il faut:

1) que le propriétaire de la résidence secondaire ne soit pas également propriétaire de la résidence principale,
2) qu'il ait eu la libre disposition de cette résidence pendant cinq ans au moins.

La condition de temps est supprimée lorsque la vente est motivée par un changement de lieu d'activité, un changement de résidence consécutif à une mise à la retraite, ou motivé par des impératifs d'ordre familial.

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4. CONCLUSION

c) Les terrains agricoles ou forestiers

(i) Cession:

L'imposition de la plus-value ne s'applique pas lors de la cession de terrains agricoles ou forestiers ou lorsque ces terrains supportent une construction d'usage agricole. Néanmoins ces terrains ne pourront être cédés à un prix supérieur à celui qui doit être déterminé par décret.
Ce prix ne pourra être inférieur à:
— 33 F le m^2 pour les vignobles d'appellation contrôlée ou pour les cultures florales;
— 11 F le m^2 pour les cultures fruitières ou maraichères;
— 5 F le m^2 pour les terrains agricoles ou forestiers.

Pour les peuplements forestiers, il y a exonération quel que soit le prix de cession.

(ii) Le remembrement:

Les biens échangés dans le cadre d'opérations de remembrement ou d'opérations assimilées, d'opérations d'échanges amiables individuels ou collectifs sont exonérés de la taxation.
Les soultes versées par les collectivités sur plus-values transitoires ou permanentes consignées au procés-verbal de remembrement rural sont également exonérées. Ces exceptions sont limitées aux opérations conformes aux procédures réglementaires en vigueur.

d) L'expropriation

Les plus-values immobilières réalisées à la suite de la déclaration d'utilité publique prononcée en vue d'une expropriation sont exonérées quand il est procédé au remploi de l'indemnité pour l'achat d'un ou plusieurs biens de même nature dans un délai de six mois et sous réserve que ces plus-values n'aient pas été taxables sous le régime antérieur.
Néanmoins le remploi de l'indemnité d'expropriation doit être fait dans le délai de six mois du règlement de cette dernière.

3.1.1.2. *Les cas d'exonération relatifs à la valeur du bien*

a) le prix de cession de l'immeuble

Lorsque le montant de la cession ne dépasse pas 30.000 Francs, il n'y a pas lieu d'imposer la plus-value réalisée.
Il est alors tenu compte de l'ensemble des cessions réalisées au cours d'une même année. Les cessions exonérées de l'impôt sur les plus-values n'entrent pas en ligne de compte.

b) la valeur de l'ensemble du patrimoine

Il y a également exonération lorsque le patrimoine immobilier familial n'excéde pas 400.000 Francs.
Cette somme est majorée de 100.000 Francs par enfant à charge, à partir du troisième.
L'évaluation du patrimoine immobilier s'effectue au jour de la réalisation de la plus-value, le bien vendu étant inclus dans le patrimoine évalué.
L'administration tiendra compte des dettes contractées pour l'acquisition et la réparation du patrimoine.

3.1.2. *Les immeubles situés à l'étranger*

Sont visés les contribuables domiciliés en France et qui sont soumis à l'impôt sur le revenu en ce qui concerne les revenus fonciers qu'ils perçoivent d'immeubles situés à l'étranger.
La plus-value ayant pour origine la cession de ces immeubles, est soumise à la présente loi sous réserve des conventions internationales fiscales existant en la matière.

3.1.3. *Détermination de la plus-value imposable*

Notons que la plus-value est constituée par la différence entre le prix de cession et le prix d'acquisition d'un bien par le cédant.

3.1.3.1. *Le prix de cession*

Est retenu le prix tel qu'il résulte de l'acte de vente.
La valeur vénale déterminée pour la perception des droits d'enregistrement ne pourra être retenue que lorsqu'il aura été établi que le prix figurant dans l'acte a subi une dissimulation.
A ce prix, on inclue les charges et indemnités prévues au contrat.
On retranche du prix ainsi déterminé, les frais de vente subis par le vendeur.
Il s'agit essentiellement du versement d'une commission à un intermédiaire ou à une agence, ou des frais de publicité.

a) le cas de la rente viagère

Doit être retenu le prix fixé dans l'acte, car c'est lui qui a servi à la constitution de la rente viagère.
A défaut, la valeur prise en compte pour la fixation des droits de mutation sera retenue.

b) le cas d'échange

Au regard du droit fiscal, il s'agit d'une double vente, aussi c'est la valeur réelle du bien acquis qui est retenue.
Il y a exonération lorsque l'échange a lieu dans le cadre d'opérations de remembrement et assimilés. Toutefois, le caractère spéculatif de l'opération peut être prouvé. Dans ce cas, le prix de cession est déterminé en tenant compte de la soulte versée ou reçue.

3.1.3.2. *Les prix d'acquisition*

a) acquisition à titre onéreux

Il s'agit du prix effectivement payé. C'est donc le prix figurant dans l'acte d'acquisition qui doit être retenu.
1) En présence d'un bien reçu en échange, le prix d'acquisition est la valeur réelle du bien cédé au coéchangiste, compte tenu éventuellement des soultes versées ou reçues.
Lorsque l'opération d'échange a eu lieu sous un régime d'exonération, la plus-value est estimée en fonction de la date et du prix d'acquisition du bien remis en échange.
2) En cas d'acquisition au moyen d'une rente viagère, doit être retenu comme prix d'acquisition, dans toutes les hypothèses, le capital représentatif de la rente au jour de l'acquisition du bien.

b) acquisition à titre gratuit

L'acquisition provient soit d'un héritage, soit d'une donation.
Entrent dans la catégorie des donation, les différentes mutations à titre gratuit entre vifs:
— les donations,
— les donations en avances d'hoiries,
— les donations partages,
— les donations par contrat de mariage.

Le prix retenu est celui de la valeur vénale du bien au jour de l'acquisition, c'est à dire, soit celui de la date d'acquisition, soit celui du décès.
En pratique, la valeur à retenir est celle qui aura servi de base au calcul des droits de succession ou de donation.
Pour les donations datant de moins de cinq ans, la plus-value est alors déterminée en fonction de la date d'acquisition faite par le donateur et de la valeur du bien à cette date.
Il s'ensuit que la durée de détention est appréciée en fonction de la date d'acquisition du bien par le donateur.
Le prix de revient est alors celui de la valeur d'acquisition par le donateur.

c) majoration du prix d'acquisition

Au prix d'acquisition tel qu'il vient d'être déterminé, on intègre les frais d'acquisition, les dépenses de construction ou d'amélioration ainsi que, sous certaines conditions, les intérêts d'emprunts pour l'acquisition ou la réparation d'une résidence secondaire.

(i) les frais d'acquisition:

Il s'agit des frais du contrat tels que les frais d'actes, les droits de timbre et d'enregistrement, les honoraires du notaire, les commissions.
S'il n'est pas possible au vendeur de prouver le montant de ces frais, il a la possibilité de déduire forfaitairement 10 pour cent du prix d'acquisition.

En cas d'acquisition à titre gratuit, il est possible de déduire les frais d'acte et de déclaration, mais il n'est plus permis d'y intégrer les droits de succession ou de donation.

(ii) les autres dépenses:

Au prix d'acquisition, peut être intégré le montant des dépenses de construction, de rénovation, d'agrandissement, de reconstruction et d'amélioration qui ont été réalisées depuis l'acquisition.
Ces dépenses seront prises en considération à condition de ne pas avoir été déjà déduites du revenu imposable et de ne pas présenter le caractère de dépenses locatives.
Les travaux effectués par le cédant, sont conjoint ou les membres de sa famille sont pris en compte dans les mêmes conditions que précédemment.
Le contribuable a le choix alors pour la prise en compte de ces travaux à inclure au pris d'acquisition:
- le montant réel des travaux, mais il est difficile de justifier de coût de la main d'oeuvre;
- un montant estimé de manière forfaitaire en appliquant le coefficient trois au prix des matériaux utilisés.

En cas de plus-value à moyen et long terme, et lorsqu'il ne sera pas possible de justifier les frais exposés, le montant des dépenses pourra être fixée au choix du cédant:
- soit à titre d'expert,
- soit forfaitairement à 15 pour cent du prix d'acquisition.

(iii) les intérêts d'emprunts:

Sont pris en compte les intérêts des emprunts contractés pour l'acquisition ou la réparation d'une résidence secondaire, dans la limite de 7.000 Francs par an, plus 1000 Francs par personne à charge.
Cette possibilité est limitée aux dix premières annuités de l'emprunt.

(iv) les honoraires des consultations fiscales:

Ceux-ci demandés au contribuable à l'occasion d'une opération soumise à l'imposition de la plus-value pourront être ajoutés au prix d'acquisition.

3.1.4. *Modalités des consultations de la plus-value*

Elle n'est pas imposée d'une manière uniforme.
Il faut établir une distinction selon que la plus-value ait été réalisée:
) à court terme, c'est-à-dire moins de deux ans après l'acquisition du bien;
) à moyen terme, c'est-à-dire entre deux et dix ans de l'acquisition du bien;
) à long terme, c'est-à-dire entre dix et vingt ans pour les immeubles, et entre dix et trente ans pour les terrains à bâtir.

Toutes les opérations immobilières réalisés à titre professionnel ne sont pas concernées par la Loi nouvelle.

Sont exclus de l'application de cette Loi:
- les personnes qui habituellement achètent des immeubles en vue de les revendre tels que les marchands de biens;
- les profits de lotissement réalisés par les marchands de biens;
- les profits de construction qui procèdent d'opérations à caractère habituel.

3.1.4.1. *Les plus values à court terme*

Les plus-values réalisées moins de deux ans après l'acquisition du bien sont assimilées à un revenu annuel imposable.
Dans le cas, il n'y a aucun correctif tenant compte de l'érosion monétaire, et il n'y a aucune atténuation au système de la progressivité de l'impôt sur le revenu.
Cependant les abattements prévus par la Loi sont applicables et notamment celui de 6000 Francs.

3.1.4.2. *Les plus-values à moyen terme*

Sont visées ici les plus-values réalisées sur un bien détenu entre deux et dix ans.
Sont maintenues les dispositions antérieures concernant les plus-values spéculatives.

a) les plus-values spéculatives

Sont visés les profits réalisés de manière occasionnelle par des particuliers à l'occasion de la cession d'immeubles achetés ou construits depuis moins de dix ans.
Ces profits sont imposés au même titre que des bénéfices industriels et commerciaux.
Ne peuvent être réputées spéculatives que les cessions à titre onéreux à l'exclusion des mutations à titre gratuit et des expropriations.

(i) Les biens soumis à imposition:

Il s'agit essentiellement:
- des immeubles bâtis ou non bâtis;
- des actions ou parts de sociétés de copropriété transparente;
- des droits immobiliers ou mobiliers;
- des titres de sociétés civiles immobilières.

Les immeubles non bâtis concernés par cette imposition sont:
- les terrains nus ou recouverts de constructions destinées à être démolies;
- les immeubles inachevés;
- les droits de surélévation d'immeubles préexistants.

Seuls les terrains destinés à la constructions et dont la cession est assujettie à la T.V.A. sont soumis à cette imposition.

(ii) Les biens non soumis à imposition:
— La résidence principale

Pour ne pas être imposable, le propriétaire doit avoir occupé personnellement sa résidence principale, et cette occupation doit avoir éte effective depuis son acquisition ou son achèvement, ou avoir duré cinq ans au moins.
Si les conditions exigées n'étaient pas remplies, le cédant ne pourrait échapper à l'imposition qu'en démontrant qu'il bénéficie d'une des présomptions d'intention non-spéculative prévue par la Loi.

— Le cas de l'échange

Le terrain reçu dans le cadre de la procédure d'un échange avec une collectivité publique n'entre pas dans le champ d'application de l'imposition.

— Autres cas

La présente Loi permet d'échapper à cette imposition dans les cas suivants:
- la première cession d'une résidence secondaire par une personne qui n'est pas propriétaire de sa résidence principale;
- la cession des terrains agricoles ou forestiers;
- les opérations qui sont présumées ne pas avoir d'intention spéculative.

(iii) Conditions nécessaire à application du régime des plus-values spéculatives:

Trois conditions sont exigées
- le bien doit être cédé à titre onéreux;
- il doit être possédé par le cédant moins de dix ans;
- il doit s'agir d'une opération spéculative.

L'intention spéculative se définit par le fait d'acheter pour revendre.
Il existe un certain nombre de cas dans lesquels l'intention spéculative est exclue.
Il en est ainsi lorsque la cession de l'immeuble est motivée par un changement de résidence ou une meilleure utilisation familiale alors qu'il a été personnellement occupé par l'acquéreur ou le constructeur, par son conjoint, ses descendants, ses ascendants.

Il n'y a pas intention spéculative lorsque:
- l'immeuble vendu n'est plus la résidence principale du contribuable, mais l'a été pendant cinq ans;
- la cession est motivée par la modification de la famille, du nombre de personnes à la charge du contribuable, à un divorce ou à une séparation de corps, à la survenance d'une invalidité du contribuable, à un règlement judiciaire ou à une liquidation des biens;
- l'immeuble a été cédé à une collectivité publique, à une société d'économie mixte;
- la cession de la résidence secondaire est motivée par des considérations familiales ou professionnelles.

(iv) Détermination de la plus-value imposable:

Dans le cas de réalisation d'une plus-value ayant un caractère spéculatif, celle-ci est constituée par la différence entre:
- le prix de cession auquel il aura été loisible de déduire les frais supportés par le cédant (tels que les commissions versées à un intermédiaire);
- le prix de revient du bien cédé. Il est constitué par le prix d'acquisition augmenté du coût réel des frais d'acquisition et des impenses. On y intègre également les intérêts des emprunts contractés pour l'acquisition ou la construction.

Ce prix est alors majoré:
- de 3 pour cent pour les cinq premières années écoulées,
- de 5 pour cent pour chaque année écoulée au-delà de la cinquième.

(v) Modalités d'imposition:

Désormais, le régime prévu par la nouvelle Loi s'applique ici.
La plus-value déterminée est diminué des abattements prévus et le système "de la division par cinq" s'applique également. Seul, le paiement fractionné ne profitera pas à ce type de plus-value imposable.

b) les plus-values n'ayant pas un caractère spéculatif

Ce sont essentiellement les plus-values réalisées par des biens qui avaient été reçus par héritage ou donation ainsi que les plus-values ne présentant pas de caractère spéculatif et qui demeurent imposable sous la nouvelle Loi.
La plus-value imposable est déterminée de la même manière qu'en ce qui concerne les plus-values à court terme.
Le prix d'acquisition est revisé proportionnellement à la variation de l'indice moyen annuel des prix à la consommation depuis la date de l'acquisition ou de la dépense. Ce coefficient n'affecte pas les intérêts d'emprunts faits pour l'acquisition d'une résidence secondaire.
La plus-value ainsi déterminée et déduction faite des abattements éventuels est intégrée dans le revenu global imposable selon le système de la division par cinq et le paiement de l'impôt correspondant peut être étendu sur un période de cinq années.

3.1.4.3. *Les plus-values à long terme*

Ce sont les plus-values réalisées à l'occasion de la cession de biens détenus depuis plus de dix ans.
Ce sont les mêmes règles que pour la détermination de la plus-value imposable réalisée à moyen terme et ne présentant pas de caractère spéculatif.

EXEMPLE I (l'imposition d'une plus-value spéculative)

Soit un immeuble acquis le 2 mai 1970 pour une valeur de 400.000 Francs.
Il est revendu le 2 juillet 1977 par une valeur de 800.000 Francs.
Des impenses ont été faites en 1973 pour une valeur de 40.000 Francs.
Les frais d'acquisition se sont élevés à 30.000 Francs.
Ce contribuable a pour l'année de référence une revenu imposable de 150.000 Francs.
Sa situation de famille est telle qu'il a droit à quatre parts.

— *Détermination du prix d'acquisition*
L'immeuble a été acquis pour 400.000 Francs. A cette some on intègre le montant des frais, soit:
400.000 + 30.000 = 430.000 Francs
Ce prix est revalorisé de 3 pour cent pour les cinq premières années, et de 5 pour cent par an pour celles écoulées au-delà de la cinquième.
L'immeuble est achété en 1970, et il est revendu en 1977 soit:
5 ans à 3 pour cent + 2 ans à 5 pour cent ce qui donne une revalorisation de 25 pour cent
Montant de la revalorisation:
430.000 x 25 pour cent = 107.500 Francs
Le prix d'acquisition brut est donc:
430.000 + 107.500 = 537.500 Francs
En 1973, le contribuable a effectué des impenses pour un montant de 40.000 Francs.
Le montant de revalorisation de ces impenses s'établit comme suit:
de 1973 à 1977, il s'est écoulé quatre ans, ce qui donne 4 x 3 pour cent = 12 pour cent
40.000 x 12 pour cent = 4.800 Francs
Les impenses revalorisées s'établissent donc à:
40.000 + 4.800 = 44.800 Francs

Le prix d'acquisition total est donc de
537.500 + 44.800 = 582.300 Francs

— *Détermination de la plus-value imposable*
La plus-value brute est donc la différence entre le prix de vente et le prix d'acquisition ainsi déterminé:
800.000 — 582.300 = 217.700 Francs
Pour obtenir la plus-value taxable, on déduit les abattements correspondants, et notamment l'abattement général de 6.000 Francs.
La plus-value imposable est donc de:
217.700 — 6.000 = 211.700 Francs

— *Montant de l'imposition de cette plus-value*
On applique, pour déterminer le montant de l'impôt dû au titre de la plus-value, le système de "la division par cinq".
Le contribuable a un revenu imposable de 150.000 Francs. Il a droit a quatre parts.
Au titre de l'année de référence (et selon le barème applicable pour les revenus de l'année 1975), il aurait dû normalement acquitter un impôt sur le revenu d'un montant de: 35.135 Francs
Suivant le système instauré, on divise le montant de la plus-value imposable par cinq:
211.700 : 5 = 42.340 Francs
Le montant normalement imposable des revenus augmenté du cinquième de la plus value nous donne:
150.000 + 42.340 = 192.340 Francs
Montant de l'impôt que ce contribuable devrait régler sur cette somme:
52.071 Francs
On fait donc la différence entre le montant de l'impôt dû normalement et celui qui vient d'être déterminé:
52.071 — 35.135 = 16.936 Francs
Ce chiffre représente le montant de l'impôt dû pour le cinquième de la plus-value
L'impôt dû au titre de la plus-value est de:
16.936 x 5 = 84.680 Francs

EXEMPLE II (plus-value réalisée à moyen terme et non-spéculative)

Soit un immeuble acquis le 2 mai 1970 pour une valeur de 400.000 Francs.
Il est revendu le 2 juillet 1977 pour une valeur de 800.000 Francs.
Des travaux ont été faits en 1973 et s'élèvent à 40.000 Francs.
Les frais d'acquisition sont de 30.000 Francs.
Ce contribuable a pour l'année de référence un revenu imposable de 150.000 Francs.
Sa situation de famille est telle qu'il a droit à quatre parts.

— *Détermination du prix d'acquisition*
L'immeuble a été acquis pour 400.000 Francs.
A cette somme, on intègre le montant des frais d'acquisition qui peuvent être évalués forfaitairement à 10 pour cent.
400.000 + 400.000 = 440.000 Francs
L'immeuble a été acquis en 1970, il faut donc corriger le prix d'acquisition en appliquant le coefficient de revalorisation prévu.
Il est de 1,52, d'après le tableau en vigueur cette année.
Le prix d'acquisition brut est donc de:
440.000 x 1,52 = 668.000 Francs
Des travaux ont été effectué en 1973 pour un montant de 40.000 Francs.
Il convient de revaloriser le coût de ces travaux en appliquant le coefficient de revalorisation de référence pour l'année 1973, soit 1,27.
Montant des travaux revalorisés:
40.000 x 1,27 = 50.800 Francs
Le prix d'acquisition total est donc de:
668.800 + 50.800 = 719.600 Francs

— *Détermination de la plus-value imposable*
La plus-value brute est donc la différence entre le prix de vente et le prix d'acquisition ainsi déterminé:
800.000 — 719.600 = 80.400 Francs
Pour obtenir la plus-value taxable, on déduit les abattements correspondants, et notamment l'abattement général de 6.000 Francs
80.400 — 6.000 = 74.400 Francs

— *Montant de l'imposition de cette plus value*
On applique, pour déterminer le montant de l'impôt dû au titre de la plus-value, le système de la "division par cinq".
Le contribuable a un revenu imposable de 150.000 Francs.
Il a droit à quatre parts.
Au titre de l'année de référence (et selon le barème applicable pour les revenus de l'année 1975), il aurait dû normalement acquitter un impôt sur le revenu d'un montant de: 35.135 Francs
Suivant le système instauré, on divise le montant de la plus-value imposable par cinq:
74.400 : 5 = 14.880 Francs
Le montant imposable des revenus augmenté du cinquième de la plus-value nous donne:
150.000 + 14.880 = 164.880 Francs
Montant de l'impôt que le contribuable devrait sur cette somme:
41.087 Francs
On fait la différence entre le montant de l'impôt normalement dû, et celui qui vient d'être déterminé:
41.087 — 35.135 = 5.952 Francs
Ce chiffre représente le montant de l'impôt dû pour le cinquième de la plus-value.
L'impôt dû au titre de la plus-value est donc égal à:
5.952 x 5 = 29.760 Francs

a plus-value nette ainsi déterminée sera iminuée:

- de 5 pour cent par année de possession au-delà de la dixième pour les immeubles autres que les terrains à bâtir.
- de 3,33 pour cent par année de possession au-delà de la dixième pour les terrains à bâtir.

La plus value ainsi déterminée, et déduction faite des abattements éventuels, est intégrée dans le revenu global imposable selon le système de la division par cinq, et le paiement de l'impôt correspondant peut être étendu sur une période de cinq ans.

3.1.4.4. *Les abattements*

a) Cas général

Un abattement forfaitaire de 6.000 Francs est appliqué pour l'ensemble des plus-values réalisées au cours d'une même année. Il s'applique même en cas de plus-values réalisées à court terme. Néanmoins, il ne pourra s'appliquer qu'une seule fois, si plusieurs plus-values sont réalisées au cours de la même année.

b) Cas particuliers

(i) L'expropriation:

Un abattement de 75.000 Francs est appliqué aux plus-values immobilières ayant pour origine une ou plusieurs expropriations au cours d'une même année. Cet abattement ne peut être cumulé avec l'abattement de 6.000 Francs.

(ii) Les résidences secondaires:

Bénéficie de cet abattement la première cession de la résidence secondaire imposable, laquelle doit avoir été détenue depuis cinq ans au moins.
La plus-value est alors diminuée de 20.000 Francs pour chacun des époux, et de 10.000 Francs par enfant vivant ou représenté.
Cet abattement est de 30.000 Francs pour les veufs, les divorcés ou les célibataires. Cet abattement se cumule avec celui de 6.000 Francs.

3.2. LES MEUBLES

L'imposition des plus-values étant généralisée, elle s'applique également aux meubles de toute nature. Cependant, le Législateur a prévu un système particulier pour la vente des métaux précieux et objets de collection.

3.2.1. *Les plus-values autre que celles realisées sur les valeurs immobilières*

3.2.1.1. *Les biens mobiliers imposables*

Il s'agit essentiellement des profits réalisés:
1) A l'occasion des opérations de Bourse de Marchandises;
2) à l'occasion des opérations sur devises étrangères lorsqu'elles ne se rattachent pas à une activité professionnelle;
3) sur les plus-values professionnelles obtenues, alors que l'activité professionnelles a été exercée moins de cinq années, et que les recettes sont inférieures aux limites du forfait;
4) sur la vente des objets précieux en cas d'option pour le régime des plus-values;

5) sur la vente des meubles divers comme les chevaux de course, les bateaux de plaisance.

3.2.1.2. *Exonération*

Sont exonérés les meubles d'usage courant. Il s'agit entre autres des meubles meublants, des appareils ménagers, des voitures automobiles.

3.2.1.3. *Détermination de la plus-value imposable*

Ces règles sont identiques à celles qui s'appliquent en matière de plus-values immobilières.

Le prix d'acquisition est majoré des frais de restauration et de remise en état.

La plus-value ainsi obtenu est intégralement taxée lorsqu'elle a pour origine la cession d'un bien détenu depuis moins d'un an.

Pour la période allant de un à dix ans, le correctif pour érosion monétaire est pris en considération.

En ce qui concerne les plus-values réalisées sur des biens détenus depuis plus de dix ans, le Législateur n'a prévu aucun abattement pour longue durée de détention, ni de limitation dans le temps.
L'abattement de base de 6.000 Francs est applicable dans tous les cas.

EXEMPLE III (plus-value réalisée à long terme)

Soit un immeuble acquis le 2 mai 1958 pour 100.000 Francs.
Il est revendu le 2 juillet 1977 pour une valeur de 400.000 Francs.
Ce contribuable a pour l'année de référence un revenu imposable de 150.000 Francs.
Sa situation de famille est telle qu'il a droit à quatre parts.

— *Détermination du prix d'acquisition*

L'immeuble a été acquis pour 100.000 Francs. A cette somme, on intègre le montant des frais d'acquisition évalués forfaitairement à 10 pour cent.
100.000 + 10.000 = 110.000 Francs
L'immeuble ayant été acquis en 1958, le coefficient d'érosion monétaire applicable est de 2,49
Le prix d'acquisition est donc de:
110.000 x 2,49 = 273.900 Francs

— *Détermination de la plus-value imposable*
La plus value brute est donc la différence entre le prix de vente et le prix d'acquisition ainsi déterminé:
400.000 — 273.900 = 126.100 Francs
L'abattement autorisé est de 5 pour cent l'an, au-delà de la dixième année l'immeuble ayant été acquis en 1958 et revendu en 1977, l'abattement est de: 5 pour cent x 9 = 45 pour cent
Montant de l'abattement à déduire:
126.100 x 45 pour cent = 56.745 Francs
Plus value nette:
126.100 — 56.745 = 69.355 Francs
Plus value taxable:
69.355 — 6.000 = 63.355 Francs

— *Montant de l'imposition de cette plus-value*
On applique le système de "la division par cinq".
Le contribuable a un revenu imposable de 150.000 Francs. Il a droit à quatre parts.
Le montant de l'impôt sur le revenu s'élève à: 35.135 Francs
Le montant de la plus-values divisé par cinq donne:
63.355 : 5 = 12.671 Francs
Le montant des revenus imposables augmenté du cinquième de la plus-value s'élève à:
150.000 + 12.671 = 162.671 Francs
Montant que le contribuable devrait sur cette somme:
40.203 Francs
Différence entre le montant de l'impôt dû et celui qui vient d'être déterminé:
40.203 — 35.125 = 5068 Francs
Impôt dû au titre de la plus-value:
5.068 x 5 = 25.340 Francs

Le système de la division par cinq, et le paiement de l'impôt sur une période de cinq ans sont applicables. Il n'y a pas de paiement fractionné pour les plus-values réalisées à court terme.

Pour être imposable, la plus-value doit résulter d'une cession supérieure à 20.000 Francs. Il est tenu compte de l'ensemble des cessions réalisées au cours d'une même année.

3.2.2. *Les plus-values réalisées sur valeurs mobilières*

Sont atteintes toutes les opérations sur titres effectuées par les particuliers dans le cadre de la gestion normale d'un portefeuille.

3.2.2.1. *Les cas d'exonération relatif à la nature du bien*

1) Les emprunts d'Etat.
Entrent dans cette catégorie les emprunts 4,5 pour cent et 7 pour cent de 1973.
2) Les valeurs mobilières à revenu variable à condition d'être cédées plus de dix ans après leur acquisition.
Sont toutefois passible de l'impôt au taux de 15 pour cent les cession de titres de sociétés passibles de l'impôt sur les sociétés lorsque les droit détenus par le cédant, son conjoint, leurs descendants, ou ascendants, ont dépassé ensemble 25 pour cent des bénéfices sociaux à une période quelconque au cours des cinq années précédant la cession.
3) Les autres obligations et titres de créances sous réserve de ceux que la Loi déclare imposables.
4) Les titres cédés dans le cadre d'un engagement d'épargne à long terme.
5) Les parts de fonds communs de placement.
Cette exonération s'applique lorsque ces parts on été souscrites en application de la Législation sur la participation des travailleurs aux fruits de l'expansion des entreprises ou des plans d'épargne des entreprises.
Sont également exonérés les titres cédés qui ont été acquis dans le cadre de cette Législation et de celle relative à l'actionnariat dans les entreprises. Néanmoins ces titres doivent revetir la forme nominative et doivent comporter la mention d'origine.
6) Les titres cédés par les fonds communs de placement dans le cadre de leur gestion.

3.2.2.2. *Les titres non-exonérés*

1) Les obligations assorties d'une clause d'indexation ou d'une clause de participation aux bénéfices.

2) Les obligations assorties d'une clause de conversion en action ou d'échange contre des actions.
3) Les obligations incorporées dans un compte spécial d'investissement à condition que leur valeur n'excéde pas un dixième du montant des actions figurant dans le même compte au moment de leur apport, de leur achat ou de leur souscription, et n'excéde pas un montant total de 50.000 Francs.

3.2.2.3. *Exonération relative à valeur des titres cédés*

Lorsque le montant de la cession ne dépasse pas 20.000 Francs, il n'y a pas lieu d'imposer la plus-value réalisée.
Il est tenu compte de l'ensemble des plus-values d'origine mobilière effectuées dans le cours de l'année.

3.2.2.4. *Les cas des opérations concernant les valeurs mobilières*

Sont exonérés égalements:
1) Les titres remis lors de la conversion ou d'échange d'obligations en vertu du contrat de souscription d'origine.
2) Les titres échangés dans le cadre des opérations de fusions ou scissions de sociétés, ou d'offres publiques d'échange.

Et ce, à condition que les droits détenus n'excédent pas une participation supérieure à 25 pour cent.

3.2.3. *Détermination de la plus-value imposable*

3.2.3.1. *Détermination du prix d'acquisition*

a) Actions et parts de société

1) En règle générale, le prix d'acquisition des actions et parts de sociétés s'apprécie, abstraction faite des droits de souscription et d'attribution intervenus depuis. Ces droits sont pris en compte s'ils sont l'objet d'une cession postérieurement à l'entrée en vigueur de la présente loi.
Dans ce cas, le prix net de la cession est défalqué de celui de l'acquisition. Il est fait application des règles de réévaluation, s'il y a lieu.
2) Le prix d'acquisition des titres reçus lors d'une augmentation de capital est le montant de la somme versée par le souscripteur et des droits acquis à cet effet.
3) Lorsqu'il y a distribution d'actions gratuites, la date d'entrée dans le patrimoine est réputée être celle des actions qui ont donné droit à cette attribution.
4) En cas de cession partielle portant sur une série de titres acquis à des dates différentes, le prix d'acquisition retenu est celui des titres acquis à la date la plus ancienne par priorité.

b) les valeurs mobilières à revenu variable ou obligations

Le contribuable a le choix entre les solutions suivantes en ce qui concerne la détermination du prix d'acquisition:
1) Le prix d'acquisition éventuellement modulé par les correctifs apportés par la loi.
2) Le dernier cours côté au comptant avant l'entrée en vigueur de la présente loi.
3) Une valeur forfaitaire calculée sur la moyenne des cours des sept années précédant l'entrée en vigueur de la loi. Dans ce cas, les dispositions concernant la réévaluation du prix d'acquisition ne pourront être appliquée que pour une période de quatre ans précédant la mise en application de la présente loi.

c) Majoration du prix d'acquisition

Le prix d'acquisition est majoré des frais afférents à l'acquisition à titre gratuit, à l'exclusion des droits de mutation, lorsqu'il s'agit d'une acquisition à titre gratuit.
Le prix d'acquisition est celui de la valeur vénale du bien au jour de l'entrée de ce bien dans le patrimoine du vendeur en présence d'une acquisition à titre gratuit.
En cas d'acquisition à titre onéreux, les frais afférents à cette acquisition sont pris en compte.
Le cédant peut fixer forfaitairement ces frais en matière mobilière à 2 pour cent. On peut y ajouter le montant des honoraires dûs en raison des consultations fiscales demandées à l'occasion d'une cession donnant lieu à imposition.

3.2.3.2. *Les prix de cession*

C'est le prix tel qu'il résulte de l'acte de vente.
En matière mobilière s'appliquent les mêmes règles que celles examinées pour la plus-value immobilière.

3.2.3.3. *Modalités d'imposition de la plus-value*

a) Plus-values réalisées à court terme

Les plus-values sur biens mobiliers réalisées moins d'un an après l'acquisition dudit bien sont intégralement assimilées à un revenu et taxée comme tel. Elles bénéficient toutefois d'un abattement de 6.000 Francs avant imposition.

b) Plus-values réalisées à moyen terme

Ce sont celles réalisées entre un et dix ans. Ces plus-values sont diminuées de 50 pour cent avant imposition, mais cet abattement ne peut se cumuler avec celui de 6.000 Francs.
Après réduction éventuelle de moins-values réalisées au cours de l'année, le système de la division par cinq est applicable.
Le total des plus-values est divisé par cinq. Le résultat ainsi obtenu est ajouté au revenu global net. Une fois calculé l'impôt dû sur cette somme, et celui normalement dû sur le revenu courant, on fait la différence entre ces deux termes.
Le chiffre ainsi obtenu représente la cinquième de l'impôt correspondant à la plus-value.
L'impôt est donc égal à cinq fois la cotisation supplémentaire ainsi obtenue.

c) Plus-values réalisées à long terme

Les plus-values mobilières réalisées plus de dix ans après l'acquisition des titres sont exonérées par la Loi.

d) Les moins-values

Les moins-values réalisées sur des valeurs mobilières soumises à l'imposition sont imputables sur les plus-values de même catégorie réalisées dans l'année ou dans les cinq années suivantes. Elles ne peuvent être en aucun cas déductibles des revenus imposables du contribuable.

3.2.4. *Création et fonctionnement du compte spécial d'investissement*

3.2.4.1. *Création*

La loi réserve la faculté aux personnes physiques et aux clubs d'investissement de constituer auprès d'intermédiaires agréés, un compte spécial d'investissement.
Celui-ci est destiné à l'acquisition et à la détention d'un portefeuille de valeurs mobilières côtées en Bourse.
Il est alimenté par des versements en espèces.
Toutefois pourront être intégrés à ce compte:
1) les titres recueillis par voie de succession, pour la valeur retenue pour l'assiette des droits de mutation à titre gratuit.
2) Les titres détenues lors de l'entrée en vigueur de la Loi, ils pourront alors être déposés dans un délai de six mois.

Ce compte est constitué par des valeurs mobilières soumises à la taxation, et n'entrant pas dans le champ d'application de l'article 160 du C.G.I.

3.2.4.2. *Fonctionnement du compte*

Dans le cadre d'un compte spécial d'investissement, ne sont soumis à l'imposition des plus-values que les retraits de compte qu'ils aient lieu en espèces ou en titres.
Pour déterminer cette plus-value, le capital investi est divisé en un certain nombre de parts.
Le prix de la part est évalué en fonction de la valeur globale du compte.

EXEMPLE IV (fonctionnement d'un compte spécial d'investissement)

Année n:
Ouverture d'un tel compte, avec un apport de 40.000 Francs en titres. Cet apport donne lieu à la création de 400 parts fictives de 100 Francs chacune.

Année n+2:
Le titulaire du compte fait un apport en espèces de 20.000 Francs.
La valeur globale du compte est alors de 64.000 Francs avant apport.
La valeur de la part est de:

$$\frac{64.000}{400} = 160 \text{ Francs}$$

L'apport de 20.000 Francs donne alors lieu à la création du nombre de parts suivant:

$$\frac{20.000}{160} = 125 \text{ Parts}$$

Le titulaire a donc au total 525 Parts

Année n+3:
Un apport de 20.000 Francs est effectué.
La valeur globale du compte est alors de 105.000 Francs avant apport.
La valeur de la part est de:

$$\frac{105.000}{525} = 200 \text{ Francs}$$

Nombre de parts attribuées:

$$\frac{20.000}{200} = 100 \text{ Parts}$$

Le titulaire a donc au total 625 Parts

Année n+7:
Le titulaire du compte effectue un retrait de 60.000 Francs.
La valeur globale du compte est de 187.500 Francs.
La valeur de la part se monte à:
187.500 : 625 = 300 Francs

Nombre de parts représentées par le retrait de 60.000 Francs:
60.000 : 300 = 200 Parts

Ce nombre de parts correspond aux apports les plus anciens, donc à ceux effectés à l'année n.
La valeur de la part à l'année n était de 100 Francs.
La valeur d'acquisition des 200 Parts cédées est donc de:
200 x 100 = 20.000 Francs

La plus-value est réalisée à moyen terme, il convient d'appliquer le coefficient d'érosion monétaire correspondant
Le coefficient appliqué est de 1,60 (fictif).
Valeur d'acquisition réévaluée:
20.000 x 1,60 = 32.000 Francs

Plus-value brute:
60.000 — 32.000 = 28.000 Francs

Plus-value taxable:
Les valeurs mobilières bénéficient d'un abattement de 50 pour cent.
La plus-value taxable est donc de
14.000 Francs

En ce qui concerne la détermination de la plus-value, tout apport est assimilé à l'achat d'un certain nombre de parts, et tout retrait à une cession de parts.
La plus-value est calculée en faisant la différence entre le prix des parts cédées auquel correspond le retrait, avec le prix d'acquisition d'un nombre équivalent de parts correspondant aux apports les plus anciens.
Le prix d'acquisition, lors d'une plus-value réalisée à moyen terme, est réévalué en fonction du coefficient de hausse des prix.
En cas d'exonération, le délai de dix ans est calculé à compter de la date des apports auxquels correspond le retrait.
Le titulaire d'un compte a la possibilité d'avoir des disponsibilités de remploi. Le montant de ces disponsibilités ne doit pas excéder 15 pour cent de la valeur estimable et globale du compte pendant un délai de deux mois.
Les revenus qui ont pour origine le titre détenu ou les produits des liquidités ne peuvent être porté au crédit de ces comptes.

3.2.4.3. *Maintain du régime antérieur*

Antérieurement à cette loi, les opérations de Bourse effectuées à titre habituel par les particuliers étaient imposables au titre des bénéfices non-commerciaux.
Ces dispositions ont été maintenues dans le but "de pouvoir taxer plus lourdement les opérations habituelles qui s'apparentent beaucoup plus à des actions spéculatives qu'à la gestion normale d'un portefeuille.

3.3. DISPOSITIONS ANNEXES

3.3.1. *Les rapatriés*

La loi du 15 juillet 1970 a institué une contribution nationale à l'indemnisation des Français ayant été dépossédés de biens situés dans un territoire antérieurement placé sous la souveraineté, le protectorat ou la tutelle de la France.
Pour effectuer cette indemnisation, l'Administration a donné aux différents biens une valeur d'indemnisation.
En se basant sur cette valeur, la Loi a prévu d'allouer aux rapatriés une indemnité.
La loi actuelle assimile à une moins-value, la différence entre la valeur d'indemnisation et l'indemnité effectivement reçue.
Cette moins-value peut s'imputer sur les plus-values réalisées.
Cette déduction sans limite de durée ne peut pas dépasser 75.000 Francs. Elle s'opère sur toutes les plus-values réalisées, qu'il s'agisse de plus-values mobilières ou immobilières.
Une seule restriction est posée à ce principe, la plus-value réalisée ne doit pas être imposable suivant les dispositions en vigueur avant cette nouvelle Loi.
C'est ainsi que sont exclues les plus-values réalisées sur les terrains à bâtir.

3.3.2. *Les sociétés par actions non-côtées en bourse*

La loi a visé à faciliter le contrôle de la nouvelle imposition sur les plus-values réalisées en matière mobilière.
Aussi, ces dispositions particulières ne concernent pas:
1) les sociétés côtées en Bourse,
2) les sociétés dont le capital social n'est pas divisé en actions.

Sont visées par ces dispositions spéciales: "Les sociétés par actions dont les titres ne sont pas inscrits à la côte officielle d'une Bourse de Valeurs ou ne sont pas admis aux négociations du marché hors côte".
Ces sociétés ont l'obligation soit:
1) de prévoir la mise sous forme nominative de toutes les actions d'une manière obligatoire.
2) de laisser aux actionnaires le choix entre:
   a) la conversion de leurs titres en titres nominatifs,
   b) le dépôt des titres dans un établissment financier tel une banque, un établissement financier habilité à recevoir des dépôts ou encore un agent de change.

La première assemblée générale ordinaire ou extraordinaire fixée après l'entrée en vigueur de la Loi, doit obligatoirement statuer sur la modification des statuts ainsi imposée.
A défaut, le président du Tribunal de Commerce homologuera la modification qui lui aura été soumise par les représentants légaux de la société.

3.3.3. *Les contribuables domiciliés à l'étranger*

3.3.3.1. *Les personnes visées*

Il s'agit d'une part:
— des personnes physiques ayant leur domicile réel hors de France quelle que soit leur nationalité,
— des personnes morales ayant leur siège social hors de France.

3.3.3.2. *Les personnes exonérées*

Il s'agit des Organisations Internationales et des Etats Etranger, des Banques Centrales, et des Institutions Publiques Financières de ces Etats.

3.3.3.3. *Le mode d'imposition*

La présente Loi prévoit un prélèvement d'un tiers, c'est-à-dire de 33 1/3 pour cent. Le prélèvement de 50 pour cent qui existait auparavant pour les terrains à bâtir et assimilés, et les profits réalisés par des professionnels ne subsistera qu'à l'égard de ces derniers.

3.3.3.4. *Les biens visés*

a) les biens immobiliers

Le prélèvement s'applique sur les plus-values résultant de la cession:
1) d'immeubles bâtis ou non bâtis,
2) de droits immobiliers,
3) d'actions ou parts de sociétés non-côtées en Bourse en constituées par un capital comprenant principalement de tels immeubles ou de tels droits.

Cette législation s'applique aux immeubles situés en France; les Français domiciliés à l'étranger bénéficiant de certaines exonérations.

b) les biens mobiliers

(i) les valeurs mobilières:

Le prélèvement n'aura lieu qu'en ce qui concerne les valeurs mobilières représentant une participation supérieure à 25 pour cent.
Dans ce cas, le prélèvement a lieu lorsque ces valeurs sont détenues depuis moins de dix ans.
Il n'y a pas de prélèvement pour toutes les autres valeurs mobilières qu'elles soient françaises ou étrangères.

(ii) les marchandises:

Les Etats Etrangers, Institutions Publiques Etrangères, et personnes n'ayant pas leur domicile en France ou leur siège social ne sont pas imposées pour les plus-values réalisées sur des marchandises achetées ou vendues sur un marché à terme de marchandises.

3.4. IMPOSITION DES METAUX ET OBJETS PRECIEUX

3.4.1. *Champ d'application*

3.4.1.1. *Les biens visés en cas de cession*

a) les métaux précieux

Selon la terminologie courante, il s'agit de l'or, de l'argent, et du platine.

L'imposition s'applique aux lingots d'or et aux pièces d'or françaises ou étrangères. A noter cependant que les métaux précieux constituant la monture de bijoux entrent dans la catégorie des objets précieux.

b) les objets précieux

Figurent dans cette catégorie:

(i) les objets d'art:

Ce sont essentiellement:
— Les tableaux, peintures, dessins, aquarelles, gouaches, pastels, monotypes, qui ont été exécutés entièrement de la main de l'artiste.
— Les gravures, estampes, et lithographies, tirées en nombre limité de planches entièrement exécutées de la main de l'artiste.
— Les productions de l'art statuaire, de la sculpture et des assemblages entièrement exécutés de la main de l'artiste. Les fontes de sculpture lorsque le tirage est limité à huit exemplaires lorsqu'elles sont contrôlées par l'artiste.
— Les tapisseries tissées entièrement de la main de l'artiste sur métier de haute ou de basse lisse, ou exécutées à l'aiguille d'après maquettes ou cartons, le tirage doit être également limité à huit exemplaires avec contrôle de l'artiste.
— Les exemplaires uniques de céramiques exécutés et signés de la main de l'artiste.
— Les émaux sur cuivre exécutés entièrement à la main limités à huit exemplaires numérotés avec la signature de l'artiste et de l'atelier d'art. Sont exclus les articles de bijouterie, d'orfévrerie et de joaillerie.

(ii) les objets de collection:

Ce sont les monnaies, médailles, les timbres et les livres précieux, les autographes, les armes, les instruments de musique.
En règle générale "les objets pour collections présentant un intérêt historique, archéologique, paléontologique, ethnographique et numismatique, ainsi que les collections et spéciments pour collections de zoologie et de botanique, de minéralogie et d'anatomie".

(iii) les objets d'antiquité:

Sont concernés, les objets d'art et les meubles anciens, ainsi que les antiquités françaises ou étrangères.

(iv) les bijoux:

Il s'agit des montures comportant du métal précieux et des pierres, et également des pierres non serties.

3.4.1.2. *Les personnes imposables*

Ce sont les personnes physiques qui dans le cadre de la gestion de leur patrimoine privé réalisent la vente de tels biens.
Sont exonérées les personnes qui font le commerce de ces biens à titre professionnel lorsqu'elles vendent. A titre d'exemple sont exonérés les bijoutiers, les antiquaires, les marchands de tableaux, les établissements financiers ou bancaires.

3.4.1.3. *Les opérations soumises à l'imposition*

L'imposition s'applique à la vente qu'il s'agisse d'une vente amiable ou aux enchères publiques.
L'exportation est assimilée à une vente, il s'ensult que les biens exportés sont imposables, sauf si l'exportation a un caractère temporaire.

3.4.1.4. *Les exonérations*

Elles concernent uniquement les objets précieux. Sont exonérées:
a) Les biens dont la vente est faite à une Musée National, un Musée classé contrôlé par l'Etat, ou à une Collectivité Locale, à une Bibliothèque Nationale, ou une autre Bibliothèque de l'Etat ou d'une autre Collectivité Locale.
b) Les ventes dont la valeur ne dépasse pas 20.000 Francs étant précisé que chaque vente doit être considérée de manière isolée.
c) Lorsque le propriétaire du bien n'a pas en France sa résidence habituelle, et lorsque d'autre part, le bien exporté a été acquis en France auprès d'un professionnel, ou a donné lieu au paiement de la taxe lors de son acquisition, et lorsque le propriétaire du bien est en mesure de justifier d'une importation antérieure.
d) Lorsque le contribuable qui n'a pas en France sa résidence habituelle, vend aux enchères publiques les objets en question.

3.4.2. *Modalités de la taxation*

3.4.2.1. *Les métaux précieux*

La Loi nous précise que la vente des métaux précieux est soumise à une taxe de 4 pour cent sur le prix de vente. Cette taxe s'applique sans franchise ni décôte.
C'est ainsi que pour une vente de 20.000 Francs, la taxe due est de:
20.000 x 4 pour cent = 800 Francs

3.4.2.2. *Les objets précieux*

a) décôte

Lorsque le montant de la vente est compris entre 20.000 Francs et 30.000 Francs, le prix de vente est diminé d'une décôte égale à la différence entre 30.000 Francs et ce prix.
Au-dessus de 30.000 Francs, il n'y a aucun abattement. L'abattement est à considérer pour chaque vente prise d'une manière individuelle.

Les limites de la décôte prévues par la présente Loi pourront être revisées lorsque l'indice moyen annuel des prix à la consommation aura varié dans un proportion de 10 pour cent.

b) le taux de la taxe

Le taux de la taxe est fixé à 3 pour cent. Ce taux est ramené à 2 pour cent dans le cas de vente aux enchères publiques. Toutefois, le contribuable a la faculté d'opter pour l'imposition selon le régime général des plus-values.
La base de la taxation est alors le montant de la plus-value réalisée du fait de la vente. Le vendeur devra justifier la date et le prix d'acquisition du bien vendu.

EXEMPLE V

Soit un tableau vendu pour la somme de 25.000 Francs. Cette vente est inférieure à 30.000 Francs, il y a donc lieu d'appliquer la décôte.
Montant de la décôte:
30.000 — 25.000 = 5.000 Francs
Prix imposable:
25.000 — 5.000 = 20.000 Francs
Montant de la taxe:
20.000 x 3 pour cent = 600 Francs

c) paiement de la taxe

Le montant de la taxe doit être versé par l'intermédiaire ou à défaut par l'acheteur du bien. C'est à l'acheteur d'en récupérer le montant auprès du vendeur.
Le versement doit s'effectuer dans les trente jours de la vente. Les mêmes garanties de recouvrement qu'en matière de taxe sur le chiffre d'affaires s'appliquent ici.

3.5. TAXATION DES PLUS-VALUES D'ORIGINE PROFESSIONNELLE

Le Législateur a entendu réaliser une harmonisation des textes existants et portant sur l'imposition des plus-values d'origine professionnelle.
Désormais, l'imposition de la plus-value est fonction du chiffre d'affaires réalisé.

3.5.1. *Exonération*

Les plus-values réalisées dans le cadre d'une activité agricole, artisanale, commerciale ou libérale sont exonérées lorsque le montant des recettes n'excéde pas la limite du forfait ou de l'évaluation administrative. Rappelons que les limites du forfait sont actuellement de:
— 500.000 Francs pour les ventes de marchandises et la fourniture de logement;
— de 150.000 Francs pour les services;
— de 500.000 Francs en matière agricole;
— de 175.000 Francs pour les professions non-commerciales.

Cependant il faut en outre:
1) que l'activité professionnelle ait été exercée à titre principal,
2) qu'elle ait été exercée pendant une durée de cinq ans au moins.

Si ces deux conditions ne sont pas remplies, les plus-values seront imposées selon le régime général des plus-values réalisées par des particuliers.

3.5.2. *Imposition*

Le régime des plus-values d'actif immobilisé réalisées à court terme et à long terme applicable aux professions industrielles et commerciales, puis aux professions agricoles est applicable également aux professions non-commerciales.
Le taux d'imposition des plus-values en matière de bénéfices non-commerciaux est de 10 pour cent.
Les cessions de terre d'une entreprise agricole ne peuvent être imposées qu'à la condition de figurer à l'actif du bilan.

3.5.2.1. *Imposition des fruits de la propriété industrielle*

Les cessions de brevets étaient, jusqu'à présent dispensées d'imposition, à la seule condition que l'inventeur ne participe ni directement, ni indirectement à son exploitation.
En revanche les redevances perçues par les inventeurs ou leurs héritiers en ce qui concerne la concession des licences d'exploitation de brevets étaient imposables au titre des bénéfices non-commerciaux.
Désormais sont placées sous le régime des plus-values à long terme:
1) la cession de brevets, de procédés ou de techniques;
2) La concession de licences exclusives d'exploitation;
3) La concession de licences d'exploitation en ce qui concerne un secteur géographique déterminé ou une utilisation particulière;
4) La cession de brevets ou la concession de licences exclusives d'exploitation de brevets en cours de délivrance.

Ces droits doivent faire partie de l'actif immobilisé et ne pas avoir été acquis à titre onéreux depuis moins de deux ans.
Les redevances perçues à l'occasion de l'exploitation de ces droits de propriété industrielle n'entrent pas dans ce régime d'imposition lorsqu'elles viennent en déduction de l'assiette de l'impôt dû par le concessionnaire, et lorsque des liens de dépendance existent entre l'entreprise concédante et l'entreprise concessionnaire.
Les redevances venant de la concession de licences non-exclusives de brevets, procédés ou techniques ou de la cession, ou de la concession de marques de fabrique sont imposables au titre des bénéfices non-commerciaux, au taux normal de l'impôt.

3.5.2.2. *Les biens ayant appartenu pendant un laps de temps au patrimoine privé de l'exploitant*

Lorsqu'un bien a figuré pendant un certain laps de temps dans le patrimoine privé du contribuable avant de figurer au bilan de l'entreprise, la plus-value correspondant à cette période est taxée dans les conditions édictées pour celles réalisées par des particuliers.
Il y a donc dans ce cas, d'une part, imposition selon le régime des plus-values réalisées par des particuliers, et, d'autre part, imposition selon le régime des plus-values réalisées par des professionnels.
Dans ce cas, il y a exonération des terrains agricoles ou forestiers. Il n'y a pas imposition à la triple condition:
1) qu'il ne s'agisse pas d'un terrain à bâtir,
2) que le terrain ait été exploité dans le cadre d'une activité agricole principale,
3) que cette activité ait été exercée pendant cinq ans au moins.

3.5.2.3. *Profits immobiliers professionnels et profits de construction*

a) Lotissement

Les lotisseurs professionnels ayant la qualité de marchands de biens sont imposés suivant les règles des bénéfices industriels et commerciaux.
Par contre, lorsque le lotisseur n'a pas la qualité de marchand de biens, c'est le régime des plus-values réalisées entre particuliers qui est applicable.
L'exonération prévue pour les opérations de caractère patrimonial et les modalités particulières de fixation du prix de revient des terrains lotis ont été supprimées.

b) Opérations de construction

Les opérations de construction donnent lieu à perception d'un prélèvement de 33 1/3 pour cent lorsqu'elles sont réalisées par des personnes physiques ou des sociétés de personnes.
Ce prélèvement peut être libératoire de l'impôt sur le revenu. Dans ce cas, la Loi prévoyait un mode pariculier de calcul du prix de revient qui subissait certaines corrections.
Ce système est supprimé par la nouvelle Loi.

3.5.2.4. *La cession des charges et offices*

Pour toutes ces cessions, le montant de la plus-value imposable est constitué par la différence entre le prix de cession et d'acquisition compte tenu des frais accessoires inhérents.

Le système qui permettait d'appliquer un coefficient de réevaluation pour les Etudes acquises avant le 31 décembre 1960 a été supprimé.
Lorsque la cession s'effectue après deux ans d'exercice de la profession ou à la suite du décés du contribuable, la plus-values est imposé au taux de 10 pour cent. Ce taux était antérieurement de 6 pour cent.
Si la cession a lieu avant deux ans d'exercice de la profession, la plus-value est intégrée pour sa totalité au revenu imposable et soumise à l'impôt sur le revenu.

3.5.2.5. *Les Sociétés Civiles Professionnelles*

Les associés sont personnellement soumis à l'impôt sur le revenu pour la part des bénéfices qui leur est attribuée.
Les modalités d'imposition sont identiques à celles en vigueur lors de la cession personnelle d'une charge ou d'un office. L'apport d'une clientèle ou d'éléments d'actif destinés à l'exercice de la profession a le caractère d'une cession à titre onéreux et peut donc donner lieu à une plus-value imposable.
En ce qui concerne les sociétés civiles professionnelles, la taxation de ces plus-values peut être reporté au moment de la transmission ou du rachat des droits sociaux par l'intéressé.
La taxation ultérieure est alors établie selon le régime applicable au moment de l'apport.

3.6. OBSERVATIONS

Le Gouvernement présentera, chaque année, à partir de 1978, un document en annexe du projet de Loi de Finances qui précisera les points suivants:
1) Le produit de l'impôt,
2) le nombre des assujettis,
3) la répartition par catégorie de biens, des cessions imposées,
4) le nombre des litiges avant opposé l'administration et les contribuables,
5) la nature des difficultés d'intervention auxquelles aura donné lieu l'application de la Loi et les solutions retenues,
6) l'effet de l'impôt sur l'évolution des transactions et le comportement des épargnants,
7) le coût de recouvrement de l'impôt,
8) l'évolution des éléments de calcul de la plus-value.

4. CONCLUSION

Par la Loi du 19 juillet 1976, le Législateur a mis notre législation fiscale en harmonie avec les autres pays.
C'est ainsi que les Etats-Unis d'Amérique ont taxé les plus-values depuis 1913, la République Fédérale d'Allemagne depuis 1925, et la Suède depuis 1928.
Le Japon, la Belgique, le Royaume-Uni, l'Espagne, l'Irlande, l'Italie ont adopté une telle législation au cours de ces dix dernières années.
Il y a lieu de noter que sont imposées les plus-values réalisées sur la quasi-totalité des transactions en Espagne, aux U.S.A., en Islande et au Japon.
Les Etats-Unis prévoient quelques exonérations pour les résidences principales, et le Japon fait porter les exonérations sur les actions.
Le Royaume-Uni exclut de l'imposition les habitations principales et les automobiles ainsi que certaines valeurs mobilières.
La Suède prévoit l'imposition des plus-values réalisées tant sur la vente des biens mobiliers qu'immobiliers.
En Allemagne, pour être imposables, les plus-values immobilières doivent être réalisées avant deux ans, et avant six mois pour tous les autres biens. Il en est de même au Luxembourg.
En Belgique, seules sont imposées les plus-values réalisées sur les terrains à bâtir revendus avant huit ans.
L'Italie et la Suisse imposent les plus-values réalisées à l'occasion de la vente d'immeubles.
La Loi qui est complexe, a prévu que ses conditions d'application seront précisées en tant que de besoin par des décrets en Conseil d'Etat. Cette mise au point exigera certainement beaucoup de soins.
Si un jour l'impôt sur le capital, dont on a tant parlé dernièrement, était appliqué en France, il faudrait alors songer, comme l'a dit le Président Edgar Faure, à l'abrogation pure et simple de cette nouvelle loi sur les plus-values.

CAPITAL GAINS TAX ON SECURITIES — FRENCH GOVERNMENT HESITATES

On April 6, 1977 the French government announced that it will postpone the introduction of capital gains taxation on securities (which was planned for January 1, 1978) with another year to January 1, 1979.
One of the reasons given is that the current stock index at the Paris Stock Exchange which is ominously low, may have an adverse effect on investment and the creation of new employment so that the further extension of the application of the capital gains legislation seems inopportune at this moment. In addition, it would give the French tax administration some more time to draft the rulings with respect to the capital gains tax on securities.
However, it seems likely that there are also political reasons behind the new Government decision. It may be recalled that the Government parties were heavily defeated in the recent municipal elections, which indicates that the Government may have lost a substantial part of its support under the middle classes. Another aspect which may have influenced the Government is that the Gaullists were against the introduction of the capital gains tax and that Mr. Chirac, the former Prime Minister, made very few efforts to conceal his dislike of the tax when he was in office. Postponement of the introduction of a major part of the tax or even a discrete abolition might help to clear the political atmosphere between the present coalition partners.

TAX GLOSSARY

by H.W.T. PEPPER *

ABATEMENT — A term broadly used for deductions in computing tax, and particularly those which reduce the *rate* payable, e.g. the deductions commonly given to individual income taxpayers for dependants, and the application to individuals of graduated tax rates commencing at a level lower than the rate applied to companies (corporations); as regards sales tax, deductions or reliefs, such as those allowed under the French VAT system to small traders.

ABATTOIR TAX — A tax encountered in some countries, usally as a specific sum per head of animals slaughtered, and intended either as a service tax on this among other *services*, or as a semi-luxury tax where the majority of the population subsists on a non-meat diet.

ABONNEMENT — The system used in Italy, in connection with the old multi-stage sales tax, to estimate the liability of traders in cases of inadequate or unreliable records. See also FORFAIT. Such methods are commonly used in most countries where business records are unsatisfactory, though most do not have any specific name for such administrative methods.

ABORTIVE PROSPECTING, ALLOWANCE FOR — Where the explorations of mining entrepreneurs are unsuccessful and the area being prospected is abandoned for further exploration, some countries provide an income tax allowance in respect of the expenditure incurred on the exploration, permitting the allowance to be off-set against other mining income. Where the prospecting, though initially abortive, is not abandoned, it is not usual to grant an allowance because subsequent exploration by the same entrepreneur may prove successful, in which case the whole cost of all the prospecting would usually be depreciable as being the cost of setting up the eventual mine.

ABSORPTION OF TAX — Term applied when a sales tax is not wholly shifted forward to the purchaser of the goods or services but partly borne by the seller or entrepreneur. (See also SHIFTING OF TAX.)

"A BUCK IS A BUCK IS A BUCK" — The phrase used colloquially to express the recommendations of Canada's Carter Commission (Royal Commission on Taxation which reported in 1967), that broadly speaking, all net incomings should be taxable (sometimes known as the accretion concept). An individual's taxable base would include income in the ordinary income tax sense plus realized capital gains, gifts and bequests, and plus certain inputed income including income earned by life insurance companies on policy reserves, and plus fringe benefits that could be quantified for tax purposes, all ranking as equally taxable.

ACADEMIC TAX — A levy proposed by the Soviet Union in September 1972 and variously also known as the "Brain Tax", "Diploma Tax", "Education Tax", "Exit Tax", and "Graduates Tax" upon those wishing to emigrate from Russia who had received their education and training there. The levy purported to recoup for the State the cost of educating each emigrant but was not apparently to be abated by the number of years a would-be emigrant had worked in Russia since graduating.

ACCELERATED DEPRECIATION — In many states entrepreneurs may opt for additional depreciation allowances during the first few years after acquisition of business assets. Such allowances exceed the actual depreciation by use of the assets and are intended as an incentive to capital investment, improving the cash flow of the business by reducing the tax payable in the years concerned. (See also FREE DEPRECIATION.)

ACCESSIONS TAX — A tax on money or other assets received by a taxpayer by way of gift or bequest. Both types of receipts or "accessions" are usually taken into account in applying graduated rates of tax. (See also "A Buck is a Buck. ." and "CAPITAL TRANSFER TAX".)

ACCOMMODATION OCCUPIED BY EMPLOYEE — Many states levy income tax on the value of the ("Fringe") Benefit (or Perquisite) inherent in the provision by the employer of free or subsidised residential accommodation for an employee, including a director or executive. Where the accommodation is necessarily occopied as a condition of the employment, e.g. apartments over a shop or factory, it is usual to regard the arrangement as "Representational" rather than as a clear benefit, and not to levy extra tax. Other examples of non-taxable or not fully taxable types of accommodation are — a cottage on a farm (where there is an implication that the employee may be called out at night to deal with sick livestock), excessively large accommodation allotted to a minister of religion with the implication that he will hold meetings of his followers on the premises.

ACCOUNTING BASIS — Method of calculating income tax, (in some cases also sales tax and payroll taxes) by reference to a taxpayer's accounting year instead of by reference to a tax year or fiscal year. (See also, however, ACCRUALS BASIS, and regarding V.A.T. ACCOUNTS BASIS.)

ACCOUNTING PERIOD — While income tax is normally computed by reference to the income of a full (fiscal) year and for an individual, by reference to his personal circumstances of that year, an accounting period may sometimes be adopted instead. Where an enterprise consistently makes up its accounts to a fixed date in the year other than the last day in the fiscal year some states accept the accounting year instead of the fiscal year for the purpose of calculating the years's tax liability. The alternative is to apportion the profits of two accounting periods (See APPORTIONMENT OF INCOME), which may delay the determination of liability to tax. On change of accounting date it may be necessary to apportion profits so as to ensure that no more nor less than 12 months' profits are charged for any one year. (See also ANNUALISATION, CHANGE OF ACCOUNTING DATE). For other taxes such as sales tax, and flat rate payroll taxes it is usually of less significance to relate the tax to fiscal years except where a change in the *rate* of tax is related to the beginning of the fiscal year.

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* *With the assistance of the staff of the International Bureau of Fiscal Documentation.*

ACCOUNTS BASIS — The method of computing V.A.T. as a percentage levy on the excess of sales over purchases is known as the "accounts basis". The method remains a theoretical concept as none of the V.A.T. countries uses it. The advantage of the method is that it would enable an exemption or abatement of tax at an earlier level to be carried through to the final price of the goods or services where it was desired to give a tax preference, e.g., to handicrafts or perishable farm produce, without altering the impact of tax at the wholesale and retail levels. The disadvantage would be the greater complexity of the tax and the possibility that neither the producer nor the consumer would receive the appropriate benefit from the tax forgone.

ACCRETION CONCEPT — The principle that a taxpayer should be taxed not solely on defined income but on the amount by which his wealth increases annually for whatever reason. (See also ACCRETION, NET.)

ACCRETION, NET — The net accretion method of computing income is used when trying to compute the true income in cases where there has been tax evasion. The method is also enshrined in the tax legislation in a number of countries, particularly in Latin America as a normal method of calculating profits for assessments in some cases whether or not the taxpayers's records are inadequate. The net wealth, or "worth" (assets less liabilities) of a taxpayer at certain dates, e.g., the beginning and end of the base tax year, are compared and the taxable income for the period is computed as the net increase or accretion of wealth between the comparison dates plus what has been spent on personal consumption, etc. Specifically non-taxable receipts*, such as gifts or bequests, may be deductible in such calculations. (* or those subjected to other taxation).

ACCRUALS BASIS — Normal method of calculating income tax, and sales taxes, by reference to income earned and sales made during the taxable period, rather than to the cash received or drawn in respect of the income or sales.

ACCUMULATED EARNINGS TAX — A tax levied in the USA where income tax is adjudged to have been avoided by unreasonably large accumulations of profits by corporations. Where, as in the USA, tax is levied on corporations' profits and also on the shareholders on the dividends paid out of those profits, the latter tax may be avoided or delayed by non- or deferred distribution. This type of tax is also levied in other states with similar tax structures.

ACCUMULATION SETTLEMENT — A device for avoiding high rates of personal income tax by transferring assets to a trust in which the investment and yield therefrom may be accumulated until the coming of age of a minor child. The total funds may be transferred at that time to the (now adult) child without attracting tax, under the tax regimes of some states. Whilst the funds are accumulating, tax is normally payable only by the trust, not by the donor, while the child may obtain a refund of some or all of the tax paid by the trust when he attains his majority.

ACQUISITION: OF STOCKS & SHARES BY DIRECTORS ETC. — Some corporate enterprises have schemes under which directors and key executives may acquire shareholdings on favourable terms, either as a mere FRINGE BENEFIT (q.v.) or as an incentive to help make the enterprise more prosperous and thus enhance the value of the shares of the enterprise (including their own holdings) so that they may make a capital gain over the price at which they acquired the shares. Under some tax systems income tax is applied to the gains by specific provisions in the tax law. In other states the gains may be treated as capital so that more favourable tax treatment results, and the value of the 'incentive' element in the scheme is accordingly increased.

ACQUISITION DUTIES — Taxes on the acquisition of assets by bequests or gift. (See DEATH DUTIES, GIFT TAXES.)

ADDED VALUE — Broadly, the difference between the cost price for goods paid by the entrepreneur and the sale price of the same goods, the difference in money terms representing the value added either by processing, or merely distributing, the goods concerned. (See also "Value Added Tax" and "Gross Profit".)

ADDED VALUE TAX — A tax on ADDED VALUE (q.v.). See VALUE ADDED TAX.

ADMINISTRATIVE COSTS — The cost, usually expressed as a percentage of the yield, of collecting a tax, sometimes referred to as the "expense ratio".

"ADMINISTRATION" OF ESTATE — Under the laws of certain countries there is an "administration period" which commences on the death of an individual and ends when the deceased's assets have been realised, distributed or conveyed to trustees where they are to be held in trust. Special tax provisions may be necessary in respect of this period to ensure that the income arising is properly attributed to those entitled to it, and charged at the tax rates appropriate to them.

ADMISSION TAXES — Taxes on the price of admission, usually to places of entertainment or "spectacles", including cinemas, theatres, cabarets, nightclubs, bullfights, football and boxing matches. The tax is usually either ad valorem or graded as a series of specific levies in line with the relative price brackets.

ADOPTED CHILD — An allowance is often made from income tax for a dependent child which has been adopted formally under adoption laws, or de facto where a child, for example, the orphaned child of a relative, has been taken informally into the household. Sometimes there are religious or other obstacles to formal adoption under a country's adoption laws and a liberal attitude to the granting of a deduction is often taken, either in the tax law or in the administration of it, to give due credit for what is normally socially desirable, i.c., that a child should be brought up with a family rather than in an institution.

ADUANAS — Spanish for customs duties.

AD VALOREM DUTIES — The ad valorem concept (Ad valorem = "According to value") is widely applied to customs duties and almost invariably to sales taxes, except that in the case of customs duties ad valorem duties are sometimes linked with minimum "specific duties" (q.v.) where valuation is likely to present problems.

ADVANCE RULINGS — Where an entrepreneur or investor wishes to set up an enterprise or make an investment, he may wish to know in advance the precise effect of the tax laws of the country in which he is interested on what he wishes to do. To a large extent the effect of the laws may be gauged by reference to the texts and to explanatory booklets prepared officially, but for greater detail or more complicated proposals it may be necessary to consult the administration. In some states (Holland is a good example) advance rulings are given of what the position would be where the proposals are set out clearly. In Britain the extent to which the tax law is modified to avoid hardship in practice is set out in published booklets explaining the concessions. Other countries tend to be reluctant to give rulings on the grounds that the case put to them is "hypothetical", in which case the person concerned can only resort to trying to obtain professional advice in the private sector.

ADVANCE CORPORATION TAX — Advance payments of corporation tax (A.C.T.) under the British system, consisting, in fiscal year 1976-77, of 35/65ths of each dividend paid, have to be accounted for by the end of the quarter of the year in which the dividend occurred. The pre-payments are set in due course against the MAINSTREAM CORPORATION TAX (q.v.) payable by the company on its income.

ADVENTURE IN THE NATURE OF TRADE — One of the terms used in the British definition of "trade" for the purposes of income tax. "Trade" is defined by both statute and case law as being somewhat wider than the narrow concept of a regular commercial trade when income tax is to be applied. Most states similarly extend by one means or another the concept of "trade" or "business" in their tax laws.

ADVERTISING TAX — Taxes on advertisement hoardings (taxes sur les affiches) are not uncommon. A fairly recent development (in Britain) is a tax or levy on the advertising revenue of commercial television companies. In that country also a graduated tax on the advertising revenue of newspapers was mooted but not found acceptable, possibly because newspapers are not usually viable on the basis of the sale proceeds of the edition itself and need advertising revenue to survive, and to tax the latter might thus be classed as an indirect tax on knowledge or freedom of speech. Retail Sales taxes on advertising *materials* (brochures, handbills) are common, e.g., in the States of the U.S.A., and on the services of advertising agents under TVA systems. (See also Newspaper Tax.) Sweden has recently (1971) introduced a 10 percent advertising tax.

AFFIDAVIT — The term is used for the declaration of assets etc., made for death duty purposes by the executors of a deceased person or order that the tax liability may be computed. If in the course of administration further assets or debts of the estate come to light, a corrective affidavit may be filed.

AFFILIATED CORPORATIONS — Corporate enterprises may, under the laws of many states, be regarded as "affiliated" or "grouped" where one has voting control of another, or both are controlled by a third, or where both are members of a GROUP (q.v.).

AFFILIATION PRIVILEGE — A number of states (e.g. Austria, Britain, France, Holland, Luxembourg, USA) permit affiliated companies or corporations certain tax privileges, such as the "grouping" of profits and losses to minimise total tax payable (where one affiliate makes a profit and another a loss). Another relief commonly accorded relates to inter-affiliate dividends — these are relieved, in effect, from all vestiges of "double" or DUAL TAXATION (q.v.). The privileges are available to affiliated enterprises which are resident in the country concerned — some states (e.g. France, Holland) extend the privilege to non-resident affiliates.

AGENCY — A concept of importance in determining the liability within a country or state to income tax or sales or use tax of an entrepreneur outside that country or state. A person is taxable in a country if he trades *in* rather than merely *with* that country. In the former case an agent has to be identified who is performing enough acts on behalf of his principal to attract income tax liability as carrying on a trade. It is customary to define these acts of trade in double taxation agreements between countries. States in a federation may also agree upon similar guide-lines so as to delimit more precisely the liability to state income taxes. Similar problems also arise with sales and use taxes, e.g., in the states of the U.S.A. where a body of case law precedents and agreements between states on particular points is gradually being built up into a general code. A third application of "agency" is evinced in the powers usually taken by a country to declare a person an "agent" of a non-resident for the purpose of collecting tax due on income arising in the country (rent, royalties, interest, dividends, profits) where such income clearly falls to be taxed. The agent is usually the person who collects the income and who may or may not have certain other duties according to the nature of the income and what is involved in collecting it.

AGENTS, TAX — Tax agents or accountants specifically authorised by law to act for a taxpayer in fulfilling his obligations towards and agreeing his tax liability with the tax department are a feature of the tax scene in some countries. It is usual to stipulate basic qualifications for those wishing to exercise this profession so that the taxpayer is properly advised. The qualifications are gradually raised for newcomers to the professions. Such agents may be helped by hand-outs and explanations provided by the administration but agents found guilty of aiding or abetting tax evasion by taxpayers may have their licences cancelled.

AGE RELIEF — Some states abate income tax for taxpayers above a certain age, commonly 65, either by providing a higher exemption limit or by allowing a specific additional deduction for the age factor. Britain uses the former method, the USA grants an extra "exemption" deduction for each spouse or single person over 65, and various such reliefs are to be found in other tax systems. Abatement of other taxes, such as tobacco duty, have at times been made in favour of the old and indigent, but have proved difficult to administer. Some States in the USA abate property tax to the aged.

AGGREGATION — The system of adding together an individual's income from all sources for the purpose of computing his liability to a graduated income tax. Aggregation also applies to the assets of a deceased person which are liable to graduated estate, succession, or transmission duties. As an anti-avoidance device, aggregation is sometimes employed to counteract avoidance by a married person transferring income or capital to a spouse, or to minor children, or, in the case of "death duties" by inter-vivos transfers within a few years of death. For this purpose income of the married couple, or parents plus minor children, is aggregated for the purpose of applying the scale of graduated rates of tax. For "death duties" all assets including those disposed of within a few years of death are aggregated.

AIRCREW, TAXATION OF — As in the case of SEAMEN (q.v.) special rules are sometimes employed in determining the tax, particularly where income tax is to be dealt with, for air crews. Sometimes the place of assessment will be the head office of the airline or charter company, sometimes the residence of the airman, and occasionally the base airport from which the airman is allocated his route or duties. The matter is often covered in the articles of a Double Taxation treaty between two countries where the airline concerned provides air services between the two countries.

[to be continued]

COUNTRY BY COUNTRY SURVEY OF LOOSE-LEAF PUBLICATIONS . . .

EUROP. ECONOMIC COMMUNITY

DROIT DES AFFAIRES DANS LES PAYS DU MARCHE COMMUN

Tome V: Régimes Fiscaux
Edition Jupiter, 21-23 rue Mont-Thabor, 7500 Paris.
Supplemented: regularly.

Loose-leaf publication on "Business Law in the Countries of the European Economic Community" consisting of various volumes divided into eleven Parts. Part V deals with taxation. Each Part deals with one subject, only, but following a common outline it makes a comparison with every country of the Economic Communities possible. Every text of the legislation is published in the home-language and in the French translation, thus enabling a proper interpretation of the law. The texts are analysed and interpreted in studies prepared by lawyers of every country in question. The material is kept up to date by the issue of supplementary pages.

DROIT D'ETABLISSEMENT — NIEDERLASSUNGSRECHT

JURA EUROPAE series: Droit des pays de la Communauté Economique Européenne/Das Recht der Länder der Europäischen Wirtschaftsgemeinschaft.
Verlag C.H. Beck, Wilhelmstrasse 9, Munich 40.
Editions Techniques Juris-Classeurs, 123 Rue d'Alésia, 75014 Paris.
Supplemented: regularly.

Loose-leaf publication providing an outline of the provisions relating to the establishment of a business, the rendering of services and the exercise of a free profession in each of the firs six EEC member countries. An introduction concerning the aims of the European Economic Community is appended. The text is bilingual. (French and German).

DROIT FISCAL — STEUERRECHT

JURA EUROPAE series: Droit des pays de la Communauté Economique Européenne/Das Recht der Länder der Europäischen Wirtschaftsgemeinschaft.
Verlag C.H. Beck, Wilhelmstrasse 9, Munich 40.
Editions Techniques Juris — Classeurs, 123 Rue d'Alésia, 75014 Paris.
Supplemented: regularly.

Loose-leaf publication providing an outline of the tax system in each of the first six EEC member countries following a common outline to facilitate comparison. The text is bilingual. (French and German).

DROIT DES SOCIETES — GESELLSCHAFTSRECHT

JURA EUROPAE series: Droit des pays de la Communauté Economique Européenne/Das Recht der Länder der Europäischen Wirtschaftsgemeinschaft.
Verlag C.H. Beck, Wilhelmstrasse 9, Munich 40.
Editions Techniques Juris — Classeurs, 123 Rue d'Alésia, 75014 Paris.
Supplemented: irregularly.

Loose-leaf publication providing an outline of the company law system in each of the first six EEC member countries following a common outline to facilitate comparison. The text is bilingual. (French and German).

VERDRAGSTEKSTEN EN AANVERWANTE STUKKEN (EEG, EURATOM, EGKS)

Samsom, Alphen a/d Rijn — Kluwer, Deventer.
Supplemented: regularly.

Loose-leaf publication containing text of treaties and documents related thereto. The treaties involved are the European Economic Community, the European Community for Atom Energy and the European Community for Coal and Steal.

LES PRINCIPALES OBLIGATIONS DES EMPLOYEURS EN MATIERE SOCIALE DANS LES PAY DE LA CEE

by Andre Frine: CED/Samsom, 7 rue Philippe de Champagne, 1000 Brussels.
Supplemented: quarterly.

Loose-leaf publication explaining in general terms the labour and social regulations in each of the countries of the European Economic Community. The obligations of employers which result from national labour legislation and social security legislation are especially dealt with.
In the chapter on international social law a very brief description of the obligations for the social security of migrant workers and the free movement of workers, according to the EEC regulations, has been given. An English version translated by Vivian Oppenheim-Lewis entitled: Employer's liabilities under social service legislation in the countries of the European Common Market, has been included. The material is kept up to date by the issue of supplementary pages.

STEUERN UND ZÖLLE IM GEMEINSAMEN MARKT

Edited by Rudolf Regul. (Original editor Heinrich Megow).
Nomos Verlagsgesellschaft, P.O. Box 610, D-7570 Baden-Baden.
Supplemented: three to four times per year.

Loose-leaf publication dealing with the activities within the European Economic Community in the field of taxation and customs regulations. Surveys of the customs and the tax systems in each member country as well as the common policy towards harmonization thereof are set out. Double taxation treaties between the member countries and with third countries are dealt with. Text of relevant statutes concerning the European Economic Community as well as related statutes and the OECD model tax treaty are appended. The material is kept up to date by the issue of supplementary pages.

EUROPEES KARTELRECHT

Handboek voor de Europese Gemeenschappen.
Samsom, Wilhelminalaan 1, Alphen a/d Rijn — Kluwer, Postbus 25, Deventer.
Supplemented: regularly.

Loose-leaf publication dealing with anti-trust laws in the member countries of the EEC. Text of case law in the national languages and related statutes are printed. Text of decisions by the Commission is in the Dutch language with reference to the authentic text language. The material is kept up to date by the issue of supplementary pages.

FISCALITE EUROPEENNE

by Pierre Fontaneau.
Les Cahiers Fiscaux Européens, 51 Avenue Victoria, 06000 Nice.
Supplemented: quarterly.

Loose-leaf publication in seven volumes which expose the tax systems of each country of the member states of the European Communities according to a common outline to facilitate comparison. The countries covered are Belgium, France, German Federal Republic, Italy, Luxembourg, Netherlands and the United Kingdom. A comprehensive index is appended. The material is kept up to date by the issuance of supplementary pages.

TABLEAUX FISCAUX EUROPEENS

by Pierre Fontaneau.
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Tax Reform and Fiscal Policy in Hong Kong.

by Y.C. JAO *

In early 1976 the Government of Hong Kong appointed a six-member committee to examine the existing tax system of Hong Kong with a view to recommending suitable tax reforms. The committee, officially known as the Third Inland Revenue Ordinance Review Committee, had the following terms of reference:

"Having regard to the economic circumstances of Hong Kong which dictate —
(a) a comparatively low level of direct taxation;
(b) that the system at given tax rates should be as productive of revenue as possible; and
(c) that the relevant legislation should be simple and inexpensive to administer;
to consider the present system of taxation of profits and other forms of income contained in the Inland Revenue Ordinance, and in particular —
(a) the system of voluntary aggregation under Personal Assessment;
(b) the taxation of husbands and wives;
(c) the treatment of dividends and its relation to the taxation of corporate profits;
(d) the treatment of interest and the relief for interest paid;
(e) the territorial ambit of the various charges (having regard, *inter alia*, to the effects of changing commercial practices and recent case law);
(f) the taxation of benefits in kind;
(g) the notional basis of the property tax charge;
(h) the taxation of specific classes of taxpayer, including profits from shipping; and
(i) the adequacy of existing relief for expenses incurred by businesses and employees; and then to make recommendations to the Governor on or before 15th December 1976."

The Committee formally began work on June 14, 1976 and after six months' deliberations, submitted its report to the Hong Kong Government on December 13, 1976. The Johnstone Report, as it is now called (named after the chairman of the Committee, Mr. J.A. Johnstone, *a distinguished British tax expert), has recently been released.* [1] *In tabling the Report to the Legislative Council, the Financial Secretary of Hong Kong,* Mr. C.P. Haddon-Cave, *stated that a working party will be formed under his chairmanship to study the financial, economic, social and political implications of the recommendations, taking into account also public comments so that the policy can be formulated and necessary amendments to the law be drafted at a later stage.*

* Senior Lecturer in Economics, University of Hong Kong. The present writer was a member of the Johnstone Committee, but as the Committee has now been dissolved on completion of its task, this paper represents of course his personal views only.

Because of its obvious importance for the future development of Hong Kong's tax system, and in view of Hong Kong's own growing stature as a trading and financial centre, a detailed analysis of the Report and its recommendations is called for. Section I of this paper discusses the historical and economic background to the Report. Section II then summarizes its recommendations, explains their rationale, and appraises their significance. Section III reviews briefly recent trends in fiscal policy, particularly the proposals contained in the latest 1977-78 Budget announced on March 2, 1977.

I

As the official name of the Committee implies, an inquiry into various aspects of the tax system had been conducted on two previous occasions — in 1952-54 by the Inland Revenue Ordinance Committee, and in 1966-68 by the Second Inland Revenue Ordinance Committee. However, the two earlier review bodies did not concern themselves with the basic structure of the Ordinance, with the result that their recommendations were largely of a technical and administrative nature only. In announcing the appointment of the Third Review Committee, however, the Financial Secretary expressly stated that *"by contrast, the intention is that the third Review Committee will examine the basic structure of the Ordinance. By 'basic structure' I mean such matters as the existence of separate schedular taxes, the territorial ambit of the charge and the lack of progression in the rates. The Committee will also be asked to consider the treatment of dividends, and in particular, the proposals formulated in 1975 for a dividend withholding tax and associated measures."* Thus the Johnstone Committee had a wider and more significant scope of inquiry than its predecessors. At the same time, the Financial Secretary also prescribed certain bounds by saying that *"the committee will not be required to concern itself with administrative matters nor with questions of fiscal policy, that is to say, actual rates of tax. In addition, the Committee will not deal with the level and extent of personal allowances, except insofar as they are related to any particular terms of reference, such as the taxation of husbands and wives."* [2]

Like its predecessors, one important reason for the establishment of the Johnstone Committee was the need to raise additional revenue. In this connection it is perhaps useful to review briefly the more important milestones in the evolution of Hong Kong's tax system. For the sake of brevity we need go no further back than to 1939, when a War Revenue Committee was appointed to consider the possibility of introducing income tax into the Colony. In deference to fierce opposition at that time to any form of full-scale income tax, the Committee eventually proposed the introduction of a "partial income tax" on the model of the 1932 Ceylon Income Tax Ordinance. Specifically, it recommended that a schedular type of taxation, consisting of corporation profits tax, property tax, salaries tax, and business profits tax, be established, and that profits tax be confined to only those profits arising in, or derived from Hong Kong. [3] These recommendations were duly incorporated in the 1940 War Revenue

1. *Report of the Third Inland Revenue Ordinance Review Committee*, Hong Kong, 1977.
2. *Official Report of the Proceedings of the Hong Kong Legislative Council*, February 25, 1976, pp. 568-569. In a footnote to his speech the Financial Secretary explained that by "administrative matters" he meant matters of machinery such as the collection of tax, the tax commissioner's powers, appeal procedures, penalties and so on.
3. *Report of the War Revenue Committee*, in *Sessional Papers Laid Before the Legislative Council of Hong Kong*, 1940, pp. 3-39.

Ordinance, which in turn was amended in 1941 to bring interest into the tax net. Immediately after the war, a taxation Committee in 1946 recommended the replacement of the War Revenue Ordinance by a new Inland Revenue Ordinance. 4 An attempt to widen the territorial ambit in order to cover not only income arising in or derived from the Colony, but also received in the Colony, was rejected; however, the schedular system was retained and two new concepts, the standard rate and personal assessment, were introduced into the 1947 Inland Revenue Ordinance. In 1952 the Inland Revenue Ordinance Committee was appointed. As it did not consider the underlying principles of the Ordinance, its recommendations were of minor importance. It did however recommend the repeal of a provision authorizing a company to deduct tax from dividends, and the withdrawal of an existing concession which enabled a taxpayer to gross up his dividends along with his other income for personal assessment and then to set off the dividend tax against his liability. 5

The Second Inland Ordinance Review Committee was appointed in 1966 and although it was also concerned only with administrative and technical matters, their recommendations, contained in their reports in 1967 and 1968, were much more important than that of its predecessor. 6 Among its major recommendations were, first, a limited extension of the profits tax by deeming certain specific items of income, such as royalties, subsidies, and rent to be profits arising in, or derived from, Hong Kong, and second, the replacement of the artificial preceding year basis of assessment of salaries and profits tax by the current year basis and the introduction of a system of provisional tax. The Committee also recommended increased powers to the Commissioner of Inland Revenue to tackle the problem of tax evasion. Over a period of years these recommendations were accepted and duly enacted into the Ordinance.

The proximate origin of the Third Inland Revenue Ordinance Review Committee can be traced to the 1973 Budget speech, in which the Financial Secretary drew attention to the fact that the narrow territorial ambit had been further eroded through case law decisions and loopholes in the existing law. This theme was further elaborated in his 1974 Budget speech in which he broached the idea of amending the Ordinance to tackle the type of case which *"involves a business conducted by a person having a permanent establishment in Hong Kong which then proceeds to earn profits which cannot possibly be said to be attributable to any permanent establishment anywhere else and which, in all probability, have not been declared for tax anywhere else. This can be done by means of 'back to back' arrangements, that is to say, reinvoicing, agency agreements, servicing agreements and a host of other similar devices."* 7 He singled out two industries, shipping and banking, for specific consideration on account of substantial tax avoidance. This proposal did not find favour with the Legislative Council however. In the following year, when the Financial Secretary had to look for another source of additional revenue, he therefore proposed a new tax on dividends with effect from 1976. As a temporary bridging measure, he increased the rate of corporation profits tax from 15 percent to 16½ percent pending the introduction of the dividend tax. At the same time, he also proposed the appointment of a third Review Committee to consider the existing tax structure as a long term measure. Again the proposal of a new tax on a hitherto untaxed income soon ran into stiff opposition, so the referral of this controversial issue to an independent commission was the only way out of the impasse.

1975 was a difficult year for Hong Kong, particularly in the first quarter. The Colony, heavily dependent on export trade, was hard hit by the world-wide recession. When the Financial Secretary presented his Budget for 1975-76 on February 26, 1975 he therefore had to plan for a deficit for the second consecutive year in a row. Even though the deficit could be covered by borrowing, the need for increasing tax yield was quite pressing.

But apart from the purely budgetary consideration, there were also other good reasons why a fundamental review of the tax system was overdue. The 1947 Inland Revenue Ordinance, as we have seen, was based essentially on the recommendations of a war-time committee. During the thirty years since 1947, the economy of Hong Kong has undergone profound changes. Whereas in 1947 Hong Kong was a small entrepot with a population of 1.75 million, today it is a leading trading, manufacturing and financial centre with a population of 4.5 million. Yet, notwithstanding successive amendments, largely of a technical nature, the underlying principles and basic structure of the Ordinance remain as they were thirty years ago. A fresh reappraisal of its rationale in the light of contemporary economic environment would therefore be both desirable and timely. Moreover, as a result of growing sophistication in business and commercial practices, many loopholes in the Ordinance have come to light, making it less productive of revenue than it could be. There are also inherent inequities that can no longer be tolerated just because the tax rates are low. Finally, social attitudes have been rapidly changing in Hong Kong, and pressure has been mounting for the provision of more public services. In response to this demand the Government has launched ambitious long-term programmes on housing, education, social welfare and public works requiring huge capital expenditures whose costs moreover have been escalating together with inflation. The financial implication of this is reflected in the fact that in recent years, the growth of public expenditure has far outstripped that of public revenue. Thus, from fiscal year 1970-71 to fiscal year 1974-75, total public expenditure increased by 157 percent, but total public revenue increased by only 93 percent. Although the deficits in the two fiscal years 1974-75 and 1975-76 can be largely attributed to economic recession, it is also clear that the halcyon days when Hong Kong can take fiscal surplus for granted are over. Quite apart from short-run exigencies, therefore, there is a need for long-term tax reform so that the tax structure can be made more productive at any given tax rates.

This then is a short survey of the historical and economic background to the appointment of the Johnstone Committee. It may also be appropriate to describe briefly how the Committee actually worked. Before it was convened advertisements were inserted in local newspapers inviting written representations from individuals and organizations on any aspect of the Committee's terms of reference. Altogether 31 organizations and firms and 133 individuals responded by sending in written submissions. These were carefully scrutinized and considered on their merits. A total of 26 formal meetings were held to discuss matters within the Committee's purview. From time to time government officials and other experts were interviewed and consulted on administrative and technical issues. In view of Hong Kong's international status the Committee also studied reports of similar review bodies in other countries, particularly the reports of the Radcliffe Commission (1953-55) in the United Kingdom and the Asprey Committee (1974-75) in Australia. The overriding concern, however, has always been Hong Kong's own interests and special position, and at no time was there any intention of transplanting ideas and proposals from other countries without examining carefully their validity and suitability for Hong Kong.

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4. *Hong Kong Hansard: Reports of the Meetings of the Legislative Council of Hong Kong*, Session 1947, pp. 119-124.
5. *Report of the Inland Revenue Review Committee, Hong Kong* 1954, paragraphs 40 and 65.
6. Second Inland Revenue Review Committee, Hong Kong *Interim Report*, 1967; *Final Report*, 1968.
7. *Official Report of the Proceedings of the Hong Kong Legislative Council*, February 27, 1974, p. 604.

II

Before we discuss and explain the recommendations of the Johnstone Report, it is necessary to summarize for the reader's easy reference and understanding the major features of Hong Kong's present tax system. 8

The first feature is that Hong Kong adheres to the "source" rather than the "residence" principle. This means that only income "arising in or derived from" Hong Kong is chargeable to tax. Income from non-Hong Kong sources but received by a resident in Hong Kong is excluded. Second, there is no full income tax as such; instead, tax is levied on specified sources of income, namely, property, salaries, profits and interest. This is known in tax literature as the schedular system, whose origin can be traced to Addison's Act of 1803 in the United Kingdom. The nearest equivalent to full income tax is an option called Personal Assessment. This however is a form of relief whereby individuals with earnings and profits, normally chargeable at the standard rate on each separate source, may elect to be assessed on total Hong Kong income, claiming personal allowances and paying tax at a sliding scale of marginal rates used for Salaries Tax. The advantage of such an option disappears when tax at the sliding scale on total income less personal allowances exceeds tax at the standard rate on total income from all local sources without allowances. The present Ordinance does not contain, as elsewhere, a sweep-up clause bringing under charge any other income not explicitly described. There is thus no tax on dividends and capital gains. Nor is there any tax on wealth and gift *inter vivos*. On the other hand, the major headings under the schedular system have been broadened over the years to bring various incomes within their orbit. Thus the Salaries Tax reaches not only salaries and wages, but also pensions and remuneration from every kind of employment. The Interest Tax applies to interest on money lent and bank deposits, as well as to annuities. Business profit is also widely defined to include copyright and patent royalties, rental income from property, income from leasing of machinery and equipment, and agricultural and other kindred operations. Furthermore, there are other taxes, such as Estate Duty, Stamp Duty, Entertainments Tax, Betting Duty, Hotel Accommodation Tax and so on that are governed by separate ordinances rather than by the Inland Revenue Ordinance. In addition, there is also another tax known as the Rates, which in the British tradition is a kind of tax for local services such as police, water, street lighting etc., but which nevertheless is outside the scope of Inland Revenue Ordinance. Given the schedular framework, it cannot be said that taxation in Hong Kong is unduly narrow in its coverage. The third feature is the low level of tax rates and lack of progressivity. The standard rate, which applies to Property Tax, Interest Tax, and Business Profits Tax, has been increased over the years from 10 percent to 15 percent by two steps of 2½ percent each. In 1975-76 a total surcharge of 2 percent was added to the standard rate for corporation profits only. These are of course uniform rates irrespective of the level of taxable income. The charge for the Rates has recently been lowered to 11.5 percent of rental value. For Salaries Tax and Personal Assessment, there is a sliding scale of marginal rates, ranging from 5 percent for the first HK$10,000 to 30 percent for the sixth HK$10,000, but subject to the limitation that total tax paid shall not exceed 15 percent on gross income before deduction of personal allowances. This means in effect that, for him whose net taxable income exceeds HK$50,000, there is a flat rate of 15 percent on his *gross* income without the benefit of allowances. A sliding scale also applies to Estate Duty, ranging from a minimum of 6 percent on estates valued between HK$300,000 and HK$400,000 to a maximum of 15 percent on estates valued in excess of HK$1 million, estates under HK$300,000 being exempt. Stamp Duty consists of two components: fixed duties vary from HK$0.15 to HK$50, whilst *ad valorem* duties range from HK$0.025 per cent to 2.25 percent. However, buyers and sellers of shares have each to pay a duty of 0.4 percent on the total value of transactions. Entertainment Tax is charged on the price of admissions to cinemas and now averages about 8 percent. Betting Duty is at present charged at 25 percent on cashsweep contributions and lotteries, and 11 percent on other bets. Hotel Accommodation Tax is levied at 4 percent on hotel bills paid by the guests. Crown Rent is now charged at 3 percent of the annual rateable value of the property, all real property being regarded as leasehold rather than freehold in the eyes of the law. As Hong Kong is a free port, there is no general import duty, except for some specific duties on a few commodities. Generally speaking, indirect taxes and non-tax revenue account for well over 60 percent of total revenue, and since direct taxes are in turn mostly charged at a flat rate, the tax system as a whole tends to be somewhat regressive.

We are now in a position to discuss and explain the recommendations contained in the Johnstone Report. The Report is organized into ten chapters and three appendices. Apart from the first introductory chapter, the other chapters are concerned with substantive matters of suggested reforms. It may therefore be convenient to follow the order in which the recommendations are presented.

1. Personal Assessment

As stated above, Personal Assessment is a form of relief whereby a taxpayer's income from various sources is aggregated at his election. This option is open to local residents only. A wife (unless she is living apart from her husband) and a person under eighteen are also excluded. From the total income, after due allowance for interest paid and charitable donations, personal and family allowances, the net taxable income is reached, which then is chargeable at the rates specified in the Second Schedule of the Ordinance. Obviously, a taxpayer will only elect Personal Assessment if it is to his advantage. One of the main deficiencies of this system is the administrative waste and duplication involved. This arises from the incompatibility between personal assessment and the schedular system, which are based on different conceptual approaches. Thus, separate returns have to be issued for each tax and separate files and records maintained; when taxpayers elect Personal Assessment, refunds of overpayment have to be made. This is particularly cumbersome where Property Tax is involved, for separate assessments have to be issued for each rateable unit of property. Thus during the fiscal year 1975-76, 63,368 cases of Personal Assessment were dealt with, of which 39,920 were refund cases. Compared with 1970-71, the number of cases increased by 54 percent, while refund cases increased by 77 percent. 9 Clearly, manpower engaged in such work could be more productively employed in other areas, such as checking and preventing evasion. More serious are the horizontal inequities arising from the co-existence of Personal Assessment and the schedular system. The Report gives two examples where in one case a taxpayer with large business profits and a salary outside his own business will pay much less tax than another taxpayer with the same total income but all of which comes from salaried employment. In the second case, a taxpayer with a relatively large salary coupled with other incomes such as

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8. Readers may like to refer to three earlier articles in this *Bulletin*: R.V. Giddy, "An outline of taxes under the Hong Kong Inland Revenue Ordinance", Vol. XXIII, No. 12, December 1969, pp. 574-583; Y.C. Jao, "Recent changes and trends in Hong Kong's taxation", Vol. XXVI, No. 7, July 1972, pp. 267-273; Y.C. Jao, "Streamlining Hong Kong's tax system", Vol. XXVIII, No. 6, June 1974, pp. 236-241. The latest edition of the 1947 Inland Revenue Ordinance is the revised edition of 1975, *Laws of Hong Kong*, chapter 112, Hong Kong, 1975.

9. *Annual Departmental Report by the Commissioner of Inland Revenue for 1975-76*. Hong Kong.

interest pays much less tax than another taxpayer with the same total income but which consists entirely of profits and interest. Various combinations of income from employment, business profits and property are undoubtedly possible to generate such horizontal inequities. For these reasons, the Report recommends that (a) a single composite return covering all four sources of income should be brought into use in order to minimize unnecessary operations and duplication and (b) the present voluntary system of personal assessment be repealed and replaced by a mandatory system of assessment on total income in order to correct the anomalies mentioned earlier. This would also provide an initial basis for the introduction of a more progressive tax structure should it be thought necessary. As we shall also see later, this mandatory system, together with the abolition of Property Tax and its integration into Business Profits Tax, should eliminate a great deal of matching collections and refunds and thus enhance efficiency and productivity as well as achieve greater equity.

2. Taxation of Husbands and Wives

This was the topic in the terms of reference which attracted more representations than others, the main theme of the majority being a request for separate tax assessment on the respective incomes of husband and wife, particularly in regard to earnings from employment. Under the present Ordinance, the salaries of a husband and his wife are aggregated, and for the purpose of aggregation the income of a married woman (unless she lives apart) is deemed to be the income of her husband. In 1970-71 a working wife's allowance of HK$3,000 was granted which was however repealed in 1973-74 as part of a package adjustment under which the personal allowance was increased from HK$7,000 to HK$10,000.

Advocates of separate assessment have rested their case on a woman's right to her own income and property and her independent status. It has also been alleged that under aggregation, the wife's earnings are subject to higher marginal rates and this acts as a deterrent to trained and qualified females from joining the labour force. On the other hand, without disputing a married woman's legitimate right and social status, there is also a highly respected school of international opinion that regards the family as the basic tax-paying unit on grounds of equity and ability to pay. This is represented for example by the 1954 *Radcliffe Report* and the 1966 *Carter Report.* 10 It is also interesting to note that in Australia, notwithstanding its long tradition of separate taxation of spouses, the *Asprey Report* has nevertheless recommended the introduction of an option for joint assessment. 11

Furthermore, complete disaggregation is certain to cause substantial loss to fiscal revenue, and give rise to abuses such as fictitious employment of the wife and income-splitting. It also discriminates against those families where there is only one bread-winner.

The opposing views were carefully weighed by the Johnstone Committee but members could not reach a unanimous agreement. The majority however felt that complete disaggregation could not be justified on grounds of equity, fiscal productivity, and administrative simplicity. It is estimated that there are now well over 50,000 wives in employment in Hong Kong, and to allow them separate assessment would create problems of administrative complexity and revenue loss of staggering proportions. The relevant passage in the Report (paragraph 59) reads:

"We had to acknowledge the stubborn fact that any close approximation to a complete separation of the income of husband and wife would result in a considerable loss of revenue and would thus lead to a relatively higher tax burden for those husbands who are the only income earners of their families — and very probably an absolutely higher one if tax rates needed to be adjusted to compensate for the short-fall."

Moreover, under the schedular system in Hong Kong, a married woman is already given *de facto* separate assessment under Profit Tax, Property Tax and Interest Tax. On the other hand, the Committee was, of course, aware that extra expenses are involved for a wife to work outside her home, that social attitudes regarding the status of women in Hong Kong are rapidly changing, and that it is desirable to give some encouragement to educated and trained married women to join the labour force thus contributing to economic growth and well-being of the community. Accordingly, the Committee agreed that the *"grant of some significant measure of relief for wives' earnings provided that the preference does not go beyond what is reasonable"* was justified and recommended the reintroduction of the working wife's allowance to be set at a fixed percentage of the personal allowance. The actual level of the "fixed percentage" was left open as it was felt that this was a matter of fiscal policy that should be decided by the government in the light of the current fiscal situation, but during the discussions a range of 30 percent to 50 percent was envisaged. The Committee advised that elementary precautions should be taken against income-splitting. It also recommended that the new allowance should, where appropriate, be available also against trading or professional profits.

3. Dividends and Corporate Profits

The proposal to introduce a Dividend Withholding Tax (DWT) and the associated Undistributed Profits Tax (UPT) was perhaps the most controversial item on the agenda for the Review Committee. Before outlining the proposal, it may be helpful to recall that the 1947 Ordinance did provide for the deduction of tax from dividend at the standard rate by a company from so much of the dividend declared payable as corresponded, on a proportional basis, to the part of the company's profits with a Hong Kong origin. If the shareholder was a second company, the rule was that the dividend was excluded from its assessable profits. If the shareholder was an individual and he elected for Personal Assessment, the dividend was duly grossed up along with his other incomes and he was allowed to set off the dividend tax against his personal assessment liability. In other words, there was a rough-and-ready kind of imputation system at work so that in effect there was no tax on dividends. In 1955 the Ordinance was amended on the recommendation of the first Inland Revenue Ordinance Committee: the provision authorizing corporations to deduct tax from dividends was repealed, and dividends ceased to be taken into account under Personal Assessment.

In his 1975-76 Budget speech on February 26, 1975, the Financial Secretary expressed the view that a withholding tax on dividends should be introduced to widen the base of direct taxation. As a stop-gap measure to protect revenue, a surcharge of 1½ per cent was added to the standard rate of 15 percent on corporation profits, pending the approval and implementation of the DWT. 12 In the 1976-77 Budget, the surcharge was raised by another half percent. The Financial Secretary also disclosed that a Bill had been drafted so that (a) resident corporations were required to deduct tax at 3½ percent from all dividends; (b) a tax at 7 percent would be imposed on undistributed profits where the pay-out ratio of dividends fell short of 50 percent; (c) on introduction of

10. *Second Report of the Royal Commission on the Taxation of Profits and Income*, Cmd. 9105 of 1954, London, Chapter 6; *Report of the Royal Commission on Taxation*, Ottawa, 1966, Vol. I, pp. 17-18. The same opinion was also expressed in the very recent *Report on the Inquiry into the Taxation of the Income of Married Women*, South Africa, 1976.

11. *Report of the Australian Taxation Review Committee* (Asprey Committee), 1975, chapter 10.

12. *Official Report of the Proceedings of the Hong Kong Legislative Council*, February 26, 1975, pp. 494-495, and pp. 533-53

the DWT, the surcharge on resident corporations would be withdrawn but that on non-resident corporations would remain, as the latter would not be within the scope of the two new taxes. 13

As mentioned earlier, the proposal had met with strong opposition both at the Legislative Council and from the business community. Critics pointed out that the proposed tax involved double taxation of the same fund in the hands of both the corporation and the shareholder. The 7 percent undistributed profits tax was particularly strongly criticized as being coercive and damaging to business confidence. In defence, the Government argued that double taxation did not exist since a corporation is an entity separate from its shareholders, and in any case the fact that the DWT was set at a rate very much below the standard rate already minimized whatever double taxation that might exist. The higher rate on undistributed profits was necessary in order to discourage avoidance of the DWT on the very reasonable norm of a 50 percent pay-out ratio.

In examining the theoretical basis for a change, the Committee recognized that from the purely legal point of view, the corporation is a separate entity from its shareholders, but expressed the view that *taxation levied in a community will interfere least with the progress of that community if its structure takes due account of economic realities rather than legal forms (paragraph 74).* On the practical working of the scheme there was some difference of opinion among the members as to its feasibility. The majority held however that a DWT would be unsound without a system of imputation. Since the proposed tax would fall on profits (including profits from the sale of capital assets) originating outside Hong Kong, this could generate pressure for changing the situs of companies. Any legislation to block this migration or to limit the charge of the DWT to assessable profits of Hong Kong origin would be too complicated and not worthwhile in terms of potential yield. Another area in which anomalies can arise is where a company both receives and pays out dividends. The period during which a setoff could be claimed was limited to one year and this was considered to be too short. The Committee also expressed disquiet at the UPT rate being set at twice the DWT rate of 3½ percent: *The need for self-finance in order to promote expansion without raising outside capital may be very pressing, and where this factor is present the imposition of any financial penalty seems to us wrong. (Paragraph 85).* There was a suggestion to modify the original proposal by lengthening the period of claims for tax credits to three years, and reducing the level of UPT to 6 percent, but this compromise did not find favour with the majority. The differential rates on resident and non-resident companies could also create anomalies. The Committee conceded that ways could be found to tackle the various problems mentioned, but the ensuing legislation would be so complicated as to violate the guideline of simplicity stated in its terms of reference. Accordingly, it recommended that the 1975 plan to introduce DWT and UPT be abandoned, but that the surcharge on corporation profits be retained at one or two percentage points higher than the standard rate. The surcharge could be regarded as a kind of franchise tax in recognition of the various advantages which a corporation enjoys (limited liability, easier access to the capital market, wider dispersion of shareholders etc.)

. Interest and Relief for Interest Paid

Under the present Ordinance, a tax at the standard rate is withheld at source from any interest arising in or derived from Hong Kong with the exception of interest on Tax Reserve Certificates, approved government bonds, and savings deposits. Interest payments to banks, corporations, authorized pawn-brokers and money-lenders whose incomes are subject to Profits Tax are also excluded. The Committee discussed the important principle of where the source of any given interest is located, and in contrast to the prevailing tendency of the law courts to give preponderant consideration to the place where the original credit or loan is given, came to the conclusion that the economically valid test should be the place where the credit or loan proceeds are actually employed. In the words of the Report, *the purpose must be to subject to tax under the Inland Revenue Ordinance all significant flows of income which are the result of economic activity carried on in Hong Kong rather than elsewhere. This purpose would be better served if the charging words in the Ordinance were supplemented by a provision ascribing a Hong Kong origin to interest paid by a person carrying on a trade or business here on money borrowed by him and employed or expended in, or in connection with, the production of the assessable profits of that trade or business (paragraph 100).* Where the fund raised is used partly for Hong Kong and partly for overseas activities the interest should be notionally divided into two separate components for the purpose of applying the new provision. This provision was also considered necessary to prevent possible manipulations for tax avoidance purposes. Apart from establishing this guiding principle, the Report also corrects a minor anomaly by granting a set-off to non-profit making trustees who both receive and pay out interest. It further recommends that the definition should be widened to cover any surplus that may arise in the redemption of certificates of deposit and similar entitlements. On the question of relief for interest paid, the Committee was of the opinion that present provisions under the Ordinance are quite adequate and did not see any justification for widening relief. In particular, it rejected the suggestion from several correspondents that interest paid on money borrowed for the purchase of owner-occupied residences should qualify for relief. Quite apart from the fact that owner-occupiers are already exempt from Property Tax, the suggested relief would involve considerable unfairness to rent-payers.

5. Territorial Ambit of the Charges

As mentioned earlier in the article, Hong Kong adheres to the "source" principle of taxation, under which only income arising from or derived in Hong Kong is subject to taxation. This principle was established by the 1940 War Revenue Committee, enshrined in the 1947 Inland Revenue Ordinance, and reaffirmed by the 1968 Final Report of the Second Review Committee. In inviting representations from the public the Johnstone Committee received many submissions from trading and professional bodies to the effect that any attempt to widen the ambit of the charge to profits and earnings from abroad could well be counter-productive in that many international trading, manufacturing and financial institutions which have regional or branch offices in Hong Kong would migrate elsewhere. While the Committee regarded this as an opinion not capable of proof or disproof, it conceded that the risk could be a serious one with adverse consequences to the economy. Paragraph 110 of the Report is well worth quoting in full:

"In the circumstances, we have come to the conclusion that the broad principle of excluding profits and earnings received in Hong Kong but having their origin elsewhere should continue to operate. Although we have pointed out that the exclusion makes the ambit of the Inland Revenue Ordinance narrower than that of the income tax codes of many other territories, it can also be said that the rule of exempting particular types of income originating outside a country's borders is well recognised as a method of preventing the international double taxation which could otherwise create obstacles to world trade. For instance, France, the Netherlands and Switzerland do not impose tax on the profits earned through foreign branches by firms established in those countries: again, the Netherlands, Switzerland and in certain cases, Canada do not charge resident companies in respect of the dividends they draw from overseas subsidiaries.

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13. *Official Report of the Proceedings of the Hong Kong Legislative Council*, February 25, 1976, pp. 552-553.

Having reaffirmed the source principle, the Committee then considered the detailed application of the principle to the individual categories of taxes in the light of changing commercial practices and case law that have developed since 1947.

For obvious reasons, there is no problem with Property Tax as far as geographical location is concerned. The practical working of the ambit rule for Salaries Tax is less simple, as over the years many multinational corporations, financial institutions and other international bodies have established regional offices in Hong Kong whose personnel, while based in Hong Kong, may render services or often travel out of Hong Kong. Under the present Ordinance, the general test is that the emoluments of an "office or employment of profit" which arise in or are derived from Hong Kong, supplemented by a further rule that any earnings which an employee derives from the rendering of services within Hong Kong during a period of more than 60 days in the year of assessment are also chargeable. The Committee considered the present double test and existing Inland Revenue departmental interpretation and practice as being quite adequate and therefore had no change to propose in the law.

It is in the area of Profits Tax that the source principle has been put under the greatest strain. The original intention of the Ordinance was that if the main supervision of a business took place in Hong Kong, the profits derived had a Hong Kong origin unless it could be clearly shown that they were due to the intervention of a permanent establishment elsewhere. However, over the years as a result of technological advances in communications and transportation, and growing sophistication in commercial practices and "tax planning", it is not difficult for peripatetic directors or senior executives to make *ad hoc* arrangements for contracts to be signed outside Hong Kong. Although it is clearly the existence of the business and its management in Hong Kong which enables the contract to be negotiated and later carried out so as to yield a profit, such profit unfortunately may in the eyes of the law be considered as arising outside Hong Kong, and in recent years there have been in fact a number of adverse court decisions resulting in an erosion of the tax base. The Committee therefore recommended that, although there should be no general extension of the tax to profits made outside Hong Kong, there ought to be legislation deeming what is called the "intermediate category of profit" to have Hong Kong origin. *The category of profit in question would be defined by specifying that it was profit accruing in the course of the carrying on of a trade or business actively exercised in Hong Kong which was not substantially caused by the action (on behalf of the trade or business) of a branch organisation located outside Hong Kong. The word "substantially" has been included to take care of the case where there is a branch which does something trivial like handing out a catalogue to an enquirer whereas a director comes over specially from the Hong Kong headquarters to negotiate and conclude the actual contract (paragraph 126).* The "branch organisation" is defined to be identical to the concept of "permanent establishment" normally used in double taxation conventions. The same principle of levying tax on the "intermediate" category of profits" is also extended to banking institutions and other deposit-taking companies which accept deposits from the Hong Kong public and in turn redeposit the proceeds in overseas markets (such as the Euro-dollar market) to profit from the interest differentials. The reason for this extension is that the financial institutions in question make use of Hong Kong infrastructure to acquire local deposits, the interest payments on which are tax-deductible, while interest receipts on Euro-dollar deposits are not due to the substantial intervention of any permanent establishment elsewhere and yet are not brought within the tax net. It is also consistent with what has been discussed earlier under the heading of "interest and relief for interest paid". Interest receipts by individuals and non-financial concerns from depositing funds abroad are not however regarded as falling within the "intermediate category of profits".

6. Benefits in Kind

Under the existing Ordinance, the general principle is that a benefit in kind is taxable only if it is convertible into cash. The exceptions to this rule are employers' contributions to an approved retirement scheme, subsidized housing, and holiday warrant or passage granted by an employer, or any allowance to purchase one. In the case of accommodation provided by the employer either in the form of actual quarters or a tenancy allowance, the rule is that the beneficiary is taxed to the extent that his rental contribution, if any, falls short of certain fixed percentages of his cash income. For private residence, this is fixed at 10 percent, while for an hotel, hostel or boarding house it is 8 percent where the accommodation consists of not more than 2 rooms and 4 percent where not more than one room is provided. The value of any holiday warrant or passage granted by an employer to an employee, or any allowance to purchase one, including payment for the transportation of personal effects, is not regarded as income.

The Committee regarded the present provisions on the taxation of fringe benefits as being generally reasonable and adequate, and recommended extension of the charge only to cases where the employer meets the costs of public utilities and domestic servants of the employee. The Committee also recommended that where a director's remuneration in a director-controlled company is artificially low (compensating himself by drawing larger dividends) in order to keep down the cash income for the calculation of value of quarters provided, the Commissioner of Inland Revenue should be empowered to use the net assessable value of the quarters for calculation of any tax liability.

7. Property Tax

Property Tax under the existing Ordinance is charged on the owner of land/or buildings. There is exemption for owner-occupiers, for unoccupied premises and for corporation-owned properties used for earning profits chargeable to Profits Tax. Unincorporated business firms can set off Property Tax paid, on premises owned and used to earn their profits, against the Profits Tax payable, while individuals claiming Personal Assessment can also set off Property Tax paid against their liabilities under Personal Assessment, any over-payment being eligible for refund.

Before April 1, 1976, Property Tax was charged at the standard rate on the rateable value — the estimated annual rent at which the property might be expected to be let at arm's length and was in turn based on the valuation list prepared by the Rating and Valuation Department — less 20 percent allowances for repairs and outgoings. Because revaluation was done relatively infrequently — normally every four years — there has been a tendency for the valuation list to lag seriously behind the actual market values. As from April 1, 1976 a new concept of net assessable values of land and buildings was introduced. The reason for this change is that while Rates are a tax on occupiers of premises towards defraying the cost of local services, Property Tax is a tax on income derived from ownership of property, a distinction which justifies some divergence in the underlying valuations. The assessment of Property Tax values independently of rating valuation lists would enable such values to be fixed in line with current market rental levels and not on a "tone of the list" basis. This new system, while coming closer to the actual current rental value as the tax base, still entails the levying of tax on a notional basis in cases where the premises are owned by a corporation not carrying on business in Hong Kong, where a taxpayer resides at more than one property, where the property is occupied either rent free or at less than the full market value by persons other than the owner's immediate family, and where clubs and similar institutions that own premises do not carry on any profit-making trade or business.

In the course of its deliberations and interviews of officials, the Committee was struck by the inefficiency of the tax as reflected in its declining relative share of revenue, by its cumbersome administration (three government departments are involved: the Treasury, Inland Revenue Department, and Rating and Valuation Department); by the waste of manpower required in handling offsetting collections and refunds; and last but not least, by the built-in inequities that result from the divergence between assessed value and actual rental value. After examining various alternatives for improving the system, the Committee came to the conclusion that only by treating actual rental income as part of the total income in a composite return can the above inefficiency, waste, and inequities be eliminated. Accordingly, it was recommended that Property Tax in its present form be abolished, and that the relevant section of the Ordinance be amended so that the exploitation of the ownership of property for pecuniary gain is treated as a business and therefore subject to Profits Tax. This recommendation is also consistent with the mandatory assessment of total income mentioned under Personal Assessment. As a corollary, it was further recommended that the relevant section be amended to disallow excessive payments of rents to directors of director-controlled companies.

8. Specific Classes of Taxpayer

Terms of reference (h) required the Committee to consider certain specific classes of taxpayer. Under the present Ordinance, there are special sections to cover the assessment of life and non-life insurance corporations, resident and non-resident ship-owners, clubs and trade associations because of the specialized nature of their business. Among them the most important are undoubtedly shipping companies as it has been pointed out by the Financial Secretary in several Budget speeches that resident ship-owners, while making use of the infrastructure and other amenities of Hong Kong, have nevertheless succeeded in arranging their affairs in such a way as to pay very little, if any, Profits Tax.

This is done by a complicated chain of organization whereby the *de facto* ship-owners form an investment company in Hong Kong, which takes shares in an offshore company set up in a tax haven. This offshore company in turn acquires a ship and registers it under a flag of convenience, and appoints a management company in the same or another tax haven to be its management agent with full authority to manage the ship but mainly to negotiate and conclude its charter parties. Although negotiation may be done in Hong Kong, all the charter parties are legally executed outside of Hong Kong. At the end of the organizational chain, a sub-agent is appointed in Hong Kong to do whatever is required for the operation of the ship, e.g. recruiting officers and crews, handling finance etc. The end result is that the resident ship-owners, notwithstanding the fact that they are actually carrying on the business of ship-owning, that they have a permanent management in Hong Kong which controls and manages the ship's operations, and that they are the ultimate beneficiaries of profits from the charter hire, can nevertheless claim to bear no liability to profits tax. A small commission is paid to the Hong Kong sub-agent, which is chargeable to tax in Hong Kong, but this of course bears no real relation to the actual size of operating profits. Over the years the business of Hong Kong ship-owners has expanded tremendously and it is estimated that they now own roughly 25 to 30 percent of the world's tonnage registered under flags of convenience, so that the revenue loss from their deliberate avoidance can no longer be ignored.

In considering the various possibilities to bring the resident ship-owners' earnings within the ambit of Profits Tax, the Committee reached the conclusion that any attempt to lift the "corporate veil" would be complicated and in any case ineffective, since the ship-owners could easily move the first unit in their organizational chain, the Hong Kong investment company, to an offshore location. However, the Committee was of the opinion that since there is a general international accord whereby a non-resident ship-owner is nowhere taxed on his charter-hire earnings, charter hire attributable to a permanent establishment outside Hong Kong should not be excluded from the Hong Kong earnings. Accordingly, it was recommended that the relevant sections of the Ordinance should be amended so that all relevant earnings by a resident ship-owner under charter parties, wherever signed, should rank as Hong Kong receipts; conversely, a non-resident ship-owner's earnings under charter parties signed in Hong Kong should be excluded from Hong Kong receipts, in order to bring the law into line with international practice. The non-resident ship-owners will however be taxed on freight and carriage lifted from Hong Kong on a fixed percentage basis. It was further recommended that "charter hire" should be more precisely redefined to correct the error made in a 1971 amendment (which in turn was based on a recommendation by the Second Review Committee) the practical effect of which has been to reduce even further the Hong Kong tax payable by resident ship-owners. Specifically, "charter hire" should be defined to include all sums receivable under charter parties with the exception of those from general charters (trip or voyage charter) without demise.

The Committee however did not see adequate grounds for changing the existing provision relating to other specific taxpayers. It only recommended that non-trading clubs should not pay Property Tax on their premises. Even this recommendation is a contingent one, since no problem will arise if the other more fundamental recommendation — that Property Tax be abolished and replaced by Profits Tax on net actual rental income — is accepted.

9. Relief for Expenses

Under the present Ordinance, there are different rules for expenses that can be legitimately deducted from income derived from employment or business. The general test for allowing a deduction of outlay from Salaries Tax liability is that (i) the outlay must not be capital expenditure; (ii) it must not be an expense of a domestic or private character; and (iii) it must have been "wholly, necessarily and exclusively" incurred in the production of the earnings in question. The first part of the test is reasonable enough — since the Ordinance imposes no tax on capital gains, capital expenditures should not be offset against taxable earnings, except in the case of a productive asset undergoing slow wastage which needs to be compensated for by depreciation allowances. The second part of the test is also evident, as the family circumstances of the taxpayer are taken care of by personal and child allowances. It is the third part that has attracted some adverse comments as being too stern and restrictive. 14 As however there are now more than 200,000 persons subject to Salaries Tax, the Committee was of the opinion that a strict interpretation of the rule was still necessary, otherwise speculative claims would be put forward which would make the administration unduly costly. The Committee also felt that, as a general principle, the costs that have to be incurred to enable the employee to discharge his duties should be borne by his employer. While concluding on balance that the existing expenses rule should remain unaltered, the Committee recognized that current ruling regarding membership of professional and learned societies appears to be unduly restrictive, and accordingly recommended that subscriptions to professional societies concerned with spreading knowledge, or with indemnifying members of a profession, should be deductible for Salaries Tax purposes.

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14. For an earlier discussion, see P.G, Willoughby, "The deduction of expenses for profits tax and salaries tax", *Hong Kong Law Journal*, Vol. 5 Part I, Jan. 1975, pp. 39-72.

With respect to the rule for business, although there are special provisions in the Ordinance for various categories of outlay (e.g. expenditures on scientific research or gifts for technical education), the normal test for deductibility is that (i) the expenditure must not be of a capital nature and (ii) it must be incurred in the production of chargeable profits. The first part of the test is subject of course to the qualification that capital allowances are in fact granted for the depreciation of capital assets such as premises, plant and machinery. Again, the Committee did not think that existing provisions, with a few exceptions, need to be revised. The Committee received a large number of proposals from trade organizations and individual businessmen for more liberal treatment of expenses, most of which it felt constrained to reject. Among those rejected were, for example, removal expenses, purchase of designs, trade mark and patents, and redundancy payments on termination of a business. The Committee also turned down suggestions that the rate of depreciation allowance for machinery be raised, and that the "straight-line" method should replace the "reducing-balance" method now being used. Nor did the Committee think that the concept of Current Cost Accounting (or inflation accounting) should now be introduced into Hong Kong for tax purposes. It also could not see any justification for granting leasehold depletion allowances to encourage industrial development. Only in two areas could the Committee find sufficient grounds for relaxing the expense rule. One was concerned with short-term leases and the other with charity. The Committee therefore recommended that relief be granted for short-term lease (up to a maximum of three years) where the payment by a lessee of a premium is akin to rent in advance and that a gift in kind to a charity be recognized as an "approved charitable donation" for reducing tax liability. Finally, on the carry-forward of losses, the Committee corrected a minor drafting anomaly in a 1975 amendment by recommending that when a trading loss is carried forward for set-off, under Personal Assessment, it should reduce the aggregate income for all tax purposes.

These are then the specific proposals for reforms of the tax system. At present the Government is studying closely the various implications of the Report as well as its technical and administrative aspects. Assuming that the major recommendations will eventually be accepted, their significance can be broadly appraised as follows.

First, the source principle, which as we have noted earlier, is a distinguishing characteristic of the Hong Kong tax system, will be preserved. In the judgement of the Johnstone Committee, the limited territorial charge has been an important determinant of Hong Kong's emergence over the past thirty years into a major international trading, manufacturing and financial centre. But this principle will be modified in several important respects: (a) where profits of a business, whether financial or non-financial, carried on actively in Hong Kong are earned without the substantial intervention of a permanent establishment elsewhere; (b) where interest is earned on overseas deposits by financial institutions that acquire and accept local currency deposits in Hong Kong; (c) where interest is paid on funds borrowed overseas but employed and used for profit-making activities in Hong Kong; (d) charter hire earnings by resident and non-resident ship-owners. The reason for these modifications is that, as a result of technological progress and growing sophistication of commercial practices and "tax planning" techniques, many multinational corporations or companies with international ties have succeeded in attributing a non-Hong Kong source to Hong Kong profits. The purpose is therefore to plug certain important existing loopholes and thus increase revenue productivity and achieve greater equity. The proposed recommendation with respect to shipping profits also has the added advantage of consistency with international practice. As to whether such reforms are feasible, the ability of those affected, particularly the resident ship-owners, to work out new avoidance devices is not underestimated. However, in framing its recommendations, the Committee has already ruled out those measures that are patently unworkable. In any case, the Commissioner of Inland Revenue is now undertaking a technical appraisal of the recommendations and will report to the Government shortly. In addition, there is the question of whether those affected by the tax change will leave Hong Kong. This is an issue that cannot be resolved by *a priori* reasoning. The present writer is inclined to think, however, that the threat of mass migration is minimal. It is not easy to find another location like Hong Kong where low taxation is combined with modern infrastructure and other excellent facilities. Provided there is no drastic change in the political situation that threatens the present *status quo* of Hong Kong, it is difficult to believe that mass exodus of business will take place because of a mild programme of tax reforms. It is important that Hong Kong should keep its taxation low and the ambit of its tax charges confined within its territorial limits, but it is equally important that Hong Kong should not be turned into a happy hunter-ground for tax-dodgers.

Second, as a result of the suggested mandatory system of composite return of and assessment on aggregate income, the present schedular system will in effect come to an end. The final result will not be quite like a full income tax because certain incomes, such as dividends, capital gains, gifts etc. are excluded. In addition, of course, it still has a territorial limit, so that it is far from being a global income tax. However, the recommendations do constitute an important step towards the evolution of a full income tax system. The abolition of Property Tax and its integration into the Profits Tax is consistent with this trend. The proposal that actual rental income, rather than the assessed value, should be used for tax purposes is also significant in that the Committee has correctly foreseen the unnecessary controversy that can arise if the notional basis continues to be used for assessing tax liability on real property and accommodation (see Section III below).

Third, as fiscal policy was expressly excluded from its terms of reference, the Committee could not make any explicit recommendation on matters like tax rates and personal allowances. However, this does not mean that the Committee was not acutely aware of the importance of vertical equity. In fact, the Report gives strong hints that personal allowances should be adjusted upwards to compensate for inflation (paragraph 28), and that the mandatory system of tax return and assessment would be "an essential step towards the introduction of a further degree of progressivity should this be thought necessary" (paragraph 46). The personal view of the present writer is that, while the low tax rates and the absence of progressivity have undoubtedly been conducive to rapid economic growth — the average annual growth rate of Hong Kong's national income being close to 8 percent in real terms during 1974-76 — and that a gradual and automatic process of "levelling up" is much to be preferred as a redistributional strategy, there is nevertheless room for introducing more progressive rates into taxes on income and wealth, provided the rates are not set at too steep a level as to produce disincentive effects on work effort and enterprise. In an age of rising expectations, it is important that not only the absolute level of the standard of living of the poorer sections of the community should improve, but also that the relative gap in income and wealth as between different social groups should also be reduced as much as possible.

Fourth, among the recommendations of the Committee, quite a few relate to tax relief. The loss to revenue involved will not be inconsiderable. However, the rationalization contained in other recommendations will hopefully plug existing loopholes, achieve greater efficiency, and thus generate higher revenues. On balance it is reasonable to expect that revenue productivity will increase at the existing level of tax rates.

Finally, in addition to the usual criteria of good fiscal performance such as economic growth, equity, efficiency, simplicity and so on, the Committee in its deliberations was also guided by what one might call "working principles". One of these was that, in examining the tax implications of any transaction, the Committee always focused more attention on the underlying economic reality rather than the outward legal form. A good example is the treatment of interest receipts and payments, as described earlier. The other working principle was that certain desirable social activities could be better promoted through the expenditure rather than the tax revenue side of the public budget. But the Committee would not support both more spending and more tax relief for the same field of activity, being deeply conscious of the inflationary consequences that such a recommendation, however popular with the public, would entail. A good example is that, while the Committee strongly endorsed the Government's policy of building more public housing estates, both for lease and for sale, for which annual increase in ear-marked expenditure is required, it could not accept the argument that interest payments on the mortgage loan of a home-purchaser should be eligible for relief. In this particular case, moreover, there is the added question of horizontal equity between home-owner and rent-payer. In short, sound fiscal principle should not be sacrificed on the altar of social expediency.

To conclude then, our broad appraisal is that, given its closely defined scope of inquiry, and the wider social and political constraints confronting Hong Kong, the Review Committee has proposed a comprehensive but realistic programme of tax reforms. If accepted and implemented, these recommendations will eliminate much waste and duplication, achieve greater equity among tax-payers, plug many loopholes and increase revenue productivity, without however any need of raising the existing tax rates or introducing complicated legislation. Some transitional difficulties in implementation are to be expected, but ultimately, the tax reforms can only enhance and strengthen Hong Kong's position as a trading, industrial and financial centre.

III

As mentioned earlier in Section I, the Johnstone Report is being studied in depth by the Government. The tax proposals in the Budget for 1977-78 announced on March 2 by the Financial Secretary were therefore unrelated to the recommendations of the Report. All of them are in the nature of tax concessions because of the better than expected outturn of the current 1976-77 fiscal year — an estimated deficit of HK$ 355 million being likely to be turned into a huge surplus of HK$ 850 million.

The first concession concerns Rates, a local tax on the occupier of premises based on the assessed rental value of the property. In 1976 a revaluation of rateable values was made after a four year lag, the outcome of which was that the new values represented on average an 80 percent increase on the old ones. Since Rates are payable by, or at least shiftable to, the tenants, the announcement of the new rateable values last November gave rise to a public furor reminiscent of the Crown Rent affair in 1971-73.[15] In the ensuing controversy there has been much confusion and misunderstanding stemming largely from a failure to distinguish between the rateable value — revaluation of which is necessary to bring it more in line with open market value — and the actual tax rate applied to such value, which is flexible as part of the government's fiscal policy. Thus, pending the completion of the revaluation exercise, the General Rate percentage was increased by two points in 1975-76, and another point in 1976-77 to protect revenue. The understanding then was that downward adjustment would be made when the new revaluation had been carried out. As public feeling was running high, however, the Government felt constrained to make an announcement in early January, some two months before the Budget, that the General Rate for urban areas would be reduced from 12 to 7½ percent, while the Urban Council rate would be reduced from 6 to 4 percent. The Budget speech gave formal confirmation of this reduction, i.e., the total rates payable in the urban areas as from April 1, 1977 will be 11½ percent, against the previous 18 percent. The general rate for the suburban New Territories will vary from 7 percent to 11 percent. Even allowing for the reduction in tax rates, tenants will still have to pay higher Rates because of the new rateable value. To cushion the impact of the increased Rates payable, a scheme of relief was proposed whereby Rates payable in 1977-78 and 1978-79 should not increase by more than one-third compared to the preceding year, though for pre-war rent-controlled premises the scheme will continue after 1978-79. It is estimated that some 120,000 people will benefit from the scheme. In passing, it should be pointed out that Rates are governed by the Rating Ordinance and were therefore outside the terms of reference of the Third Inland Revenue Ordinance Review Committee.

The second concession concerns lower-income taxpayers. There are now some 290,000 Salaries Tax files, but of those already processed, 62 percent have assessable incomes of less than HK$ 30,000 per annum, contributing however only 9.5 percent of total tax collectible. Since the assessments will be small and not worth collecting in terms of administrative costs, the Financial Secretary therefore formulated a proposal that will have the effect of removing 45,000 small taxpayers from the tax net, keeping out a further 10,000 who would otherwise become liable for provisional tax for the year 1977-78, and bringing some relief to salaries and personal assessment taxpayers in the lower and middle income ranges. The main points of this proposal are:

(a) The basic personal allowance of HK$ 10,000 for the taxpayer and his spouse will be retained. To this a supplementary allowance of HK$ 2,500 each will be added, which however will be reduced by 20 percent of the amount by which the taxpayer's income exceeds the supplemented basic allowance until the point is reached where the entire supplement disappears. In absolute terms, taxpayers with income of about HK$ 36,000 (approximately US$ 7,600) per annum and below will receive the greatest benefit.

(b) Concurrently, child allowances will also be increased. The allowance for the first child will be increased from HK$ 3,000 to HK$ 4,000; for the second child from HK$ 2,500 to HK$ 3,000; and for the third child from HK$ 1,500 to HK$ 2,000. The allowances for the fourth to sixth child will remain at HK$ 1,000 each and for the seventh to the ninth child at HK$ 500 each. These new allowances will be effective for provisional Salaries Tax for the year 1977-78, and for final Salaries Tax and Personal Assessment for the year 1976-77 as well. It is estimated that the number of Salaries Tax and Personal Assessment taxpayers benefiting from the increased allowances will be about 193,800.

The third set of tax relief relates to Stamp Duty. First, certain archaic heads under the Stamp Ordinance will be eliminated, at a cost of only HK$ 30,000, but sparing the legal and financial professions some inconvenience. Second, as a further earnest of the Government's intention to promote home ownership, the

15. For a discussion of the affair, see Y.C. Jao, "Landuse policy and land taxation in Hong Kong", in John Wong (ed.), *The Cities of Asia: A Study of Urban Solutions and Urban Finance*, Singapore, 1976, pp. 277-303.

ceiling on low-value properties that enjoy concessionary rates of Stamp Duty will be raised to HK$175,000. For properties up to HK$100,000, only the fixed charges of HK$20 will be levied, and on properties up to HK$815,000, an *ad valorem* rate of one percent will be charged. The new platforms will also extend to voluntary dispositions *inter vivos*.

The final relief has to do with Estate Duty. The exemption limit will be raised from HK$300,000 to HK$400,000. The limit on funeral expenses will be increased from HK$5,000 to HK£10,000, and the further limitation of 2½ percent of the value of the estate allowance for funeral expenses will be abolished.

The total costs to revenue of these concessions will amount to about HK$127 million, thus reducing estimated revenue to HK$8,285 million (approximately US$1,863 million). As estimated expenditure is HK$8,245 million (approximately US$1.854 million) this still leaves a small surplus of HK$40 million (about US$9 million) for the 1977-78 Budget.

These tax proposals, which will take effect from the fiscal year 1977-78 beginning April 1, 1977, have been very well received. The ingenious supplementary allowance with a "claw-back" feature deserves a particularly high mark, for it will not only relieve or even eliminate the tax burden of the lower-income group, but will be relatively inexpensive in terms of the loss to revenue. It will certainly be much cheaper than an across-the-board increase in personal allowance which incidentally will also reduce the effective tax for those who can afford to pay it. On grounds of equity, fiscal productivity and administrative simplicity, the new scheme is to be highly commended.

One other potential tax development that could be of considerable international significance is the question of interest withholding tax. As a result of Hong Kong's raising stature as a financial centre, there has been growing interest on the part of foreign financial institutions (including the World Bank itself) in issuing Hong Kong dollar denominated bonds. However, the requirement of withholding interest at source has so far been a stumbling block. In his Budget speech the Financial Secretary disclosed that a working party has been set up, under the chairmanship of the Secretary for Monetary Affairs, to advise him on the monetary and tax implications of permitting international financial institutions access to the local bond market.

In his speech the Financial Secretary also described the objectives of budgetary policy in Hong Kong to be *first, progressively, and to the maximum extent that the economy will permit, to implement approved Government policies and programmes in such a way as to secure the public interest; secondly, to ensure that revenue is raised as equitably as possible between particular classes and groups of taxpayers or potential taxpayers; thirdly to minimise any adverse effects of public expenditure and of the fiscal system on the internal cost/price structure of the economy and private investment decisions so that the growth rate of the Gross Domestic Product is not constrained or business confidence damaged.* The stress on equity is significant because, as we have seen in Section II, the whole Johnstone Report is permeated with an acute concern about the elimination of inequity and closure of loopholes that are being exploited by a privileged class of taxpayers or potential taxpayers. International tax experts therefore will watch with interest what the Government's final decision on the Report will be.

Space consideration does not permit a detailed analysis of Hong Kong's fiscal policy which must form the subject for another article. However, certain features of fiscal policy that have been evolving under the present Financial Secretary should be briefly noted. *The first feature* is that, in order to achieve the objectives of budgetary policies outlined above, certain guidelines have been formulated which, though not absolutely rigid, are meant to impose a degree of discipline. They are (a) that recurrent expenditure should absorb no more than 80 percent of recurrent revenue and that at least 60 percent of capital expenditure should be financed by the surplus on recurrent account; (b) that at least half of the deficit on capital account should be financed by capital revenue and no more than half with debt; (c) that annual debt service should not, at any time, exceed income earned on fiscal reserves; (d) that the ratio of direct to indirect taxation should ideally be 45:55 and that of direct and indirect taxation taken together to all other recurrent revenue should ideally be 65:35; (e) that the relative size of the public sector, defined as the ratio of public expenditure to Gross Domestic Product, should not exceed 20 percent.

Second, a notable innovation has been the introduction of a longer-term outlook by including in the Budget a 4-year forecast of the economy and public finances. This feature was totally absent in the budgets presented by previous Financial Secretaries. Last year, Hong Kong's economic performance was so exceptionally good that the actual growth rate in real terms, now known to be 16.2 percent, far exceeded the original estimate of 9 percent. For the next few years, an annual real growth rate within the range of between 6 and 8 percent has been envisaged as being feasible up to 1980-81.

Third, although fiscal neutrality is still being regarded as of paramount importance, some evidence that budgetary policy has been used for "fine-tuning" the economy can be discerned. Thus, for two consecutive fiscal years, 1975-76 and 1976-77, a deficit was deliberately planned for reflationary purposes, though last year the recovery of the economy was so unexpectedly rapid that the projected deficit has been turning into an embarrasingly large surplus. For the current fiscal year 1977-78, therefore, a small surplus has been budgeted. In any case, instead of trying to balance the budget every year, as in the past, the purpose now appears to be balancing the budget over the whole business cycle.

Finally, a more rigorous cost-consciousness about public services is also being developed. Certain public services, such as education and medical services, obviously should not be charged for at cost, but according to the Financial Secretary, *in a low tax environment, all other things being equal, public services must be charged for, at least on a cost-related basis, provided adequate remission arrangements are available when required.* Last year an appropriations-in-aid system was introduced, under which certain fees and charges would not be credited to General Revenue, but would be used to offset approved expenditure. Broadly speaking, receipts classified as appropriations-in-aid are incomes received by government departments or government-owned enterprises from the provision or sale of services to the public (e.g., fees for certificates and licences, sales of services such as airport, railway, post office, water supply etc.). Allocation of funds from General Revenue to each department will then be the total estimated expenditure less the estimated appropriations-in-aid. The advantage of this system is that, by putting the finances of certain departments on a quasi-commerjcial basis, the true costs of governmental activities will be more readily apparent, and that the departments concerned will have the incentive to increase receipts from fees and charges and to reduce expenditure.

SOME MAJOR TAX REFORMS SINCE 1945

The postwar period was marked by the need for many countries to re-establish their economy. New principles as to the role of government gained momentum. It was the time to reconsider the tax systems and some major tax reforms were the result. Ever since tax legislation has been on the move. In fact, one may speak of a continuous tax reform. Sometimes, the whole tax system was reviewed. Some of these reforms were prepared by special committees whose reports had, and still have, a significance across national borders. The following is a selected list of major tax reforms enacted or still under review, indicating where possible the reports of government or special committees.

AUSTRALIA

1961: Report of the Commonwealth Committee on Taxation (Ligerwood Committee).
1972: Appointment of the Taxation Review Committee (Asprey Committee) to review the entire federal tax system.
1975: Publication of the Asprey Report.
1975: Report of the Committee of Enquiry into Inflation and Taxation (Mathews Committee).

Relevant Reports: Ligerwood Report — Asprey Report — Mathews Report, all published by the Government Printer, Canberra, Australia.

BELGIUM

1962: Abolition of the schedular system of income taxes (which had existed from 1919) by a unitary system. Introduction of the imputation system of corporate income tax.

Relevant Reports: Official Explanation to the tax reform (Document Chambre des Représentants 264 (1961-1962) No. 1) and Report of the Finance Committee of the House of Representatives (Document Chambre des Représentants 264 (1961-1962) No. 42). (Dutch and French).

CANADA

1948: Completion of a general revision and re-codification of the rules under the old legislation.
1952: Income Tax Act, result of recommendations made in the reports of several Royal Commissions.
1962: Royal Commission on Taxation, chairman Kenneth Lem. Carter. Assignment was a complete revision of the Canadian income tax system.
1966: Publication of the Commission's Report, referred to as the "Carter-Report".
1972: The Carter-Report resulted in a new Income Tax Law, introducing, inter alia, an imputation system in order to alleviate the double economic tax burden on distributed corporate profits.

The Carter Report: Report of the Royal Commission on Taxation, 1966, published in six volumes, available from Roger Duhamel, F.R.S.C., the Queen's Printer and Controller of Stationery, Ottawa, Canada.

FRANCE

1948: Replacement of the schedular income tax system by a semi-unitary system under which a separate corporate income tax was introduced and a proportional tax (essentially schedular in nature) and a progressive surtax on total income of individual taxpayers.
1959: General report of the Fiscal Study Group on the French tax system (Brasart Report).
1961: General report of the Fiscal Study Committee (subjects: the taxation of the flow of capital and individual income tax rates).
1965: Introduction of the imputation system of corporate income tax.
1977: Introduction of capital gains taxation.

Relevant Reports: Brasart Report (Statistiques et Etudes Financières 1959 Suppl. 125).
Rapport de la Commission d'Etudes Fiscales (Statistiques et Etudes Financières 1961 No. 152 p. 1442).
"Orientations de la réforme de l'impôt sur le revenu des personnes physiques" (Journal Officiel — Conseil économique et social 1969 No. 9).
Monguilan Report on capital gains taxation (2 volumes), published by La Documentation Française, Paris.

GERMAN FEDERAL REPUBLIC

1948: Monetary reorganization, with certain tax consequences.
1953: So-called "Small Tax Reform" introducing, inter alia, an alleviation of the double economic tax burden on distributed corporate profits by applying a lower corporation tax rate on distributed as compared to non-distributed profits.
1968: Tax Reform Committee assigned to review the whole German tax system.
1971: Report of the Committee resulting in a step-by-step reform of the major tax laws during the period 1972-1977.
1977: New corporation tax; introduction of a full imputation system.

Relevant Reports: Gutachten der Steuerreformkommission 1971, one volume. Schriftenreihe des Bundesministeriums der Finanzen, Heft 17, available from Wilhelm Stollfuss Verlag, Bonn, Federal Republic of Germany.

HONG KONG

1966: Appointment of the Second Inland Revenue Ordinance Review Committee.
1967/1968: Interim and Final Reports of the Committee.
1976: Report of the Third Inland Revenue Ordinance Review Committee (Johnstone Committee).

Relevant Report: Johnstone Report (Government Printer, Hong Kong).

ITALY

1958: The so-called "Vanoni-Reform" named after the Minister of Finance Prof. Ezio Vanoni, who largely prepared it from 1949 until his death in 1955. Purpose: a more equitable tax burden and simplification of the tax system. Result: *Testo Unico delle imposte dirette* (Unified Text concerning direct taxes) effective as of 1 January, 1960.
1973: Direct Tax Reform. Abolition of the schedular tax system, substitution by a synthetical system as in most other European countries. Progressive personal income tax. Corporation tax. Effective 1 January, 1974.

Relevant Reports: Relazione del Vice-Presidente del Comitato di studio per l'attuazione della reforma tributaria al Ministro delle Finanze Luigi Preti (Report of the Vice-President of the Tax Reform Committee to Mr. Luigi Preti, Minister of Finance). February 28,

1967, in: Associazione Bancaria Italiana, Serie "Documenti" No. 6, Bancaria, Roma, 1967.
Reports of the Minister of Finance concerning the introduction of the new individual, corporation and local income taxes appeared (in Italian) in: Bollettino Tributario d'Informazioni, No. 23, December 15, 1973.

INDIA

1953: Appointment of Taxation Enquiry Commission headed by dr. John Matthai.
1954: Matthai Report published. It deals with the income tax system in relation to: redistribution of wealth, development, capital formation, inflation, deflation. The Finance Act, 1955 and subsequent Acts gave effect to the recommentations.
1956: Nicholas Kaldor, Indian Tax Reform, Report of a Survey. Proposal to introduce as a single operation taxes on income, capital gains, personal expenditure, gifts. All proposals were enacted in subsequent years but the Expenditure Tax was later repealed.
1958: Report of the Law Commission of India recommending replacement of the Income Tax Act, 1922.
1961: Income Tax Act, 1961 replacing the Act of 1922.
1967: Final Report on the Rationalisation and Simplification of the Tax Structure, by S. Bhoothalingam.

Relevant Reports: Report of the Taxation Enquiry Commission, 1953-54, 3 volumes, Government of India, New Delhi, 1955.
Kaldor, Nicholas, Indian Tax Reform: Report of a Survey Government of India, Ministry of Finance, Department of Economic Affairs, New Delhi, 1956.
Bhoothalingam, Final Report on Rationalisation and Simplicity of the Tax Structure, Government of India, Ministry of Finance, New Delhi, 1968.

JAPAN

1947: General Tax Reform.
1949: Report on Japanese Taxation, by the Shoup Mission, headed by Prof. Carl S. Shoup. Many of the comprehensive proposals were enacted but soon afterwards either repealed or modified.
1955: Establishment of a Tax Advisory Commission, whose recommendations resulted in several tax reforms.
1964: Report of the Tax Commission on how the fundamental system of taxation should be adjusted to the progress of the national economy and society.

Relevant Reports: Report on Japanese Taxation by the Shoup Mission, in 4 volumes, General Headquarters, Supreme Commander for the Allied Powers, Tokyo, 1949.
Second Report on Japanese Taxation by the Shoup Mission (Tokyo, 1950).

REPUBLIC OF KOREA

1948: Introduction of a modern tax system based on the recommendations of the Tax Law Committee.
1953: H.P. Wald's Report and Recommendations for the Korean Tax System.
1959: Report by the Tax Consultants Group headed by Dr. Hall.
1974: Comprehensive Tax Reform.

SWITZERLAND

1976: Proposal to harmonise the direct tax legislation of the Cantons and to modify the direct federal tax legislation. While approved by the Swiss Federal Parliament, the proposal is still subject to a referendum.

Relevant Reports: Explanatory Memorandum of the Swiss Government published in German in the Bundesblatt (Official Gazette) No. 17 of 3 May, 1976, pages 1384-1574.

UNITED KINGDOM

1955: Royal Commission on the Taxation of Profits and Income, Final Report.
1964: White Paper: "A Scheme for an Accounts Basis for Income Tax on Company Profits", Cmnd. 2347.
1965: A result of the above report and the White Paper introduction of the Corporation Tax according to the classical system. Introduction of a general capital gains tax.
1972: Replacement of classical system by an imputation system of Corporation Tax.

Relevant Reports: Final Report of the Royal Commission on the Taxation of Profits and Income, June 1955 (Command Paper — Cmnd. 9474).
Report from the Select Committee on Corporation Tax (House of Commons, Session 1970/71), October 1971.

Bibliography

Books.

Any inquiries concerning books on this list should include the reference numbers listed.

AFGHANISTAN

INVESTITIONS- UND STEUERRECHT

Cologne, Bundesstelle für Aussenhandelsinformation, 1977. Berichte und Dokumente zum ausländischen Wirtschafts- und Steuerrecht, No. 91, January 1977, 26 pp.
Booklet explaining the foreign and domestic private investment law of 1974 and the tax system in Afghanistan. Full text of the investment law in English version is appended.

WIRTSCHAFTLICHE ENTWICKLUNG 1973-75

Cologne, Bundesstelle für Aussenhandelsinformation, 1976. 65 pp.
Data on economic development in Afghanistan during 1973-75. (B. 50.686)

ALGERIA

GUIDE PRATIQUE DES IMPOTS 1976

Tome II: taxe sur l'activité industrielle et commerciale; impôt sur les bénéfices agricoles; impôt sur les bénéfices des professions non-commerciales; taxe sur l'activité des professions non-commerciales; impôt sur les traitements et salaires, t.h.s., versement forfaitaire, exonérations visant certaines catégories de revenus et contribuables; impôt complémentaire sur le revenu. Alger, Etudes & Documentation Fiscales, 1976. ± 80 pp.
Volume II of this series summarizes the following taxes: tax on industrial and commercial activities, tax on agricultural profits, tax on non-commercial activities, tax on non-commercial profits, tax on salaries, wages, pensions and life annuities, complementary tax on income and statistic levies (Rasm el Ihsaiya). (B. 10.764)

GUIDE PRATIQUE DES IMPOTS 1976

Tome IV: impôt sur le revenu des créances, dépôts et cautionnements; droits d'enregistrement — droits de timbre; dispositions communes (impôts directs). Alger, Etudes & Documentation Fiscales, 1976. ± 150 pp.
This volume IV explains the taxes levied on dividends and interest, stamp and registration duties, motor vehicle tax, and local direct taxes. (B. 10.769)

GUIDE PRATIQUE DES IMPOTS 1976

Tome V: régimes spéciaux entreprises étrangères. Alger, Etudes & Documentation Fiscales, 1976. ± 200 pp.

ASIA

ASIEN.WIRTSCHAFTSDATEN

Ausgabe 1976, Teil I. Cologne, Bundesstelle für Aussenhandelsinformation, 1976, 48 pp.
Brochure entitled "Asian Economic Data" covering economic information of Bangladesh, Burma, Israel, Republic of Korea, Pakistan and Thailand. (B. 50.685)

AUSTRALIA

EXPLANATORY MEMORANDUM TO THE INCOME TAX ASSESSMENT AMENDMENT BILL (NO. 3) 1976 AND INCOME TAX (COMPANIES AND SUPERANNUATION FUNDS) BILL 1976

Canberra, Government Printer, 1976. 95 pp. (B. 100.192)

INCOME TAX ASSESSMENT ACT 1936-1975

With tables of provisions, notes and index to Act and Regulations.
Canberra, Australian Government Publishing Service, 1975. 662 pp. (B. 100.081)

OECD ECONOMIC SURVEYS: AUSTRALIA

Paris, Organization for Economic Co-operation and Development, 1976. 66 pp., Fr.Frs. 10.-. (B. 100.181)

AUSTRIA

DIE EINKOMMENSTEUER

By Josef Zapletal and Kurt Reichel. Band II. Rechtsprechung zum Einkommensteuergesetz 1967. 21.-25. Ergänzungslieferung. Vienna, Anton Orac Verlag, 1976. Price complete work, including binders, ÖS. 1390.-.
The supplements 21-25 bring this collection of recent tax court decisions under the Individual Income Tax Law up to date to October 1976.

HANDBUCH FÜR INVESTORENINFORMATION

Vienna, Bundesministerium für Handel, Gewerbe und Industrie, 1976.
Second edition of a loose-leaf publication entitled "Handbook on Investor's Information", which is designed to provide a complete picture of data necessary for investors in Austria. The material also includes a chapter on taxation. (B. 9223)

BELGIUM

COMPARAISON DES SYSTEMES NATIONAUX D'IMPOTS SUR LES REVENUS DES PETITES ET MOYENNES ENTREPRISES ET DES TRAVAILLEURS INDEPENDANTS

Ghent, International Study Institution of the Middle Classes, 1975. ± 150 pp.
Final report of study days convened by International Study In-

stitution of the Middle Classes on December 1-2, 1975 in Ghent on the subject concerning the comparison of national systems of income taxes for small and medium enterprises and for independent workers. The topic is dealt with by contributors from the German Federal Republic, Belgium, Spain, France, Luxembourg, Italy and the Netherlands. A general report analyzing the subject as a whole is appended. (B. 100.185)

BRAZIL

PRINCIPIOS COMUNES DE DIREITO CONSTITUCIONAL TRIBUTARIO

By Victor Uckmar, São Paulo, Editora Revista dos Tribunais, Ltda., 1976. 122 pp.
Portuguese translation by Marco Aurélio Greco. The book covers the basic principles of taxation as established in the main constitutions. The historical background of these principles is also considered. (B. 15.623)

CAMEROUN

LE CAMEROUN DANS LES RELATIONS INTERNATIONALES

By Adamou Ndam Njoya. Paris, Librairie Générale de Droit et de Jurisprudence, 1976. 414 pp., Fr.Frs. 139.-.
An exhaustive study of the history of the international relations of Cameroon. (B. 10.818)

CANADA

DOING BUSINESS IN CANADA

Taxation on income, business, property. Ottawa, Office of Information and Public Relations Department of Industry, Trade and Commerce, 1977. 20 pp. (B. 100.203)

MATERIALS ON CANADIAN INCOME TAX

Third edition. Toronto, Richard de Boo, Ltd., 1977. 1200 pp., $ 39.95.
This book provides the basic materials for the general course in income tax in Canadian law schools, and is a useful and portable source of reference for practitioners. It also reports on all leading tax cases. (B. 100.157)

PRELIMINARY TAXATION STATISTICS/
STATISTIQUE FISCALE PRELIMINAIRE

Analyzing the returns of individuals for the 1974 taxation year. Ottawa, Government Printer, 1976. 60 pp. (B. 100.201)

TAXATION STATISTICS/STATISTIQUE FISCALE

1976 Edition; analyzing the returns of individuals for the 1974 taxation year and miscellaneous statistics. Ottawa, Government Printer, 1976. 231 pp. (B. 100.201)

TRANSLATION OF FOREIGN CURRENCIES

By R. MacDonald Parkinson. Toronto, Canadian Institute of Chartered Accountants, 1974. 144 pp., $ 5.50.
Research study on accounting techniques to be employed in the translation into Canadian currency of international transactions and of assets, liabilities, revenues and expenses of subsidiary companies and branches carrying on business outside Canada.
(B. 100.169)

DENMARK

SKATTE TABELLER 1977

By V. Spang-Thomsen. Copenhagen, A/S Skattekartoteket Informationskontor, 1976. 128 pp.
Income and net wealth tax tables for 1977 with annotations. (B. 100.220)

EASTERN EUROPE

NATIONALEINKOMMEN IM SOZIALISMUS

Produktion, Verteilung, Umverteilung, Verwendung, Informationssystem und Modellierung. Berlin, Verlag "Die Wirtschaft", 1976. 503 pp., M. 23.60.
Book composed by a number of authors from Bulgaria, East-Germany and the U.S.S.R. explaining the various economic aspects of national income in socialist states. (B. 100.120)

ECUADOR

INVESTITIONSBEDINGUNGEN

Prepared by Wolfgang Lehmann. Cologne, Deutsche Gesellschaft für Wirtschaftliche Zusammenarbeit/Bundesstelle für Aussenhandelsinformation, 1976. 60 pp., DM 10.-.
Guide designed to inform German investors who want to invest in Ecuador. Relevant data including taxation on investment opportunities is dealt with. (B. 15.619)

EUROPEAN ECONOMIC COMMUNITY

LA RESTITUTION DE TAXES PERÇUES INDUMENT PAR L'ETAT

Geneva, Georg, 1976. 254 pp. Etudes suisses de droit européen/Schweizerische Beiträge zum Europarecht, Volume-Band 18.
Study on comparative law on the subject concerning the recovery of dues improperly levied by a state. The topic is dealt with by contributors from the German Federal Republic, United Kingdom, Austria, Belgium, France, Italy, the Netherlands and Switzerland. European Community Law in connection therewith is considered. (B. 100.186)

European Economic Community (cont.)

TAX PROBLEMS OF CULTURAL FOUNDATIONS AND OF PATRONAGE IN THE EUROPEAN COMMUNITY

By Isaac Claeys Boúúaert. Deventer, Kluwer, 1976. 116 pp., Dfl. 45.-.
Comparative study on the tax systems of the nine member states of the European Economic Community on cultural foundations with the aim to clear up certain problems in the field of fiscal policy formulated by the services of the European Economic Community. (B. 100.197)

FRANCE

GUIDE PRATIQUE DU CONTRIBUABLE 1977

Impôts sur les revenus; impôts locaux; plus-values. Paris, Revue de l'Enregistrement et des Impôts, 1977. 160 pp.
Annual tax guide 1977 containing short explanation of the French tax laws. (B. 100.214)

POURQUOI ET COMMENT CONSTITUER UNE SOCIETE ANONYME

11th Edition. By Francis Lemeunier. Paris, J. Delmas & Cie. 1976. ± 300 pp.
Monograph explaining why and how to establish a French corporation. The material is updated as of July 10, 1976. Text of relevant statutes and a bibliography list is appended. (B. 100.145

GERMAN FEDERAL REPUBLIC

ABGABENORDNUNG AO 1977

By Karl Kock, Cologne, Carl Heymanns Verlag, 1976. 946 pp. DM. 42.-.
Handbook providing an extensive comment on the new German Fiscal Code 1977 and containing the text of the law and parts of the introductory law to the new law and other laws, as well as comparison between the old and the new law. (B. 100.125)

DOKUMENTATION STEUERBEGÜNSTIGTE KAPITALANLAGEN 1976/77

Cologne, Peter Deubner Verlag, 1976. 60 pp., DM. 16.50.
Overview of tax incentives with respect to capital investment for the years 1976/77, published as a special service of the German tax periodical "Steuer-Telex". (B. 100.161)

EINFÜHRUNG IN DAS BESONDERE STEUERRECHT

Band III: Das Internationale Steuerrecht der Bundesrepublik. By Hermann Weber and Volker Kluge. Munich, C.H. Beck'sche Verlagsbuchhandlung, 1976. Schriftenreihe der Juristischen Schulung, Heft 34. 208 pp., DM. 22.80.
Third part of a series of books dealing with special aspects of tax law. This volume particularly deals with the international tax law in the Federal Republic of Germny and covers a number of essential aspects of German international tax law, such as the foreign tax credit and the influence of tax treaties. (B. 100.130)

KÖRPERSCHAFTSTEUERGESETZ 1977

Mit Vorschriften des EStG und UmwStG 1977. By Kay D. Kläschen. Bonn, Stollfuss-Verlag, 1976. 250 pp., DM. 29.80.
Loose-leaf service containing comments on the new German Corporate Income Tax Reform Law, including the provisions of the individual income tax law and reorganization tax law as amended by the corporate income tax reform law. (B. 100.155)

KÖRPERSCHAFTSTEUERREFORM — UMWANDLUNG-STEUERREFORM

By Günther Felix. Cologne, Arbeitskreis für Steuerrecht, 1976. 188 pp., DM. 66.-.
Monograph analyzing the most important aspects of the new corporate income tax reform and frequently referring to articles in German tax periodicals. This book, in which many examples clarify the new law, was composed on the basis of the 20th "training-session" in Cologne. (B. 100.122)

THE PRIVATE COMPANY IN GERMANY

A translation and commentary. By M.C. Oliver. Estover, Plymouth, MacDonald & Evans, Ltd., 1976. 120 pp., £ 2.50.
Short explanation on the features of the German private company (GmbH). The text of the German Private Companies Act in both the English and German languages is appended. (B. 100.165)

DIE STEUERLICHE BEGÜNSTIGUNG DER KARTELLE

By Gerhard Niemeier. Bielefeld, Gieseking Verlag, 1976. Industriegesellschaft und Recht, Band 4. 180 pp., DM 44.-.
Monograph dealing with the income tax and turnover tax liability of cartels and trust and the various tax incentives granted to them in this respect. (B. 100.224)

ZUR STEUERRECHTLICHEN ANERKENNUNG VON RÜCKSTELLUNGEN

By Ursula Niemann. Bonn, Institut Finanzen und Steuern, 1977. "Finanzen und Steuern", Heft 113. 77 pp., DM. 19.75.
Thesis discussing the question whether and to what extent liability provisions as considered in the light of the German Corporate Law are recognized in tax matters. (B. 100.216)

STEUERSTRAF- UND STEUERORDNUNGSWIDRIGKEITENRECHT EINSCHLIESSLICH VERFAHRENSRECHT

By Günther Kohlmann. Cologne, Otto Schmidt Verlag, 1976. 120 pp., DM. 145.-.
Loose-leaf publication containing an extensive discussion of the German legislation with respect to fiscal penalties. The text of the relevant legal provisions, mainly those of the Fiscal Code are included. The book also contains a separate part in which the most relevant concepts, such as tax avoidance, tax evasion, are defined. Supplements are delivered annually. (B. 100.222)

STEUERTABELLEN

Listen, Tabellen und Übersichten für die Steuerpraxis. Munich, Verlag C.H. Beck, 1977. ± 1920 pp., DM. 38.-.
Second edition of a loose-leaf publication containing a compilation of various tax tables, depreciation tables and other practical information. Updated as of January 1, 1977. (B. 100.221)

DER VERLUSTRÜCKTRAG

By Walter Schick. Munich, C.H. Beck'sche Verlagsbuchhandlung, 1976. Steuerrecht im Rechtsstaat, Heft 15. 80 pp.
Booklet explaining the most important aspects of the carry-back for losses as introduced by the law of April 20, 1976. (B. 100.148)

CAPITAL TRANSFERS, TAXES AND INTERNATIONAL CORPORATE OPERATIONS (APRIL 1972)

International competitiveness - an empirical analysis of Swedish manufacturing (September 1972). By Gunnar Eliasson. Second, unrevised edition, May 1976. Stockholm, Federation of Swedish Industries, 1976. 180 pp.
Reprint of two papers investigating the problems related to the international economic interdependency of industrialized countries and multinational companies. (B. 100.187)

INTERNATIONAL

FINANTELE SI CERINTELE DEZVOLTARII AGRICULTURII PE PLAN MONDIAL

By Julian Vacarel. Bucharest, Editura Politică, 1976. 300 pp.
Study on a number of economic aspects of agricultural enterprises throughout the world entitled "Finance and Agricultural Development Requirements in the World". A chapter on taxes levied on agricultural income throughout the world is included. Three categories of countries are discussed: developed western countries, socialist countries and developing countries. (B. 100.182)

INTERNATIONAL DIVESTMENT

A survey of corporate experience. Geneva, Business International, 1976. 134 pp.
Research report based on interviews with executives of international companies on their experience with foreign disinvestments. (B. 100.143)

PRINCIPLES AND METHODS FOR THE PROVISION OF ECONOMIC INCENTIVES IN WATER SUPPLY AND WASTE WATER DISPOSAL SYSTEMS (INCLUDING THE FIXING OF CHARGES)

A report prepared under the auspices of the ECE Committee on Water Problems. New York, United Nations, 1976. 25 pp. (B. 100.179)

THE STATEMAN'S YEAR-BOOK

Statistical and historical annual of the states of the world for the year 1976-1977. Edited by John Paxtion. London, Macmillan Press, Ltd., 1976. 1556 pp., £ 7.95.
This 113th edition updates the information and statistics of the one-volume encyclopaedia of the world's nations. To each country a list of books for further reading is appended. (B. 100.167)

JAPAN

FINANCIAL REPORTING IN JAPAN

By Robert J. Ballon, Iwao Tomita and Hajime Usami. Tokyo, Kodansha International, Ltd., 1976. 303 pp.
Study providing information and explanation on essential background material on corporate organization and financing in Japan and other context which is necessary for proper understanding of Japanese financial reporting. Since this study is addressed to non-Japanese business executives, an appendix is included with a case study of a Japanese company with 25 percent ownership in the U.S. and 75 percent in Japan. (B. 50.665)

NEPAL

RESOURCE MOBILISATION AND FINANCIAL DEVELOPMENT IN NEPAL

By Maxwell J. Fry. Kathmandu, Centre for Economic Development and Administration, 1974. 94 pp.
Text of three lectures delivered at the Centre for Economic Development and Administration, Kathmandu, 26-29 July, 1974. (B. 50.668)

THE NETHERLANDS

BELASTINGGIDS DE TELEGRAAF

Editie 1977. By J.L. van Hedel. Amsterdam, Teleboek, 1976. 464 pp.
Tax guide for filing 1976 individual income tax return. (B. 100.218)

FISCAAL MEMO

Deventer, Kluwer, 1977. 63 pp.
Revised edition of Fiscal Memo providing practical information in a nutshell concerning tax provisions effective as of January 1977. (B. 100.166)

HET INSTITUUT VAN DE FISCALE EENHEID IN DE VENNOOTSCHAPSBELASTING

Tweede druk 1976. By K. Rijks. Deventer, FED, 1976. Fed's Fiscale Brochures, Vpb: I-3. 72 pp.
Second edition of monograph on the concept of fiscal unity under the Dutch corporate income tax law. The law is stated as of October 1976. With reference to European Economic Community developments. A short outline of group relief in the other member countries, if any, is added. (B. 100.170)

KWIJTSCHELDINGSWET

Derde herziene druk 1976. By M.J.H. Smeets and H.M.N. Schonis. Deventer, FED, 1976. Fed's Fiscale Brochures, IB: 3.33. 58 pp.
Revised third edition of monograph dealing with the Dutch taxation in case of remission of a debt and other such related events in business practices. (B. 100.223)

VAD BILL

Regulation of excess profits sharing (Excess Profits Sharing Act). The Hague, American Chamber of Commerce, 1976. 29 pp., Dfl. 10.40.
English translation of the full text of the VAD Bill introduced to the Dutch Parliament in June, 1976. (B. 100.140)

NIGERIA

RECURRENT AND CAPITAL ESTIMATES OF THE GOVERNMENT OF THE FEDERAL REPUBLIC OF NIGERIA 1976-77

Lagos, Federal Ministry of Information, 1976. 574 pp. (B. 10.813)

PHILIPPINES

THIRD SURVEY ON TAX CONSCIOUSNESS IN THE PHILIPPINES

Manila, National Tax Research Center, 1976. 137 pp.
Report on the third nationwide sample survey on tax consciousness prepared jointly by the National Tax Research Center and the Bureau of Internal Revenue in September 1975. (B. 50.687)

THAILAND

THAILAND WELCOMES FOREIGN INVESTMENT

Bangkok, Board of Investment, 1976. 30 pp.
Information booklet on foreign investment opportunities today in Thailand. Taxation is dealt with. (B. 50.689)

UNITED KINGDOM

BELASTING VAN BEDRIJVEN IN HET VERENIGD KONINKRIJK

By Edo de Vries. Deventer, Kluwer, 1977. 223 pp.
Monograph designed as an introduction to explain the tax system on business income in the United Kingdom. Double taxation treaty between the United Kingdom and the Netherlands and a short explanation of the foreign exchange regulations are dealt with. The material is updated as of August 1, 1976. Reference to case law and statute is annotated to the text. (B. 100.198)

CAPITAL GAINS TAX

Third edition. By Vera di Palma. Estover, Plymouth, MacDonald & Evans, Ltd., 1977. 224 pp., £ 2.-.
Third revised edition of textbook explaining the capital gains tax illustrated with one hundred and thirty examples. The law and practice are stated as of April 30, 1976. (B. 100.163).

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2nd Edition. By Kenneth E. Wright and Malcolm O. Penney. London, Institute of Chartered Accountants in England and Wales, 1976. 201 pp., £ 5.20.
Second edition of monograph on capital transfer tax designed to inform those individuals who plan to distribute their wealth either during their life or at death. (B. 100.164)

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— by *Prof. Dr. Apoloniusz Kostecki*

Continuation of *M.W.T. Pepper's Tax Glossary*

IN THIS ISSUE

Four issues of the *Bulletin* in its new format and style have now appeared. The large number of new subscriptions seems to indicate that the present formula appeals to people in many different functions who want to be informed on new developments in taxation in various parts of the world. It is not only factual information we wish to supply but also the background and philosophy, thus giving a theoretical basis for articles of practical value.

It is, of course, true that a taxpayer's main concern is how much he will have to pay when involved in international transactions. There are also good reasons for him to consider the role of taxation within a country's national economy or socio-economic policy. The present issue of the *Bulletin* draws attention to this aspect from various angles.

In many countries nowadays the public sector is involved in the economy through other means than taxation alone. Funds are transferred in the form of social security benefits, grants of all kinds and many other payments which in one way or another aim at a redistribution of income and wealth and which at the same time may stimulate the economy. In the case of the Netherlands, lower and middle income groups do not only pay tax (if at all) in the lower brackets of progression, but they also benefit from a sophisticated system of child allowances, exemption from tuition fees at schools or universities, grants for children who follow higher education, as well as subsidies in cases where the rent of houses or flats exceeds a given proportion of their income. If this income reaches a certain ceiling, many of these benefits are lost while at the same time the progressive income tax scales take away a larger part of consumable income. The Dutch Council for middle and higher executives examined the combined effects of taxation and other measures. In individual cases these effects may result in the paradoxal situation that an increase of gross income leads to a net decrease. In a more comprehensive manner the situation in THE NETHERLANDS — which may exist in other countries as well — is described in the article by Professor *Halberstadt* and Mr. *de Kam*.

The role of taxation may also be considered from a quite different angle. Those engaged in business in a foreign country will be generally interested in the level of taxation imposed by the central government; in many countries, local taxation may be significant as well. In federally organized countries it may even well happen that taxation of the political subdivisions is more important than federal taxation. There may be historical reasons for this but it is also possible that the whole structure of a country's tax system is the result of a political-economic concept which is particular to the country concerned. In a period where business relations between Western and East European countries tend to increase in number and significance, the article on Federalism in YUGOSLAVIA by Professor *Bogoev* is of current interest.

Small independent or autonomous territories whose economics often are not diversified are nevertheless members of the international community. Their problems and the opportunities they sometimes offer are a matter of concern and interest to a larger group of people, for different reasons and varying degrees. In this issue attention is given to the situation in two groups of islands in the Caribbean in an article by Mr. *Nizar Jetha* and Mr. *Nurali Peera* on the LEEWARD & WINDWARD ISLANDS. A series of brief notes on the budgets of developing countries is continued by a survey on MALAYSIA. Further, it is interesting to note that the existing tax treaty network is expanding, indicating that an increasing number of developing countries want to be more actively involved in the tax aspects of international trade and investment. Countries in South East Asia are more and more aware of the value of tax treaties. Their involvement may have significance for the development of new principles in international taxation along the lines of the special U.N. Group of Experts. This issue contains a survey of the treaties concluded by SINGAPORE following a similar survey on treaties to which INDIA is a party (No. 1977/3). At a later stage, various treaty clauses will be treated comparatively.

As usual, this issue of the *Bulletin* gives information on new tax publications, on existing loose-leaf services on a country by country basis (new supplements are announced in the loose-leaf section of the Bibliography), as well as on tax conferences or seminars to be held during the coming months.

All this background information, combined with different types of documentation on taxation developments, is possible as a result of the international team work organized and coordinated by the research staff of the International Bureau of Fiscal Documentation. In this context, local expertise is indispensable and we are grateful for the world-wide support we receive.

There are many trends of which all those involved in tax matters ought to be aware. At domestic levels, the role of taxation is if not predominant at least of crucial significance. There is every reason to believe that internationally this role will become more and more important as well. The *Bulletin*, by recognizing the need for a more fundamental approach, has embarked on a new course which is again reflected in this issue.

Tax Rates in the Netherlands:

A Suitable Case for Treatment.

Victor Halberstadt*/ Flip de Kam**

I. INTRODUCTION

Early in 1975 the Dutch government published its *Interim Note on Income Policy*. After publication of the *Interim Note* the steady debate on the role of taxation as an instrument to influence the personal distribution of incomes has markedly intensified. In addition, the nature and degree of inequality have moved to the centre of political and academic discussion ever since. At the same time a general consensus emerges that the improvement in recent years of lower real incomes — especially through minimum wage legislation and certain tax measures — compared to the development of net average labour income of (semi) skilled workers, might put an increasing strain on industrial wage relations.

A main feature of the public sector in The Netherlands should be noted here. The minimum benefits in publicly financed income transfers are equal to the net legal minimum wage, as from 1974. At present a relatively large part of the population (about a third) is receiving such transfers. These are important factors in making tax revenues of the public sector — expressed as a percentage of Net National Income — one of the highest in the OECD-area (52.6 pct.). See also Table 1. As a consequence the average worker is heavily taxed at the moment. This will be illustrated in paragraph 4. High rates endanger social solidarity between workers and non-workers. Moreover the heavy tax burden seems to affect labour supply in a negative way.

The share of indirect taxes in the structure of public revenues is clearly smaller than in a number of other comparable developed economies. After France, The Netherlands rank second in the weight of social insurance burdens. Social insurance contributions as a percentage of Net National Income nearly doubled during the past ten years. The dramatic rise of these contributions in The Netherlands obviously has important implications for any distributive policy, since their impact is quite different from — for instance — the progressive income tax. Marginal income tax rates are already high in The Netherlands, climbing from 20 percent to 72 percent on taxable income exceeding Dfl. 155,000 (seven times the taxable income of an average worker). The income tax structure is therefore clearly progressive. Especially middle-to-high incomes are confronted by steeply rising rates. On the other hand lower incomes are subject to a relatively heavy burden of social insurance contributions.

*Table 1. Tax structure of The Netherlands 1977**

	millions of guilders	as % of total
Total tax revenue:		
1. On goods and services	30,085	25.25%
2. On personal income	32,900	27.61%
3. On corporate income	7,600	6.38%
4. On net wealth	1,015	0.86%
5. On other taxes	40	0.03%
6. On social insurance contributions from households	25,856	21.70%
7. On social insurance contributions from employers	21,647	18.17%
Total tax revenue	119,143	100 %

* Local taxes excluded.

Source: *Miljoenennota 1977 (Budget Plan 1977), p. 77. Begroting Sociale Zaken 1977 (Ministry of Social Affairs Budget 1977), No. 3. Annex VI, p. 22-23.*

The combined rate of these public levies might explain growing rumours about a rapidly emerging black money "circuit". General awareness of successful tax avoidance practices is spreading quickly. Many seek legal ways to lighten their tax burden. These developments are by some observers considered added proof that the present combined rates of income tax and social insurance contributions are generating increasing resistance among taxpayers.

2. THE INTERIM NOTE ON INCOME POLICY

In its *Interim Note on Income Policy* the government attempts a more comprehensive and consistent set of policies with regard to the distribution of income and wealth. Instead of ad hoc or partial policies towards specific aspects of (re)distribution, it tries to present an overall picture. Thus it takes into account the distribution of incomes before and after taxes and transfers (whether in money or in kind). A wide range of policy proposals is outlined. However, the *Interim Note* indicates that possibilities for an exclusively national tax policy are limited, in view of potential emigration of labour and capital. Therefore, emphasis is put on in-

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fluencing the formation of primary income, as the most effective tool for realising redistributive goals.

The government stresses the point that a further use of the income tax to implement an income policy would increasingly stimulate taxpayers to avoid the tax burden or to adjust primary income (tax-shifting). The *Interim Note* expresses serious doubts concerning a greater role of the income tax in (re)distribution. Employees may attempt to compensate for the impact of income tax on their net incomes by demanding higher gross wages. Some results of econometric analysis in this field suggest that rising income tax and social insurance contributions have been an element in surging pay demands of recent years.

Discrepancies between intended and effective taxation clearly frustrate (re)distributive effects. The government considers the erosion of the tax base too large already. Measures against tax avoidance, better administrative control and international exchange of relevant information are announced. A more stringent application of present tax law is emphasized. Closing of certain tax loopholes is under consideration. Special attention will be given to budgetary and income policy aspects in defining the income concept and certain items deductible in computing taxable income.

Personal distribution of incomes after income tax in The Netherlands was about 25 percent more equal than before tax, both in 1950 and in 1967. It follows from ample statistical evidence that during the period 1950-1967 the income tax did *not* induce a further levelling of personal income differences.

By now still another problem — largely neglected in the government's *Interim Note on Income Policy* — can no longer be disregarded. The in many ways surprising and uncoordinated pattern of combined public levies on income and of income-related grant programmes is deservedly getting growing attention. In American literature this problem is known as the "notch-problem". Both marginal and average rates are affected as we will show hereafter.

In Section 3 we shall enumerate the taxes considered and develop a comprehensive definition of the concept of marginal and average tax rates, that will be used throughout this article. After that, in Section 4, we present the main results of our calculations on marginal and average tax burdens in The Netherlands for the year 1976. In Section 5 we proceed with a short comment on these findings and draw some inevitable conclusions.

3. DEFINITIONS

We consider the (first order) distributional impact of the most important income-based public levies:

a. the individual income tax [1];
b. social insurance contributions, consisting of:
   (i) national insurance premiums (old age pension, disability benefits, widows and orphans allowance, family (children) allowance and special medical provisions);
   (ii) insurance for employed (mainly disability benefit, unemployment benefit and sickness benefit);
   (iii) obligatory insurance against medical costs, for most employed and certain lower and medium income groups.

Social insurance programmes in The Netherlands are mainly financed by way of contributions (premiums) from employers and households, though in recent years the government provided an increasingly important support out of the national budget. The rates vary from programme to programme. However, a common characteristic is that contributions are proportional with income up to a ceiling and thus are a flat charge at higher income levels.

Social insurance systems can pursue two kinds of objectives: to insure the individual against loss of income and to reach a more equal distribution of incomes. The insurance principle at present (still) dominates the scene of social programmes in The Netherlands, though its relative importance is fading.

We define the *average* tax rate as that part of yearly gross income which is taken in income tax and in social insurance contributions (x 100). We define the *marginal* tax rate as the part of an individual's rise in gross income with Dfl 1,000, which is taken in income tax and in social insurance contributions, *or* lost in income-related grant programmes (x 100). We take into account only two main national grant programmes, i.e. *housing rent-subsidies* and the *system of student-grants and -loans.*

Housing-policy of the present government seeks to guarantee that every adult can be independently housed for a price that is in reasonable proportion to his or her income. Those with lower incomes do not have to pay more than a certain percentage of their income in rent. A "gap" with actual higher rent is bridged by individual means-tested rent-subsidies, that shrink with rising income. Individuals are entitled to a diminishing rent-subsidy until their taxable income surpasses Dfl. 33,000.

Depending on parental income, students can claim a combined loan/grant to cover their cost of living and education. Insofar as parental taxable income exceeds a certain minimum (Dfl. 16,950), the maximum loan/grant is curtailed by 43 percent of the difference.

4. MAIN RESULTS

In order to compute *theoretical average rates* we have to establish a relation between gross income on the one hand, and the base for social insurance contributions and taxable income on the other hand. First we shall briefly explain our main assumptions. [2]

1. In The Netherlands there is only one (national) income tax.
2. A detailed description of assumptions and computations in C.A. de Kam and T. de Vries, "Over de gemiddelde druk van enige collectieve lasten" (On the average burden of some collective charges), in *Economisch Statistische Berichten*, 30 June 1976, p. 625-630.

We concentrate on employees not in government service. This group consists of *circa* two thirds of the working population. We assume they receive only labour-income, have two children under 16 and a non-income earning wife. [3] For those not under the obligatory insurance against medical cost we take into account a comparable voluntary premium. Furthermore we only allow for the following deductions:

a. 2.35 percent contribution in private pension-schemes;
b. 5.6 percent contribution for insurance for employed;
c. 11.9 percent contribution for national insurance;
d. 4 percent for deductible expenses (maximum Dfl. 950), a deduction that is automatically applied to labour-income.

The results are given in Table 2.

*Table 2. Income tax and social insurance contributions as percentage of gross personal income, under assumptions (1976)**

Gross (labour) income	Income tax (pct.)	Social insurance contributions (pct.)	Total (pct.)
Dfl. 18,500 (legal min. wage)	5.7	25.9	31.6
Dfl. 26,000	10.3	26.0	36.3
Dfl. 35,000	14.3	24.6	38.9
Dfl. 50,000	21.2	18.9	40.1
Dfl. 120,000	44.0	7.9	51.9
Dfl. 200,000	54.1	4.8	58.9

* Married couple, two children under 16.

Source: see footnote 2.

There is of course a difference between the tax rates which theoretically apply and the real tax burden. This margin results from a number of causes. Certain types of income may be exempt (i.e. most capital gains on assets that are not part of business capital). Moreover there are a number of legal means to lower the amount of income tax due. Personal allowances, deductions, opportunities to treat part of normal household expenditures as deductible business expenses, fringe benefits that are inadequately taxed, etcetera, provide opportunities to decrease the tax bill. And then there is downright fraud.

In Table 3 we present some recent empirical evidence concerning the redistributive impact of the progressive income tax rate-structure (*excluding* social insurance contributions) for the year 1970. Tax units in deciles 1 to 9 relatively gain, those in the top decile are losing. The last column gives average tax rates for each decile. It is interesting to note that for the "super rich" (top 0.01 percent of all taxpayers) the income tax works out regressive. Apart from a probably falling ratio of taxable to total income at the (very) top, this pattern is caused by special rates for certain types of (mostly capital gains) income, accruing to the top-decile.

Table 3. Income tax burden by deciles, Netherlands, 1970 (Total income figures)*

Decile	Income share before tax	Income share after tax	Tax as percentage of taxable income
Bottom decile	1.2%	1.5%	1.8%
2nd decile	3.0%	3.5%	3.2%
3rd decile	4.6%	5.2%	5.1%
4th decile	6.0%	6.7%	6.9%
5th decile	7.4%	8.1%	8.9%
6th decile	8.7%	9.4%	9.5%
7th decile	10.1%	10.7%	11.0%
8th decile	12.1%	12.8%	11.5%
9th decile	14.9%	15.2%	14.3%
10th decile	32.0%	26.9%	30.0%
Top 5%	22.4%	17.4%	34.8%
Top 1%	9.6%	5.6%	51.2%
Top 0.01%	1.1%	0.8%	40.9%

* Excluding negative incomes.

This indicates a growing importance of tax expenditures for the rich.

In order to compute *theoretical marginal rates*, as defined earlier, at a number of income-levels we again have to establish a relation between gross income and taxable income, because the size of the rent-subsidy and the student loan/grant depends on (parental) income in the previous year. [4] We use the assumptions already mentioned. Furthermore we had to estimate an "average" loss of rent-subsidy as marginal rates may slightly vary with total yearly rent. Moreover we now assume that one child studies but is no longer living at home, while the second child is under 16, in secondary school and still living at home.
The results (rounded) are given in Table 4.

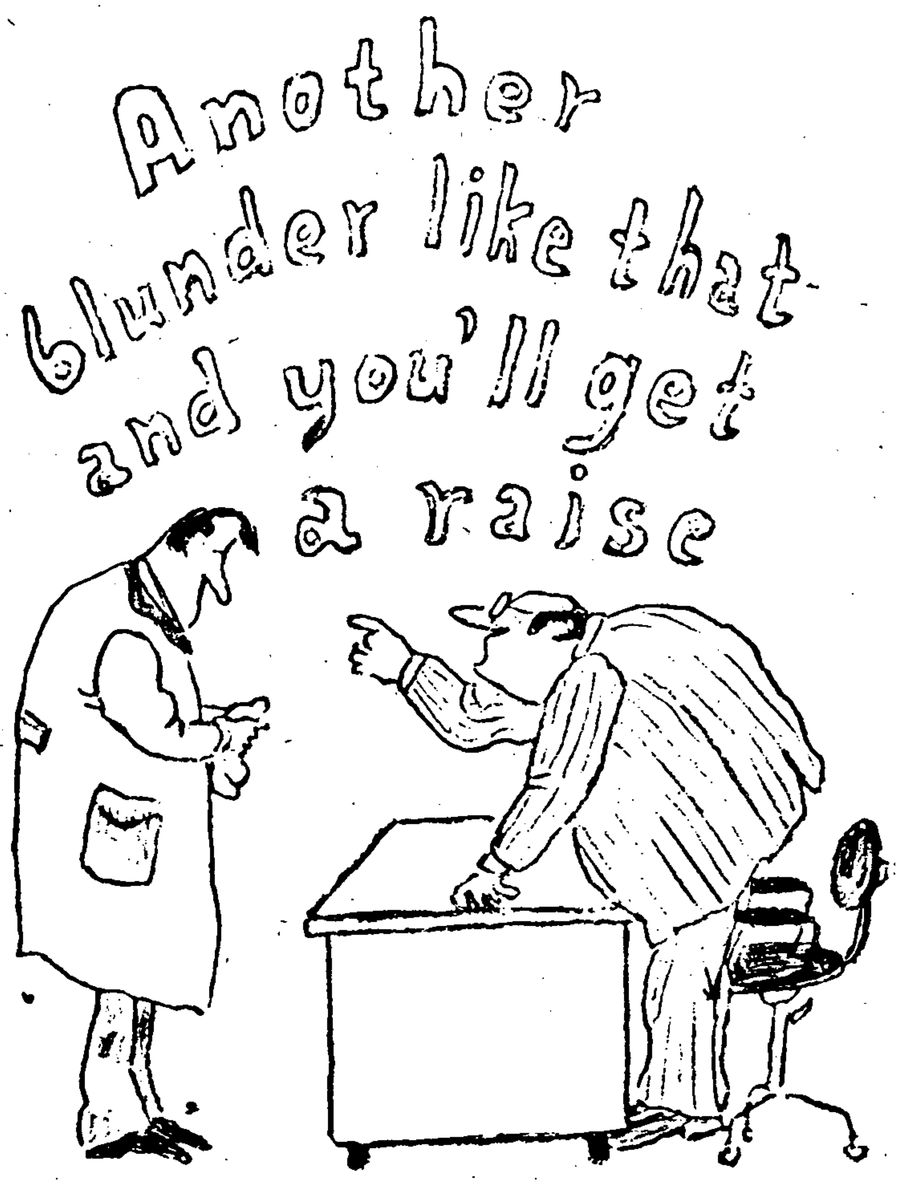
5. SHORT COMMENT ON FINDINGS

From Table 2 it is clear that the social insurance system in The Netherlands is financed in a strongly degressive way. The reasons are:

— contributions are levied at a flat rate, in proportion to income,
— but only up to a relatively low maximum income-ceiling, and,
— contributions are tax-deductible, and thus worth more to taxpayers as marginal income tax rates are higher.

Social insurance contributions tend partly to offset the redistributive effects of progressive income taxation. It would appear that for example the government, parliament, civil servants and the population at large do not sufficiently realize the distributional impact of the combined public levies considered in this article. Such lack of insight hampers rational decision-making on matters of (re)distributional policy.

3. These are the usual assumptions in government publications.
4. For reasons of simplicity we further base our calculations on taxable income in the current year (i.e. 1976). This does not distort the results in a significant way.



A Reasonable Story?

There is nothing unusual about you being 42 years old, married, with two children (an 18-year-old son studying economics and living away from home and a 16-year-old daughter in secondary school) and a gross salary of Dfl. 26,500, excluding vacation bonus. A normal, common enough situation.

But it is most certainly unusual, not to say bewildering, what happens if you get a promotion to department chief and a raise in salary of Dfl. 4,000.

Now, a Dfl. 4,000 increase in salary is certainly reasonable in such a situation; you have more responsibility on your shoulders, more concerns to worry over. Moreover, the tax administration and other institutions are each going to want their piece of your raise.

Now comes the bewilderment: namely, that in reality the result of your raise is a net *loss* of about Dfl. 1,000 per year!

Yes, you really have read it correctly: a Dfl. 1,000 loss! Take a look at the following calculations and see what happens:

Elements of income:		*before promotion:*		*after promotion:*
Gross salary		26,500		30,500
Less: wage tax, pension premiums, social insurance premiums, and national health insurance premiums or private health insurance costs		7,749		10,364
Net salary		18,751		20,136
Child benefit payments	+	1,824	+	1,824
Study allowance for the son	+	7,935	+	6,381
Compensation for study costs of the daughter	+	300		—
Daughter's tuition	—	88	—	117
Rent subsidy (figured on a rent of Dfl. 5,850 per year)	+	1,380	+	850
		30,102		29,064

This example could even be considered a "favorable" example of your promotion in that it does not consider the possible costs for care by general practitioners and dentists.

[From SOCIAAL ECONOMISCH MANAGEMENT, Brochure "Balans voor een inkomensbeleid", with kind permission of the publishers.]

The same conclusion stands as far as marginal rates are concerned. The combined marginal rate of income tax and social insurance premiums for employed in The Netherlands fluctuates around 45 percent at all income-levels, up to Dfl. 50,000. In the income-range Dfl. 25,000 - 40,000 the loss of income-related grants poses special problems. Marginal rates over 100 percent are no longer an exception. [5] At the same time — judging from the income tax rate — everybody seems to agree that a maximum-rate of 72 percent is the limit.

We feel that the problem of average and marginal tax rates in The Netherlands needs more attention and after thorough study adequate treatment. The present situation could endanger the credibility of the tax system in an unacceptable way. One solution certainly worth considering is to combine a number of now separately levied social insurance contributions with the income tax, in order to create a more consistent rate-structure. Given present and projected budgetary needs it seems that a high average rate of taxes for all taxpayers is inevitable. It might be possible, however, that integration of public levies results in a more acceptable over-all pattern of rates.

But then there is still the problem of marginal rates, mainly created by income-related grant programmes. We seem to get entwined in insoluble contradictions

5. By now there are more than 400,000 recipients in the housing rent-subsidy programme and over 200,000 students benefiting from the loan/grants programme.

*Table 4. Marginal tax rates as percentage of additional gross personal income, under assumptions (1976)**

Gross (labour) income after rise of Dfl. 1,000	Income tax (pct.)	Social insurance contributions (pct.)	Subtotal income tax and social insurance contributions (pct.)	Loss in grant-programs (pct.)	Total (pct.) **
Dfl. 19,000 (legal minimum wage + 1,000)	21.3	26.0	47.3	—	47.3
Dfl. 26,000	22.3	26.3	48.6	55.7	104.3
Dfl. 35,000	26.0	16.4	42.4	50.0	92.4
Dfl. 50,000	48.8	—	48.8	—	48.8
Dfl. 120,000	67.4	—	67.4	—	67.4
Dfl. 200,000	70.2	—	70.2	—	70.2

* Married couple, rented house, one child under 16, the other child studying and not living at home.

** Extra tax relief and child allowance for higher-income parents with children studying and not living at home, are not taken into account here.

here. On the one hand ending grant programmes would meet heavy opposition by many who believe them necessary to compensate for present inequalities of income and opportunity. On the other hand, flattening out the marginal rate, i.e. give higher transfers to present recipients and bring more people (with higher incomes) in the programme, is impossible because of the strained budgetary picture. In this situation it is paramount not to introduce new income-related programmes that intensify present problems. Regrettably more of such programmes are on some politicians' drawing-boards just now.

Introduction of those plans would — in our opinion — lead to increasing resistance among taxpayers, in combination with diminished incentives to work and a growing tendency to avoid taxes or to evade them outright. Such socially undesirable effects should be prevented.

As to the more general issue of redistributive policy we may conclude that of course virtually every government activity influences the distribution of income. However, the measurement of effectiveness is difficult. We lack a coherent frame for analysis and many relevant data, e.g., on shifting and incidence of taxation.

There can be little doubt that collection and timely analysis of data on the systems of burdens and benefits, resulting from public sector activities, are a necessary condition for more effective and efficient distributive policies.

Policy studies and academic debate on the optimal tax structure, and moves in some countries towards tax reform, all prove that at present this condition is far from being fulfilled. This poses a challenge for policy oriented research, as a combined effort by both tax lawyers and public sector economists alike.

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Trends in Fiscal Federalism.

by Prof. Dr. Ksente Bogoev *

I. WORLD CENTRALIZATION TRENDS

Trends towards the strengthening of centralism in both unitary and federal countries have reached the point where the central authorities, wielding their sovereignty and fiscal powers, have become the dominant factor in the use of the fiscal system and fiscal policy measures for aims of economic and social politics in the fields of allocation, development and distribution.

The possibility of autonomous fiscal initiatives on the side of the local and regional authorities in the unitary countries, or on the side of the federal units in federal countries has been considerably restricted. Their financial dependence on the central sources has increased and they have been directed towards the cooperation in and the application of stabilization policies and the wider economic and social programmes which have been passed by the central authorities.

A large number of factors objectively conditions these trends. There is "a formidable set of forces operating through time that promote an increasing degree of centralization within the public sector". [1] First of all, wars, economic crises and recessions swiftly increase the responsibilities of and the intervention by the central authorities. The centralization of the public sector and its increased administrative, political and economic powers are actually caused by technological and economic development, industrialization and modernization of the structure of the economy. All of these require a greater concentration of financial powers and measures.

Central government and local authorities

This complex system of relationships forms the basis of the opinions of those who hold that modern fiscal policy can be successfully carried out only if its basic subject is the central government. The increases in knowledge, mobility and real income which follow economic growth reduce the framework for an independent budgetary policy at the level of lower governments. The central government either takes over the considerable sources of fiscal revenues, such as income tax and turnover tax, entirely, or controls the major share in them, while having also acquired broad rights to incur debts and having concentrated in its hands powerful means for economic and social transfers in order to finance its active political, economic and social commitments.

These trends all over the world (particularly in those countries with a longer tradition of local autonomy) have led to a conflict between local independence and the centralizing powers; this conflict results from the "economic, social and technical pressure of our time", where local independence is becoming marginal rather than absolute. [2]

Subventions

This process is not brought about by usurpation or suspension of the functions of local communities or by the narrowing of the domain of their responsibilities, but by a strong expansion of the radius of the functions of central governments. While faced with an increase of their own responsibilities, lower authorities are primarily preoccupied with overcoming the deterioration of the local treasuries, their lack of abundant sources of revenue and their static nature. Although there are many examples of a diversification of local taxation and of a branching out towards more productive and more flexible sources of revenue, such as personal income taxes and turnover taxes, there are countries where the independent fiscal domain of local authorities remains presently insufficient, so that an increase of subsidies from the central government has become the basic exit from the fundamental deficiencies in local finances. It is common to find countries where subsidies cover an average of approximately one-third of local expenditure, but in many countries this proportion is considerably higher. "Subventions from higher authorities thus loom large on the local government's horizon", despite all the complaints of the local authorities about the erosion of their traditional autonomy. [3]

By varying the amounts and the conditions of subsidies and loans which they transfer, central authorities maintain a constant influence on the level and structure of local expenditure, depending on the economic situation of the country concerned, and induce cooperation in the realization of the increasing number of broad economic and social programmes. Local authorities in many countries take part in infrastructural programmes on that basis and also in the form of measures for implementing regional and spatial development policy and by realizing social programmes connected with employment, housing, special allowances for the poor and children, educational progress, environmental conservation, etc.

Division of functions

Although all this involves a certain loss of sovereignty, it forms a basis

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1. See, Wallace E. Oates, *Fiscal Federalism*, Harcourt Brace Jovanovich, New York, 1972, p. 225.
2. See, A.H. Marshall, *Local Government Finance*, IULA, The Hague, 1969, p. 46.
3. Id., p. 23.

for some sort of partnership and integration with the plans of the central authorities. Recent theories, which have been generally accepted, emphasize the fact that coordination between central and regional authorities is inevitable, taking into consideration the extent of decentralized expenditure and the increasing importance which has been given to the correction of regional imbalances of a structural and stabilizing nature.

Apart from the fact that the optimal degree of decentralization varies in the different countries, decentralization is inherent in federalism and its basic philosophy is built on the division of functions and the realization of common interests and aims on the basis of the independence of the federal units. It is an indisputable fact, however, that the trend towards the strengthening of centralism in the course of this century has caused serious frictions in the relations between central authorities and federal units. This phenomenon has brought about many pessimistic conclusions about the prospects of federalism, some of them even predicting its end. [4]

Fiscal federalism

Since financial relations generally have their origin in, and are considerably determined by, the political structure new dynamic trends on the political front have also made themselves strongly felt in fiscal federalism. The centralization of public functions has led to the centralization of fiscal functions in the federations. The traditional distinction of tax resources between indirect taxes (such as consumption taxes, customs duties and excises) levied by the federation, and direct taxes levied by the federal units, could not survive. Recent experiences in the United States of America, the Federal Republic of Germany and Switzerland indicate that modern individual and corporate income taxation cannot, in practice, remain outside the fiscal domain of the central authorities:

The contemporary theory of fiscal federalism justifies the strengthening of the financial powers of the central authorities in order to meet the objective needs of economic and technological development and in consideration of a stronger coordination. It is believed that the federation should levy those taxes which depend on the general state of the economy and which influence that state decisively.

Therefore, from an economic and administrative point of view, modern taxation of income and capital, which is effectively used for aims of stabilization and redistribution, can be more rationally applied at the central government level rather than on the basis of the co-existence of different laws in each federal unit, which would result in complications of double taxation and a division of fiscal liabilities among a larger number of tax authorities. According to this concept, the essence of the fiscal autonomy of the federal units should be their right to vary their expenditure and taxes reasonably within the framework of their functions. [5] The categorical standpoint held in an evaluation of fiscal federalism in the 1970's in the United States is typical in this respect:

"Bearing in mind the great mobility of capital and labour beyond geographical boundaries, it does not make sense to have 51 independent income taxes on individuals and corporations, with mild differences in the definition of taxable income and residence and with interstate allocational formulae, plus innumerable local variations in income or revenue taxation". [6]

Such trends in financial relations in the federations have also brought changes in the system of distribution of fiscal sources between the federation and the decentralized units. They have been manifested in two directions.

Systems of distribution

Firstly, the system of separation, or separate revenues, based on both the traditional concept of a division of functions between the different levels of governments and the independence of such governments' actions within the framework of their responsibilties, has been abandoned because of the emphasis put on the interdependence between different levels of governments and the need for their common, cooperative commitments in the realization of wider aims of the country's economic and social policy. It is believed that the inadequate behaviour of decentralized organs under a division of tax sovereignty can hinder the effective application of stabilization policies. In addition, the traditional separation of the federal units' taxation systems from the system of the federation is an obstacle to the achievement of harmonization and a more adequate balance between the taxation systems of the federal units as well as those of the local authorities. The prevailing alternative systems to separation are combined systems in which the various governments share the same or common sources of revenue. A mixed system of revenue sharing has the advantage of allowing a more adequate financial equalization and the elimination of large differences in fiscal burdens on the territories of different governments.

Secondly, the unequal distribution of fiscal capacities and the differences in the level of development and economic structure between different federal units (horizontal fiscal imbalances), as well as the imperfect correlation between the revenue resources and the obligatory public functions of different levels of governments (vertical intergovernmental fiscal imbalances), also impose the trend of strengthening the granting of subsidies in the system of federal finances which, as has been correctly stated, is a practice of the federal countries which is as old as the countries themselves. The fiscal development of the 20th century is characterized by a considerable increase in the use of subsidies as an integral part of the process of centralization and simultaneously of the cooperation between, and the common responsibility of, the various

4. Wallace E. Oates (see footnote 1, supra), pp. 230-241.
5. See, J.Sh. Hunter, *Vertical Intergovernmental Financial Imbalances*, Finanzarchiv, No. 3/1974, p. 491.
6. See, Joseph Pechman, *Fiscal Federalism for the 1970's*, The Brookings Institute, Washington D.C., Reprint 215, 1971 p. 287.

levels of governments, in carrying out the long list of public services. [7]

The effect of subsidies

From the point of view of their importance as far as size, economic effects and political implications are concerned, the problem of subsidies is one of the dominant questions in the discussions about the federal finances. Thus, whether the federation should support a certain minimum level of public services for the citizens of each federal unit with its policy of subventions and financial equalization remains a controversial point. While this approach contains elements of a limited regional equalizing of income and the satisfying of recognized needs, the alternative approach suggests a comprehensive satisfying of the needs of every citizen in all federal units. [8] In practice, the United States of America is considered to be more committed to the former system, while the latter approach prevails in the federal Republic of Germany.

An interesting problem is the dilemma related to the policy of subsidies, i.e. the problem of equality of individuals and federal units in matters of federal finances from an economic point of view, versus the allocative effectiveness of the subsidies (the dynamic consideration). There are, in fact, those, who hold that the policy of financial equalization by means of subsidies which are given to areas with insufficient resources prejudices the rate of the general economic growth. It would be more appropriate to concentrate efforts on areas which are rich in potential, despite the fact that those areas already have high incomes and a high rate of growth (here, the subsidies in question are obviously those which are intended to support economic growth and not those merely intended to cover financial needs of public functions in the narrower sense of the term). [9]

Theory and practice affirm the necessity of respecting both aspects of the policy of financial equalization in federations: the vertical, when the transfers in question are between different levels of government (because of the imperfect correlation between revenues and obligatory public functions); and the horizontal, when the transfers are between different governments at the same level but with unequal fiscal capacities (between "rich" and "poor" federal units).

Contributions by the lower authorities

As a rule, evaluations of the experiences of fiscal federalism based on a system of contributions, or "cotisation", tend to be negative. The state of the central government is considered to be weak if it is to a high extent dependent on the contributions of the member countries for its financial needs. This sytem, which existed previously, was abandoned with the strengthening of the authority of the federation and attempts to reinstitute such relations in those federations proved to be a pure anachronism. [10] It is held that expenditure for public defence, for example, which is inherent to a central government, as well as certain other responsibilities of the central government, cannot be rationally covered without the federation's own revenue sources. There are those who hold that even the confederations can no longer depend on contributions ("cotisation") for their financing and that they should have their own taxation rights and rights to incur debts, even though supranational governments do not usually make revenue from their own resources, but have a system of "support payments" from the member countries. In that case, the problem of the criteria for these "support payments" or the amount of contributions always arises. The generally accepted principle is that the amount of contributions to the higher authority's finances should be determined in proportion to the taxation capacity of each member country.

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7. Wallance E. Oates (see footnote 1, supra), p. 238.
8. See, Richard Musgrave, *The Theory of Public Finance*, McGraw-Hill Book Company, Inc., New York, 1959, p. 138.
9. See, *Fiscal Harmonization in Common Markets*, Vol. I: Theory, ed. Carl S. Shoup, Columbia University Press, 1967, New York, p. 26.
10. *Handbuch der Finanzwissenschaft*, Zweiter Band, Zweite Auflage, J.C.B. Mohr, Tübingen, 1956, p. 751.

II. DECENTRALIZATION AND ELIMINATION OF THE STATE IN PUBLIC FINANCE IN YUGOSLAVIA

The development of the financial relations between the socio-political communities (different levels of government) in Yugoslavia is not characterized by the strengthening of the financial power of the centre, but rather by trends in the reverse direction, namely by a decentralized division of functions and realization of common functions at the federation level by means of equal cooperation from the federal units (the Socialist Republics and the Socialist Autonomous Provinces). The impetus for vertical decentralization of functions and the affirmation of inter-republic and inter-communal collaboration in the community arises not only from the specific features of Yugoslav federalism (i.e. its multinational structure), but also from the concept of the state and of the responsibilities of the communes, which have wide autonomy. A particular feature of the development of decentralization in financial relations has been the process of eliminating the state from many public functions, the organization of the functions on the basis of self-management and a system of "defiscalized" financing.

Vertical decentralization

Although the decentralization of public financing has been a continuous process, three separate periods can be distinguished, each with its particular characteristics.

1. In the period between 1947 and 1951 a method of totally united and centralized public financing was in use, with a hierarchy of functions. Federal legislation decided on the absolute unity of the budgetary and taxation systems for all levels of government. Throughout the country, there was a consistent application of the principle of horizontal equality of taxation ("equal taxation of equals") and the tax resources were distributed according to the principles of a system of sharing in the revenue of the higher governments. This left limited possibilities of financial independence for the Republic and the Provinces. Balancing of



the budgets of all levels of governments and equalization of the standards of public services were achieved with a policy of subsidies and differentiated revenue-sharing.

The problem of coordination of public finance policies did not even arise. "Harmonization" was fully realized within the framework of a single budget structure for all governments, through its preparation and implementation procedures and through the supremacy and competence of the higher organs of authority to carry out global and structural harmonization of all elements of financing.

2. From 1952 until the constitutional amendments of 1971, there was a continuous process of decentralization and elimination of the state in relations and in financing of general and collective spending (public consumption). This period was primarily characterized by the abandonment of the single budget for all governments and the removal of hierarchy in fiscal relations between the different levels of government. The independence of the Republics, the Provinces and the local authorities in their budgetary rights was consistently stated. At the same time, especially from 1955 onwards, a vigorous decentralization of functions was carried out, together with local financing, thus affirming the concepts of the communal system. The system of sharing revenue was abandoned and all efforts were directed towards the strengthening of a system of separation of revenues. As regards the policy of fiscal equalization, the method of discretional distribution of subsidies was abolished and criteria of objectivity and stability were introduced into the mechanism of these transfers. Then began a gradual transfer of functions to the Republics and local communities for differentiation of the size of revenues (rates of taxation) which belonged to them. At first, this was decided within the framework of stated maximum limits for different forms of taxation, but later generalized delimitation evolved and developed into methods of agreed harmonization of the size of the tax burden.

Simultaneously with the evolution of the vertical decentralization of fiscal decision-making, a process of eliminating public financing from the budget was realized. This was based

ARTICLE 9 OF THE YUGOSLAV CONSTITUTION DEALING WITH SELF-MANAGEMENT *

"Self-management in work organizations shall include in particular the right and duty of the working people:

1) *To manage their work organizations directly or through bodies of management elected by themselves;*
2) *To organize production or other activities, to promote the development of their work organizations, and to lay down working and development plans and programmes;*
3) *To decide on the exchange of products and services and on other matters relating to the operation of their work organizations;*
4) *To decide on the use and disposition of social resources and to employ them with economic efficiency, so as to ensure the highest possible returns for work organizations and the community;*
5) *To distribute the income of their work organizations and provide for the development of the material base of their work; to allocate income among the working people; to fulfil the work organizations' obligations towards the community;*
6) *To decide on the admission of working people into their work organizations and their dismissal, and on other labour relations; to determine working hours in the work organizations in conformity with general working conditions; to secure internal supervision and make their work public;*
7) *To regulate and promote their working conditions; to organize industrial safety measures, and rest; to provide conditions for their education, and to advance their own and the general standard of living;*
8) *To decide on the split-up of their work organizations and on turning parts of them into separate organizations, and to decide on merger and association of their work organizations with other work organizations.*

Exercising their self-government rights, the working people in socio-political communities shall decide on matters concerning the guidance of economic and social development, the distribution of the social product, and other affairs of common concern.

Citizens directly concerned, representatives of the organizations concerned, and representatives of the community may participate in the management of work organizations regarding matters of special concern to the community.

In order to secure a uniform socio-economic position for the working people, self-management rights of the working people employed in state agencies, socio-political organizations or associations shall be regulated by statute or by-laws, in conformity with the nature of work of these agencies and organizations.

Working people shall exercise self-management in the unified socio-economic system in accordance with the Constitution, statute and their by-laws, and shall be held accountable for their work.

Any act violating the self-management rights of the working people shall be unconstitutional."

* From "Foreign Investment in Yugoslavia" (1974), published by the Committee for invisible transactions of the OECD (Paris).

on the concept of elimination of the state in social functions and the growing independence of their financing. In this period, a multitude of independent public funds was set up, the principle of budgetary unity lost importance and a multi-budget system for financing of public expenditure at all levels of governments became widespread. The range of social institutions which acquired independent financial status widened and their functions were organized on the basis of self-management. The whole system of social security was constituted on the basis of self-management and has consistently relied on self-financing from earmarked contributions.

The decentralization and the gradual elimination of the state from public financing created a new and developed structure of public financing and posed the problem of coordination of fiscal decisions on the side of the independent participants on the vertical and horizontal scales. Nevertheless, the question of coordination could be successfully solved throughout this period, owing to the fact that, until the constitutional amendments of 1971 and the new constitutions of 1974, basic fiscal legislation for regulating the tax and budgetary systems, as well as fund financing, were a function of the federal government and had common foundations for the whole country. This is no longer true.

3. The third period, which began with the constitutional amendments of 1971, brought about radical changes, especially in two fields: that of fiscal federalism, particularly in the position and prerogatives of the Federation, and that of the financing of collective spending which was taken out of the budget completely and reformed to a separate subsystem of public financing based on self-management.

The position of the Federation

The basic changes in the position and the functions of the Federation took place in the following fields:

— There was a shift from the system of revenue separation under which the Federation retained the most abundant sources of revenue, such as turnover tax, duties, personal income tax, etc. in its hands to a system of *contributions* or "cotisation", where the sources of revenue of the Federation would not even cover 50 percent of its budgetary needs. Thus, the most vital factor in the provision of the necessary revenue for the Federation's budget became the *contributions* which the Republics and Provinces paid out of their fiscal revenues.

The only important source of revenue which the Federation has at its disposal under the new system is customs duties. Owing to the known advantages of these duties for economic purposes over fiscal ones and also because of the sensitivity of this revenue to extra-fiscal influences, especially in years of acute instability at home and abroad and difficulties in the balance of payments, this leading source of the Federation's own revenue causes constant instability in the support of the Federation's public functions.

The global amount of contributions which the Republics and Provinces must pay to balance the Federation budget is determined each year in proportion to the difference between the total expenditure in the Federation's budget and its own revenues. The contribution ("cotisation") to be paid by each Republic or Province is determined according to its economic and fiscal capacity, that is, its total income in the sense of "national" income and payment of sales tax.

— The last constitutional amendments established the requirement that the Federation budget must be sent to the Republican and Provincial Assemblies before it is put to vote, and that the latter must agree on the total amount of the Federation's expenditure.

If the revenues are lower than expected or if the budgetary equilibrium is upset, the Federation is obliged to ask the Republics and Provinces to agree on a reconsideration of the amount of budgetary expenditure, that is, on an increase of the Republican and Provincial contributions. The instability of the financing of the Federation's budgetary expenditure makes the manner and scale of deficit financing of the Federation an urgent question.

— Through its legislation, the Federation has lost its sovereignty to decide on a single tax and budgetary system for the country as a whole. The Federation's legislation now regulates only its own financing. The Republics and the Provinces have become competent to decide on their own legislation which is to be applied in their territories with respect to taxation, budget and other forms of public financing at local and republican level. The only exception to this fiscal sovereignty of the Republics and the Provinces is the general sales tax, the receipts of which belong to the revenue of the Republics and Provinces, but which is levied equally throughout the country according to a federal law. Such an institutional structure undoubtedly forms the basis for a change-over from a single fiscal system to a differentiation of the fiscal structures of the Republics and Provinces in all their elements.

The Republics are empowered to introduce all taxes, fees and other fiscal revenues and they decide on the distribution between the Republics' and local authority's budgets. For their financing, the Republics now mainly depend on the general and Republican sales tax and on the taxation of the income of enterprises.

The Republics have constitutional responsibility to financially balance deficits in local governments' budgets. The criteria applied for subsidies to the local authorities differ in each Republic and Province, but the average size of the subsidies in the whole country is about 30 percent of the total amount of the local communities' budgets.

The local communities decide on the size of their revenues independently, that is, they themselves determine the fiscal burden to be imposed within their territory and the choice of priorities and the standards in the financing of their public functions. Their main sources of revenue are the local retail sales tax, the income tax on individual workers and the taxation of incomes obtained in the private sectors of agriculture, small crafts and professional services, as well as the taxes on property.

— Public funds at the Federation level have been discontinued, except the fund for the faster growth of the less developed Republics and Provinces. The federation has no right to use non-budgetary sources in its financing. The right of the Federation to incur debts is also conditioned by prior agreements with all the Republics and Provinces.

— Changes have also been made in the system of subsidies from the Federation's budget to the less-developed Republics and Provinces: the global amount of the subsidies is decided in proportion to, and as a fixed percentage of, the average gross national product for the entire five-year period, for which there are plans for economic and social development in the country. The size of the subsidies is determined by law on the basis of agreements with the Republics and Provinces. The subsidies are block subsidies: they are transferred to the less-developed Republics and Provinces without a designated function. The beneficiary Republics themselves decide on the use of the subsidies. The basic criterion in determining the size of the subsidy is the increase of the per capita revenue in the less-developed Republics and Provinces to the approximate average in the country as a whole. These changes in the system of subsidies ensure their greater stability and flexibility in the formation of financial means, depending on economic dynamics.

— There has been a further decentralization of the functions which were previously financed at the Federation level. The Federation's budget now includes the following areas: National defence — mainly the regular army, since territorial defence is provided for at the levels of the Republics and the communities; subsidies to the less-developed Republics and Provinces; social security for war veterans, war invalids and the military; material reserves; and the work of the Federal administration.

YUGOSLAV BUDGET 1974

RECEIPTS OF BUDGETS INCLUDING INTER-BUDGETARY TRANSFERS

	Million dinars 1974
BY SOCIALIST REPUBLICS	82 302
Federal budget	*48 606*
Budgets of republics	*15 124*
Bosnia and Herzegovina	4 987
Montenegro	908
Croatia	1 560
Macedonia	2 365
Slovenia	1 888
Serbia	3 507
Budgets of provinces	*3 131*
Kosovo	1 539
Vojvodina	1 592
Budgets of communes	*15 440*
Bosnia and Herzegovina	2 565
Montenegro	358
Croatia	3 953
Macedonia	957
Slovenia	1 822
Serbia	5 785
Restricted territory	3 743
Kosovo	490
Vojvodina	1 552
RECEIPTS BY SOURCES	82 302
Taxes (contributions) on income & from personal income	7 754
Turnover tax, tax on estate and receipts from estate	16 913
Stamp duties	1 293
Custom duties	20 807
Additional resources	4 670
Contributions of SR and SAP to the Federation	20 160
Other receipts	10 704

DISTRIBUTION OF RECEIPTS OF BUDGETS INCLUDING INTER-BUDGETARY TRANSFERS

	Million dinars 1974
DISTRIBUTION OF RECEIPTS BY REPUBLICS	81 492
Federal budget	*48 263*
Budgets of republics	*15 023*
Bosnia and Herzegovina	4 897
Montenegro	907
Croatia	1 556
Macedonia	2 357
Slovenia	1 800
Serbia	3 505
Budgets of provinces	*3 083*
Kosovo	1 529
Vojvodina	1 554
Budgets of communes	*15 122*
Bosnia and Herzegovina	2 506
Montenegro	352
Croatia	3 891
Macedonia	935
Slovenia	1 787
Serbia	5 650
Restricted territory	3 651
Kosovo	483
Vojvodina	1 516
DISTRIBUTION OF RECEIPTS BY END USE	81 492
Social & public utility services	6 965
National defence	21 103
Administrative agencies	13 939
Non-economic investments	3 343
Economic investments	14 510
Additional resources [1]	16 780
State liabilities, reserves, etc.	4 852

1 Including an amount of contributions of SR and SAP to the Federation.

From: "Statistical Yearbook of the Socialist Federal Republic of Yugoslavia" (1974), ed. Federal Institute for Statistics.

Decentralization and elimination of the state in public financing

The relations in, and the characteristics of, fiscal federalism in Yugoslavia mentioned above only apply to the domain of public financing which includes the traditionally "pure" functions of the state: administration, defence, law and order, and certain kinds of transfers. These, however, account for less than one-half of the total means for public financing (i.e. less than 20 percent of the national income). The other part, that is, the larger part of public financing expenditure, consists of that sector of public functions which provides collective consumption goods of importance for the individual and public standard living (called "collective spending", in Yugoslav terminology), in the fields of education, science, culture, social security, etc. This area of public expenditure is structurally and financially entirely separate from state financing from the budgets of all levels of government and all kinds of taxation.

From the point of view of federalism, it should be noted that all these public activities are decentralized, i.e. they are financed only at local and republican levels.

Collective spending in the new Yugoslav system is financed within the framework of *the self-managing communities of interest*, which have been organized separately in each area of the public functions mentioned above. For example, all institutions and organizations in the area of compulsory education in the territory of a community are united in a community of interest; likewise, the institutions and organizations in the area of culture or science, etc. all have their own community of interest.

Contributions form the basic kind of revenue which supports the self-managing communities of interest. They are a specific kind of public, non-fiscal revenue. They have been introduced on a basis of self-management and do not have the force of state decisions or laws. The size of the contributions is decided by the assemblies of the self-managing communities of interest, which consist of representatives of both the providers of public goods and the beneficiaries of those goods. Thus, within the self-managing communities of interest supply and demand in the field of collective spending are brought together and balanced out. In this way, the contributions represent an income which workers in education, science, culture and other social activities earn through what might be called an exchange of their labour for the labour of the beneficiaries of their services, that is, primarily the workers in the enterprises and in the private sector.

Obviously, the services, that is, the goods, of collective spending cannot be left to the laws of market allocation; therefore, the social and economic reasons behind this approach to collective spending in the Yugoslav system must primarily be regarded as an intention to establish this sector of public activities consistently on a basis of self-management, to provide development in these social activities, both in their structure and overall, and furthermore, to harmonize them more directly with the material capacities and needs of the society. In this institutional approach, the beneficiaries of the services of collective spending are given direct influence on the programmes of the organizations engaged in this field and on the use of the means which are supplied for their financing. Finally, this system will contribute to the creation of a more equal status between the working people in social activities and the working people in other activities and will ensure an indispensable degree of solidarity in satisfying collective needs.

As to its global financial, economic and social effects, collective spending represents a very relevant element in the balances of distribution, growth and stabilization; it represents more than 20 percent of the national income. Therefore, its importance must not be considered in isolation, but as an integral part of the other domain of public financing which belongs to the traditional fiscal functions of the state.

Coordination in public financing

Bearing in mind the extremely decentralized structure of public financing and the great number of autonomous decision-makers involved, the question of the principles, methods and instruments for the realization of effective coordination in financial decisions and the harmonization of the foundations of the system of public financing is of great importance for Yugoslavia.

Considering the constitutional authority of the Republics and Provinces to raise taxes and other fiscal revenues and to totally regulate public financing in their areas, a lack of coordination and of measures to harmonize the foundations of the system of public financing in the framework of the country as a whole would easily lead to drastic differentiations between the fiscal systems of the Republics and Provinces which, if taken to extremes, would tend to create eight different fiscal systems in the single Yugoslav market (the Yugoslav Federation consists of six Republics and two Provinces). The heterogeneity of the system of public revenues and public financing in general is further underlined by the autonomy of the subsystem of collective spending. Except for the fact that these are managed by the Republics and Provinces themselves, the revenues in this area, in their particular and cumulative effect, equal the effect of direct taxation and have to be taken into consideration from all aspects of fiscal policy, both from the micro- and macro-economic points of view.

Because of all these characteristics of the decentralized model of public financing and the pluralism of its institutions, a particular respect for certain principles in the concept of its harmonization and the coordination of public financing becomes vital. These principles are as follows:

a) *to prevent any differentiation of the system and policies of public financing which would lead to any of the following consequences:*
   — *distortion of economic conditions and competition in the domestic market;*
   — *a hindering of the free mobility of goods and production factors;*
   — *the inclusion of elements of fiscal discrimination which are based on the residence of taxable subjects or the territorial origin of products;*
b) *to effectuate the necessary coordination of the policy of public financing at all levels in connection with the effective application of common measures in growth and stabilization policies;*
c) *to prevent such use of taxes and contributions which would lead to a shifting of the fiscal burden between the Republics and Provinces; and*
d) *to keep the differences in the level of taxation within such limits as would not weaken the social and political homogeneity of the country.*

Because of the possible implication of the branching-out and decentralization of public finance, the constitution of the Federation and the constitutions of the Republics and Provinces contain explicit clauses on harmonization and coordination in this sphere. The basic coordination which should be realized for the sake of maintaining unity and stability in the domestic market takes the form of direct agreements between the Republics for the purpose of harmonizing the basic elements of the taxation system and taxation policies. This kind of horizontal harmoniza-

tion of fiscal policy of the Republics and Provinces is assisted by the intercommunal collaboration within the Republics and Provinces.

In the event of market disturbances, or when the interest of the country, in the case of emergency, require it, the Federation is permitted to intervene in order to harmonize relations in fiscal policies throughout the country.

The constitution categorically forbids measures or actions which might cause any fiscal discrimination in the treatment of individuals or legal entities between the Republics, or which might introduce open or hidden fiscal barriers in the circulation of production factors or goods from one area to another.

Finally, because of the dual system of the financing of public spending in Yugoslavia, with "pure" spending financed by the state on the one hand, and collective spending financed on a basis of self-management on the other hand, a new institution has been introduced to coordinate these two domains of public financing. It is called *the balance of financial means for "pure" and collective public consumption* and it is the responsibility of the communities, the Republics and the Provinces. Its aims are to determine the optimal global relations between the two fields of public spending and to conform them with both the overall financial capacity of the economy and the basic aim of economic policy within the framework of each level of government.

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Tax Structure and Policy in the Windward and Leeward Islands of the Caribbean Community.

By Nizar Jetha
and Nurali Peera*



The most striking feature of the economies of the Windward and Leeward Islands is the coexistence of a relatively high rate of investment with negligible domestic savings. Given the paucity of their resources, these countries will continue to need substantial inflows of external capital, but it is unlikely that the high magnitude of the prevailing resource gap can be maintained indefinitely. Mobilization of domestic resources for development thus constitutes a major issue confronting the Eastern Caribbean countries. Since public sectors assume important roles in these economies, tax policy has a pivotal part to play in lifting the rates of domestic savings. The object of this paper is to review the islands' tax structures and to compare them with those in other Caribbean countries in order to arrive at some broad conclusions for future taxation policy. The Windward Islands form the focus of the analysis in this paper, but the economic and fiscal structures of the Eastern Caribbean countries display sufficient similarities to permit the extension of policy conclusions to the Leeward Islands.

I

The Windward (Dominica, Grenada, St. Lucia and St. Vincent) and the Leeward (Antigua, St. Kitts-Nevis-Anguilla and Montserrat) Islands consist of seven small territories scattered over 500 miles, with a combined land area of 1,170 square miles, and an estimated 1970 population of 475,000. Economic co-operation among these countries which had been largely confined to the monetary sphere through the membership of the Eastern Caribbean Currency Authority (ECCA) and the use of a common currency, received a strong impetus in 1968 when the seven countries combined to form the Eastern Caribbean Common Market (ECCM). During the same year, the ECCM countries also joined the Caribbean Free Trade Association (CARIFTA), a broader grouping that included five larger states in the Caribbean (viz., Jamaica, Trinidad and Tobago, Guyana, Barbados and Belize). Since May 1974, all ECCM countries have become members of the Caribbean Community and Common Market (CARICOM), which superseded CARIFTA. Politically, Grenada has been fully independent since February 1974, whereas Montserrat is still a colony; the remaining five enjoy full internal self-government, but the United Kingdom retains responsibility for foreign affairs and defence. [1]

Agriculture and tourism dominate the Eastern Caribbean economies. The agricultural sector accounts for about a fifth of the GDP, and provides virtually all commodity exports. Export production is narrowly based, with the bulk of earnings on visible trade derived from bananas, sugar, cocoa and nutmegs. Tourism has emerged as the most dynamic sector in recent years: gross foreign exchange receipts from tourism now contribute about 60% of the islands' foreign exchange earnings, though net receipts are likely to be much lower given the high import content of the expenditures that characterizes the tourist industry throughout the Caribbean.

In the overall macroeconomic picture, the concomitance of a relatively high rate of investment and a low rate of domestic savings stands out. The investment ratio of one-third of GDP reflects in part the diseconomies of scale encountered in small economies, but is nevertheless remarkable. Gross domestic savings, on the other hand, have been negligible in recent years, and may have even turned negative in some years, implying an excess of consumption over domestic income. The resource gap — measured by the excess of imports of goods and non-factor services over exports of goods and non-factor services — amounts to some 40% of the GDP, reflecting the large imbalance between investment and domestic savings [2] (Table 1). The maintenance of this unusually wide gap has been made possible by inflows of private as well as public capital.

The heavy reliance on external resources is reflected in the countries' central government finances (Table 2). About 70-80% of the islands' central government capital expenditures have, in recent years, been financed through external assistance, mainly grants. The United Kingdom is by far the largest source of capital finance. In 1972/73, out of estimated external financing of EC$40.8 million for the capital budgets, EC$29.1 million came from the United Kingdom. [3] Canada, the second largest source, provided EC$9.3 million. The remaining EC$2.5 million was provided by the Caribbean Development Bank, which is one of the key institutions of the Caribbean integration movement, and is expected to emerge as a major source of development finance

* International Bank for Reconstruction and Development, Washington, D.C., and University of Salford, England, respectively. The views expressed here are personal and should not be attributed to the institutions to which we are attached. We are indebted to Sidney Chernick, Lady Hicks, Manmohan Agarwal and Paul Applegarth for helpful comments.

1. An excellent account of the islands' economies is to be found in Carleen O'Loughlin, *Economic and Political Change in the Leeward and Windward Islands* (Yale University Press, New Haven, 1968). For recent developments, the most useful are *Carifta and the New Caribbean* (Commonwealth Caribbean Regional Secretariat, Guyana, 1971); and *From Carifta to Caribbean Community* (Commonwealth Caribbean Regional Secretariat, Guyana, 1972).
2. Statistics for the ECCM countries are seriously deficient, both quantitatively and qualitatively. The latest year for which GDP data are available for all countries is 1971.
3. The East Caribbean dollar is pegged to, and since 1973 floats with, Sterling at EC$4.80 per £.

for the islands' capital budgets. In addition to providing development aid, the U.K. has also been granting budgetary aid amounting to about EC$6-7 million annually towards recurrent expenditure. [4]

TABLE 1

RESOURCE AVAILABILITY AND USE IN THE WINDWARD AND LEEWARD ISLANDS, 1971

	EC$ million	% of GDP
1. Gross domestic product (Y)	377	100.0
2. Imports of goods and non-factor services (M)	273	72.4
3. Exports of goods and non-factor services (X)	117	31.0
4. Resource gap (M − X)	156	41.3
5. Resource availability (Y + M − X)	533	141.3
6. Consumption (C)	404	107.2
7. Investment (I)	129	34.1
8. Resource use (C + I)	533	141.3
9. Gross domestic savings (Y − C)	−27	−7.2

Sources: Government statistical publications; CARICOM Secretariat, Georgetown, Guyana.

Domestic resources for capital budgets have been tapped mainly through borrowing. Market borrowing through the issue of debentures and Treasury bills is now undertaken by most countries, and is a relatively recent development, dating from the late sixties. The support for local securities has come primarily from national provident funds, commercial banks, insurance companies, ECCA (through its fiduciary issue), and Caribbean governments and financial institutions. Public savings present a dismal picture. Although tax receipts have shown impressive growth over the period 1968-73, the current budget has been in deficit each year before taking account of the budgetary aid, and since 1971, even with this aid. Furthermore, there is reason to believe that the actual outturns have been worse than is suggested by the estimates for 1972-73. [5]

In terms of growth and employment-generation, the performance of the ECCM countries has not been very satisfactory during the sixties: GDP at constant prices grew at an annual average rate of about 3% during 1961-71, and employment remained unchanged in absolute numbers. The desirability of accelerating growth cannot be stressed too much in a region which has a per capita income of about US$340 (1971), one of the lowest in the Western hemisphere. Moreover, unless past performance is improved on significantly, the unemployment problem may become unmanageable. The rate of unemployment, estimated at 10% of the labour force in most islands, does not seem to have risen between 1960-70 because a high rate of emigration limited population increases at the rate of only 1% per annum, and the labour force remained constant. Should the rate of emigration decline significantly in the seventies — and there are indications that this is already occurring as a result of the more restrictive immigration policies of Canada and the United States — the rate of population growth will be much higher and the rate of growth of the labour force higher still.

Although a continuing dependence on external resources is inevitable in the short term, it seems highly improbable that a resource gap of the present magnitude can continue to be filled by external capital over a prolonged period. Higher domestic savings will, therefore, have to constitute an integral part of any development strategy that seeks to achieve a higher rate of economic growth. The public sectors, whose shares in GDP and capital formation had already reached 20% and 30%, respectively, in 1971, are playing a rapidly growing role in the Eastern Caribbean. The chances of generating the needed savings will thus be much improved if the islands' public sectors achieve reasonable surpluses on their current budgets. Hence, tax policy will be an important determinant of the overall savings performance.

II

The review of tax structures that follows in this section draws on the experience of the "more developed countries" (MDCs) of the CARICOM [6] for comparison, but for convenience, the "less developed countries" (LDCs) are represented by the Windward Islands only. The subsequent section examines a number of hypotheses concerning tax effort and structure, utilizing observations for all CARICOM countries except Belize. The final section then briefly considers some of the major implications for the evolution of tax policy in the LDCs.

In the Windward Islands, four taxes — income tax, import duties, consumption tax and excises — account for over four-fifths of tax revenues (Table 3). Income taxes contribute only 23% to tax revenues. Import duties, the single most important tax source, bring in about 43%, while the relative shares of consumption and excise taxes amount to 15% and 3% respectively. The overall contribution of export duties to tax revenues (2.5%) masks considerable inter-island variation in their relative importance. Land and house taxes play a very limited role in the tax systems. A recent development has been the introduction of various taxes on tourism (e.g., hotel and airport taxes).

Broadly, the major difference between the tax structures of the LDCs on the one hand, and the MDCs on the other, is that the latter derive a much greater proportion of tax revenue (45%) from income taxes — nearly twice as high as that in the LDCs; this is partly due to the greater importance of company tax revenues in the MDCs. The major indirect taxes are relatively less important and account for about 42% of tax revenues. As in the LDCs, export and land taxes are relatively unimportant. [7]

Personal Income Tax. The structure of income tax throughout the English-speaking Caribbean still retains the basic features inherited from the British administration. In general, personal income tax in the CARICOM is characterized by wide-ranging personal allowances that are generous relative to per capita income; and this is coupled with fairly steep marginal tax rates. In the Windward Islands, besides single and married allowances

4. The aid statistics given here are derived from donor sources and are not comparable with those in Table 2 because of different fiscal years, time lags, etc.
5. The economic and financial position of most ECCM countries has deteriorated recently, partly as a result of higher oil prices.
6. Jamaica, Trinidad and Tobago, Guyana and Barbados.
7. A detailed description of the tax structure of one MDC will be found in Nizar Jetha, "The Structure of Major Taxes in Guyana", *Bulletin for International Fiscal Documentation*, Vol. XXX, no. 2, February 1976.

TABLE 2

CENTRAL GOVERNMENT FINANCES IN THE WINDWARD AND LEEWARD ISLANDS, 1968-73

(EC$million)

	Actual 1968	Actual 1969	Actual 1970	Actual 1971	Est. 1972	Est. 1973
1. Tax revenues [a]	40.9	51.4	64.9	72.6	79.5	90.0
2. Other local current revenues	16.5	19.9	23.8	25.3	26.4	30.8
3. Total local current revenues (1 + 2)	57.4	71.3	88.7	97.9	105.9	120.8
4. External grants [b]	8.1	8.1	5.4	6.9	5.3	5.7
5. Total current revenues (3 + 4)	65.5	79.4	94.1	104.8	111.2	126.5
6. Total current expenditures	62.5	71.7	89.8	110.1	118.3	127.1
7. Surplus (+) or deficit (—) on the current account	3.0	7.7	4.3	—5.3	—7.1	—0.6
8. Capital expenditures [c]	24.5	23.3	33.5	56.9	58.2	89.8
9. Sources of finance for capital expenditures						
Current surplus or deficit	3.0	7.7	4.3	—5.3	—7.1	—0.6
External capital grants	9.6	10.6	17.3	31.4	35.2	43.8
Borrowing (local & foreign) [d]	2.6	8.4	8.9	18.0	14.0	33.6
Other [e]	9.3	—3.4	3.0	12.8	16.1	13.0

Source: Government accounts.

a) Excluding Montserrat, whose tax revenues are included in other local current revenues.
b) Mainly budgetary aid from the United Kingdom.
c) All capital expenditure and revenue figures are estimates.
d) Mainly domestic borrowing and loans from the Caribbean Development Bank.
e) Balancing item.

TABLE 3

COMPOSITION OF TAX REVENUES IN THE WINDWARD ISLANDS AND MDCs

(Percent)

	WINDWARD ISLANDS [a]	MDCs [b]
Income tax	23.3	45.5
Major indirect taxes	61.2	41.6
Import duties	(43.2)	(19.8)
Consumption taxes	(15.0)	(5.4)
Purchase tax [c]	(—)	(2.4)
Retail sales tax	(—)	(1.0)
Excises	(3.0)	(13.0)
Property taxes	0.5	0.5
Land and house taxes	0.5	2.5
Export duties	2.5	0.2
Hotel and airport taxes	1.0	0.3
Other	10.9	9.4
TOTAL	100.0	100.0

Source: Government accounts.

) Estimates for 1973.
) 1973/74 for Jamaica, 1972 for Trinidad and Tobago, 1973 for Guyana and 1973/74 for Barbados.
) Imposed only by Trinidad and Tobago; equivalent to a consumption tax.

TABLE 4

COVERAGE OF PERSONAL INCOME AND COMPANY TAXES IN SELECTED CARICOM COUNTRIES

	Year	Number of Tax Returns Reviewed	Tax Returns as % of Population	Gross Incomes (Personal and Corporate) Reviewed [a] as % of GDP
Grenada	1970	6,767	7.4	38
St. Lucia	1971	6.279	6.1	33
Jamaica	1965	79,925 [b]	4.6	40
Guyana	1970	90,000 [c]	12.4	28
Barbados	1968	34,341	14.4	76

Sources: Report of the Commissioner of Income Tax for the Year-ended 31st March, 1966 (Government Printer, Kingston, Jamaica); Annual Report of the Commissioner of Inland Revenue for the Year 1969-70 (Government Printing Office, Barbados); interviews with officials dealing with taxation.

a) There is some double-counting involved since dividends received by residents appear as part of both personal and company incomes.
b) While precise data are lacking, it is known that the number of taxpayers is now much larger.
c) This figure seems to be on the high side.

deductions are granted for children, dependent relatives and housekeepers. The practice of giving a measure of relief for the taxpayer's and the spouse's earned income is also widely prevalent. The major features relating to savings comprise deductions for life insurance premiums, and for contributions to pension and provident schemes. The imputed income of owner-occupied housing is taxable in most countries, but substantial differences exist in the computation of such income (Appendix Table IV). Capital gains are not treated as taxable income. The minimum marginal rates range from 3-10%, and the maximum, from 50-65%. The MDCs grant the same type of allowances and deductions as the LDCs and their effective tax rates are also broadly comparable (Chart I).

The Caribbean countries also display the two major shortcomings of income taxes frequently encountered in developing countries: restricted scope and ineffective taxation of agricultural incomes. Income tax has not been used as a vehicle for mass taxation: for instance, in St. Lucia and Grenada, only 6-7% of the population files income tax returns, so that the fraction of the population actually paying income tax is even less (Table 4). The proportion of GDP assessed for income and company taxes — another convenient index for judging the coverage of income taxes — is also low, and amounts to about 30-40%. Barbados has succeeded in assessing 14% of the population and 76% of GDP for tax, but the situation in the other MDCs parallels that in the LDCs. [8] Inadequate coverage of agricultural incomes is probably one of the major reasons for the limited income tax bases: St. Lucia, which can be taken to represent the LDCs, manages to assess for income tax a mere 5% of the GDP derived from the agricultural sector. In Barbados, the ratio of total agricultural incomes assessed to agricultural GDP is much higher (16%), but the performance of the other MDCs has not been as good (Appendix Table V).

Company Tax. The region displays a bewildering variety of company tax systems, ranging from company income tax at the one end of the spectrum, to a full corporation (profits) tax, at the other. The main difference between a company income tax and a corporation tax is that resident shareholders receiving dividends can claim credit against their income tax liability for the former, but not the latter. In the Windward Islands, companies are taxed through an income tax at the rate of 40-45%. MDCs as a group do not have a uniform system of company taxation, but in general, companies are taxed either partly through an income tax and partly through a corporation tax (as in Guyana), or wholly through a corporation tax (as in Barbados). Substantial differences also exist in the magnitude of deductions allowed in the computation of taxable profits and the scope of withholding taxes on foreign remittances (such as dividends and interest payments). The former is due largely to dissimilar depreciation schedules; the latter is a direct consequence of the differing obligations under double taxation agreements.

Harmonization of fiscal incentives for industry has helped to attenuate somewhat the effects of the region's disparate company tax practices on new investments. An "approved enterprise" either qualifies for complete relief from payment of customs duties and income taxes (including corporation tax) for a specified number of years, or for a concessionary rate of income tax on profits derived from "non-traditional" exports. In the former case, the maximum number of years for which relief may be granted depends on the share of domestic value-added in the sales price, whereas in the latter case, the maximum reduction in income tax rates varies with the fraction of total profits accruing from exports. In either case, however, the extent of tax relief granted by individual countries is at their discretion subject to the permissible maximum. [9]

Indirect Taxes. With the exception of a few commodities that are subject to special duties, imports into the ECCM have faced a common external tariff since October, 1972. Special duties are lower than the corresponding common duties, and are particularly important in respect of alcoholic beverages, petroleum products, motor vehicles, cameras, jewellery and perfumes. A country is not, however, obliged to impose the special duties; it may apply the appropriate common duty or any other rate in between.

The common external tariff (CET) adopted by the MDCs on August 1, 1973, is to be extended to the ECCM countries over a five-year period starting from 1977. The CET is divided into preferential and general rates; the former are confined to goods originating in and consigned from the British Commonwealth and the latter applying to imports from all other countries. For most commodities, general rates exceed preferential rates by about 10%. Under the CET, raw materials and capital goods bear comparatively low rates of tax with somewhat higher rates imposed on semi-manufactured goods and the highest rates applied to finished goods. Foodstuffs, however, enter duty-free, except where protective considerations are involved. In general, the tariff is characterized by both moderate nominal rates and rate differentiation between "necessities" and "luxuries".

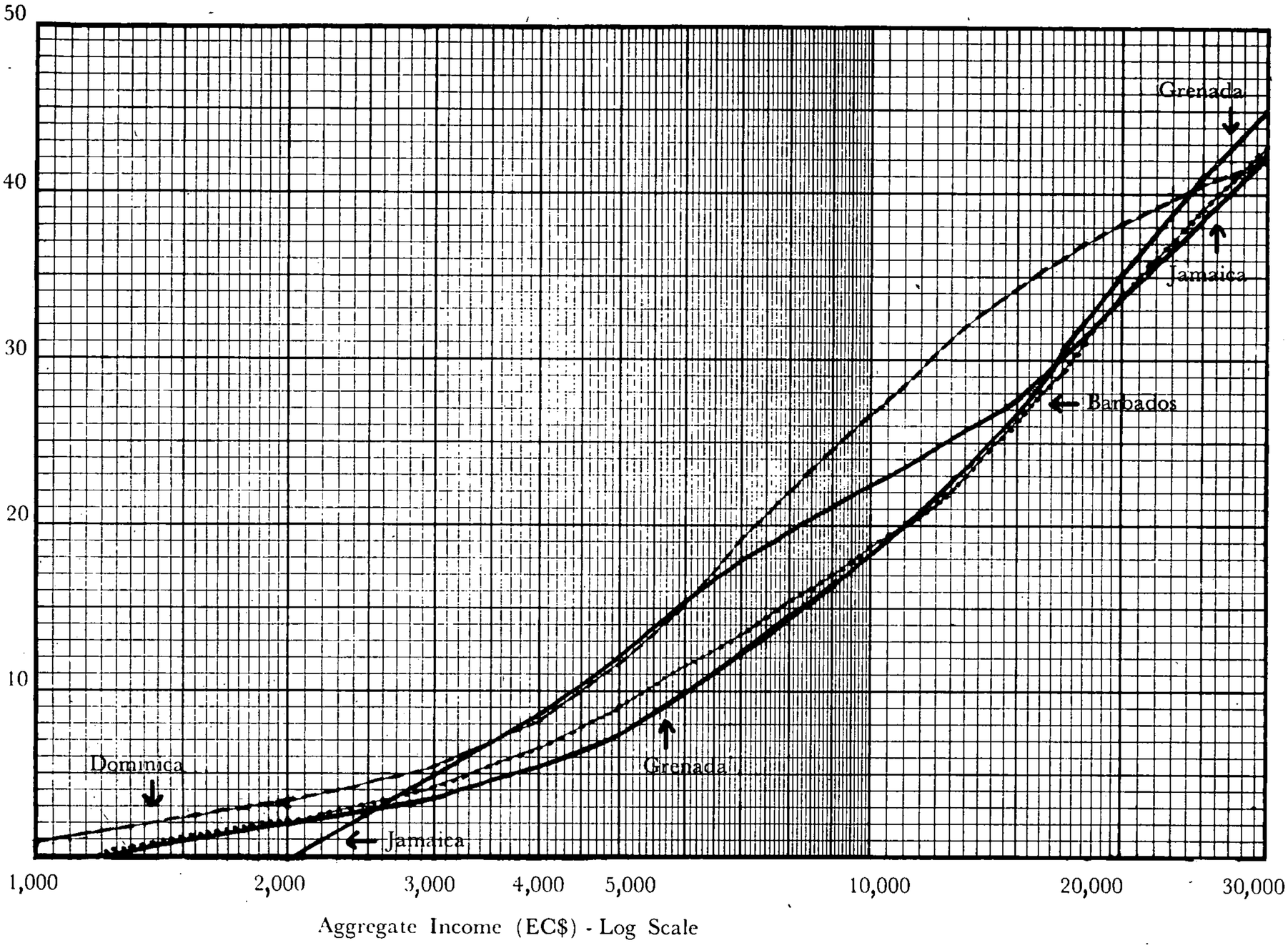
Although the ECCM and CET rates are identical for over 50% of the commodities, the former are substantially lower for commodities such as spirits, cigarettes, petroleum products, clothing, durable consumer goods and other luxury goods; revenue considerations are likely to be particularly important in these cases. For example, the CET rates on spirits are about 2½ to 4 times the highest special rates in the Windward Islands; the general CET duty on clothing is 45% as against the general ECCM rate of 30%; and the CET for most durable consumer goods and "luxuries", levied at the rates of 30% and 45%, is 10-15% above the relevant ECCM rates.

Consumption taxes were introduced in the Windward Islands in 1968 to compensate for the anticipated loss of revenue following the removal of import duties on goods originating from the other members of the CARIFTA, as well as the loss of freedom to vary the level of import duties on non-CARIFTA imports. [10] The tax is neutral as regards area-origin: specified goods, whether domestically-produced or imported (from CARICOM as well as non-CARICOM sources) are taxable. Exports and goods utilized as materials by a manufacturer are exempt, however. The price realized by the manufacturer in the "open market" constitutes the tax base for domestically-produced goods. For imports, the practice varies: some countries levy the tax on the c.i.f. value, whereas others regard the c.i.f. value plus the import duty payable as the tax base. Except in Dominica, consumption taxes in the Windward Islands have narrow coverage and limited rate differen-

8. During the early fifties, gross incomes reviewed as percentage of GDP ranged between 10-25% in the MDCs. See A.R. Prest, *A Fiscal Survey of the British Caribbean* (H.M.S.O., London, 1957), p. 105.
9. See *Agreement on the Harmonisation of Fiscal Incentives to Industry* (CARICOM Secretariat, Georgetown, July 1973) for further details.
10. The LDCs have been permitted to retain import duties, for protective or revenue purposes, on certain goods imported from the MDCs. All such duties are to be phased out by 1983, however.

Chart I - Effective Rates of Income Tax : Single Person

Grenada, Dominica, Jamaica and Barbados



tiation. This is reflected in the concentration of revenues on a few commodities: for example, in St. Lucia, alcoholic beverages and tobacco were responsible for 65% of the yield of consumption taxes in 1973.[11] Dominica imposes consumption taxes on a wide range of commodities at rates ranging from 5-40%.

Excises are levied on domestic products only, but for obvious reasons an imported CARICOM product is subject to an excise equalization tax at a rate equivalent to that on a similar domestic product. Low level of manufacturing activity has limited the scope for excise taxation in the Windward Islands. Rum has traditionally been the only, or the major, excisable product; tobacco and beer are also excisable in some countries. The introduction of consumption taxes has further reduced the usefulness of excises from the point of view of revenue.

The structure of indirect taxation in the MDCs differs from that in the LDCs in three major respects. Firstly, a much lower proportion of tax revenues is raised through import duties. Secondly, the reliance on excises is much higher, and domestic production accounts for a greater proportion of total consumption tax collections. Thus, the share of consumption tax on locally produced goods amounts to only 27% in Dominica, as against 36% in Guyana, and 69% in Jamaica.[12] These aspects mirror the greater degree of industrialization in the MDCs, where the fraction of total GDP originating from manufacturing varies between 10 and 15% as compared to less than 5% in the LDCs. Last, but not the least, the rates of indirect taxation are generally higher in the MDCs; this reflects the adoption of the CET, and more widely based and differentiated "internal" taxes, such as consumption taxes and excises. It is worth noting that retail sales taxes have recently been introduced in Jamaica (1973) and Barbados (1974). The Jamaican tax is rather selective, being confined to a limited number of consumer durables. By sharp contrast, the Barbadian tax has extensive coverage, with all retail transactions regarded as taxable unless specifically exempted; among the

11. Based on the data for the period January 1 to November 27, 1973.
12. The data for Dominica relate to January 1 — October 31, 1973; for Guyana, to 1972; and for Jamaica, to the fiscal year 1972/73.

major categories of goods exempted are food, fertilizers and pesticides, machinery and capital equipment, building materials, transport equipment and exports.

Export and Land Taxes. Export and land taxes constitute the two main taxes aimed specifically at the agricultural sector in the Windward Islands. Some form of export taxation exists in all the islands except St. Vincent, where it was abolished in 1972. Coverage varies between the islands and is fairly comprehensive in Grenada and Dominica, but is confined to a single product (bananas) in St. Lucia. Given the high commodity concentration of the islands' exports, the bulk of the revenue is derived from two to three products even where the tax is broadly based. Only Grenada has succeeded in raising significant amounts from export duties.

Land taxes are levied in all the islands except Dominica. While all prevailing taxes are based on acreage rather than value, the rate structures vary a great deal. Grenada levies a flat rate of EC$0.50 per acre for residents and EC$5 for non-residents. St. Vincent, on the other hand, has adopted an incremental rate structure, tax rates varying from EC$1 per acre for the first 10 acres to EC$6 per acre for holdings of more than 500 acres. In St. Lucia, also, tax rates vary with the size of the holdings: those under 10 acres are not taxable, but thereafter rates rise from EC$0.25 per acre for holdings of under 50 acres to a maximum of EC$1 per acre for holdings of 500 acres and over.

In the MDCs, export taxation was, until recently, confined to Guyana. Barbados has now imposed a levy on sugar exports and Guyana has supplemented export taxes with a sugar levy to take advantage of a favourable trend in sugar prices; in the former country, however, the proceeds are not allocated to the central government budget. [13] Land taxes are levied in all countries other than Guyana, the most common form of such taxation being the site value (unimproved land) tax.

III

Economic, political and social factors may be expected to affect a country's tax effort and structure. The influence of certain economic characteristics — such as, per capita income, average import propensity, and the fraction of GDP originating in agriculture — has been extensively investigated, notably by Musgrave. [14] In this section, similar hypotheses are examined for eleven CARICOM countries with a view to extending the comparative study in the previous section at a somewhat more aggregative level, and to collate the results with those obtained by Musgrave.

The CARICOM is not an economically homogeneous area: the members of this regional union are at different stages of development; in general, the LDCs have lower per capita income, obtain a larger proportion of output from agriculture, and rely more heavily on imports. In terms of non-economic characteristics, however, the CARICOM constitutes a fairly homogeneous community: these former British dependencies in the Caribbean share a common speech, outlook, customs, geographical and climatic environment, and political institutions. Hence, there is considerable justification for suppressing the political and social variables in considering the determinants of tax effort and structure. A comparison of the results obtained here with those based on Musgrave's sample, which covers countries with much more diverse social and political circumstances, should, therefore, be of interest.

The results of regressing the aggregate tax ratio, T/GDP, on certain indicators of economic structure are comparable with those obtained by Musgrave (Table 5). T/GDP is not associated with per capita income, Y_c, (equation 1), and this is in conformity with Musgrave's findings for low-income countries. T/GDP is also not explained by the share of imports, M/GDP, (equation 2), a result similar to that found by Musgrave. Finally, it is found that not only is there no association between T/GDP and the fraction of output originating in agriculture, A/GDP, but even the sign of the coefficient of A/GDP is contrary to *a priori* expectations (equation 3). The last result is at variance with that found by Musgrave, whose estimate is based on a sample that contains both low- and high-income countries. Musgrave did not estimate the equation for low-income countries alone; when this is done — using his data for countries with per capita income of under US$600 — the coefficient of A/GDP remains significant, but the R^2 falls substantially (from .54 to .30). The inclusion of Y_c in our equations 2 and 3 does not change the picture (equations 4 and 5); this is not surprising since Y_c is highly correlated with M/GDP and A/GDP.

In contrast with their complete failure to explain levels of taxation, the selected indices are found to be of considerable importance as determinants of tax structure. Following Musgrave, most of the hypotheses relate to the share of indirect taxes in total tax revenue, T_i/T. In order to avoid definitional problems, and to ensure comparability, T_i is defined to comprise the major indirect taxes such as import, consumption, excise, and other similar taxes.

The share of indirect taxes, T_i/T, is negatively related to per capita income (equation 6), and positively to the share of imports (equation 7) and the share of agriculture (equation 8). This is consistent with a priori expectations, and the association is further confirmed when T_i/GDP is substituted for T_i/T (equations 9, 10, and 11, respectively). But when Y_c is combined with A/GDP (equations 12 and 13), the coefficients of A/GDP lose their significance; these results are likely to be unreliable, however, because of the problem of multicollinearity.

Two further results, which concern the general nature of indirect taxes, relate T_i/T and T_i/GDP to T/GDP, and are worth noting. Musgrave postulates a positive association between T_i/T and T/GDP on the grounds that "...direct taxes are given initial preference but that indirect taxes are resorted to increasingly after direct tax rates have reached higher levels..." [15], but gets a statistically significant coefficient with a wrong sign. The present sample yields a positive coefficient for T/GDP, but the coefficient is not significant (equation 14). The inclusion of Y_c does not render the relationship significant, though the sign of the coefficient of T/GDP changes (equation 15). As Musgrave points out, the relationship between T_i/T and T/GDP may well be non-linear. Finally, the association between T_i/GDP and T/GDP is found to be positive (equation 16); moreover, the in

13. Jamaica and Guyana recently imposed greatly increased taxation of bauxite and alumina through production levies; these production levies are akin to export duties.
14. Richard A. Musgrave, *Fiscal Systems* (Yale University Press, New Haven, 1969), chs. 4-6.
15. Musgrave, *op.cit.*, p. 149.

TABLE 5

REGRESSIONS ON TAX REVENUE AND STRUCTURE

(Figures in parentheses are t-ratios)

Equation							R^2
			(i) *Regressions on Tax Revenues*				
(1)	T/GDP	=	25.7 (10.9)	− 0.007 Y_c (1.55)			.21
(2)	T/GDP	=	17.0 (4.46)	+ 0.077 M/GDP (1.45)			.19
(3)	T/GDP	=	20.4 (9.83)	+ 0.11 A/GDP (1.02)			.10
(4)	T/GDP	=	21.6 (3.07)	− 0.005 Y_c (0.79)	+ 0.04 M/GDP (0.62)		.25
(5)	T/GDP	=	26.8 (4.22)	− 0.008 Y_c (1.06)	− 0.033 A/GDP (0.20)		.21
			(ii) *Regressions on Tax Structure*				
(6)	T_i/T	=	71.0 (22.0)	− 0.036 Y_c (5.74)			.79
(7)	T_i/T	=	30.3 (3.93)	+ 0.34 M/GDP (3.14)			.52
(8)	T_i/T	=	43.8 (9.9)	+ 0.56 A/GDP (2.53)			.42
(9)	T_i/GDP	=	17.5 (13.2)	− 0.012 Y_c (4.4)			.68
(10)	T_i/GDP	=	4.62 (1.68)	+ 0.11 M/GDP (2.79)			.46
(11)	T_i/GDP	=	9.00 (5.71)	+ 0.17 A/GDP (2.20)			.35
(12)	T_i/T	=	75.0 (8.66)	− 0.041 Y_c (3.8)	− 0.11 A/GDP (0.50)		.79
(13)	T_i/GDP	=	19.0 (5.32)	− 0.013 Y_c (2.95)	− 0.042 A/GDP (0.45)		.69
(14)	T_i/T	=	32.6 (1.76)	+ 0.95 T/GDP (1.16)			.13
(15)	T_i/T	=	75.0 (5.82)	− 0.038 Y_c (4.99)	− 0.16 T/GDP (0.32)		.79
(16)	T_i/GDP	=	−3.46 (0.83)	+ 0.70 T/GDP (3.77)			.61
(17)	T_i/GDP	=	5.78 (1.83)	− 0.008 Y_c (4.43)	− 0.46 T/GDP (3.83)		.89
(18)	T_y/T	=	14.6 (2.7)	+ 0.039 Y_c (3.64)			.60
(19)	T_y/T	=	45.9 (9.03)	− 0.73 A/GDP (2.9)			.48
(20) *	T_p/T	=	14.0 (8.8)	+ 0.008 Y_c (2.48)			.51
(21) *	T_p/T	=	20.9 (12.6)	− 0.17 (A/GDP (2.22)			.45

T = Tax revenue; Y_c = per capita GDP; M = imports; A = value added by agriculture; T_i = revenue from major indirect taxes; T_y = income tax (personal and corporate) revenue; T_p = personal income tax.

* 8 observations (Windward Islands and MDCs).

Source: Statistical data given in Appendix Table I.

clusion of Y_c yields the right signs for both the coefficients, and the fit also improves (equation 17).

The results pertaining to the share of income taxes in total tax revenues, T_y/T, substantiate some of the conclusions reached with regard to indirect taxation. T_y/T is found to be positively associated with Y_c, and negatively with A/GDP (equations 18, and 19, respectively). Since the LDCs and MDCs derive vastly different proportions of income tax revenues from company taxes, it is interesting to replace T_y/T by the share of personal income tax in total tax revenue, T_p/T. When this is done for the countries for which the requisite data are available (viz., Windward Islands and the MDCs), the results remain significant (equations 20 and 21). The last result is noteworthy: it brings out the negative impact of A/GDP on T_y/T, thereby supporting the suggestive evidence of the previous section.

To sum up the statistical evidence, it appears that differences in tax effort do not depend on the structural characteristics of the economies. On the other hand, the overall rate of indirect taxation and tax effort show a high positive correlation, and a large part of the variation in the relative importance of indirect taxes is explained by the selected indices of development. Also, more direct evidence has been found concerning the influence of per capita income and the share of agriculture on the relative importance of personal income taxes.

IV

Given the small size of the corporate sector and limited domestic production of manufactures, the prospects for revenue growth should be the greatest in taxes on personal income and imports. It follows, *inter alia*, that the coverage of income and consumption taxes, and the effectiveness of the various taxes impinging on the agricultural sector, will need careful consideration in any strategy of tax reform. Section III, above, suggests that indirect

taxes are likely to dominate the tax structure in the foreseeable future. Nevertheless, a conscious effort is needed to develop direct taxes; otherwise, their share in total tax revenues could fall drastically. Such a trend would be undesirable on equity grounds. In the difficult task of restructuring taxes in the LDCs, the experience of the MDCs (other than that of Barbados in the area of income taxation) in the spheres of personal income taxation and agricultural taxation is not of much relevance, but recent developments in the MDCs in indirect taxation provide a useful guide to what needs to be done. The remaining part of the paper discusses the major taxes from the viewpoint of their revenue potential. [16]

Personal Income Tax. The curtailment of the range and the magnitude of various allowances and deductions granted under the income tax holds out the best prospects for an enhanced contribution from this source. There is little doubt that the structure of allowances has greatly eroded the tax base. To use St. Vincent as an illustration, single persons become liable to income tax only when their gross income is twice the per capita income, and a married person with four children begins to pay tax only when his income is more than six times the per capita income. Clearly, the tax net cannot be cast very widely in this situation. Since the attainment of internal autonomy, the role of the government has changed from that of a passive provider of law and order and basic infrastructure, to one of an active agent in promoting economic development; the system adopted during colonial times cannot therefore be expected to meet present revenue requirements. A thorough overhaul of the system of income tax allowances is long overdue.

Considerations of space preclude a comprehensive analysis of the structure of allowances, but some illustrations indicating the unrealistic nature of certain allowances are in order. The provisions concerning earned income allowances, the treatment of imputed income of owner-occupied housing, and contributions to pension and provident schemes provide good examples. The earned income allowance is very costly in terms of the revenue foregone since, given the economic structure of the LDCs, virtually everyone qualifies for it. Even in the United Kingdom, where it originated, the rationale of this allowance has never been formulated with sufficient cogency. In any case, in countries desperately short of savings, the case for an earned income allowance must be regarded as questionable. As for the taxation of imputed income of owner-occupied housing, the widespread undervaluation of properties and the application of rather low percentages to capital values for deriving imputed income have, together, transformed the assessment of imputed income, in a significant proportion of cases, to an allowance because interest payments exceed the imputed income. Finally, the treatment of contributions to private pension and provident schemes, and national provident funds, is also very generous: in the former case, while benefits are taxable, no limitations are placed (except in Grenada) on the deductible contributions; in the latter case, not only are the benefits tax-exempt, but all contributions are also deductible.

The Windward Islands have been considered collectively to keep the discussion manageable, but it is not intended to imply that an identical structure of rates and allowances should be adopted. Indeed, since these countries are likely to face divergent revenue requirements, it is important that each country is in a position to adapt its personal income tax to the revenue needs. It is essential that each country retains some major independent sources of revenue, whose structure and rates it could vary in accordance with its needs; otherwise, a number of countries are likely to find themselves in a fiscal "straight-jacket". Given the loss of independence over import duties following the membership of the CARICOM, and the desirability of maintaining broadly similar company tax structures and rates within a common market, personal income and consumption taxes are the only major independent tax sources available to the LDCs. It would, therefore, be a grave error to harmonize either personal income taxation or consumption taxes within the CARICOM. [17]

Company Taxation. The LDCs may need to change the system of company taxation in the interests of fiscal harmonization within the CARICOM, and to renegotiate their double taxation agreements so as both to safeguard their revenues and to ensure that the benefits of fiscal incentives are transmitted to foreign investors. The revenue effects of these measures are likely to be small however.

The trend in the MDCs has been towards the replacement of company income taxes by corporation taxes. The LDCs may, therefore, need to consider a similar policy. The substitution of an income tax on companies by an equi-rate corporation tax could be expected to give greater encouragement to profit retentions since, with the abolition of credit for the taxes paid by companies, dividends are likely to suffer higher rates of tax in the hands of resident shareholders. Thus, the revenue effect will depend primarily on the magnitude of income tax credits which are avoided in relation to the tax revenues lost through greater retention of profits. In the context of the LDCs, however, the revenues are unlikely to change materially. There are two reasons for this. Firstly, a substantial fraction of dividends will be received by foreign investors, whose tax liability will not change under a corporation tax. Secondly, private companies (i.e., limited liability companies "controlled" by less than five persons), which represent the predominant form of corporate organization, would tend to substitute salaries and fees for dividends in order to reduce their overall tax liability.

The renegotiation of the current double taxation agreements with the main investing countries for the purpose of securing a more favourable division of tax revenues has been under consideration in the LDCs for some time. The prevailing agreements, negotiated decades ago, greatly restrict the powers of the LDCs to tax income remitted to non-residents. It is particularly important that the LDCs should be in a position to impose a withholding tax on interest payments made to non-residents, since under the existing provisions a highly-geared foreign company can minimize its contribution to the LDCs' revenues by transferring most of its income through interest payments rather than dividends. "Tax sparing" features also need to be embodied in the new agreements to ensure that tax concessions by the LDCs benefit foreign investors instead of foreign treasuries. [18]

The recent double taxation agreement negotiated between the LDCs and the MDCs represents a step in the right direction. The

16. Problems of tax administration will not be discussed here, but it need to be mentioned that improved administration could help to raise revenue significantly. Strengthening of income tax administration, in particular deserves high priority in every LDC. Greater regional co-operation in tax administration could facilitate this.

17. According to the Article 40 of the Common Market Annex of the *Treaty Establishing the Caribbean Community*, "Member States agree to study the possibility of approximating income tax systems and rates with respect to companies and individuals".

18. See J.D. Pounder, "The Need for Double Taxation Treaties in Caribbean Countries" (mimeographed, October 1973).

agreement will ensure that the flow of capital from the MDCs to the LDCs is not impeded by tax considerations, in addition to safeguarding the latter's revenues and ensuring that the tax inducements granted by the LDCs are not negated by the policies of the MDCs. A favourable treatment for the LDCs is secured by defining "permanent establishment" more broadly than is normally the case, by permitting the LDCs to impose their full rates of income tax on interest payments made to MDCs, and by providing for concessional rates of tax on dividend and interest payments made by the MDCs to the LDCs. The "tax sparing" aspect is taken care of by providing that when an LDC-based company distributes to MDC residents profits which are exempt from any LDC tax under the scheme for the harmonization of fiscal incentives to industry, such distributions are also exempt in the MDCs. [19]

Indirect Taxes. The consumption tax is the most flexible, independent, indirect tax available within the context of economic integration. The fact that no two countries of the CARICOM have contiguous boundaries also permits greater disparity in tax rates than is usual with common markets. The long period envisaged for the full implementation of the CET, the moderate nature of the nominal CET rates, and the low degree of rate differentiation between different categories of goods underline the desirability of using consumption taxes more vigourously than in the past, both for revenue purposes and for spreading the burden of indirect taxes in the desired manner. A careful examination of the MDC indirect tax systems should prove rewarding in this respect. The introduction of retail sales taxes would, however, be premature; given the countries' present stage of development, the objectives of a retail sales tax can be achieved, with greater administrative ease, through consumption taxes.

Three further points need to be made for completeness. Firstly, it is desirable that all countries relate the consumption tax on imports to the sum of the c.i.f. value and import duty payable. The advantage of this procedure is that the consumption tax on final goods would leave the rate of effective protection unchanged. Secondly, the absorption of various levies on imports into consumption taxes is to be strongly recommended: quite apart from simplifying administration, this would make it easier to understand the effects of the taxes. Levies such as package taxes, stamp duties and surtaxes on imports have proliferated in recent years, and one or more of these taxes are imposed in all Windward Islands; their importance varies from 4% of import duty collections in Grenada to 20% in St. Lucia. Thirdly, given the need to utilize fully the available revenue sources, the maintenance of special import duties does not make sense; if low duties on certain goods are deemed desirable for encouraging tourism, then a less costly method of achieving this objective would be to establish "duty-free" shops for *bona fide* tourists.

Agricultural Taxation. An improvement in the operation of income tax on the agricultural sector, and substitution of the existing land taxes by those on market values should form the key elements of a strategy for an adequate taxation of agricultural incomes. While export duties have a role to play — at least, until the effectiveness of the income tax is increased substantially — greatly increased reliance on these taxes would not be advisable in view of their deficiencies from the points of view of equity and resource allocation. [20]

There is little doubt that the income tax has not succeeded in taxing even the estates adequately. It may well be that the income tax, in its present form, is not suitable for assessing agricultural incomes in the Eastern Caribbean environment, requiring as it does, relatively sophisticated taxpayers and proper accounts. Where these are lacking, the introduction of an income tax on agricultural incomes based on imputed incomes deserves serious consideration. This is a convenient place to mention that in view of the intrinsic difficulties in taxing agricultural incomes, and the consequent use of agriculture as "tax shelter", the right to deduct "losses" in agricultural activities from profits derived from other activities should be withdrawn.

A land tax based on market values could make a sizeable contribution to revenues. [21] The current land tax rates are rather low: assuming a uniform price per acre of EC$1,000, the present land tax on, say, a holding of 100 acres amounts to a mere 0.19% of the market value of the holding even in St. Vincent, where the tax rates are higher than in the other islands. In practice, there is great variation in the price per acre — the price range being roughly estimated at EC$500-5,000 per acre in the Windward Islands — and, therefore, the incidence of the present tax is likely to be haphazard. In view of the wide disparity in the price per acre, it is unlikely that a land tax based on acreage — even if levied at steeply graduated rates — can yield substantial revenues without degenerating into an unacceptably regressive tax. A tax related to market values is, therefore, to be preferred. The valuation problems should not prove insurmountable given the small size of the islands. Moreover, the operation of the tax could be simplified considerably by exempting holdings of less than a given size, since the distribution of land holdings is skewed: in Dominica and Grenada, for example, although holdings over 25 acres account for only 2-3% of total holdings, the corresponding acreage is over 50%. [22] A more effective system of land taxation is also needed to encourage better utilization of land; this is particularly important because a substantial proportion of agricultural land in the Windward Islands is left idle, and underutilization is more frequent on large estates.

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19. See *Agreement for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and for the Encouragement of International Trade and Investment* (CARICOM Secretariat, Georgetown) for further details.
20. There is an additional constraint to the use of export duties. Article 18 of the Common Market Annex of the *Treaty Establishing the Caribbean Community* prohibits the imposition of export duties on goods exported by one member state to another. Certain transitional arrangements have been provided for in the Treaty to deal with export duties that existed before the establishment of the Caribbean Community.
21. Lady Hicks had recommended the introduction of effective taxes on real property as early as 1963. See Report of the Fiscal Commissioner (Ursula K. Hicks), *Federation of East Caribbean Territories* (Cmnd. 1991, H.M.S.O., London, 1963), para. 108.
22. Data derived from the 1971 agricultural surveys for Dominica and Grenada.

APPENDIX TABLE I

STATISTICAL DATA (1971) FOR REGRESSION EQUATIONS

	Y_c [a]	T/GDP	M/GDP	A/GDP	T_i/T	T_i/GDP	T_y/T	T_p/T [b]
WINDWARD ISLANDS								
Grenada	348	23.7	69.4	30.0	52.1	12.3	25.5	15.9
St. Vincent	223	23.4	70.2 [c]	24.8	63.7	14.9	26.3	16.6
Dominica	279	26.1	83.2 [d]	29.4	63.9	16.7	23.9	16.9
St. Lucia	375	23.0	90.8	23.2	60.7	13.9	26.1	15.7
LEEWARD ISLANDS								
Antigua	440	23.9	74.4 [e]	3.1	56.4	13.5	32.7	n.a.
St. Kitts	361	18.5	90.9	24.4	58.2	10.8	26.5	n.a.
Montserrat	537	20.6	72.6	16.0	57.3	11.8	20.9	n.a.
MDCs								
Jamaica	694	20.8	41.2	9.2	45.6	9.5	48.0	20.1
Trinidad and Tobago	861	16.1	39.6	4.6	38.8	6.2	47.0	18.3
Guyana	344	22.6	54.0	20.5	51.9	11.7	38.2	14.9
Barbados	676	26.7	75.8	11.8	43.7	11.7	45.3	22.2

Sources: Government statistical publications; Appendix Tables II and III.

a) Per capita GDP at factor cost (US$).
b) For St. Vincent, Dominica and St. Lucia, T_p/T relates to 1972; for Barbados, to 1968.
c) 1969.
d) 1970.
e) 1968.

APPENDIX TABLE II

TAX REVENUES OF THE WINDWARD AND THE LEEWARD ISLANDS, 1971

(EC$'000 and Percent)

	GRENADA	ST.VINCENT	DOMINICA	ST.LUCIA	TOTAL WIND-WARDS	ANTIGUA	ST.KITTS	MONTSERRAT	TOTAL LEE-WARDS	TOTAL LDCs
					(%)				(%)	(%)
Income tax	3,964	2,437	2,471	4,550	25.4	4,506	1,648	507	29.7	26.7
Major indirect taxes	8,095	5,897	6,588	10,595	59.0	7,774	3,626	1,388	57.0	58.4
Import duties	(6,839)	(4,848)	(4,796)	(8,314)	(46.9)	(5,169)	(2,755)	(791)	(38.8)	(44.5)
Consumption taxes	(856)	(608)	(1,460)	(1,789)	(8.9)	(2,543)	(802)	(597)	(17.6)	(11.5)
Excises	(400)	(441)	(332)	(492)	(3.2)	(62)	(69)	(—)	(0.6)	(2.4)
Property taxes [a]	141	—	26	146	0.6	182	—	318	2.2	1.1
Land and house taxes	105	138	—	56	0.6	19	120	—	0.6	0.6
Export duties	1,037	150	334	219	3.3	5	—	—	—	2.3
Hotel and airport taxes	152	—	58	152	0.7	461	—	54	2.3	1.2
Other [b]	2,055	629	1,116	1,731	10.5	846	831	157	8.2	9.8
TOTAL	15,549	9,251	10,593	17,449	100.0	13,793	6,225	2,424	100.0	100.0

Source: Government accounts.

a) Mainly estate duties.
b) Package taxes, stamp duties, entertainment taxes, licences, etc.

APPENDIX TABLE III

TAX REVENUES OF MDCs, 1971

(EC$million) [a]

	JAMAICA [a]	TRINIDAD & TOBAGO	GUYANA	BARBADOS [b]	TOTAL MDCs Amount	%
Income tax	261.8	133.8 [c]	42.9	35.1	473.6	46.1
Major indirect taxes	248.4	110.6	58.2	37.5	454.7	44.2
Import duties	(124.3)	(64.0)	(38.6) [d]	(23.1) [e]	(250.5)	(24.3)
Consumption taxes	(6.7)	—	(6.6)	(10.1) [f]	(23.4)	(2.3)
Purchase tax	—	(19.7)	—	—	(19.7)	(1.9)
Excises	(117.4)	(26.9)	(13.0)	(4.3)	(161.6)	(5.7)
Property taxes [g]	—	1.4	2.9	1.0	5.3	0.5
Land and house taxes	3.8	3.3	—	2.9	10.0	1.0
Export duties	—	0.1	2.7	—	2.8	0.3
Hotel and airport taxes	4.1	—	0.1	1.1	5.3	0.5
Other [h]	27.1	35.5	5.4	8.2	76.2	7.4
TOTAL	545.2	284.7	112.2	85.8	1,027.9	100.0

Source: Government accounts.

a) Exchange rates used: J$ = EC$2.4; TT$ = G$ = B$ = EC$.
b) 1971/2.
c) Excluding the unemployment levy.
d) Including the defence levy.
e) Including additional import duties.
f) Including the motor spirit and diesel fuel tax.
g) Mostly estate and/or succession duties. Guyana's property tax is a tax on net worth.
h) Motor vehicle licences, stamp duties, entertainment and betting taxes, etc.

APPENDIX TABLE V

NUMBER OF TAXPAYERS AND GROSS INCOME ASSESSED FOR INCOME TAX IN ST.LUCIA, GRENADA AND BARBADOS

	GRENADA (1970)		ST.LUCIA (1971)		BARBADOS (1968)	
	Number of taxpayers	Gross income assessed (EC$'000)	Number of taxpayers	Gross income assessed (EC$'000)	Number of taxpayers	Gross income assessed (EC$'000)
COMPANIES	*82*	*4,100*	*74*	*2,491*	*350*	*48,172*
Agriculture			3	88	40	2,629
Manufacturing and construction			—	—	45	4,189
Public utilities and transport			—	—	30	2,848
Finance			67	1,594	97	29,340
Trade			4	809	90	7,424
Other			—	—	48	1,742
INDIVIDUALS	*6,685*	*18,172*	*6,205*	*22,415*	*24,091*	*59,516*
Agricultural proprietors	450	2,346	123	554	89	1,220
Professionals	36	503	16	279	273	3,232
Traders	549	2,685	392	2,563	677	2,347
Investors	248	838	65	541	1,099	6,315
Property owners	—	—	60	295	335	911
Employees	5,402	11,800	5,549	18,184	21,618	45,491
Government	(2,370)	(6,144)	(2,011)	(7,838)	(6,394)	(10,682)
Agriculture	(3,032)	(5,656)	(3,538)	(10,346)	(1,437)	(3,199)
Other					(13,787)	(31,610)
TOTAL	6,767	22,272	6,279	24,906	24,441	107,688

Sources: Annual Report of the Commissioner of Inland Revenue for the Year 1969-70 (Government Printing Office, Barbados); interviews with officials dealing with taxation.

APPENDIX TABLE IV

PERSONAL INCOME TAX ALLOWANCES AND DEDUCTIONS: WINDWARD ISLANDS, 1973

(EC$)

	GRENADA	ST.VINCENT	DOMINICA	ST.LUCIA
Earned income relief	Nil	10% of earned income; max. 500	10% of earned income; max. 480	10% of earned income; max. 500
Personal allowance	1,200	800	800	1,500
Wife allowance	500	600	600	1,000 a)
Wife's earned income relief	100 if wife's earned income exceeds 500	Nil	90% of earned income; max. 480	90% of earned income; max. 500
Child allowance b)				
(a) under 16	300	300	350	250
(b) over 16, under 25				
(i) receiving education in the state	300	700	350	250
(ii) receiving education outside the state	300	700	720	750
Dependent relatives c)	120 each; max. 240	200	125 each; max. 250	200
Housekeeper d)	120	200	120	200
Maintenance or separation allowance or alimony	Up to a max. of 960	Full payment	Full payment	Full payment
Deduction for life insurance premiums e)	Up to 1/6 of chargeable income; max. 1,440	Up to 1/6 of chargeable income	Limited to 1/6 of total income or 1,200, whichever is less	Up to 1/6 of chargeable income; max. 2,400
National provident and insurance schemes	No national provident scheme at present	Employees' and employers' contributions deductible; benefits not taxable	Employees' and employers' contributions deductible; benefits not taxable	Employees' and employers' contributions deductible; benefits are taxable
Approved provident and pension schemes	f)	—"—	Employees' and employers' contributions are deductible. Pensions are taxable.	
Treatment of imputed income of owner-occupied housing	Imputed income taxable; mortgage interest deductible	Imputed income not taxable; but mortgage interest deductible	Imputed income (= 6% of capital value) taxable; mortgage interest deductible	In general, imputed income (= 3% of capital value) taxable Post-1965 houses under 30,000 exempt. In both cases, interest deductible

Source: Income Tax Ordinances.

a) Wife's earned income, if any, assessed separately, and husband allowed 1,500 and wife 1,000; but wife's income taxed at special marginal tax rates.
b) "Child" includes a step-child, a legally adopted child, or illegitimate child living with and maintained by the taxpayer. Allowance given for child over 16 (but under 25) only if receiving full-time instruction at a college, or full-time training lasting not less than two years for a trade or profession.
c) Allowed only where a relative incapacitated by old age or infirmity is maintained.
d) Available only to a widower for a relative taking care of his children or acting as his housekeeper.
e) In all countries, the relief is further restricted in the case of each policy to 7% of the capital sum assured.
f) Contributions (whether paid by employer or employee) of up to 10% of the employee's remuneration are deductible. Annuities paid are taxable.

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ABC FÜHRER LOHNSTEUER

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Loose-leaf publication service providing extensive information on wage taxation. The relevant texts are appended.

ABC FÜHRER SOZIALVERSICHERUNG

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Loose-leaf publication on the German Foreign Tax Law containing the text of the law, comments thereon, the rulings and the German — Swiss double taxation treaties on income and capital and succession duties.

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DEUTSCHE STEUERPRAXIS — NACHSCHLAGEWERK PRAKTISCHER STEUERFALLE

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Loose-leaf publication of handbook containing a survey of the company law, accounting principles, tax law, labour legislation and forms in connection with the limited liability company (GmbH).

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Supplemented: regularly.

Loose-leaf publication of handbook on the turnover tax containing the full text of the 1967 turnover tax law (value added tax), the implementing regulations and a detailed comment in general terms per subject matter. The material is kept up to date by the issue of replacement and supplementary pages.

KOMMENTAR ZUR ABGABENORDNUNG UND FINANZGERICHTSORDNUNG

By. W. Hübschmann, E. Hepp, A. Spitaler, 7th edition.
Verlag Dr. Otto Schmidt, Ulmenallee 96-98, 5 Cologne 51. 1976.
Supplemented: regularly.

Loose-leaf publication regarding a revised comment on the new German Fiscal Code 1977. Supplements will be delivered in 1977 and thereafter. The whole work will have approximately 5,500 pages to be issued in 6 volumes.

KOMMENTAR ZUM EINKOMMENSTEUERGESETZ

By F. Lademann, E. Lenski and H. Brockhoff.
Richard Boorberg Verlag, Scharstr. 2, D-7000 Stuttgart 80. 1970.
Supplemented: two or more times a year.

Third edition of a loose-leaf explaining the German individual income tax law. Text of the law and other relevant legislation is appended.

KOMMENTAR ZUR EINKOMMENSTEUER (EINSCHL. LOHNSTEUER) UND KÖRPERSCHAFTSTEUER

Verlag Dr. Otto Schmidt, Ulmenallee 96-98, 5 Cologne 51.
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Loose-leaf publication of monograph containing comment and text on the individual income tax (including wage tax) and the corporate income tax law.

KOMMENTAR BEWERTUNGSGESETZ — VERMÖGENSTEUERGESETZ

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Loose-leaf commentary (with text) on the valuation law for purposes of the net worth tax law.

KOMMENTAR ZUM AUSSENSTEUERGESETZ

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Verlag Dr. Otto Schmidt, Ulmenallee 96-98, 5 Cologne 51. 1973.
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KOMMENTAR ZUM GEWERBESTEUERGESETZ

By E. Lanski and W. Sternberg.
Verlag Dr. Otto Schmidt, Ulmenallee 96-98, 5 Cologne 51.
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Detailed loose-leaf commentary on the trade tax law in the Federal Republic of Germany. Text of relevant law in connection with the subject is appended.

KÖRPERSCHAFTSTEUERGESETZ 1977

By K.D. Kläschen.
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Supplemented: annually.

Loose-leaf commentary (with text) on the corporate income tax law effective as of January 1, 1977 (Corporate income tax reform law of 1977).

MEHRWERTSTEUER

Textsammlung mit Gesetze, Durchführungsverordnungen und Verwaltungsvorschriften.
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Loose-leaf publication containing text and comment of the reorganization law in general and with particular reference to taxation.

UMWANDLUNGSSTEUERGESETZ 1969

By. G. Loos.
Verlagsbuchhandlung des Instituts der Wirtschaftsprüfer GmbH, Cecilienallee 36, D-4000 Düsseldorf.
Supplemented: once per year.

Loose-leaf publication of monograph containing comment on the 1969 reorganization tax law. Relevant text is appended.

List of Tax Treaties Singapore.

concerning comprehensive double taxation treaties on income/capital.

The list is up to date as of December 31, 1976.

Treaty with	Concerning	Concluded	Official Text	Published in the English language in
Australia	income	February 11, 1969	English	SLS 10/69
Exchange of notes	income	May 21, 1975	English	SLS 31/75
Belgium	income	February 8, 1972	English	SUPP. SER. Section C SLS 53/73
Canada [1]	income	March 6, 1976	English	[2]
Denmark	income	March 7, 1969	English	SUPP. SER. Section C SLS 16/69 Treaty Series, Vol. 751, p. 202 IX UN A(1) 270
France	income	September 9, 1974	English and French	SUPP. SER. Section C SLS 39/75
German Federal Republic	income, capital	February 19, 1972	English and German	SUPP. SER. Section C SLS 51/73 IX UN A(1) 315, 335
Israel	income	September 27, 1971	English	SLS 26/72 IX UN A(1) 332 BULL Supplement C (1974)
Japan	income	January 29, 1971	English	SLS 49/71 IX UN A(1) 283
Malaysia	income	December 26, 1968	English	SLS 97/68
Supplementary agreement	income	July 6, 1973	English	SLS 40/73
Netherlands	income, capital	February 19, 1971	English and Dutch	SUPP. SER. Section C SLS 57/71 IX UN A(1) 297 Treaty Series, Vol. 801, p. 29
New Zealand	income	August 21, 1973	English	SLS 65/73

1. Not yet in force.
2. Not yet published.

Treaty with	Concerning	Concluded	Official Text	Published in the English language in
Norway	income	September 9, 1966	English	SUPP. SER. Section C SLS 67/66 IX UN A(1) 170
Sweden	income, capital	June 17, 1968	English	SUPP. SER. Section C SLS 11/69
Switzerland	income, capital	November 25, 1975	English and German	SLS 57/76
Thailand	income	September 15, 1975	English	SLS 20/76 BULL Supplement E (1976)
United Kingdom	income	December 1, 1966	English	SUPP. SER. Section C SLS 12/67 IX UN A(1) 176 Treaty Series, Vol. 605, p. 154
Protocol	income	July 21, 1975	English	1

. Not yet published.

ABBREVIATIONS:

BULL	= Bulletin for International Fiscal Documentation. International Bureau of Fiscal Documentation. Amsterdam.
SUPP. SER. Section C	= Supplementary Service to European Taxation. Section C.
SLS	= Subsidiary Legislation Supplement. The Republic of Singapore Government Gazette.
Treaty Series	= Treaties and international agreements registered or filed and recorded with the Secretariat of the United Nations. In addition to the official text of each agreement, this publication produces a translation in either English or French as the case may be.
UN	= United Nations. Department of Economic and Social Affairs. International Tax Agreements, World Guide. Text of tax treaties exists in an English and a French edition. This publication contains several volumes.

Malaysia: Tax Changes for 1977.

Extract from the Malaysian budget for fiscal year 1977 presented by Finance Minister Tengku Razaleigh on October 29, 1976.

Having already explained to the House the economic position and the Government accounts, I now come to the tax changes for the 1977 Budget.

The tax proposals and changes in the tax structure that I will now introduce, have been designed in accordance with the Budget Strategy that I outlined earlier. These tax changes will help to:—

(a) *stimulate* economic growth, particularly industrial expansion;
(b) *reduce* the cost of living particularly of our people in the lower income groups.

These tax changes will incur some sacrifice of the present revenue receipts. Nevertheless these measures are to be adopted so as to achieve the socio-economic objectives that I have mentioned.

The Government is therefore doing its share and it is hoped that the private sector will contribute its own share by responding effectively to these new incentives.

It is also hoped that the lower income groups amongst our people who will benefit from these tax sacrifices, will now be able to increase their *savings*.

These sacrifices in tax receipts foregone are expected to be compensated by the better growth prospects of the economy, which will consequently increase the tax receipts, at the existing rates.

I would like to mention at this stage that any reference to estimated revenue yield which I might make is the estimated yield for a full year even though I might not say so specifically. I shall deal first with direct taxes.

Individual Income Tax

For resident individuals deduction for personal relief from total income in arriving at the chargeable income has remained the same for several years. Representations have been made repeatedly in this House and elsewhere to increase the deduction for personal relief and relief for wife.

The Government has carefully considered these representations and has decided that in order to ameliorate the difficulties faced by taxpayers in the lower income group, certain concessions should be made.

It is, therefore, now proposed that instead of increasing the personal relief deductions from total income in arriving at the chargeable income, each resident individual, excluding the working wife, who elects to be assessed separately on her employment income, be granted a *tax rebate* of $ 60. The Government prefers to grant a flat rate rebate rather than increase the personal relief deduction from total income mainly on grounds of equity. Lest someone may interpret that the $ 60 rebate as being trivial, let me clarify what this rebate really means.

The tax rebate of $ 60 would have the same effect as though the personal relief deduction from total income is increased by $ 1,000 to those in the lowest taxable income group, but if personal relief deduction is given to every taxpayer regardless of his total income, the beneficiaries will be those in the higher income bracket.

The proposed tax rebate of $ 60 should therefore not be mistaken to be only a small amount if one converts it into its relief equivalence. I would like to cite the following examples in order to make this point clear. For taxpayers in:

6% tax bracket the rebate = $ 1,000 relief
12% tax bracket the rebate = $ 500 relief
55% tax bracket the rebate = $ 109 relief

If a flat increase in the personal relief deduction from total income of $ 1,000 is given, for example from the current $ 2,000 level to $ 3,000, in absolute money terms, it is the higher income group who will benefit more. If a $ 1,000 extra personal relief deduction is given, the taxpayer in the lowest 6 percent tax bracket will benefit by only $ 60 (i.e. 0.06 x 1,000) in terms of the reduction in his tax liability; to the taxpayer in the 12 percent tax bracket the extra personal relief will give him a benefit of $ 120 (i.e. 0.12 x 1,000) in tax reduction; *but* to the taxpayer in the 55 percent tax bracket, it will bring him a benefit of $ 550 (i.e. 0.55 x 1,000) in tax reduction.

The granting of the $ 60 tax rebate will not apply to working wives who elect to be assessed separately on their employment income because presently a working wife qualifies for the higher personal relief deduction of $ 2,000 together with an earned income relief deduction and also the benefit of lower tax burden arising from separate assessment.

Based on the same method of rebate for the taxpayer, I propose to grant to a resident individual, other than a working wife who elects to be assessed separately on her employment income, a further tax rebate of $ 30 in respect of the non-working wife, or a working wife who does not elect to be assessed separately on her employment income.

This proposal will come into force for the year of assessment 1977 and subsequent years of assessment.

The above measures will result in the loss of revenue amounting to $ 17.4 million.

Development tax

At present under the Supplementary Income Tax Act, 1967, a person other than an individual, for example a company, will have to pay a minimum development tax of $ 100 or $ 250 or $ 500 according to the paid-up capital even if it does not make any profit, and in the case of a club or association, trust, estate of a deceased person or a Hindu joint family, it will have to pay a minimum development tax of $ 100. I propose that this minumum development tax should be abolished, and tax should be payable only when profit is made by the company or other relevant person. Where there is no profit no tax should be payable. Where income (i.e. profit) arises from the development source, either 5 percent thereof or the minimum development tax whichever is the greater will still be payable.

Development tax is now levied on individuals once their income from development source exceeds $ 3,000 or $ 2,000 in the case of a partner with a partnership source. In both cases they are taxed on every ringgit of the income without allowing any relief. Given a flat rate of 5 percent tax the absence of such relief means that those who are not liable to income tax are still caught with the liability to development tax and there is a greater burden for those with development income of just above $ 3,000 or $ 2,000 for a partner with a partnership source, particularly among the lower income group with income up to $ 8,000.

A perennial complaint on the imposition of the development tax comes particularly from the small growers in the agricultural sector and farmers. Since by definition income from agricultural activity or farm is included under business income, the levy of development tax has subjected the smallholders, farmers and other agricultural producers to the development tax. Unlike the estate sector which is run by companies, the smallholders are finding it difficult to obtain adequate income from their agricultural activity. The imposition of the new development tax as such becomes an additional burden to them apart from the fact that these people do not get a good bargain in the marketing of their produce.

In order to relieve the burden on the lower income group, I propose that, in respect of individuals only, income in excess of $ 3,000 or $ 2,000 for a partner with a partnership source be subject to development tax. Thus an individual with income of, say, $ 5,000 should only be taxed on $ 2,000 at the present rate of 5 percent. If he is a partner with a partnership source, the 5 percent development tax is payable on any income in excess of $ 2,000.

This proposal will come into force for the year of assessment 1977 and subsequent years of assessment and it will entail in the loss of revenue of $ 12.7 million.

Taxation of Cooperative Societies

Taxation of cooperative societies also needs to be reviewed in the light of the present situation.

For the years of assessment up to and including the year of assessment 1967 any cooperative society registered under any written law relating to the registration of cooperative societies was totally exempt from income tax. However, as from the year of assessment 1968 a cooperative society is exempt from tax only if the principal activities of the society consist of:—

(a) transactions with its members or other registered cooperative societies;
(b) marketing the produce or products of its members; or
(c) selling to its members goods purchased for the purpose of being so sold.

From this it will be seen that only cooperative societies who satisfy any of these three conditions are exempt from income tax. The current provisions and scheme of taxation applicable to cooperative societies are not entirely free from administrative difficulties. This is simply because of the fact that what necessarily is the principal activity of a cooperative society in one year, in view of developments, may not remain so in a subsequent year and may in fact turn out to be a subsidiary activity resulting in making some other activity as the principal activity in that subsequent year. Hence there is the possibility of a cooperative society being exempt from tax in one year but becoming liable to tax in another year, resulting in cumbersome administration. Each case has to be dealt with and reviewed annually in the light of its annual accounts. Further as cooperative societies embark in multifarious activities, the exemption based on the principal activity may render the income from various other activities, the sum total of which may even exceed the income from its principal activity alone, also exempt from tax. The present scheme and provisions therefore are liable to be abused. Hence a revision is necessary.

The Government of course realises that the cooperative movement, particularly those based on the principle of mutuality, needs to be encouraged in order to play a useful role in the economy. Many, through Government tax incentives, have since then succeeded to stand on their own feet and are able to earn substantial income.

I now propose that the existing tax exemption clause on income of cooperative in the Income Tax Act, 1967 be deleted. All cooperatives subject to certain exemptions to be mentioned, will now be subject to tax. However, in recognition of the fact that the cooperative movement is encouraged by the Government, the tax to be imposed will not be at the same level as that for companies. It is reasonable to expect that cooperatives should also contribute their share to meet the revenue needs of the nation.

It is proposed that the income of all cooperatives be taxed on the following rates:—

Chargeable income	*Rate of tax* (%)
For every dollar of first $10,000	5
For every dollar of next $10,000	7
For every dollar of next $10,000	10
For every dollar of next $10,000	14
For every dollar of next $10,000	20
For every dollar of next $25,000	23
For every dollar of next $25,000	27
For every dollar of next $50,000	30
For every dollar of next $100,000	34
For every dollar of next $250,000	37
For every dollar of next $500,000	40

Realising the various circumstances and problems surrounding existing and new cooperatives, the above tax proposed shall only apply subject to the following conditions:—

(a) a tax exempt period of five years from the date of registration to be allowed;
(b) after the five years, cooperatives having members' fund of $ 500,000 or less shall continue to be tax exempt;
(c) a deduction should be allowed against income up to a maximum of 25 percent of net income for contributions to statutory reserve fund required to be created under the Cooperative Societies Ordinance;
(d) excess profit tax and development tax shall not be levied on the income of cooperative societies;
(e) distribution of income made by cooperative societies shall not be taxed in the hands of the members and no credit shall be given to the members for the income tax paid by the cooperative society making the distribution.

The above provisions are intended to allow new cooperatives an inception period before they are subjected to tax in order to solve the problems of small cooperatives, and to meet the need to allow for untaxed working fund which is compulsory under cooperative law, and which will eventually be returned for public purpose in the event of liquidation.

Given the above provisions, only the large and profitable cooperatives will bear the imposition of the new tax and therefore the agricultural and fishermen's cooperatives would not likely be liable to this new tax. Given the 25 percent deduction from income prior to tax and the scale rates applicable, the tax burden on most cooperatives would, in effect, be much less than that falling on companies.

This proposal will come into force as from the year of assessment 1977 and is expected to yield an estimated $11.5 million.

Withholding tax on interest paid to non-residents

Presently interest derived from Malaysia by a non-resident on an approved loan is wholly exempt from tax. Approved loans are those made after 1st January 1972 for the purpose of financing development projects or for the purchase of capital equipment for development projects and formally approved for the purpose of this tax exemption. Any interest received by a non-resident on any other loans, deposits or other indebtedness is subject to a withholding tax at 15 percent on the gross amount of the interest.

In order to encourage and facilitate further flow of funds from abroad which I trust will help stimulate mobilisation of additional funds required for investment, I now propose to exempt the interest paid to non-residents for long-term deposits or loans from abroad of not less than 3 years made from 1st January 1977.

Gratuity received by employees

Gratuity received by an employee is taxable, but gratuity received on retirement due to ill health or on reaching the age of 50 in the case of a female employee and 55 in the case of a male employee is fully exempt from tax provided the employee

has completed 10 years service with the employer paying the gratuity. If the conditions for such exemption are not satisfied, the gratuity received by the employee at the instance of cessation of employment is taxable by spreading the amount of the gratuity for the period of the employment with the employer paying the gratuity or for a period of 5 years whichever is the shorter.

In paying gratuity on termination of employment the employer generally takes into consideration the whole service of the employee. Where the period of service is more than five years, I consider the spreading of the amount of gratuity for a period of only five years would be somewhat burdensome to the employee. I propose that the tax liability be spread out over a period of 10 years or the actual period of employment, whichever is the shorter. The 10-year period will still be within the time for raising additional assessements and will thereby ensure that the full amount of the gratuity is still taxable.

The proposed change in taxing gratuity paid on termination of employment will be effective as from the year of assessment 1977.

The estimated revenue loss for the reduction in the tax burden in respect of gratuity would be in the region of $ 3 million.

Pensions payable to retired employees

Related to the reduction in the tax on gratuity, I also propose to exempt pensions received by residents from income tax payment with effect from the year of assessment 1977. As Hon'ble Members are aware, majority of pensioners are retired Government employees. As there are only a few retired persons under pension schemes operated by private sector organisations, the exemption from income tax on pensions payable to retired persons will benefit mostly ex-Government employees. I would like to emphasize here that this exemption will be taken into account as one of the benefits granted by the Government in any revision of salaries of Government employees which may come about in the future.

The loss of revenue in giving exemption from income tax on pensions is estimated to be $ 3.3 million.

Accelerated Depreciation Allowance

Presently accelerated depreciation allowance in the form of increased intial allowance of 60 percent is given for timber extractions and to the tin industry. In order to encourage the establishment, modernisation and expansion of selected industries or activities, I now propose that accelerated depreciation allowance in the form of an annual allowance of 80 percent on plant and machinery (instead of the normal annual allowance at rates prescribed for various industries) be accorded to certain industries on a selective basis, particularly to agro-based, and resource based, food and other essential industries for expenditure incurred during the basis period for assessment years 1978, 1979 and 1980. This means that the economic activity expanded in 1977, 1978 and 1979 would qualify for this concession. The annual allowance of 80 percent is granted in lieu of the normal allowances prescribed in the Income Tax (Qualifying Plant Annual Allowance) Rules, 1968. The initial allowance of 20 percent however remains unchanged. This means that 100 percent or the entire amount of the capital cost of plant and machinery is allowed to be written off for tax purposes in one year. It is hoped that such accelerated depreciation allowance will provide incentive for some industries to be set up and for existing ones to modernise and expand their capacities for increased and more efficient production. This accelerated annual allowance will be granted to the following types of industries:

1. Slaughtering, preparing and preserving meat (including processing and packing activities and quick-freezing).
2. Pineapple canning (including pineapple juice).
3. Canning and preserving of fruits (other than pineapple) and vegetables, and their juices (including dehydrated and quick-frozen fruits and vegetables and canned soups).
4. Canning, preserving and processing of fish, crustacea and similar sea-foods (including fish and sea-food soups and specialities).
5. Manufacture of coconut oil (refined and unrefined).
6. Manufacture of sago and tapioca flour, tapioca flakes and chips, ragi and other products of sago and tapioca.
7. Manufacture of biscuits (including prawn crackers and ice cream cones).
8. Production of prepared feeds for animals and fowl (including dog and pet foods), mixed, canned, frozen and dried.
9. Manufacture of rubber products such as industrial and mechanical rubber goods, rubber specialities and sundries e.g. gloves, mats, sponges and other vulcanised articles etc. (excluding manufacture of tyres and tubes, and any other form of production, processing or manufacture of natural rubber).
10. Manufacture of structural clay products.
11. Manufacture of pottery, china and earthenware.
12. Foundries.
13. Manufacture of structural metal products.
14. Manufacture of brass, copper, pewter and aluminium products.
15. Manufacture of metal and wood working machinery.
16. Manufacture of special industrial machinery and equipment (except metal and wood working machinery) for specialised industries such as food machinery, textile machinery, paper industry machinery, chemical industry machinery, oil refining machinery etc.
17. Shipbuilding and repairing (including specialised marine engine and ship parts manufacture, conversion, alteration and breaking-up of ships).
18. Manufacture of professional, scientific, measuring and controlling equipment (including surgical, medical, orthopedic and optical instruments, radar equipment, X-ray and electric therapeutic apparatus).
19. Manufacture of wooden and cane containers and small cane ware.
20. Manufacture of furniture and fixtures (mainly of wood and other materials other than metal).

THE 1977 INCOME TAX CHANGES IN THE REPUBLIC OF SOUTH AFRICA

By Dr. Erwin Spiro

As it appears from the budget speech which Senator O.P.F. Horwood, the Minister of Finance, delivered on March 30, 1977, there will generally be no increase this year in income tax or loan levy on individuals or on companies. There are, however, certain concessions designed to encourage saving and the provision of housing for employees. The following changes may be mentioned.

Taxation of agricultural co-op societies
Co-operatives will be liable for tax in respect of tax years beginning on or after April 1, 1977. The normal rules for the determination of the taxable income of ordinary companies now also apply to agricultural co-operatives, but having regard to the particular operational circumstances of these co-operatives some adjustments have been provided for.

In the first instance, surpluses of agricultural co-operatives which are declared, in whatever form except dividends, to members within six months of the close of the financial year, will be allowed as a deduction for tax purposes. As at present, the distribution will, on allocation, be taxable in the hands of the recipients.

In the second instance, as in the case of industrial undertakings in prescribed circumstances, co-operatives will be granted a building investment allowance and an annual allowance in respect of factory buildings and buildings used for the storage of agricultural products of producers.

In the third instance, as a bridging measure, agricultural co-operatives, in determining their taxable income, will be permitted, for the first ten years, to deduct repayments of loans which the Secretary for Inland Revenue is satisfied were raised to provide facilities for the storage or primary processing of the products of their members.

Oil mining
It is proposed to increase the maximum rate of the normal tax which will eventually be payable by oil mining companies. The reason for the increase is to bring the rates into line with those of other countries who also increased their rates as a result of the energy crisis. Particulars will be discussed below (Companies (v)).

Pension and retirement annuity funds
The maximum deduction in respect of current contributions to a pension fund will be increased from R 1,500.00 to R 1,750.00 per annum and to a retirement annuity fund from R 3,000.00 to R 3,500.00. Whereas arrear pension contributions are not at present deductible, a maximum deduction of R 1,000.00 per annum will now be allowed in this respect. The maximum exemption in respect of lump sum payments from pension, provident and retirement annuity funds will be increased from R 40,000.00 to R 45,000.00.

Housing allowance
Employers (other than farmers and mining companies where other provisions apply) are at present allowed to deduct 25 percent of expenditure on housing for their employees up to a maximum of R 2,500.00 per dwelling. In order to encourage employers to provide such housing the maximum will be increased to R 3,000.00.

Insurance premiums, medical expenses
Primarily in order to encourage saving and the making of adequate provision for old age, and also because of the rising cost of medical services, the maximum combined abatement for insurance premiums and medical expenses will be, subject, however, to the conditions applying to all abatements, increased from R 700.00 to R 1,000.00 for a married person and from R 600.00 to R 750.00 for an unmarried person.

Rates of income tax (normal tax)
Apart from oil mining companies there have been no changes in the rates, including surcharge and loan levy, and the position is as follows.

Persons other than companies
Persons other than companies are, in respect of the year of assessment ending February, 1978 or June 30, 1978, subject to the tax at the rates contained in the two tables annexed to this article. Provided the basic tax is R 150.00 or more, there is added a surcharge of 10 percent. In the case of a natural person who is over sixty years of age on the last day of the year of assessment and whose taxable income for that year is R 5,000.00 or less the surcharge is not payable at all. There is also a loan levy of 10 percent which is subject to the same conditions as the surcharge. The basic tax is in each instance calculated on the taxable amount, that is the amount remaining after deducting from taxable income the abatements applicable.

Due regard being had to the surcharge of 10 percent and the loan levy of 10 percent, the maximum marginal rate is 72 percent.

Companies
The rates for companies in respect of taxable income derived in the Republic of South Africa and taxable income derived in South-West Africa for the year of assessment, that is the financial year ending during the twelve-month period from April 1, 1977, to March 31, 1978, are as follows:

(i) *taxable income derived otherwise than from mining:* if derived in South-West Africa 35 cents per R 1 and if derived elsewhere than in South-West Africa — that is in the Republic of South Africa — 40 cents per R 1. A surcharge of 7½ percent of such tax and a loan portion of 15 percent thereof are to be added to such tax. The effective rate is thus 42.875 and 49 cents per R 1, as the case may be.

(ii) *taxable income derived from gold mining:*
(a) on any mine other than a post-1966 gold mine an amount determined in accordance with one of the formulae laid down plus a surcharge (which is not payable in respect of certain assisted gold mines) equal to 10 percent of the said amount and a loan portion equal to 15 percent thereof;
(b) on a post-1966 gold mine an amount determined in accordance with one of the formulae laid down plus a surcharge of 10 percent of the said amount and a loan portion of 15 percent thereof;
(c) in the form of excess recoupments over capital expenditure accruing to companies which are or have been gold mining companies the average rate of tax as determined in accordance with the Act or 35 cents per R 1 whichever is higher.

(iii) *taxable income derived from mining for diamonds:* 45 cents per R 1 plus a surcharge of 10 percent of such amount and a loan portion of 15 percent thereof.

(iv) *taxable income derived from mining operations other than mining for gold or diamonds:* the position is the same as in the case of a non-mining company (see (i) above).

(v) *taxable income derived from mining for natural oil:* since 1967 up to the present, but without the rates being subject to annual fixations, if derived from mining for natural oil (excluding gas) 50 cents per R 1 and if derived from mining for natural oil in the form of gas 40 cents per R 1, subject, however, to a reduction of the normal tax to or by such an amount as the Minister of Mines, in consultation with the Minister of Finance, may determine. Where sulphur, salt or any other mineral is won in the

course of mining for natural oil, the income derived from the mining of such sulphur, salt or other mineral is deemed to be derived from mining for natural oil. In addition to such tax there will be now payable, in respect of taxable income derived from mining for natural oil (excluding gas) won during any year of assessment ending on or after April 1, 1977, by way of additional normal tax, an amount equal to forty percent of the amount remaining after deducting the said amount of normal tax from such taxable income, subject, however, to a reduction to or by such an amount and on such conditions, as the Minister of Mines, in consultation with the Minister of Finance, may determine.

ANNEXURES / Table I

Taxable amount		Rates of tax in respect of married persons
Where the taxable amount — does not exceed R 1,000		9 percent of each R 1 of the taxable amount;
exceeds	but does not exceed	
R 1,000	R 2,000	R 90 plus 10 percent of the excess over R 1,000;
R 2,000	R 3,000	R 190 plus 10 percent of the excess over R 2,000;
R 3,000	R 4,000	R 290 plus 11 percent of the excess over R 3,000;
R 4,000	R 5,000	R 400 plus 12 percent of the excess over R 4,000;
R 5,000	R 6,000	R 520 plus 14 percent of the excess over R 5,000;
R 6,000	R 7,000	R 660 plus 16 percent of the excess over R 6,000;
R 7,000	R 8,000	R 820 plus 18 percent of the excess over R 7,000;
R 8,000	R 9,000	R 1,000 plus 20 percent of the excess over R 8,000;
R 9,000	R 10,000	R 1,200 plus 22 percent of the excess over R 9,000;
R 10,000	R 11,000	R 1,420 plus 24 percent of the excess over R 10,000
R 11,000	R 12,000	R 1,660 plus 26 percent of the excess over R 11,000;
R 12,000	R 13,000	R 1,920 plus 28 percent of the excess over R 12,000;
R 13,000	R 14,000	R 2,200 plus 30 percent of the excess over R 13,000;
R 14,000	R 15,000	R 2,500 plus 32 percent of the excess over R 14,000;
R 15,000	R 16,000	R 2,820 plus 34 percent of the excess over R 15,000;
R 16,000	R 17,000	R 3,160 plus 36 percent of the excess over R 16,000;
R 17,000	R 18,000	R 3,520 plus 38 percent of the excess over R 17,000;
R 18,000	R 19,000	R 3,900 plus 40 percent of the excess over R 18,000;
R 19,000	R 20,000	R 4,300 plus 42 percent of the excess over R 19,000;
R 20,000	R 21,000	R 4,720 plus 44 percent of the excess over R 20,000;
R 21,000	R 22,000	R 5,160 plus 46 percent of the excess over R 21,000;
R 22,000	R 23,000	R 5,620 plus 48 percent of the excess over R 22,000;
R 23,000	R 24,000	R 6,100 plus 50 percent of the excess over R 23,000;
R 24,000	R 25,000	R 6,600 plus 52 percent of the excess over R 24,000;
R 25,000	R 26,000	R 7,120 plus 54 percent of the excess over R 25,000;
R 26,000	R 27,000	R 7,660 plus 56 percent of the excess over R 26,000;
R 27,000	R 28,000	R 8,220 plus 58 percent of the excess over R 27,000;
R 28,000		R 8,800 plus 60 percent of the excess over R 28,000.

Rates of other taxes contained in the Income Tax Act

Non-resident shareholders' tax
The non-resident shareholders' tax is 15 percent of the amount of the dividend or interim dividend in question.

Undistributed profits tax
The undistributed profits tax is 33 1/3 cents on every R 1 by which the distributable income as defined exceeds the amount of dividends distributed during the specified period as defined.

Non-residents tax on interest
The non-residents tax on interest is 10 percent on the amount of the interest in question.

Donations tax
The donations tax is at progressive block rates, the block exceeding R 90,000.00 being taxable at the rate of 25 percent.

Table II

Taxable amount		Rates of tax in respect of persons who are not married persons
Where the taxable amount — does not exceed R 1,000		12 percent of each R 1 of the taxable amount;
exceeds	but does not exceed	
R 1,000	R 2,000	R 120 plus 12 percent of the excess over R 1,000;
R 2,000	R 3,000	R 240 plus 13 percent of the excess over R 2,000;
R 3,000	R 4,000	R 370 plus 14 percent of the excess over R 3,000;
R 4,000	R 5,000	R 510 plus 17 percent of the excess over R 4,000;
R 5,000	R 6,000	R 680 plus 20 percent of the excess over R 5,000;
R 6,000	R 7,000	R 880 plus 23 percent of the excess over R 6,000;
R 7,000	R 8,000	R 1,110 plus 26 percent of the excess over R 7,000;
R 8,000	R 9,000	R 1,370 plus 28 percent of the excess over R 8,000;
R 9,000	R 10,000	R 1,650 plus 30 percent of the excess over R 9,000;
R 10,000	R 11,000	R 1,950 plus 32 percent of the excess over R 10,000;
R 11,000	R 12,000	R 2,270 plus 34 percent of the excess over R 11,000;
R 12,000	R 13,000	R 2,610 plus 36 percent of the excess over R 12,000;
R 13,000	R 14,000	R 2,970 plus 38 percent of the excess over R 13,000;
R 14,000	R 15,000	R 3,350 plus 40 percent of the excess over R 14,000;
R 15,000	R 16,000	R 3,750 plus 42 percent of the excess over R 15,000;
R 16,000	R 17,000	R 4,170 plus 44 percent of the excess over R 16,000;
R 17,000	R 18,000	R 4,610 plus 46 percent of the excess over R 17,000;
R 18,000	R 19,000	R 5,070 plus 48 percent of the excess over R 18,000;
R 19,000	R 20,000	R 5,550 plus 50 percent of the excess over R 19,000;
R 20,000	R 21,000	R 6,050 plus 52 percent of the excess over R 20,000;
R 21,000	R 22,000	R 6,570 plus 54 percent of the excess over R 21,000;
R 22,000	R 23,000	R 7,110 plus 56 percent of the excess over R 22,000;
R 23,000	R 24,000	R 7,670 plus 58 percent of the excess over R 23,000;
R 24,000		R 8,250 plus 60 percent of the excess over R 24,000.

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Handbook providing an extensive comment on the history, the theory, the case law, the civil and fiscal law aspects of the concept "Organschaft" in the German Corporate Income Tax Law. A special chapter on the importance of the "Organschaft" under the Corporate Income Tax Reform Law is included. (B. 100.235)

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INDIA

Taxation and Government's Savings.

by G. Thimmaiah *

The need for increasing the average as well as the marginal savings rates to quicken the pace of economic development of underdeveloped countries can hardly be exaggerated. On this point at least there seems to be a consensus among economists irrespective of their allegiance to different schools of thought and ideologies. Several policy designs have been suggested by economists for achieving higher rates of savings in underdeveloped countries. Of these suggestions, those related to increasing the total domestic savings through fiscal measures are very prominent. But there is a divergence of opinion regarding specific fiscal policy measures to increase savings in these countries. One opinion is that these countries should try to promote savings through exempting savings from taxation. This opinion is backed by the traditional argument that savings are dependent on disposable income and, therefore, the higher the income, the higher the MPS (marginal propensity to save), and vice versa. From this it follows that if the Government wants to encourage private saving it must exempt savings from taxation, particularly from direct taxation, e.g. income tax. This suggests two tax policy designs: (1) the selective exemption of desirable savings from direct taxes, (2) the non-selective exemption of all types of savings. The second policy design implies: (a) a Fisherian type of income tax where taxable income is defined to include only consumption, (b) a Kaldorian type of expenditure tax, and (c) indirect taxes including excise duties, a sales tax, a turnover tax, etc. But the tax principle which emerges from these alternative tax designs to encourage private savings through tax incentives is regressive. The reliability of this line of argument has been questioned, however, by Richard Goode. [1]

The second opinion is that these countries should increase government savings by resorting more to indirect taxes with a view to taxing a majority of the people. It is maintained that because of the general poverty of the masses and the relatively negligible portion of rich people in underdeveloped countries, direct taxes based on the progressive taxation principle with the usual minimum exemption limit cannot cover many people and hence cannot yield an increasing amount of tax revenue to the Government. Therefore, it is recommended that in order to reach a greater number of people through taxation it is necessary to levy taxes on goods and services consumed by large numbers of people. This invariably calls for a sales tax, excise duties, etc. on commodities and services of mass consumption. Besides, it is argued that the payment of taxation entails the use of money. This spreads the extent of monetization which in turn quickens the pace of development by changing the attitude of the people with respect to the earning and spending of money income. An effective way of increasing the extent of monetization is by making as many people as possible pay taxes. This can be achieved by resorting to the taxation of commodities of mass consumption. Further it is maintained that in underdeveloped countries almost all income groups of the society who are operating within the monetary economy are affected by the national and international demonstration effects. These effects push up their average as well as their marginal consumptions. Most of this consumption would be non-essential in nature. Therefore, it is necessary to curb such misdirected consumption by levying high rates of commodity and service taxes and by augmenting government savings. Furthermore, it is argued that in underdeveloped countries governments have been incurring expenditures on free medical services, educational facilities, road development and other social and economic infrastructure facilities which are enjoyed by the masses. Therefore, it is recommended that the only way to make them contribute to development efforts and to make them feel like partners of development efforts is to levy indirect taxes on commodities and services which are consumed by the majority of the people.

The third opinion is that both direct and indirect taxes should be used to reduce the incremental consumption and divert it to public sector savings, thereby increasing the total domestic savings in the economy. [2] *The logic of this argument is that the Government should use steeply progressive taxation and higher rates of indirect taxes to divert the increased income from the non-essential consumption of both upper and lower income groups. This will not lower the savings rate of the private sector since the savings rate of the upper income groups in these countries is not very high because of the operation of the national and international demonstration effects, and the savings of the lower income groups are lower because of both low income and the operation of the demonstration effect. The traditional view that the rich people save more as their income increases does not hold true in underdeveloped coun-*

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1. "Taxation of Saving and Consumption in Underdeveloped Countries", *National Tax Journal*, December 1961, pp. 305-322.
2. See for details, R.J. Chelliah, *Fiscal Policy in Underdeveloped Countries.* George Allen & Unwin (India), 2nd edition, Bombay, 1969, Chapter IV.

tries, primarily because the upper income groups are not as savings-minded as their counterparts in developed countries were in the early stage of their economic development.

Finally, there is the radical view which maintains that in underdeveloped countries it is necessary to expand the public sector even at the expense of the private sector not only as a means of achieving a rapid rate of economic development but also as a means of developing the economy in the socially desired direction. It is maintained that if the private sector is encouraged to undertake investments, on the basis of profit motivations, in whatever field of economic activity it desires, a major portion of the national investment may tend to go to luxury and other socially undesirable fields of activity. Therefore, the Government should try to encourage the expansion of the public sector by diverting the savings from the private sector to the public sector, mainly through taxation. According to this point of view, "taxation, therefore, remains as the only effective financial instrument for reducing private consumption and investment and transferring resources to the Government for economic development". [3]

Relation between taxation and savings

It becomes clear from the foregoing description that the relationship between taxation and savings is assumed to be direct and simple. It is believed that taxation reduces the disposable income of all the sectors of society and thereby reduces their conspicuous consumption. The resultant taxation prevents the incremental income from going to incremental consumption in the case of the upper, middle and even the lower income groups and thereby enhances the public sector savings. As there is a possibility that the higher taxation of upper income groups might reduce their savings, which form a major part of household and corporate savings, economists are not sure of the effect of the steeply progressive taxation of income, wealth, assets and so on. However, the logic in regard to the relationship between indirect taxation and savings seem to be very clear, namely that such taxation reduces consumption and increases the public sector savings.

An important aspect which is ignored in this kind of discussion is the impact of high taxation on consumption by the Government. It has been maintained by Stanley Please [4] that when governments raise more revenue, the normal tendency is to increase their expenditures on defence and on current consumption. In this context, therefore, increased public revenue through increased taxation will only reduce the total domestic savings by encouraging the governments to increase their consumption expenditures. In other words, Mr. Please has maintained that increased taxation by itself will not ensure increased government savings because of the possibility of increasing the government's non-productive expenditures. This point of view is similar to that of Mr. Northcote Parkinson [5] who has sarcastically observed that when governments find more revenue the only economy they make is in thinking how to spend it. Therefore, it is quite possible that increased taxation resulting in increased public revenue might make the governments complacent about any economy in expenditures and as a result it might increase the consumption expenditure of the governments in underdeveloped countries. This possibility must be examined in order to establish that additional taxation will promote savings in underdeveloped countries.

Furthermore, for the purpose of analysing the impact of taxation on savings it is not sufficient if we study only the relationship between taxation and government savings. It is also necessary to study the interconnections between taxation and government savings, taxation and government consumption, taxation and household savings, taxation and private consumption, taxation and corporate savings, and, finally, taxation and total domestic savings. The logical (*a priori*) relations can be established in the following way:

If the taxation and government savings vary directly, it means taxation and private consumption vary inversely and/or taxation and government consumption vary inversely. This would leave the private savings unaffected. If the taxation and household savings vary directly and taxation and private consumption vary inversely, taxation and total savings should vary directly. However, it is quite possible that taxation and private consumption, and taxation and household and corporate savings may vary inversely so as to increase the government savings or offset any increase in government consumption. Similarly, taxation and private consumption may vary inversely and taxation and private savings may vary inversely also, but taxation and government savings may vary directly so as to increase the total savings. If the taxation and government savings vary directly, this may be due to a reduction in Government consumption and/or a reduction in private consumption. Hence, taxation should vary inversely with government consumption and/or private consumption. However, the positive relation between taxation and government savings might be the result of the negative relation between the taxation and household and/or corporate savings keeping the consumption of the government and/or private sector constant or rising. In other words taxation and government savings may vary directly but taxation and household and/or corporate savings may vary inversely, while at the same time taxation and government and/or private consumption may vary directly also. These behaviour relations may or may not show a positive relation between taxation and total domestic savings depending upon the magnitude of variations in the savings

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3. "Taxation and Economic Development in Asian Countries", *Economic Bulletin for Asia and the Far East*, November 1953, p. 3.
4. "Saving Through Taxation — Reality or Mirage?" *Fund and Bank Review: Finance and Development*, March 1967.
5. *The Law and the Profits*. John Murray, London, 1960, p. 1.

and consumption of the government, household and corporate sectors. Therefore, in order to know the influence of taxation on government savings and on total domestic savings, we need to know the relation between taxation and government consumption, and household and corporate savings and consumption. Further the influence of direct taxes on household and corporate savings and on private consumption must be examined separately in order to test the earlier mentioned views about their particular type of association as well as to suggest tax policy designs for increasing total domestic savings.

Taxation and savings in India

In India the taxation policy has been designed by the Government of India and to some extent by the State Governments to increase the Government revenues. The Five Year Plan documents [6] very clearly declare the policy of the Government in regard to the mobilization of financial resources through additional taxation. As a result, the country has resorted to additional taxation measures which include: (1) the introduction of new taxes, (2) the extension of old taxes to new tax bases by reducing exemptions and by increasing the coverage and (3) increasing the tax rates. As a result of all these measures, the ratio of tax revenue to GNP has increased gradually though slowly. For instance the ratio of tax revenue to GNP which was only about 6 percent in 1950-51 has increased to 15 percent in 1972-73 as shown in Table 1. However, in recent years doubts have been expressed as to whether this increased resource mobilization through additional taxation has really generated additional savings in the economy at all. It has been observed by Narottam Shah that "In the early years after independence, a bold effort at resource mobilization by a Finance Minister was always regarded as something highly creditable for two reasons. First, all responsible people appreciated the great need for augmenting public resources for economic development. Secondly, everyone understood that any Finance Minister who dares to risk unpopularity by raising resources — particularly through non-inflationary methods like taxation — deserves high admiration for his courageous service to the nation. But of late it has become difficult to be enthusiastic about the efforts at resource mobilization, however bold they might be. Rather the time has now come to ask the pointed question: Resource mobilization for what? This question has to be asked because the experience of recent years indicates that the nation has not much to gain from resource mobilization by the Government". [7] This doubt has been the outcome of two reasons: (1) the unimpressive increase in the national savings rate, and (2) the unprecedented increase in the non-developmental expenditures. In addition to these two reasons, the increasing number of reported cases of public corruption and wastage of public funds have added credibility to the belief that additional taxation might not have resulted in additional savings in the economy. In this connection, however, reliable empirical studies have been lacking though not totally absent. Perhaps one of the earliest attempts to study the influence of taxation on government savings was made by Ramesh K. Diwan [8] by using linear regression analysis. He has found that during the period between 1950-51 and 1962-63, current tax revenue exerted a significant positive influence on government savings. Also, K. Krishnamurthy [9] made a study of the influence of taxation, income and prices on government savings in India. He has studied the impact of taxation on the marginal saving ratio by regressing the marginal saving ratio on the rate growth of income, rate of increase in prices and the marginal tax ratio. He has used both time series and cross-section analysis for the period of ten years from 1951 to 1961 excluding 1957. As indirect evidence he also found the influence of the marginal rate of taxation on total and private consumption. His study reveals a high association between taxation and savings in India. In his own words, "The results for India revealed significant negative association of tax rate with the marginal rates of private and total consumption and hence, a positive link to the saving rate. Inclusion of other variables did not alter the result of the tax variable." [10]

Another study by S.K. Singh [11] is related to taxation

Table I

Tax Revenue in Relation to GNP in India

Year	Percent of total tax revenue to GNP	Percent of direct taxes revenue to GNP	Percent of indirect taxes revenue to GNP
1950-51	6.0	2.0	4.0
1951-52	7.0	2.0	5.0
1955-56	8.0	2.5	5.5
1956-57	8.0	2.0	6.0
1960-61	9.0	2.0	7.0
1961-62	10.0	3.0	7.0
1962-63	11.0	3.0	8.0
1963-64	12.0	3.0	9.0
1964-65	11.0	3.0	8.0
1965-66	12.0	3.0	9.0
1966-67	12.0	3.0	9.0
1967-68	11.0	3.0	8.0
1968-69	11.0	2.0	9.0
1969-70	11.0	2.0	9.0
1970-71	12.0	3.0	9.0
1971-72	12.0	3.0	10.0
1972-73	15.0	3.5	11.5

6. See for instance: (a) *Second Five Year Plan*, Government of India, Planning Commission, New Delhi, 1956, Ch. IV; (b) *Third Five Year Plan*, Government of India, Planning Commission, New Delhi, Ch. VI; and (c) *Fourth Five Year Plan*, 1969-1974, Government of India, Planning Commission, New Delhi, 1969, Ch. IV.
7. "Unconvincing Promises", *Commerce, Union Budget, 1974-75: A survey*, March 8, 1975, p. 9.
8. "Are we Saving Enough for our Plans"?, *Economic and Political Weekly*, Vol. II, Nos. 3-5, February 1967, pp. 292-302.
9. "Savings and Taxation in Developing Countries: An Empirical Study", *IBRD Working Paper No. 23*, August 28, 1968.
10. *Ibid.*, p. 10.
11. "The Determinants of Aggregate Savings", *IBRD Working Paper No. 127*, March 1972.

and savings in India but it is only a part of his major study of the determinants of aggregate savings. He has used taxation as one of the determinants of savings and estimated its influence on both savings and marginal rates of government savings in 54 underdeveloped countries including India. According to him, "... while on the average the Government saves 10 percent out of its taxes at the margin, in countries around the development level of $100 of per capita income, it saves 16 percent out of the extra dollar. Thus advocates of increasing the overall saving rate by taxation get mild support. The increasing tax rate would increase the overall savings rate in the economy but very slowly indeed. Thus taxes would have to be increased by about 6 percent of the GNP in LDCs for governments to save an additional 1 percent of GNP". [12] He has also tested Please's hypothesis and found that the weaker version of the hypothesis is confirmed in underdeveloped countries. But in Singh's study India is included in the aggregate of 46 underdeveloped countries and as a result it is not singled out for an in-depth study as in the case of Krishnamurthy's study. Krishnamurthy's study is no doubt based upon both time series and cross-section analyses, but it refers to a period during which additional taxation was not resorted to by the government on any large scale. This is also the case with Diwan's study. It can be observed here that the most important innovations in taxation in India were implemented during the Second Five Year Plan and they reached the productive stage of yielding revenue towards the end of the Third Five Year Plan. Moreover, neither Krishnamurthy nor Diwan examined the influences of direct and indirect taxes on savings separately. Such an examination is necessary from the point of view of testing the opinions about taxation and savings mentioned earlier as well as for suggesting specific tax policy designs for increasing aggregate savings.

Other than those two studies some attempts have been made to study taxation and government savings together in underdeveloped countries. For instance, Elliot R. Morss [13] has found a significant relation between taxation and savings through indirectly relating taxation and private and total consumption. Professor Houthakker has studied the influence of the total revenue of the government on its savings in both developed and developing countries by using cross-section analysis. He has found that the governments with low revenues saved relatively more. [14] However, both these studies exclude India. Professor J.G. Williamson [15] has made a study of the determinants of household savings in Asian countries including India. He has found that direct taxes do not affect real household savings in the short-run though they do reduce real household savings in the long-run.

Data and methodology

This study is intended to find out the extent of the influence of taxation on government savings in India covering a period of thirteen years from 1960-61 to 1972-73. It is based on the data published by the Central Statistical Organisation [16] in its recent publication. Though the data regarding savings and national income are not reliable in India, in recent years the Central Statistical Organisation has tried to improve the quality of these data and I have used these data in this study. For the purpose of reliability of the data, I have taken the net as well as gross household savings, NNP and GNP and taxation data at current prices from the same source. However, I have used the wholesale price index prepared by the Economic Adviser. It would have been appropriate to use the all India cost of living index in order to find out the impact of inflation on savings. But in the absence of such an index, and instead of using the available cost of living index of urban non-manual workers or of industrial workers who constitute a very minor portion of the people, I have used the index of wholesale prices by shifting its base to 1960-61. For the purpose of estimating the influence of inflation on corporate savings I have used the index of prices of manufactured goods only, by separately working it out based on the break-ups given by the Economic Adviser. Further, I have used the interest rate which is an average of the rates on one year fixed deposits. This rate fairly indicates the movement of interest rates in the economy as far as the organised sector of banking is concerned.

In this study I have used linear multiple regression analysis to estimate the extent of the influence of taxation on Government, household, and corporate savings. It is a well known fact that the household savings of a country are influenced by many economic and non-economic factors. However, I have selected only some important economic determinants of household savings for the purpose of this study. I related household savings to direct tax revenue, indirect tax revenue, per capita income, rate of growth of income, the wholesale price index and interest rates. It is necessary to mention here that I am only interested in the influence of taxation on savings, and other important economic determinants of savings are taken into account in the regression with a view to determining the relative influence of taxation on savings when it is operating along with other important factors.

I have tested the nature and extent of the influence of direct and indirect taxation on marginal savings. The justification for focusing the attention only on marginal savings should be obvious. Tax measures have been used to divert an increasing portion of the national income to savings. In order to investigate whether taxation has achieved this objective or not, it is only appropriate to

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12. *Ibid.*, p. 32.
13. "Fiscal Policy, Savings and Economic Growth in Developing Countries: An Empirical Study", *Finanzarchiv*, Vol. 28, 1969, pp. 460-464.
14. "On some Determinants of Saving in Developed and Underdeveloped Countries", in *Problems in Economic Development* (ed.), E.A.G. Rabinson, MacMillan & Co. London, 1965, pp. 220-225.
15. "Personal Saving in Developing Nations: An Intertemporal and cross-section from Asia", *The Economic Record*, June 1968.
16. *National Income Statistics, 1960-61 to 1972-73*, Department of Statistics, Ministry of Planning, Government of India, New Delhi, January 1975.

study the relation between marginal tax revenue and marginal savings. Further, I have used both gross and net marginal savings, although it is the net savings which really matter in increasing the pace of economic development. Finally, I have tested the influence of marginal tax revenue on marginal savings with as well as without a time lag. In order to verify indirectly the results obtained through regressing marginal savings on marginal tax revenue, I have also tested the extent of the restraining influence of taxation on the consumption of the Government and the private sector.

Taxation and government savings

Here Government savings refer to marginal net as well as gross Government savings, including savings of the Government departments, departmental public undertakings, and public corporate savings. I have included in the regression estimates the marginal Government consumption ratio as an indirect verification, and have excluded the interest rate since it is irrelevant. The results are:

Table 2

Relative shares of Government savings, household savings and Private Corporate Savings in the total domestic savings of the country

Year	Net Govt. Savings as % of net domestic savings	Net household savings as % of net domestic savings	Net private corporate savings as % of net domestic savings	Net domes-savings as % of NDP (at factor cost)
1960-61	23.33	68.06	8.61	9.3
1961-62	28.40	61.28	10.32	8.4
1962-63	26.44	64.48	9.08	9.5
1963-64	29.50	62.24	8.26	9.8
1964-65	30.18	64.59	5.23	9.2
1965-66	23.08	72.99	3.93	11.2
1966-67	19.98	76.37	3.65	11.9
1967-68	12.34	85.01	2.65	9.3
1968-69	15.90	81.58	2.52	10.4
1969-70	15.90	80.48	3.62	11.5
1970-71	17.40	78.09	4.51	12.4
1971-72	18.94	75.60	5.46	10.4
1972-73	15.83	80.45	3.72	11.6

$$\left(\frac{\Delta NGS}{\Delta NNP}\right)_t = \underset{}{0.52842} \underset{(-0.89816)}{-0.71885}\left(\frac{\Delta Td}{\Delta NNP}\right)_t \underset{(-1.90024)}{-1.08658}\left(\frac{\Delta Ti}{\Delta NNP}\right)_t \underset{(0.81111)}{+0.3039}\left(\frac{\Delta NNP}{\Delta P}\right)_t \underset{(-1.78246)}{-4.83852}\left(\frac{\Delta NNP}{NNP}\right)_t$$

$$\underset{(0.28797)}{+0.18942}\left(\frac{\Delta Pw}{Pw}\right)_t \underset{(1.48473)}{+0.37252}\left(\frac{\Delta Gc}{\Delta NNP}\right)_t \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots (1)$$

$\bar{R}^2 = 0.1037$; F-value = 1.05451

$$\left(\frac{\Delta NGS}{\Delta NNP}\right)_t = \underset{}{0.03517} \underset{(0.84919)}{+0.53446}\left(\frac{\Delta Td}{\Delta NNP}\right)_{t-1} \underset{(-0.17966)}{-0.06880}\left(\frac{\Delta Ti}{\Delta NNP}\right)_{t-1} \underset{(-0.49168)}{-0.01697}\left(\frac{\Delta NNP}{\Delta P}\right)_{t-1}$$

$$\underset{(0.36739)}{+0.73644}\left(\frac{\Delta NNP}{NNP}\right)_{t-1} \underset{(-2.77426)}{-3.27766}\left(\frac{\Delta Pw}{Pw}\right)_{t-1} \underset{(2.70517)}{+0.86436)}\left(\frac{\Delta Gc}{\Delta NNP}\right)_{t-1} \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots (2)$$

$\bar{R}^2 = 0.4118$; F-value = 1.60082

$$\left(\frac{\Delta GGS}{\Delta GNP}\right)_t = \underset{}{0.48629} \underset{(-1.34191)}{-1.06026}\left(\frac{\Delta Td}{\Delta GNP}\right)_t \underset{(-2.27757)}{-1.48013}\left(\frac{\Delta Ti}{\Delta GNP}\right)_t \underset{(-1.16351)}{-0.04110}\left(\frac{\Delta GNP}{\Delta P}\right)_t \underset{(-1.73440)}{-1.94227}\left(\frac{\Delta GNP}{GNP}\right)_t$$

$$\underset{(0.31551)}{+0.17635}\left(\frac{\Delta Pw}{Pw}\right)_t \underset{(1.62068)}{+0.76600}\left(\frac{\Delta Gc}{\Delta GNP}\right)_t \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots (3)$$

$\bar{R}^2 = 0.4075$; F-value = 2.63517

$$\left(\frac{\Delta GGS}{\Delta GNP}\right)_t = \underset{}{0.40087} \underset{(-0.33239)}{-0.42596} \left(\frac{\Delta Td}{\Delta GNP}\right)_{t-1} \underset{(1.26126)}{+1.54333} \left(\frac{\Delta Ti}{\Delta GNP}\right)_{t-1} \underset{(-0.10744)}{-0.00742} \left(\frac{\Delta GNP}{\Delta P}\right)_{t-1}$$

$$\underset{(0.94521)}{+2.07356} \left(\frac{\Delta GNP}{GNP}\right)_{t-1} \underset{(-1.63367)}{-3.47612} \left(\frac{\Delta Pw}{Pw}\right)_{t-1} \underset{(-1.79276)}{-1.37638} \left(\frac{\Delta Gc}{\Delta GNP}\right)_{t-1} \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots (4)$$

$$\bar{R}^2 = 0.2639; \qquad \text{F-value} = 0.70451$$

Where:

NGS	=	net government savings at current prices
GGS	=	gross government savings at current prices
NNP	=	net national product at current prices
GNP	=	gross national product at current prices
Td	=	revenue from direct taxes
Ti	=	revenue from indirect taxes
P	=	population of the country
Pw	=	wholesale price index with 1960-61 as a base
Gc	=	government consumption expenditure at current prices
$\bar{R}^2$	=	adjusted coefficient of multiple determination
Δ	=	change in the relevant variable in the fiscal year indicated
t	=	current fiscal year
t-1	=	previous fiscal year
***	=	t - coefficient (shown in parentheses) is significant at 10 percent level
**	=	t - coefficient significant at 5 percent level
*	=	F-value significant at 5 percent level.

The foregoing results indicate that both direct and indirect taxation exerted a negative influence on marginal net as well as on gross government savings but the negative influence of indirect taxation is significant only in the non-lagged relations. The adjusted coefficients of multiple determination are also significant for these relations. However, it would be rewarding to probe further and find out the influence of taxation on marginal Government consumption before we come to any conclusion regarding the influence of taxation on marginal Goverment savings.

Taxation and Government consumption

The following are the results of the regression between marginal government consumption and marginal tax revenue and other relevant independent variables:

$$\left(\frac{\Delta Gc}{\Delta GNP}\right)_t = \underset{(1.60486)}{-0.12804} \underset{}{+0.91615} \left(\frac{\Delta Td}{\Delta GNP}\right)_t \underset{(3.89149)}{+1.16365} \left(\frac{\Delta Ti}{\Delta GNP}\right)_t \underset{(-0.18105)}{-0.0051} \left(\frac{\Delta GNP}{\Delta P}\right)_t \underset{(+1.29069)}{1.10453} \left(\frac{\Delta GNP}{GNP}\right)_t$$

$$\underset{(-1.68385)}{-0.66994} \left(\frac{\Delta Pw}{Pw}\right)_t \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots (5)$$

$$\bar{R}^2 = 0.8602; \qquad \text{F-value} = 14.29262$$

$$\left(\frac{\Delta Gc}{\Delta NNP}\right)_t = \underset{}{-0.15745} \underset{(2.65142)}{+1.07761} \left(\frac{\Delta Td}{\Delta NNP}\right)_t \underset{(5.43000)}{+1.27673} \left(\frac{\Delta Ti}{\Delta NNP}\right)_t \underset{(1.55665)}{+0.03301} \left(\frac{\Delta NNP}{\Delta P}\right)_t$$

$$\underset{(5.43000)}{-0.28795} \left(\frac{\Delta NNP}{NNP}\right)_t \underset{(-2.15615)}{-0.80270} \left(\frac{\Delta Pw}{Pw}\right)_t \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots (6)$$

$$\bar{R}^2 = 0.9156; \qquad \text{F-value} = 24.46779$$

$$\left(\frac{\Delta Gc}{\Delta GNP}\right)_t = \underset{}{0.38659} \underset{(\ 1.12790)}{+0.75175} \left(\frac{\Delta Td}{\Delta GNP}\right)_{t-1} \underset{(-1.58684)}{-1.35252} \left(\frac{\Delta Ti}{\Delta GNP}\right)_{t-1} \underset{(\ 0.15501)}{+0.00622} \left(\frac{\Delta GNP}{\Delta P}\right)_{t-1}$$

$$\underset{(-2.14620)}{-1.97864} \left(\frac{\Delta GNP}{GNP}\right)_{t-1} \underset{(\ 6.10612)}{+2.60247} \left(\frac{\Delta Pw}{Pw}\right)_{t-1} \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots (7)$$

$$\bar{R}^2 = 0.8060; \qquad \text{F-value} = 11.86988$$

$$\left(\frac{\Delta Gc}{\Delta NNP}\right)_t = \underset{}{0.38247} \underset{(\ 0.95889)}{+0.58546} \left(\frac{\Delta Td}{\Delta NNP}\right)_{t-1} \underset{(-3.13032)}{-1.18127} \left(\frac{\Delta Ti}{\Delta NNP}\right)_{t-1} \underset{(\ 0.56513)}{+0.01867} \left(\frac{\Delta NNP}{\Delta P}\right)_{t-1}$$

$$\underset{(-1.19682)}{-2.342994} \left(\frac{\Delta NNP}{NNP}\right)_{t-1} \underset{(\ 5.48895)}{+3.05335} \left(\frac{\Delta Pw}{Pw}\right)_{t-1} \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots (8)$$

$$\bar{R}^2 = 0.8501; \qquad \text{F-value} = 10.14375$$

The foregoing results indicate that indirect taxation had a significant positive influence on marginal Government consumption in the case of a non-lagged relation whereas it had a significant negative influence in the case of a lagged relation. Though these results can be interpreted to be inconclusive, the t-values are higher in the case of the non-lagged relation than in the case of the lagged relation. Moreover, direct taxation had a positive influence on government marginal consumption in the case of both lagged and non-lagged relations. Apart from these, taxation generally determines the level of marginal government consumption in the same fiscal year whereas its influence on marginal government savings is normally lagged. Therefore, the foregoing results in the case of non-lagged relations would suggest that the increasing tax revenue has been devoted to meeting the increasing consumption of the Government in India. Thus, the earlier results indicating a negative significant influence of taxation on marginal government savings is supported by these results showing the positive significant influence of taxation on marginal government consumption. But as a further indirect test of these results, it would be necessary to analyse the influence of taxation on marginal household savings, marginal corporate savings and marginal private consumption.

Taxation and household savings

Marginal household savings are regressed on the same independent variables as in the case of marginal government savings except that the interest rate is introduced as an appropriate substitute. The results are:

$$\left(\frac{\Delta NHS}{\Delta NNP}\right)_t = \underset{}{-0.36813} \underset{(-1.01081)}{-2.52501} \left(\frac{\Delta Td}{\Delta NNP}\right)_t \underset{(\ 1.06003)}{+1.63414} \left(\frac{\Delta Ti}{\Delta NNP}\right)_t \underset{(-0.16350)}{-0.02477} \left(\frac{\Delta NNP}{\Delta P}\right)_t$$

$$\underset{(\ 0.24927)}{+2.32014} \left(\frac{\Delta NNP}{NNP}\right)_t \underset{(\ 1.40398)}{+3.48297} \left(\frac{\Delta Pw}{Pw}\right)_t \underset{(-0.67753)}{-0.16174} (\ r)_t \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots (9)$$

$$\bar{R}^2 = 0.0635; \qquad \text{F-value} = 1.39132$$

$$\left(\frac{\Delta NHS}{\Delta NNP}\right)_t = \underset{}{-1.05653} \underset{(-0.22148)}{-0.68533} \left(\frac{\Delta Td}{\Delta NNP}\right)_{t-1} \underset{(0.91232)}{+2.05939} \left(\frac{\Delta Ti}{\Delta NNP}\right)_{t-1} \underset{(0.17293)}{+0.03183} \left(\frac{\Delta NNP}{\Delta P}\right)_{t-1}$$

$$\underset{(0.51984)}{+6.16222} \left(\frac{\Delta NNP}{NNP}\right)_{t-1} \underset{(1.08953)}{+3.53144} \left(\frac{\Delta Pw}{Pw}\right)_{t-1} \underset{(-1.15416)}{-0.39003} (\Delta r)_{t-1} \quad \ldots\ldots\ldots\ldots\ldots (10)$$

$$\bar{R}^2 = 0.0876; \qquad \text{F-value} = 0.79498.$$

Where: r = average of interest rates on one year deposits.

Here I have examined the influence of taxation only on net marginal household savings as the data on gross household savings are not readily available. The foregoing results indicate that direct taxation had a negative influence on the net marginal household savings whereas indirect taxation had a positive influence in both the lagged and the non-lagged relations. However, these results are not significant as evidenced by low t-values, low values of adjusted coefficients of multiple determination, and low F-values.

Taxation and corporate savings

Corporate savings here include only savings of private corporate organisations. The determinants of marginal private corporate savings differ slightly from those of marginal household savings. Here the interest rate becomes less important whereas the corporate profit becomes more relevant. The data on corporate profits are taken from Reserve Bank of India studies on Company Finances. Further, I have used only the wholesale price index for manufactured commodities rather than the index for all commodities, which is not relevant. Here again, for want of reliable data on gross marginal corporate savings, I have used only net marginal corporate savings. The results of the regression for net marginal corporate savings are as follows:

$$\left(\frac{\Delta NCS}{\Delta NNP}\right)_t = \underset{}{0.05860} \underset{(-1.24168)}{-0.12214} \left(\frac{\Delta Td}{\Delta NNP}\right)_t \underset{(-0.93410)}{-0.06038} \left(\frac{\Delta Ti}{\Delta NNP}\right)_t \underset{(0.71738)}{+0.00369} \left(\frac{\Delta NNP}{\Delta P}\right)_t$$

$$\underset{(-1.20570)}{-0.42956} \left(\frac{\Delta NNP}{NNP}\right)_t \underset{(-1.72477)}{-0.22615} \left(\frac{\Delta Pm}{Pm}\right)_t \underset{(1.07773)}{+0.04048} \left(\frac{\Delta CPB}{CPB}\right)_t \quad \ldots\ldots\ldots\ldots\ldots (11)$$

$$\bar{R}^2 = 0.3703; \qquad \text{F-value} = 2.47528$$

$$\left(\frac{\Delta NCS}{\Delta NNP}\right)_t = \underset{}{-0.00859} \underset{(1.23749)}{+0.17008} \left(\frac{\Delta Td}{\Delta NNP}\right)_{t-1} \underset{(-0.30854)}{-0.02804} \left(\frac{\Delta Ti}{\Delta NNP}\right) \underset{(-0.49807)}{-0.00364} \left(\frac{\Delta NNP}{\Delta P}\right)_{t-1}$$

$$\underset{(0.53954)}{+0.26176} \left(\frac{\Delta NNP}{NNP}\right)_{t-1} \underset{(-0.18694)}{-0.03391} \left(\frac{\Delta Pm}{Pm}\right)_{t-1} \underset{(1.01515)}{+0.05225} \left(\frac{\Delta CPB}{CPB}\right)_{t-1} \quad \ldots\ldots\ldots\ldots\ldots (12)$$

$$\bar{R}^2 = 0.0894; \qquad \text{F-value} = 0.79774$$

Where: Pm = wholesale price index of manufactured commodities with 1960-61 base.
CPB = Corporate profit before tax.

The results show that indirect taxation had a negative influence on net marginal corporate savings both in lagged and in non-lagged relations, but that direct taxation had a negative influence in the case of a non-lagged relation and a positive influence in the case of a lagged relation. In both these cases however, the influence is not significant.

Taxation and private consumption

I have tested the nature and extent of influence of taxation on marginal private consumption in the following way:

$$\left(\frac{\Delta Pc}{\Delta GNP}\right)_t = \underset{}{0.12459} \underset{(4.30529)}{+0.70217}\left(\frac{\Delta Td}{\Delta GNP}\right)_t \underset{(-0.27245)}{-0.35005}\left(\frac{\Delta Ti}{\Delta GNP}\right)_t \underset{(1.99166)}{+0.18296}\left(\frac{\Delta GNP}{\Delta P}\right)_t$$

$$\underset{(-1.07877)}{-4.14884}\left(\frac{\Delta GNP}{GNP}\right)_t \underset{(1.06389)}{+0.12599}\left(\frac{\Delta Pw}{Pw}\right)_t \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots (13)$$

$$\bar{R}^2 = 0.8361; \qquad \text{F-value} = 11.99831$$

$$\left(\frac{\Delta PC}{\Delta NNP}\right)_t = \underset{}{-0.61644} \underset{(0.30032)}{+0.92166}\left(\frac{\Delta Td}{\Delta NNP}\right)_t \underset{(1.76968)}{+3.19231}\left(\frac{\Delta Ti}{\Delta NNP}\right)_t \underset{(2.11604)}{+0.37773}\left(\frac{\Delta NNP}{\Delta P}\right)_t$$

$$\underset{(-0.55711)}{-6.41921}\left(\frac{\Delta NNP}{NNP}\right)_t \underset{(1.40392)}{+0.38277}\left(\frac{\Delta Pw}{Pw}\right) \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots (14)$$

$$\bar{R}^2 = 0.4924; \qquad \text{F-value} = 3.05584$$

$$\left(\frac{\Delta PC}{\Delta GNP}\right)_t = \underset{}{-0.64667} \underset{(25.42871)}{+0.77684}\left(\frac{\Delta Td}{\Delta GNP}\right)_{t-1} \underset{(6.49131)}{+2.50366}\left(\frac{\Delta Ti}{\Delta GNP}\right)_{t-1} \underset{(2.98246)}{+0.09143}\left(\frac{\Delta GNP}{\Delta P}\right)_{t-1}$$

$$\underset{(1.14471)}{+1.09569}\left(\frac{\Delta GNP}{GNP}\right)_{t-1} \underset{(-8.86326)}{-0.34675}\left(\frac{\Delta Pw}{Pw}\right)_{t-1} \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots (15)$$

$$\bar{R}^2 = 0.9894; \qquad \text{F-value} = 155.37437$$

$$\left(\frac{\Delta PC}{\Delta NNP}\right)_t = \underset{}{-0.95496} \underset{(0.10991)}{+0.060284}\left(\frac{\Delta Td}{\Delta NNP}\right)_{t-1} \underset{(0.76476)}{+3.05959}\left(\frac{\Delta Ti}{\Delta NNP}\right)_{t-1} \underset{(-0.93228)}{-0.29273}\left(\frac{\Delta NNP}{\Delta P}\right)_{t-1}$$

$$\underset{(1.20932)}{+25.17856}\left(\frac{\Delta NNP}{NNP}\right)_{t-1} \underset{(-0.46065)}{-0.23948}\left(\frac{\Delta Pw}{Pw}\right)_{t-1} \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots (16)$$

$$\bar{R}^2 = 0.1930; \qquad \text{F-value} = 0.39993$$

The foregoing results regarding the influence of taxation on marginal private consumption show that on the whole taxation had a significant positive influence on marginal private consumption. This would indicate that both direct and indirect taxation did not have a restraining influence on marginal private consumption. This goes to disprove the hypothesis that taxation diverts increasing income from private consumption to government savings. Therefore, our earlier findings relating to the influence of taxation on marginal Government savings are once again reinforced by these results.

Conclusion

The foregoing study leads to the following tentative conclusions: (1) taxation had a significant negative influence on marginal Government savings and (2) taxation had a significant positive influence on marginal Government consumption.

These results suggest that even if taxation favourably affects the marginal domestic savings and marginal household savings, it cannot be taken for granted that this is achieved by restraining the marginal consumption of the Government and/or the private sector as Messrs. Krishnamurthy and Morss have concluded. The relationships are so complex that they have to be analysed in greater detail to know the effect of taxation on savings in underdeveloped countries.

Table 3

Relative share of the Government's Consumption Expenditure in the Government's Revenue and Gross Domestic Product

Year	Government consumption expenditure as % of GDP	Government consumption expenditure as % of GDP of the Govt. sector	Government consumption expenditure as % of Govt.'s total revenue	Government consumption expenditure as % of total tax revenue
1960-61	7.23	70.61	63.58	71.40
1961-62	7.54	69.59	61.85	69.79
1962-63	8.53	73.12	63.04	70.57
1963-64	9.54	81.45	65.59	74.59
1964-65	8.70	77.57	64.49	71.53
1965-66	9.52	75.13	66.05	73.33
1966-67	9.06	73.74	64.52	71.27
1967-68	8.59	71.35	67.59	74.68
1968-69	9.09	70.31	67.21	75.60
1969-70	9.18	69.01	66.88	75.51
1970-71	9.31	72.18	66.09	73.73
1971-72	10.25	69.14	65.89	73.14
1972-73	10.09	N.A.	63.95	70.15

Note: The difference between the Government consumption/tax revenue and net Government savings/tax revenue ratios may be attributed to capital consumption in the public sector.

CONFERENCE DIARY

JULY 1977

Business International Institute: International Seminar (including International Taxation Theory, International Tax Techniques etc.). Port Chester, New York (U.S.A.) July 18-29 (English).

OCTOBER 1977

31st Annual Congress of I.F.A.: I. Inflation and Taxation; II. Determination of the Taxable Profit of Corporations. Vienna (Austria) October 3-8 (English, French, German, Spanish).

Hawaii Tax Institute: The 14th Annual Tax Meeting (including Tax Shelter Review, Doing Business Abroad — Tax Implications etc.). Waikiki (Hawaii) October 23-28 (English).

NOVEMBER 1977

U.S. Branch of I.F.A.: National Meeting. New York (U.S.A.) November 3-4 (tentatively) (English).

JANUARY 1978

Associated Business Programmes Ltd: Tax Planning and International Trade; Taxation of Personal Wealth of Individuals; Sales Taxes, Value Added Taxes and Double Taxation Conventions. Honolulu (Hawaii) January 22-27 (English).

SEPTEMBER 1978

32nd Annual Congress of I.F.A.: I. The Taxation of Extractive Industries; II. The Differences in the Tax Treatment between Local and Foreign Investors and the Effects of International Treaties. Sydney (Australia) September 17-23 (English, French, German, Spanish).

For further information please write to:

Associated Business Programmes Ltd.: 17 Buckingham Gate, London SW1E 6LN (United Kingdom).

Business International Institute: c/o Business International Corporation, One Dag Hammarskjold Plaza, New York (U.S.A.); 12-14 Chemin Rieu, 12-11 Geneva 17 (Switzerland); 301-3 Asian House, 1 Hennessy Road, Hong Kong; 5th Floor, Pola Building, 5, 2-chome, Minami Aoyama, Minato-ku, Tokyo (Japan).

Hawaii Tax Institute, Chaminade College of Honolulu, 3140 Wailalae Avenue, Honolulu (Hawaii).

International Fiscal Association (I.F.A.): General Secretariat, Woudenstein, Burg. Oudlaan 50, P.O. Box 1738, Rotterdam (Netherlands).

31st I.F.A. Congress: Secretary c/o Interconvention, P.O. Box 35, A-1095 Vienna (Austria). Non-members of I.F.A. should apply to International Fiscal Association (I.F.A.) in Rotterdam. P.O. Box 1738.

U.S. Branch of I.F.A.: Secretary of U.S. Branch of I.F.A., Suite 44-27, 345 Park Avenue, New York, N.Y. 10022 (U.S.A.).

International Bar Association

An international tax luncheon was held in Paris on 16th May 1977. It was organized under the joint auspices of the French Section of the Committee on Taxes of the I.B.A. Business Section, Tax Planning International and Tax Management.

The topic discussed related to the implications of recent tax law reform in France as regards the French — U.S. tax treaty and, more generally, to the various pending problems raised by the application of that treaty and the proposed new tax law reform in the United States.

The Meeting was presided over by Me J.C. Goldsmith, Chairman of the I.B.A. Business Section, Committee on Taxes. Leonard Silverstein of Silverstein and Mullens in Washington, Chief Editor of Tax Management, accompanied by the main executives of Tax Management and Tax Planning International, were also on the Panel.

Among the guests of honour were primarily Mr. Pierre Kerlan Chief of the International relations department, General Department of Taxes, French Finance Ministry, and Me Jacques Lassier, Chairman of the I.B.A. Business Section.

The speakers were:
- Mr. Pierre Kerlan and Me J.C. Goldsmith for France,
- Mr. Leonard Silverstein and Mr. R.T. Tait for the United States.

Fiscal Incentives for the Development of Northeast Brazil.

by Professor Pedro Massone *

1. PRELIMINARY REMARKS

Brazil should be included among those countries that have made extensive use of incentives to promote development. Its experience covers a wide range: export promotion, sectorial incentives, regional incentives, as well as other kinds of incentives; however, within this range, regional incentives constitute perhaps the most elaborate and successful kind.

The present Brazilian system of regional incentives was first established in 1961 with the basic aim of promoting the Northeast regional development.

According to the original pattern, enterprises could deduct up to 50 percent of their income tax liability for investment in industrial activities located in the Northeast region.

This system proved to be an effective instrument to stimulate the expansion and development of the concerned region. In a short period the money deposited with the Brazilian Northeast Bank for investment in the Northeast region reached a considerable amount and was assigned to a large number of projects in that area.

The plan was afterwards extended to another region (the Amazon) and to certain economic sectors (fishing, tourism, and forestry). This expansion of the original plan and the establishment of social interest programs (Plan for National Integration, Program for Land Distribution, etc.) led to the absorption of an important part of the funds originally intended for the Northeast region.

The Brazilian Government decided to reformulate some main features of the tax incentive system under discussion not only for the foregoing reason, but also taking other problems into consideration. Thus, by Decree-Law No. 1376 of December 12, 1974, it established several funds, namely, the Northeast Investment Fund (Finor), the Amazon Investment Fund (Finam), and the Sectorial Investment Fund (Fiset). All these funds are primarily formed by amounts derived from part of the taxpayers' income tax liability which are deposited with special banks, administered and controlled by special agencies, and finally invested in the purchase of shares issued by companies operating in the concerned region or sector.

With the establishment of this new set of rules, decisions concerning investment previously taken by the companies deducting the incentive from their income tax and depositing it with the special bank (taxpayer company) are now the responsibility of the corresponding agencies administering the fund.

On the other hand, the taxpayer companies are entitled — after making the proper deposits — to receive securities representing an interest in the pertinent fund — securities which are afterwards to be changed into shares belonging to the fund's portfolio.

Alongside the above mentioned incentives available to enterprises, there are also similar incentives for individuals, whose implementation is simpler.

Moreover, a separate set of tax incentives and financial support is provided for those enterprises operating in the eligible region when they develop projects that are considered by the proper agency to be of interest for the development of that region.

Although several rules dealing with incentives are common rules applicable to the development of the Northeast region as well as to other regions (Amazon) and sectors alike, the scope of this article will be limited to the Northeast region; if it is necessary to cover those common rules, the subject will be dealt with from the Northeast point of view only.

* University of Chile, Valparaíso. This article has been prepared on the basis of some material provided to the author by Mr. João Lopes Filho, advogado at the Superintendencia do Desenvolvimiento do Nordeste in Brazil, to whom he wants to express his gratitude.

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2. GENERAL INCENTIVES AVAILABLE TO ANY ENTERPRISE
(enterprises operating inside or outside the Northeast region)

2.1. General remarks and general limit

In Brazil, enterprises (the term enterprises encompasses legal entities and individual enterprises) are subject to income tax at a normal flat rate of 30 percent. Nevertheless, according to the system of incentives under consideration, legal entities and individual enterprises can reduce their income tax liability by opting to have part of it (up to a maximum of 50 percent) invested in some specified areas or economic sectors through special funds established by law and, to a certain extent, selected by the taxpayer. In order to enjoy the benefits of this tax reduction, the taxpayer is supposed to select in its yearly income tax return the investment funds through which its saved income tax will be invested. In this selection the taxpayer must take into account not only the above-mentioned general limit of 50 percent of its income tax liability, but also some other specific limits established separately for each fund.

2.2. Specific limits

As stated above, the maximum amount of income tax that can be applied to the specified investments is limited to 50 percent of the tax liability. But, in addition to this general or global limit, there are some special or particular limits according to which the tax to be invested through a specific fund can not exceed a certain percentage of the income tax liability of the enterprise. These special limits or percentages of income tax liability are separately established for each fund, as follows:

(i) The enterprise can apply up to 50 percent of its income tax to be invested through the Northeast Investment Fund (FINOR), and/or through the Amazon Investment Fund (FINAM), in projects considered by the concerned agency to be of interest for the economic development of the region, in sectors such as industry, agriculture and telecommunications. Tourism, fishing and forestry projects to be developed in the area are also eligible to receive investments through these Funds in spite of the fact that they belong to other sectors included separately within the global system of incentives.
In the case under discussion the percentage representing the specific limits is the same as established for the general limit. Moreoever, the intent of the ruling is that the enterprise may decide to invest the whole saved income tax through any of the two funds or divide the saved income tax between them, but in any case the combined amount to be invested through both funds cannot exceed 50 percent of the income tax liability of the enterprise.

(ii) The enterprise can apply up to 50 percent of its income tax to be invested through the Sectorial Investment Fund—Forestry Section in forestry projects to be developed in the Northeast or Amazon region, when the investment is to be done under certain special rules of implementation that will be covered under Section 3.3.(a) (rules established for taxpayers controlling the enterprise receiving the investment).

(iii) The enterprise can apply to 12 percent of its income tax to be invested through the Sectorial Investment Fund-Tourism Section in tourism projects approved by the Tourism National Council.

(iv) The enterprise can apply up to 25 percent of its income tax to be invested through the Sectorial Investment Fund-Fishing Section in fishing projects approved by the Fishing Development Superintendency.

(v) The enterprise can apply up to a percentage of its income tax (the percentage varies according to the taxable year) to be invested through the Sectorial Investment Fund-Forestry Section, in forestry projects approved by the Brazilian Institute for Forestry Development. The percentages of income tax that can be applied in this case are:
— for the taxable year 1974 — 45 percent;
— for the taxable year 1975 — 40 percent;
— for the taxable year 1976 and later years — 35 percent.

(vi) The enterprise domiciled in Espiritu Santo State can apply up to 33 percent of its income tax to be invested through the Fund for the Economic Recovery of Espiritu Santo State. This possibility is only available until the 1978 financial year.
It appears that the enterprise can even concentrate its saved tax in only one eligible fund, when it is allowed by the specific limit of the fund (i.e. the Northeast Investment Fund or the Amazon Investment Fund). On the other hand, if the enterprise wants to invest its saved tax in funds with more stringent limits, it must distribute the saved tax between several funds.

2.3. Additional percentages

There are some additional percentages of the income tax liability of an enterprise that can be applied — or even that must be applied — to be invested through other specified channels, and these are dealt with separately because they are not included in the 50 percent general limit and are not affected by it. These additional percentages are the following:

(i) The enterprise can apply up to 1 percent of its income tax to be invested in new shares issued by the Brazilian Aeronautic Enterprise. This possibility is only available until the 1980 financial year.

(ii) The enterprise can apply up to 1 percent of its income tax (2 percent as of the 1977 financial year) to be invested in specific reading and writing teaching projects developed by the Mobral Foundation. Instead of this possibility, the enterprise can deduct from its income tax liability a sum ranging between 1 and 2 percent of such liability, if it corresponds to amounts already donated to the Foundation during the taxable year. This incentive is only available until the 1979 financial year.

(iii) The enterprise must apply 5 percent of its income tax to investment through the enterprise Plan for National Integration.

INVESTMENT IN NORTHEAST BRAZIL

The fiscal incentives resulted in 1970 in investments in an amount of almost 3,300 million Cruzeiros. The industrial sector received about 75 percent of this sum, i.e. 2,600 million Cr. Other sectors received the following sums:

agriculture and cattle breeding	672	million Cr.
telecommunication	27	million Cr.
tourism (hotels)	15	million Cr.
electricity	40	million Cr.
sugar industry	8.7	million Cr.

At 1975 prices, industrial investments in the Northeast of Brazil, from 1963 on, total 30,000 million Cr. This sum is distributed between States as follows:

Maranhão	— 517.8 million Cr.
Piauí	— 1,298.2 million Cr.
Ceará	— 2,439.7 million Cr.
Rio Grande do Norte	— 1,026.3 million Cr.
Paraíba	— 2,127.3 million Cr.
Pernambuco	— 8,204.2 million Cr.
Alagoas	— 1,053.9 million Cr.
Sergipe	— 304.5 million Cr.
Bahia	— 12,037.6 million Cr.
Minas Gerais	— 1,006.0 million Cr.



3. IMPLEMENTATION OF THE INCENTIVES COVERED UNDER THE PREVIOUS SECTION

3.1. General implementation rules

The income tax saving scheme available to enterprises that have been covered under Section 2 does not operate automatically. In fact, the enterprise is supposed to express — in its income tax return — its intention or decision of using a percentage of its income tax for investment through one or more of the eligible channels.

Moreover, in order to have the saved income tax invested in accordance with the purpose established by law, several other implementation steps are to be taken. In addition to properly filing the income tax return, the enterprise must file a collection form in due time with one of the banks that are entitled to receive federal revenue. [1]

Once the tax to be used for eligible investments (saved tax) has been deposited, the Federal Revenue Office issues in triplicate a nominative provisional certificate

1. From these Banks the funds are transferred to the Bank of Brazil and from here that part of the saved tax corresponding to the Northeast Investment Fund is transferred to the Brazilian Northeast Bank. If the deposit or payment is done after the financial year is over, the sums will be entered into the National Treasury account and the benefit will be lost for the taxpayer enterprise.

stating that the saved tax will be used to be invested through the eligible channels, the so-called Certificate of Application of Fiscal Incentives.

Within one year from the issuing date of the provisional certificate, the enterprise must deliver that certificate in order to exchange it for another document. For this purpose the enterprise delivers the three copies of the Certificate to the Brazilian Northeast Bank — or to other specified institutions that have been named to act as agents of the Northeast Investment Fund — immediately receiving back one of the copies, duly certified. [2]

Within 45 days, the Brazilian Northeast Bank or other agent receiving the provisional certificate (Certificate of Application of Fiscal Incentives) delivers a new document to the taxpayer, namely the Investment Certificate, representing an interest or share in the Northeast Investment Fund; this certificate is nominative and endorsable.

The enterprise holding Investment Certificates may use them in the following ways; they may:

(i) use the certificates to buy shares in enterprises receiving investments from the Northeast Investment Fund; these are nominative shares which are sold by auction and can only be transferred after 4 years from the exchange date, i.e. from the date on which the shares were changed for the Investment Certificates;
(ii) sell the certificates in the stock exchange to private investors;
(iii) use the certificates to guarantee obligations to the federal government agencies; and
(iv) keep the certificates in order to receive the profits that may result from the operations of the Northeast Investment Fund.

3.2. Investment of the saved tax by the Northeast Investment Fund

On the other side, the Northeast Investment Fund is managed and represented by the Brazilian Northeast Bank in its capacity of agent and depositary of the funds. The Bank invests the available funds in those projects which are considered by the Northeast Development Superintendency to be of interest for the Northeast economic development in sectors such as industry, agriculture and telecommunication.

The funds can also be invested in the area, in projects related with fishing, tourism, and forestry sectors, but in these cases the project approval is issued by the sectorial agency, namely the Fishing Development Superintendency, the Brazilian Tourism Enterprise, or the Brazilian Institute for Forestry Development. These agencies and the Northeast Development Superintendency are supposed to contact each other in order to harmonize their activities related to the Northeast region.

The Brazilian Northeast Bank invests through the subscription of shares issued by corporations operating in the Northeast region under the rules and instructions given by the Northeast Development Superintendency. In certain cases a special permit can be granted by the government in order to place funds by means of investing them in bonds issued by the same kind of enterprises whether convertible into shares or not.

It is emphasized that the above only gives a brief outline; the rules according to which the investments are made are much more complicated if all details are taken into account. However, at this stage it is sufficient to give only an overview, since the subject will be discussed again and in more detail in Section 6.

3.3. Special implementation rules

The general incentives available to all enterprises and the investment of saved tax may in some cases be implemented according to special rules. These special rules represent a more direct and simple procedure and they are available when there is a certain affinity between the investing enterprise (taxpayer) and the enterprise receiving the investment.

To be more precise it is necessary to state that there are two different sets of special rules each of which applies to two rather different situations, viz: (a) rules for controlling enterprises; and (b) rules for the case of "total identity".

(a) *Rules for controlling enterprises:* One of these sets of special rules applies to enterprises or groups of related enterprises which isolatedly or jointly hold at least 51 percent of the voting stock in the corporation receiving the investments of saved taxes through the Northeast Investment Fund. For these purposes "related enterprises" are those enterprises the majority of whose voting stock is controlled directly or indirectly by the same individual or legal entity; the controlling enterprise is also considered as part of the groups and it can profit from the arrangement.

In order that this set of special rules be available it is also necessary that each enterprise or group of related enterprises included in the arrangement hold at least 5 percent of the voting capital of the corporation receiving the investment.

When the above mentioned requirements are met, the enterprises or group of related enterprises are entitled to receive directly, and after delivering their provisional certificates (Certificates of Application of Fiscal Incentives) to the Brazilian Northeast Bank, shares issued by the enterprises receiving the investment from the Northeast Investment Fund. These shares are nominative and non-transferable for four years.

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2. If these steps are not taken at the proper time the corresponding value will accrue to the Fund itself and will be lost for the taxpayer.

This means that some major steps are avoided, namely those of issuing Investment Certificates and their ensuing exchange into shares issued by the enterprises receiving the investment.

(b) *Rules for the case of total identity:* The second set of special rules deals with the case of "total identity" between the enterprise holding the Certificates of Application of Fiscal Incentives and the enterprise receiving the investment from the Northeast Investment Fund. This is to say that the same enterprise is acting on both sides: investing the saved tax and receiving the investment.

When this is the case, the concerned enterprise is entitled to receive, within one year and after delivering its provisional certificates (Certificates of Application of Fiscal Incentives), its own shares subscribed by the Northeast Investment Fund which had so far been held by the Brazilian Northeast Bank. The enterprise, after receiving its own shares, is supposed to distribute them among its shareholders according to the number of shares held by each of them at the exchange date (date on which the shares were received in exchange for the provisional certificate).

It is necessary to remember that these are nominative shares that can only be transferred after four years from the date of exchange. In this case the distribution of the shares is a special exception that applies only to that distribution.

4. GENERAL INCENTIVES AVAILABLE TO ANY INDIVIDUAL

4.1. The incentives available to individuals

In Brazil, individuals are subject to a personal income tax at progressive rates ranging from 3 to 50 percent. [3]

Within the set of incentives established in order to promote the Brazilian Northeast development, a special benefit related to the personal income tax of individuals is also included.

In fact, under the Income Tax Regulation [4] individuals are entitled to deduct from their personal income tax liability varying percentages related to the sums that they, during the taxable year, applied to certain specified investments considered to be of economic or social interest. These percentages are different for each kind of investment and they range from 3 to 42 percent. [5]

The 42 percent applies to the amounts invested in the subscription to and the payment of nominative shares or endorsable nominative shares issued by industrial or agricultural enterprises considered to be of interest for the Northeast economic development. This deduction can also be based on the direct subscription of shares (quotas) in the Northeast Investment Fund.

It is necessary to stress that the amount of the particular deduction under consideration represents 42 percent of the sums invested in the subscription and the payment of a certain kind of shares. This means that the amount of the reduction is proportionate to the amount invested.

However, there is another proportion or rate to be taken into consideration. In fact, the total personal income tax reduction available to individuals and based in investments considered to be of economic or social interest (which may also include investments not related to the Northeast development) is also limited in a certain sense by the amount of the income tax liability normally incurred by the individual.

Using more precise terms, the whole tax reduction based on previous investment cannot exceed a certain percentage as applied to the tax liability itself. The percentage (to be applied to the tax liability) varies according to the amount of the individual's personal gross income as shown in Table 1.

TABLE I

*Amounts of gross income**		*Limit of the reduction*
Lower limit CR$	*Upper limit CR$*	*(percentage to be applied to the normal tax liability*
—	100,000.00	60%
100,001.00	134,300.00	55%
134,301.00	183,900.00	50%
183,901.00	241,500.00	45%
241,501.00	331,200.00	40%
331,201.00	529,300.00	35%
529,301.00	—	30%

* Amounts vary yearly and those mentioned in the table were established by Portaria MF No. 473 of December 3, 1976.

It is now clear that the amount of the whole deduction available to individuals is determined by three factors, namely the amount of the investment, the amount of the gross income, and the amount of the tax liability. It can also be noted that the amount of the deduction is increased by increasing the investment and by increasing the tax liability; however, the percentage of the deduc-

3. Note that individual enterprises are treated like legal entities for income tax purposes; the incentives available to them are therefore included in Sec. 3.

4. The income tax legislation in Brazil consists of Laws, Decree-Laws and Decrees. These documents are consolidated from time to time into a single text which is called Income Tax Regulation (Regulamento do Imposto de Renda) and is issued by Decree.

5. There are 15 items or percentages to be deducted, but considering their extent and the scope of this article the discussion will be strictly limited to the item directly related to the Brazilian Northeast development. There are also other sums to be deducted from the income tax liability and to be invested after filing the income tax return, will not be covered because they are not included in the subject of this article.

tion is diminished by increasing the gross income amount.

4.2. The implementation of this incentive

The procedure to be followed in order to benefit from the incentive we are discussing (available to individuals) is much simpler than that provided for enterprises discussed in Sections 2 and 3. On the other hand the opportunity or timing according to which the incentive is implemented is in a certain sense the opposite of that provided for those enterprises.

Where enterprises and the incentives discussed in Section 2 are concerned, the first step of the taxpayer is to deduct (apply) a certain amount of its income tax to be invested through certain channels and for some specified purposes, without on that occasion making any actual investment at all; the real investment will be done afterwards in a pluriphased process.

However, where individuals are concerned and the incentive discussed in this Section is dealt with, the taxpayer must, during the taxable year, subscribe and pay in advance for eligible shares, namely shares issued by industrial and agricultural enterprises considered to be of interest for the Northeast development by the related Superintendency.

In addition, the individual taxpayer investing in shares must at the very moment of subscribing the eligible shares give written notice to the issuing company of his intention of deducting the invested amount from his income tax liability.

The company receiving the investment and the above-mentioned notice is supposed to register a transfer ban preventing the disposal of the shares during a period of two years. The company receiving the investment also delivers the proper voucher stating that a subscription under the specific standards has been done.

The final step to be taken by the taxpayer (individual) is to deduct in his personal income tax return the sums invested in the eligible shares. It is also necessary to state in the individual income tax return the investments that make the deduction available, as well as the date and specifications relating to the subscription and the payment of the eligible shares, and the date and specifications relating to the registering of the transfer ban affecting the shares. Once the income tax return has been properly filed the implementation of the benefit is complete except for the fact that the Office of Federal Revenue ensures that the deductions comply with the legal requirements.

5. SPECIAL INCENTIVES AVAILABLE TO ENTERPRISES OPERATING IN THE NORTHEAST REGION

5.1. General remarks

So far we have discussed general incentives available to *any* enterprise — and also those general incentives available to *any* individual — irrespective of the place or area within Brazil where they carry on their activities. In addition to those general incentives, enterprises operating in the Northeast region of Brazil, or to be established in the same area, are eligible to receive other special incentives according to the nature of the project they develop or intend to develop, especially with regard to the importance of those projects from the point of view of national interest.

The incentives that can be granted to enterprises operating in the Northeast region are the following: customs duty exemption, customs duty reduction, income tax exemption, income tax reduction, State benefits, and Municipal benefits.

5.2. Customs duty exemption and customs duty reduction

(a) A customs duty exemption can be granted by the Northeast Development Superintendency for those projects to be developed in the Northeast region and considered to be of relevant national interest, which necessitates approval by the Northeast Development Superintendency, by the Customs Policy Council and finally by the Brazilian President. The approval of the Customs Policy Council is to ensure that there is no other similar project in Brazil.

(b) A customs duty reduction can be granted by the Northeast Development Superintendency for assets necessary to develop certain specified industrial projects.

The eligible assets include equipment, machinery, instruments, accessories, and tools not produced in Brazil. The customs duty reduction can amount to 50 or 80 percent according to the sector to which the project belongs.

Eligible sectors are included in two separate lists prepared by the Industrial Development Council, namely, one list for those sectors that can benefit from an 80 percent reduction and another list devoted to those other sectors that instead can benefit from 50 percent reduction.

The 80 percent reduction is available for projects included in some of the following sectors:

(i) production of machinery and equipment, including production of their components;
(ii) production of machinery and equipment for agriculture, transportation and forestry;
(iii) production of components for the electric, electronic and mechanic industries;
(iv) production of railroad equipment;
(v) production of vehicles for public transportation;
(vi) naval and aircraft construction;
(vii) non-ferrous primary metallurgy;
(viii) production of cement and heat resisting materials;
(ix) production of cellulose and paper;
(x) production of fertilizers and pesticides for agriculture, including production of their raw materials;
(xi) production of basic chemical and pharmaceutical raw materials;
(xii) mineral extraction industry; and
(xiii) industries and activities linked with national security as defined by the National Security Council.

5.3. Income tax exemption

Industrial and agricultural undertakings established in the Northeast region as of July 12, 1963 onwards and starting operations not after December 31, 1978 are exempted from income tax for up to ten years from the date on which they started or start operation.

This exemption can be extended by the Northeast Development Superintendency up to 15 years, in those cases in which the project development is thought to face special disadvantages due to its unfavourable location and to the low rate of returns to be expected from investment.

The income tax exemption that we are discussing must be accepted by the Northeast Development Superintendency, which gives notice of such acceptance to the proper Federal Revenue Agencies.

The taxpayers to whom the benefit is granted are nevertheless supposed to file normal income tax returns where the saved income tax is to be calculated and stated. This saved tax must be incorporated into the enterprise's capital during the tax year following that receiving the benefit from the exemption, and must then be invested in the Northeast region in activities directly related to production.

There are some enterprises for which the exemption discussed under this heading is excluded, namely:

(i) industrial undertakings intended to produce goods considered by the Northeast Development Superintendency to be non-essential, unless these goods are to be exported (if the non-essential goods are to be exported, the exemption is still available); and
(ii) enterprises similar to others already established in the Northeast region unless
   — the benefit has already been granted to another similar enterprise, or
   — the new enterprise — preferably located in the less industrialized areas — is intended to supply markets located outside the region or to supply a local market or a limited area within the region.

5.4. Income tax reduction

Industrial and agricultural undertakings that were operating in the Northeast region on or before June 27, 1963 are entitled to enjoy an income tax reduction of 50 percent.

Industrial and agricultural undertakings established in the Northeast region on or after June 27, 1963 can also benefit from this 50 percent income tax reduction, unless they are entitled to an income tax exemption under the rules discussed in Section 5.3. This 50 percent income tax reduction does not exclude the possibility of taking advantage of the general incentives available to any enterprise and already discussed in Section 2, according to which any enterprise, irrespective of the area in which it operates, is entitled to a 50 percent deduction from its income tax liability in order to invest the saved tax through special funds.

Therefore industrial and agricultural enterprises operating in the Northeast region can combine in this way both incentives and thus obtain an effective tax reduction of 75 percent, paying only 25 percent of their normal income tax unless they are totally exempt.

Taxpayer enterprises enjoying the 50 percent income tax reduction granted to enterprises operating in the Northeast region must calculate and state in their normal income tax returns the saved tax; in this case also the tax must be incorporated into the enterprise's capital during the tax year following that receiving the benefit from the tax reduction, and then invested in the Northeast region in activities directly related to production.

5.5. Benefits granted by State governments and by Municipalities

Northeast State Governments also grant fiscal incentives and financial support to enterprises that decide to develop projects to be located in their territories.

These benefits encompass tax exemptions or tax reductions, loans for preparing projects, supply of sites located in industrial districts or zones at token prices, and subscription of preferential shares without voting rights.

Some Northeast Municipal Governments as well grant incentives and benefits to enterprises established in their territories.

6. FINANCIAL SUPPORT AVAILABLE TO ENTERPRISES IN THE NORTHEAST REGION

6.1. General remarks

Besides tax incentives, enterprises operating in the Northeast region are entitled to receive financial support by having the Northeast Investment Fund subscribe to their shares, or by being granted loans or by receiving other benefits. Some of these benefits cannot perhaps be properly considered "fiscal incentives", but will be also covered in this article because they appear to be closely related to fiscal incentives and should be included in a global outline of incentives that cannot be duly understood with a limited or partial approach.

Furthermore, irrespective of whether we are dealing with fiscal incentives or whether we are dealing with financial support, some common conditions and procedural requirements are to be met by an enterprise trying to take advantage therefrom. Special rules are provided in certain cases too. These general conditions and procedural requirements, and some special rules too, will be covered under this Section.

In addition to those general conditions and procedural requirements, some other standards or guidelines estab-

lishing priorities and even limiting the extent of the benefits are to be taken into account. These standards or guidelines will be dealt with in Section 7.

6.2. *Subscription of shares by the Northeast Investment Fund*

A very important financial support available to enterprises operating in the Northeast region is the possibility of receiving capital contributions through the subscription of shares by the Northeast Investment Fund. In order to receive these capital contributions, some procedural requirements must be complied with, namely, the preliminary application letter, the project approval, and the issuing and subscription of the shares.

(a) *The preliminary application letter.* The first step to be taken by the enterprise interested in receiving capital contributions from the Northeast Investment Fund in order to develop a project in the area is to submit a preliminary application letter with the Northeast Development Superintendency.

In this document, the project to be developed must be explained by staing its location (normally in Industrial Districts), the new employment opportunities involved, the market demand for the articles to be produced, the raw materials needed, the managerial experience of the enterprise or group undertaking the project, and a financial capacity consistent with the development of the project and with the standards or guidelines established by the Northeast Development Superintendency. Values must be expressed in special indexed units related to Readjustable Bonds of the National Treasury. The preliminary letter can be answered by the Northeast Development Superintendency in one of the following ways:

(i) that in principle the project satisfies the needed requirement on the basis that the technical, economic and financial information provided by the preliminary application letter is in order;
(ii) that the project does not satisfy certain general standards or guidelines established by the Northeast Development Superintendency, namely in article 21 of Order (Portaria) No. 83 of April 30, 1976;
(iii) that in principle the project does not satisfy the appropriate requirements on the basis that the provided information is insufficient to prove the technical, economic and financial feasibility of the project.

(b) *The project approval.* If the enterprise interested in receiving capital contributions from the Northeast Investment Fund gets a favorable answer to its preliminary application letter, it prepares a project under the rules established for this purpose by the Northeast Development Superintendency. Also in this case values must be expressed in special indexed units, related to Readjustable Bonds of the National Treasury.

Once it is prepared and within 180 days from the issuing of a positive reply to the preliminary application letter, the project is to be submitted by the enterprise to the Northeast Development Superintendency, which studies the technical, economic and financial aspects in order to decide its practicability and to determine its priority level.

After studying the project the Northeast Development Superintendency can decide through its Executive Secretary's Office or through its Board of Trustees:

(i) to ask the enterprise for more information about the project;
(ii) to introduce modifications or alterations to the project, which, in order to become effective, must be accepted by the enterprise;
(iii) that the project is simply approved; or
(iv) that the project is rejected.

If the project is approved, the Northeast Development Superintendency gives a notice to the enterprise including a copy of the ruling or decision approving the project, a copy of the report on which the ruling or decision is based and a schedule for investment and disbursement of the funds. Once the enterprise has received the notice of approval, it must accept the conditions put forward by the Northeast Development Superintendency, if any, and begin the development of the project, investing its own resources devoted to it.

(c) *Issuing and subscription of the shares.* At this stage the Northeast Development Superintendency controls the physical and financial development of the project and, if everything is in order, it issues a special permit granted to the Brazilian Northeast Bank in order that this institution be able to subscribe and pay the shares issued by the enterprise receiving the contribution, in name and behalf of the Northeast Investment Fund.

On the other hand, the enterprise is requested to comply with certain formal or legal requirements of the Brazilian Northeast Bank, namely: to produce the updated charts of incorporation, including the benefits granted to preferential shares; general assembly of shareholders or meeting of the board of directors approving the issuing of the shares.

When the above-mentioned legal requirements have been complied with, the Brazilian Northeast Bank, under the permit granted by the Northeast Development Superintendency, credits the current account of the enterprise, with a notice to the enterprise which from that moment can make use of the funds.

The Northeast Development Superintendency checks periodically if the funds are being properly invested by the enterprise receiving them, Moreover, enterprises receiving capital contributions from the Northeast Investment Fund must file quarterly a special form with the Northeast Development Superintendency reporting on the development of the project.

6.3. Granting of loans [6]

In addition to the possibility of receiving capital contributions from the Northeast Fund, enterprises operating in the Northeast region can take advantage of some other financial benefits or facilities, particularly by receiving loans under different rules.

The loans we have referred to do not exclude the possibility of getting capital contributions from the Northeast Investment Fund; nevertheless in order to combine both possibilities it is necessary to comply with those standards and guidelines that will be discussed in Section 7.

The available loans are the following: general loans, loans granted to agricultural enterprises using industrial procedures, and loans granted to small and medium size enterprises.

(a) *General loans.* Enterprises operating in the Northeast region can get loans or guarantees from the Brazilian Northeast Bank and from the National Bank for Economic Development, according to the rules of those banks, in order to develop projects previously considered by the Northeast Development Superintendency to be of interest for the Northeast development. For projects whose value is below a certain amount, approval of the Northeast Development Superintendency is even not necessary.

(b) *Special loans available to agriculture enterprises using industrial processes.* Special loans are available to those agricultural enterprises that are designed to submit animal or vegetable raw materials to industrial processes in order to improve and transform such raw materials, when such materials have not been previously industrially processed. A purely agricultural project can also benefit from these loans if the concerned enterprise enters into a contract in order to devote its entire production to supply a specified industry. In order to receive these loans, the enterprise is supposed to submit a preliminary application letter to the Northeast Development Superintendency. The terms of the loans (payment terms, correction for inflation, rate of interest) are different for different aspects of the project. This means that the purely agricultural part of the project receives more favorable terms than the industrial part of it, and that fertilizers (organic or chemical), seeds, rotation crops and other technical factors receive specially favorable treatment. The term for repayment of the loans can reach 12 years, with the first 3 years free; monetary correction ranges from none at all (agricultural part of the project), to a 10 percent prefixed monetary correction (industrial part of the project); and interest ranges from none at all (for fertilizers, seeds, rotation crops, and other technical factors) to 7 percent (for the rest of the project).

(c) *Special loans available to small and medium size enterprises.* Special loans are granted to small and mediim size enterprises established in the Northeast region by the Brazilian Northeast Bank and by official State owned banks in order to form their capital or to improve their productivity. For this purpose, "small or medium size enterprises" mean enterprises for whom the result of adding their previous fixed investment to the projected investment does not exceed 15 million cruzeiros. Enterprises belonging to groups of related companies whose global and net worth is above 30 million cruzeiros are not eligible to receive this kind of loans.

Hotels, motels, boarding houses, inns, and other similar facilities for tourists, if they are small or medium size according to the rules mentioned above, can receive loans granted to small or medium size enterprises, provided that they are located in interior areas of a State, preferably off paved federal roads. The terms of these loans vary according to the amount of the investment (previous fixed investment plus projected investment) but cannot exceed 7,500,000 cruzeiros, nor 70 percent of the investment amount (previous fixed investment plus projected investment).

7. GUIDELINES UNDER WHICH THE INCENTIVES ARE GRANTED

7.1. General remarks

According to what has already been seen, enterprises operating in the Northeast region are eligible to receive several benefits encompassing tax incentives (tax exemptions and tax reductions), and financial support (capital contributions and loans). The discussion has also covered the conditions or requirements to be met by enterprises interested in these benefits.

Nevertheless, it is necessary to stress that, besides those conditions or requirements, there are some pre-established standards or guidelines to be followed in order to receive the benefits. These standards or guidelines reflect some priorities in the concession of the benefits and some limits in the extent to which the benefits can be granted.

Although these standards or guidelines vary for different benefits, under this Section we will only discuss those standards or guidelines that can be considered important, namely those referring to the possibility of receiving capital contributions from the Northeast Investment Fund and those referring to the possibility of receiving loans from the Brazilian Northeast Bank or from the National Bank for Economic Development.

7.2. General guidelines referring to the possibility of receiving capital contributions from the Northeast Investment Fund

The possibility for an enterprise to receive capital contributions from the Northeast Investment Fund

6. Although the granting of loans is not a tax incentive, we will discuss it in this article because, in addition to what we have already said in Section 6.1., these loans are or can be related to the possibility of receiving capital contributions according to what will be seen in the next Section.

is influenced by a system of priorities in which the new projects are distributed into five different levels, namely, A, B, C, D, and E, A representing the highest priority.

Every project is included in a certain priority level according to the sum of the different marks or points it has been awarded under several fixed rules or factors. Thus, in order to have a project entering one of the priority levels it is necessary that it reach the minimum mark pre-established for that particular level.

On the other hand, the fact that a project is included in a certain level of priority determines the percentage of the project's cost that can be financed through capital contributions from the Northeast Investment Fund as compared to the total cost of the project (loans received from other sources are to be excluded from the cost of the project).

The different levels of priority, the marks or points necessary to enter each level and the financial consequences thereof are shown in Table II.

TABLE II

Level of priority	Marks or points needed to enter the level Lower limit	Upper limit	Rate of receivable capital contributions on the total cost of the project
A	50	—	75%
B	40	49	60%
C	30	39	50%
D	25	29	40%
E	—	24	30%

Some of the factors according to which marks or points are granted to a specified project are:

(a) Projects whose purpose is to implant, complement, modernize or enlarge:

(i) the electric system through the construction of generators, transmitters, distribution channels and rural electrification . . . . . 25 points

(ii) the telecommunications sytem through telegraphy, telephone and radio-communication, the interlinking by means of reciprocal transmissions two or more communities located in the Northeast region not constituting an urban unit . . 25 points

(b) Projects to be located as follows:

(i) in Maranhão and Piauí States, and in Fernando de Noronha Territory . . . . . 25 points

(ii) in Rio Grande do Norte and Sergipe States . . . . . 20 points

(iii) in Creará, Paraíba and Alagoas States and in that part of Minas Gerais State included in the Northeast region . 15 points

(iv) in that part of Pernambuco and Bahia States located in the Polígono das Secas and in that part of Bahia State located to the west of the border of the Polígono . . . . . 10 points

(c) Projects to implant, complement, modernize or enlarge processing industries that produce items considered by the Northeast Development Superintendency to be essential to the regional economic development, as follows:

(i) industries producing capital assets and basic intermediary assets . . . . . 20 points

(ii) industries producing other intermediary assets . . . 15 points

(iii) industries producing durables and textile goods . . 10 points

(d) Projects providing substitutes for imports or which devote at least 40 percent of their production to export . . . . 10 points

7.3. Special guidelines referring to capital contributions from the Northeast Investment Fund

In addition to the above-mentioned general guidelines, there are some special guidelines that in certain cases alter the availability or the amount of the capital contribution to be received under the general guidelines. These special guidelines can be briefly covered as follows:

(i) There are some specified kinds of projects for which capital contributions are excluded. Although there are several items determining this exclusion, they will not be covered here in detail. It suffices to say that these items relate mainly to the fact that the project is not economically important, the fact that the enterprise undertaking the project has already received capital contributions from the Northeast Development Fund (this exclusion is not absolute), or the fact that the promotors are not properly qualified to undertake the project.

(ii) Foreign controlled enterprises or foreign capital enterprises cannot receive capital contributions from the Northeast Investment Fund above their own resources invested in the project. This is to say that the invested resources from the enterprise must be equal to the capital contribution from the Northeast Investment Fund.

(iii) Projects to be developed in comparatively more developed areas (Recife, Salvador, neighboring areas, and industrial areas related to them) can only be included up to the B level of priority, being excluded from the A level.

(iv) Agricultural and cattle breeding projects are normally classified A and only in some specified and limited cases as B.

(v) Projects of high priority for the regional development of the Northeast can receive capital contributions under special rulings set down by the Northeast Development Superintendency without regard to the above-mentioned general guidelines.

7.4. Guidelines referring to loans

Loans granted by the Brazilian Northeast Bank and by the National Bank for Economic Development are also subject to standards or guidelines that in this case can be grouped into two different sets: whether they are or are not combined with the possibility of receiving capital contributions from the Northeast Development Fund.

When there is no capital contribution, the rules are very simple, namely loans granted by the Brazilian Northeast Bank cannot exceed 50 percent of the whole investment; and loans granted by the National Bank for Economic Development cannot exceed the amount of the fixed investment from the enterprise.

When there is a capital contribution from the Northeast Development Bank the standards to be followed are illustrated in Table III.

TABLE III

Level of priority [1]	Financial distribution		
	Bank loans [2]	Capital contribution [3]	Own resources [4]
A	50%	37.5%	12.5%
B	50%	30 %	20 %
C	50%	25 %	25 %
D	50%	20 %	30 %
E	50%	15 %	35 %

Notes:
1. For the marks or points needed to enter a certain priority level see the table in 7.2. above.
2. These loans can be granted by the Brazilian Northeast Bank or by the National Bank for Economic Development.
3. These capital contributions are to be received from the Northeast Investment Fund.
4. These resources are to be provided by the enterprise undertaking the project.

8. FINAL REMARKS

If legal aspects are taken into account fiscal incentives can be established in two ways. We focus more on the legal pattern in which some incentives can be cast. Within these limits, we briefly refer to tax exemptions and to tax reductions as a starting point.

Tax exemptions and tax reductions presuppose the existence of a general rule submitting some persons or facts to a certain amount of tax and, moreover, a second and special rule excluding or reducing for certain persons or facts the tax that otherwise would be due according to the general rule.

Tax exemptions and tax reductions (and perhaps other incentives too) do not normally operate automatically, in the sense that they are not just a direct consequence of the law establishing them, but rather presuppose also the existence of some conditions that must be met to make the benefit operative.

These conditions can be simple and be complied with without much effort; they can also be more complicated and demand an effort or involvement from the person interested in taking advantage of them.

From another angle, these conditions are sometimes to be met before the benefit is enjoyed, or sometimes to be met during the period in which the benefit is being enjoyed or even after it has been enjoyed. If the conditions are not met, the logical consequence would be that the benefit is lost and the whole tax is due, and rather not a compulsory obligation for the taxpayer to comply with the conditions.

There is still another possibility to which we want to point and which we want to stress in these final remarks: the taxpayer, in order to avoid or reduce his tax liability, can be supposed to assume a new and different obligation or debt (e.g. to deposit a certain amount of money for a certain period, to make a certain investment, etc.) or even several obligations.

In order to really consider whether we are facing a new obligation or debt as something different from a simple condition to make the exemption or rebate available, it is necessary that this new obligation have some kind of independence from the tax debt. This independence appears more clearly when there is the possibility, provided by the particular law or by the general legal system, that the debtor be compelled to comply with this new obligation, or also when the law provides several measures or mechanisms to strongly stimulate, to control, or even to ensure such compliance.

We can even think that in this case the taxpayer is placed before two different and alternative obligations in such a way that he must expressly or implicitly select one of them thus being freed from the other.

Any attempt to view in such a case the compliance with the new obligation without an independent approach and simply like a condition to enjoy the exemption or reduction, will only lead to an incomplete or partial view that — in addition to be inexact — can be misleading, especially for the exact understanding and interpretation of the law.

The incentives available in Brazil to enterprises discussed in Section 2 suggest that they were modelled in the design we have just discussed, although perhaps not quite consciously.

It is necessary to recognize that there are some features that seem to contradict our point of view, but they are in a certain sense minor and in any case it would be much more difficult and contradictory to consider the compliance of the "obligation" like nothing else than the fulfillment of a condition to make the exemption or reduction available. Perhaps lawmakers should consciously take into account the two possibilities we have considered and decide which of them suits better the aims of their policies, taking into account the importance they attach to the compliance of the new "obligation" as compared with the tax debt. This conscious decision could help to draft laws dealing with this subject more clearly and consistently and in this way facilitate their understanding and compliance.

NOTE ABOUT TRANSLATION

Several Brazilian institutions have been mentioned in this article by means of an English name translated from Portuguese. Thus, it is appropriate to give the original name for each of those English expressions used to mention such institutions, as follows:

Amazon Investment Fund: Fundo de Investimentos de Amazônia — FINAM
Bank of Brazil: Banco de Brasil
Brazilian Aeronautic Enterprise: Empresa Brasileira de Aeronáutica S.A. — EMBREAR
Brazilian Northeast Bank: Banco do Nordeste do Brasil S.A. — BNB
Brazilian Institute for Forestry Development: Instituto Brasileiro de Desenvolvimento Florestal — IBDF
Brazilian Tourism Enterprise: Empresa Brasileira de Turismo
Certificate of Application of Fiscal Incentives: Certificado de Aplicações en Incentivos Fiscais — CAIF
Customs Policy Council: Conselho de Política Aduaneira — CPA
Federal Revenue Office: Secretaria de Receita Federal
Fishing Development Superintendency: Superintendência do Desenvolvimento de Pesca — SUDEPE
Fund for the Economic Recovery of the "Espiritu Santo" State: Fundo de Recuperação Econômica do Estado do Espíritu Santo — FUNRES
Investment Certificate: Certificado de Investimento — CI
Mobral Foundation: Fundação Mobral — Movimento Brasileiro de Alfabetização
National Bank for Economic Development: Banco Nacional do Desenvolvimento Econômico
National Security Council: Conselho de Segurança Nacional
Northeast Development Superintendency: Superintendência do Desenvolvimento de Nordeste — SUDENE
Northeast Investment Fund: Fundo de Investimento do Nordeste — FINOR
Plan for National Integration: Plano de Integração Nacional — PIN
Program for Land Redistribution: Programa de Redistribuição de Terras e de Estímulos à Agroindústria do Norte e do Nordeste — PROTERRA
Readjustable Bonds of the National Treasury : Obrigação Reajustável do Tesouro Nacional
Sectorial Investment Fund: Fundo de Investimentos Setoriais — FISET (This Fund encompasses three separate accounts or Sections for fishing, forestry and tourism that are mentioned in the way mentioned below.)
Sectoria Investment Fund — Fishing Section: Fundo de Investimentos Setoriais — Pesca
Sectorial Investment Fund — Forestry Section: Fundo de Investimentos Setoriais — Florestamento e Reflorestamento
Sectorial Investment Fund — Tourism Section: Fundo de Investimentos Setoriais — Turismo
Tourism National Council: Conselho Nacional de Turismo

COUNTRY BY COUNTRY SURVEY OF LOOSE-LEAF PUBLICATIONS . . .

INTERNATIONAL

DOUBLE TAXATION OF NON-RESIDENTIAL SHIPPING

The Baltic and International Maritime Conference (BIMCO), 19 Kristianiagade, DK-2100 Copenhagen.
Supplemented: annually.

Loose-leaf publication providing information on freight taxes and regulations regarding "Double Taxation of Non-Residential Shipping" in all countries where, according to BIMCO information, double taxation in some form may be levied against non-residential shipowners.

FOREIGN TAX AND TRADE BRIEFS

By Walter H. Diamond. Matthew Bender, 1275 Broadway, Albany, N.Y. 12201.
Supplemented: monthly.

Loose-leaf publication in two binders designed to provide a general picture of information on taxation and trading laws in the principal nations of the world where United States capital is most frequently invested. Countries are listed in alphabetical order under the continent or section of the world in which they are located.

FOREIGN TAX AND TRADE BRIEFS

International Withholding Tax Treaty Guide. By Walter H. Diamond. Matthew Bender, 1275 Broadway, Albany, N.Y. 12201.
Supplemented: quarterly.

Loose-leaf publication designed as a quick reference guide to give the user information on the normal withholding tax rates and withholding tax rates under tax treaties, if any, of about 90 countries in the world on dividends, royalties, rentals, technical fees, interest and income from shipping and aircraft.

INTERNATIONAL TAX AGREEMENTS

United Nations, Department of Economic and Social Affairs, New York, N.Y. 10017.
Supplemented: once or twice a year.

Loose-leaf publication designed to contain the text of tax agreements (on income/capital, estate duty, income from maritime and air transport, etc.), concluded by all the countries in the world. The texts of the agreements are presented in an English and a French edition (Conventions Fiscales Internationales). The work consists of several volumes: the first seven are bound, the later ones, eight and nine, are loose-leaf. Volume eight entitled "World Guide/Répertoire Mondial" consists of schedules summarizing for each country the tax agreements signed, ratified, applied and amended. Volume nine contains the texts of the more recent double taxation agreements.

INTERNATIONAL TAX STRATEGY

Edited by M. Edwardes-Ker. In-Depth Publishing, Ltd., Alton House, Herbert Street, Dublin-2.
Supplemented: once or twice a year.

Loose-leaf publication designed as a guide to international tax planning for corporations using the practical opportunities for avoiding taxes. The aim of tax avoidance is to maximize after tax profits. Included are the following subjects: overseas trading activities, anti-avoidance measures, intercompany pricing, fiscal export incentives, international financing strategy, management services, lease, international mergers, shipping and aircraft operations, administrative head office, tax strategy for individuals, North Sea oil offshore companies, the international capital markets in Switzerland, in the United Kingdom, the Netherlands, holding companies, offshore funds, the no-tax havens, exchange fluctuations, etc.

INVESTING, LICENSING & TRADING CONDITIONS ABROAD

Business International Corporation, One Dag Hammarskjold Plaza, New York, N.Y. 10017.
Supplemented: monthly.

Loose-leaf publication in three volumes designed to provide information on trading with and operating in and from the major markets in countries on the free world. There is a country by country description of the following subjects: general political and foreign investment climate, state role in industry, rules of competition, remittability of funds, incentives, taxation, licensing, labour and foreign trade. An introduction in each volume provides a general overview of new trends in development in the region covered (i.e. Africa, Middle East, Europe, Asia, North America, Latin America).

TAX HAVENS ENCYCLOPAEDIA

Edited by B. Spitz. Butterworths Law Publishers, Ltd., 88 Kingsway, London WC2B 6AB.
Supplemented: twice a year.

Loose-leaf publication which sets out in part one, the law and practice of high tax countries, which can limit the tax advantages of foreign operations. Included in this part of the book are the United Kingdom, United States, France, Canada and Germany. Part two of the book contains the description of the tax systems in the most well known tax haven countries. The country services have been written by different authors, with an introduction by B. Spitz.

TAX HAVENS OF THE WORLD

By Walter H. Diamond and D.B. Diamond. Matthew Bender, 1275 Broadway, Albany, N.Y. 12201.
Supplemented: quarterly.

Loose-leaf publication in two binders containing information of the tax havens in the world. It reviews various areas such as government, labour, taxation, banking, transfer of funds, transportation, etc. to be considered in choosing a tax haven either for business purposes or as a retirement haven for individuals.

IRELAND

THE INCOME TAX ACT, 1967

With Statutory Regulations, etc. Cross-references to former enactments, Tables of Rates, Income Tax personal reliefs and an Index. Published by the Stationery Office, under the authority of the Revenue Commissioners. Government Publications Sales Office, G.P.O. Arcade, Dublin 1.
Supplemented: annually.

Loose-leaf publication in two volumes setting out the provisions of the Income Tax Act, 1967 and containing also certain statutory regulations which are affected by Finance Acts of 1967 and later years, as well as statutory regulations giving effect to double taxation agreements. A comprehensive index is appended.

IRISH INCOME TAX AND CORPORATION PROFITS TAX

By F.N. Kelly and K.S. Carmichael. HFL (Publishers), Ltd., 9 Bow Street, Covent Garden, London WC2E 7AL.
Supplemented: annually.

Loose-leaf publication which describes the law and practice of the income tax and corporation profits tax in Ireland excluding the six countries comprising Northern Ireland. A comprehensive index is appended.

THE LAW OF STAMP DUTIES

Containing the Stamp Acts, 1891 and amending statutes. Second edition. Published by the Stationery Office, under the authority of the Revenue Commissioners. Government Publications Sales Office, G.P.O. Arcade, Dublin 1.
Supplemented: irregularly.

Loose-leaf publication on the law of stamp duties. The work consists of four principal parts. Part 1 contains the Stamp Act, 1891, together with relevant sections of Finance and Revenue Acts, passed in the period between 1894 and 1971, which contain provisions affecting stamp duty. Part 2 contains the Stamp Duties Management Act, 1891, and amending provisions. Part 3 contains the special exemptions from stamp duty contained in Miscellaneous Acts other than Finance and Revenue Acts. Part 4 contains provisions in Miscellaneous Acts imposing, or otherwise relating to, stamp duty. A comprehensive index with various cross references is appended.

LUXEMBOURG

CODE FISCAL LUXEMBOURGEOIS

Edited by Joseph Sinner. Editions de l'Imprimerie St-Paul, P.O. Box 1908, 6-8, rue J. Origer, Luxembourg.
Supplemented: annually.

Loose-leaf publication consisting of nine volumes and containg the integral text in the original language (either French or German) of the tax laws of Luxembourg. Each section of the law is followd by annotations and full publication of relevant implementing regulations, ministerial directives and extracts of case law related thereto.

MOROCCO

LES CODES MAROCAINS: CODE FISCAL

Fiduciaire Marocaine d'Editions Techniques, 81, rue Colbert, Casablanca.
Supplemented: four times a year.

Loose-leaf publication containing text of tax laws, measures to encourage private investment as well as decrees by the Minister of Finance and summaries of case law.

GUIDE DES IMPOTS AU MAROC

Fiduciaire Marocaine d'Editions Techniques, 81, rue Colbert, Casablanca.
Supplemented: twice per month.

Loose-leaf publication containing a summary of taxes levied in Morocco. The material is updated by loose-leaf supplements contained in the magazine entitled "La Revue Fiduciaire Marocaine".

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SINGAPORE:
Foreign Investment and Tax Treaties.

by M.P. Dominic *

1. Foreign investment plays an important role in Singapore. With its increasingly sophisticated commercial, industrial and financial facilities it is developing into a financial and regional headquarter centre for Asia and Pacific and as a manufacturing base. The Asian dollar market is well developed in Singapore.

2. The tax climate in Singapore is favourable for foreign investment. A resident is taxed on foreign income only when it is remitted. A non-resident is not taxed on foreign income even when it is remitted to Singapore. A company's residence in Singapore is based on the exercise of control and management of its business in Singapore; hence, possibilities exist, for accumulation of foreign income outside Singapore and for change of the company's residence when it desires to remit this income. The result of the residence change is that the accumulated foreign income will not be taxed when remitted. This can be done even if all the company's trading operations are exercised in Singapore. Integration of company taxation and shareholder's taxation by the deduction of company tax from the dividends paid to shareholders and by the grant of credit for the tax deducted against the shareholder's tax also plays an important influence in attracting investments. There is no tax on capital gains. In addition, various tax incentives are provided for the purpose of encouraging industries, exports, Asia-dollar market, shipping, reinsurance companies etc.

3. However, taxation of a foreign investor depends not only on Singapore taxation but also on taxation in the home country of the investor. In order to mitigate the burden of international double taxation, the Singapore Government is empowered under Section 49 of the Income Tax Act to conclude tax treaties with other countries. Singapore has concluded tax treaties with Australia, Belgium, Canada (not yet ratified), Denmark, France, Germany, Israel, Japan, Malaysia, Netherlands, New Zealand, Norway, Sweden, Switzerland, Thailand and United Kingdom. The purpose of this analysis is to make a comparative survey of these tax treaties in respect of certain types of foreign investments.

4. These tax treaties have taken into account the territorial basis of taxation in Singapore, its system of integration of company taxation and shareholder's taxation, non-taxation of capital gains and the provision of tax incentives. These treaties are generally based with certain modifications on the O.E.C.D. model treaty. The treaties generally provide for taxation at source of the following types of income:
   i) Industrial, commercial, agricultural and mining profits of a non-resident enterprise if it is engaged in business through a permanent establishment.
   ii) Professional income.
   iii) Remuneration for personal services except in the case of short-term employment.
   iv) Income from immovable property such as rents, mortgage interest, royalties etc.

5. The concept of permanent establishment is unknown in the Singapore internal tax law. However, the concept is adopted in all the tax treaties. The O.E.C.D. definition is followed with some variations. In the Malaysian tax treaty, no time limit is specified with respect to the treatment of building sites, construction or assembly project as permanent establishments. In the other treaties, they are considered as permanent establishments if they are carried on for more than 6 months.
   The supervisory activities in connection with the construction, installation or assembly project are deemed to be permanent establishments if they are carried on for more than 6 months (no time limit in the Malaysian treaty). The treaties also differ both among themselves and from the O.E.C.D. model with respect to criteria used to determine whether dependent agents are permanent establishments. The Australian and New Zealand tax treaties employ the principle of attribution in determining the profits taxable at source.

(to be continued on p. 275).

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NEW ZEALAND	NORWAY	SWEDEN	SWITZERLAND	THAILAND	UNITED KINGDOM
S - Income Tax N.Z. - Income Tax - Excess Retention Tax	S - Income Tax N- National Income Taxes (including tax equalization dues and special income tax in aid of developing countries) - Municipal Income Taxes - Seaman's Tax	S - Income Tax Swed - State Income Tax (including saloir's Tax and Coupons Tax)	S - Income Tax Swit - Income and Capital Taxes levied by the Federation, cantons and municipalities	S - Income Tax T- Income Tax - Petroleum Income Tax	S - Income Tax U.K. - Income Tax (including Surtax, Profits Tax, Corporation Tax and Capital Gains Tax)
Same - principle of attraction	Same	Same	Taxed in Source Country if a Permanent Establishment exists - principle of attribution	Same	Same
Same	Same	Same	Permanent Establishment if for more than six months	Same	Same
Same	Same	Same	Permanent Establishment if for more than six months		Same
Independent Agents - No P.E. Dependent Agents - P.E. if - Authority to conclude contracts - Maintenance of stocks to fill orders - Manufacturing, assembly - Mining, quarrying, extraction of natural resources	Same as in Belgium	Same	Same	Independent Agents - No P.E. Dependent Agents - P.E. if - Authority to conclude contracts - Maintenance of stocks to deliver - Habitually secures orders wholly or almost wholly	Same as in Belgium
			Taxed in situs	Taxed in situs	
Exempt in Source Country	Tax in Source Country reduced to 50%, with credit against tax in Resident Country against its tax on such profits	Tax in Source Country reduced to 50%, with credit against tax in Resident Country on such profits	Aircraft - Exempt in Source Country Shipping - Tax in Source Country reduced to 50%	Aircraft - Tax in the place of effective management Shipping - Tax in Source Country reduced to 50%	Exempt in Source Country
Sing. Co. to New Zealand Resident - exempt in Sing. New Zealand Co. to Sing. Resident - 15% in New Zealand	Sing. Co. to Norway Resident - exempt in Sing. Norwegian Co. to Sing. Resident - exempt in Norway	Sing. Co. to Swedish Resident - exempt in Sing. Swedish Co. to Sing. Parent Co. with at least 25% holding - 10% in Sweden Swedish Co. to other Sing. Resident - 15% in Sweden	Sing. Co. to Swiss Resident - exempt in Sing. Swiss Co. to Sing. Parent Co. with at least 25% shares - 10% in Switzerland Swiss Co. to other Sing. Resident - 15% in Switzerland	Sing. Co. to Thai Resident - exempt in Sing. Thai Co. to Sing. Parent Co. with 25% voting shares - 20% in Thailand Thai Co. to other Sing. Resident - normal rate in Thailand	Sing. Co. to U.K. Resident - exempt in Sing. U.K. Co. to Sing. Resident - exempt in U.K. (Special provision is made for parent companies with at least 10% holding)
Source Country Tax - 15%		Source Country Tax - Paid to Government - exempt - Paid to financial institutions by an industrial undertaking - 10% - Otherwise - 15%	Source Country Tax - 15%	Source Country Tax - Paid to Government - exempt - Paid to a financial institution (including an insurance company) - 10% - Otherwise - 25%	

FRANCE	GERMANY (Fed. Rep.)	ISRAEL	JAPAN	MALAYSIA	NETHERLANDS
S - Income Tax F - Income Tax - Corporation Tax (including withholding tax, précompte or advance payment)	S - Income Tax G - Income Tax (including Surcharge) - Corporation tax (including Surcharge) - Capital Tax - Trade Tax	S - Income Tax I - Income Tax (including Capital Gains Tax and Company Tax) - Security Levy	S - Income Tax J - Income Tax - Corporation Tax	S - Income Tax M - Income Tax - Tin Profits Tax - Development Tax	S - Income Tax Neth - Income Tax - Wages Tax - Company Tax - Dividend Tax - Tax on Fees of Directors of Companies - Capital Tax
Same	Same	Same	Same	Same	Same
Same	Same	Same		Permanent Establishment - No time limit	Permanent Establishment if for more than six mont
Same	Same	Same		Permanent Establishment - No time limit	Permanent Establishment if for more than six mont
Same	Same	Same	Same	Same	Same
Taxed in situs	Taxed in situs	Taxed in situs		Taxed in situs	Taxed in situs
Exempt in Source Country	Tax only in Resident Country. But not in Singapore if there is majority foreign participation and 13A of the Income Tax Act applies	Exempt in Source Country	Exempt in Source Country	Tax in Source Country reduced to 50%	Tax in Source Country reduced to 50%
t Sing. Co. to French Resident - exempt in Sing. French Co. to Sing. Parent Co. with at least 10% shares - 10% tax in France - no avoir fiscal - refund of précompte French Co. to other Sing. Residents - 15% tax in France - avoir fiscal - refund of précompte if no avoir fiscal. French Parent Co. owning at least 10% shares in Sing. Co. to French Resident out of Sing. dividends - avoir fiscal	Sing. Co. to German Resident - exempt in Sing. German Co. to Sing. Parent Co. with at least 25% shares - 15-27% in Germany German Co. to other Sing. Residents - 15% in Germany	Sing. Co. to Israeli Resident - exempt in Sing. Israeli Co. to Sing. Resident - exempt in Israel	Sing. Co. to Japanese Resi-Parent Co. holding at least 50% voting power, at least 6 months before declaration of dividend - 10% in Sing. Sing. Co. to other Japanese Resident - 15% in Sing. Japanese Co. to Sing. Parent Co. holding at least 50% of voting power, at least 6 months before declaration of dividend - 10% in Japan Jap. Co. to other Sing. Resident - 15% in Japan	Taxed where the dividend is derived or deemed to be derived. The same country must give credit for the tax deducted or deemed to have been deducted from such dividend. - Special provisions regarding residence and deemed source	Sing. Co. to Neth. Reside - exempt in Sing. Neth. Co. to Sing. Parent Co. with 25% holding - exempt in Netherlands Neth. Co. to other Sing. Resident - 15% in Netherlands
Source Country Tax - Interest paid by industrial undertakings - exempt - Paid to a Government - exempt - Otherwise - 10%	Source Country Tax - Paid to Government - - exempt - Otherwise - 10%	Source Country Tax - 15%	Source Country Tax - Paid to Government - exempt - Paid by an industrial undertaking - exempt	May be taxed in the Source Country	Source Country Tax - Paid to Government - exempt - Otherwise - 10%

Taxes	AUSTRALIA S - Income Tax A - Commonwealth Tax - Additional Tax on undistributed profits	BELGIUM S - Income Tax B - Individual Income Tax - Corporate Income Tax - Income Tax on Legal Entities - Income Tax on Non-Residents - Prepayments and Additional Prepayments - Surcharges (including communal supplement to the Individual Income Tax)	CANADA S - Income Tax C - Income Taxes	DENMARK S - Income Tax D - Ordinary Income Tax - Municipal Income Tax - Old Age Pension Contribution - Seaman's Tax - Special Income Tax (Capital Gains Tax) - Church Tax
Business Profits (Industrial and commercial profits)	Taxed in Source Country if a Permanent Establishment exists - principle of attraction	Taxed in Source Country if a Permanent Establishment exists - principle of attribution	Same	Same
Building Site, Construction, Assembly, etc.	Permanent Establishment, if for more than 6 months	Same	Same	Same
Supervisory Activities in connection with construction etc.	Permanent Establishment, if for more than 6 months	Same	Same	Same
Agents	Independent Agents - No P.E. Dependent Agents - P.E., if - Authority to conclude contracts - Maintenance of stocks to fill orders - Manufacture or process	Independent Agents - No P.E. Dependent Agents - P.E., if - Authority to conclude contracts - Maintenance of stocks to fill orders	Same	Same
Immovable property		Taxed in situs	Taxed in situs	Taxed in situs
International Traffic - Shipping and Air Transport	Aircraft - Exempt in Source Country Shipping - Tax in Source Country reduced to 50%	Tax only in the place of effective management	Aircraft - Exempt in Source Country Shipping - Exempt in Source Country	Tax in Source Country reduced to 50%
Dividends	Sing. Co. to Australian Resident - exempt in Sing. Australian Co. to Sing. Resident - 15% in Australia	Sing. Co. to Belgian Resident - exempt in Sing. Belgian Co. to Sing. Resident - exempt in Belgium	Sing. Co. to Canadian Resident - exempt in Sing. Canadian Co. to Sing. Resident - 15% in Canada	Sing. Co. to Danish Resident - exempt in Sing. Danish Co. to Sing. Resident - exempt in Denmark
Interest	Source Country Tax - 10%	Source Country Tax - 15%	Source Country Tax - 15% - Interest paid to Export Development Corp. of Canada - exempt	Source Country Tax - Interest paid to financial institutions by industrial undertakings - 10% - Paid to Government - exempt - Otherwise - 15%
Royalties - Patent and Know-how	Source Country Tax - 10%	Source Country Tax - exempt	Source Country Tax - 15%	Source Country Tax - exempt
Royalties - Copyright	Source Country Tax - Scientific Work - 10%	Source Country Tax - Scientific Work - exempt - Literary and Artistic - both countries	Source Country Tax - Scientific Work - 15% - Literary & Artistic - 15%	Source Country Tax - Scientific Work - exempt
Royalties - Cinematograph Royalties - Natural Resource		Source Country may tax Situs	Source Country Tax - 15% Situs	Situs

SINGAPORE	SINGAPORE	SINGAPORE	SINGAPORE	SINGAPORE
i) Ordinary credit ii) Credit for underlying taxes in the case of dividends paid by a Norwegian Co. to a Sing. resident iii) Credit for the tax on shipping and aircraft profits (at 50% rate) in Norway against Norway tax on such profits	i) Credit for the tax on shipping and aircraft profits (at 50% rate) in Sweden, against Sing. tax on such profits ii) Ordinary credit iii) Credit for the underlying taxes in the case of dividends paid by a Swedish Co. to a Sing. Parent Co. with 25% holding	i) Ordinary credit ii) Credit for underlying taxes in the case of dividends paid by a Swiss Co. to a Sing. Parent Co. with at least 25% shareholding	i) Ordinary credit ii) Credit for underlying taxes in the case of dividends paid by a Thai Co. to a Sing. Parent Co. with at least 25% of the voting shares	i) Ordinary credit ii) Credit for underlying taxes in the case of dividends paid by a U.K. Co. to a Sing. Parent Co. with at least 10% of the voting power
NORWAY	**SWEDEN**	**SWITZERLAND**	**THAILAND**	**UNITED KINGDOM**
i) Credit For the tax on shipping and aircraft profits (at 50% rate) in Sing. against Norwegian tax on such profits ii) Exemption a. Income (other than income referred to in i)) taxable in Sing. under the treaty b. Profits exempted under the Expansion Incentives Act c. Dividends exempted under the Expansion Incentives Act. d. Capital gains from Immovable Property in Sing. e. Royalties - patent - copyright for scientific work f. Gains from alienation of royalty right	i) Credit for a. Dividends - 15% b. Interest - 15% against Swedish tax on such income ii) Exemption a. Dividends paid by a Swedish Co. to a Sing. Co. if the dividends are paid out of income from business activities in Sing. carried out by the paying Co. or by a Co. in which it has at least 25% holding b. 50% of the royalties - patent - copyright for scientific work iii) Ordinary credit - Income taxable in Sing. under the treaty	i) Ordinary credit - Dividends, interest and royalties ii) Partial exemption - Dividends, interest and royalties iii) Lump sum reduction of Swiss tax - Dividend, interest and royalties Switzerland will determine the applicable relief under i), ii) or iii) iv) 10% exemption - dividends, interest and royalties v) Exemption with progression - Other income	i) Ordinary credit ii) Credit for underlying taxes in the case of dividends paid by a Sing. Co. to a Thai Parent Co. with at least 25% of the voting shares	i) Ordinary credit ii) Credit for underlying taxes in the case of dividends paid by a Sing. Co. to a U.K. Parent Co. with 10% of the voting power
Exists		Exists		Exists
Exists		Exists	Exists	Exists
Same	Same	Same	Same	Same
Exempt in Source Country unless business is carried on through a Permanent Establishment	Immovable Property - Situs Movable Property - Royalty right - Exempt in Source Country - Part of Permanent Establishment - Source Country - Ships & aircraft - Resident - Shares - Special Provisions - Others - Resident Country	Immov. Property - Situs Movable Property -Part of Permanent Establishment - Source Country - Ships & aircraft - Resident Country - Royalty rights - Both Countries	Immov. Property - Situs Movable Property - Royalty Right - Source Country Tax - 15% - Part of Permanent Establishment - Source Country - Ships & aircraft - Place of effective management - Others - Resident Country	Exempt in Source Country unless busines is carried on through a Permanent Establishm
Employment income is taxed in the country where employment is exercised. Short-term employment is exempt	Where services are performed. Short-term employment is exempt	Where services are rendered. Exception - Short-term employment	Where services are performed. Short-term employment is exempt	Employment is taxed i the country where em ment is exercised. Short-term employme exempt
Exists	Exists	Does not exist	Exists	Exists

SINGAPORE	SINGAPORE	SINGAPORE	SINGAPORE	SINGAPORE	SINGAPORE
i) Ordinary credit ii) Credit for underlying taxes in the case of dividends paid by a German Co. to a Sing. Parent Co. with at least 25% holding	i) Ordinary credit ii) Credit for underlying taxes in the case of dividends paid by a Israelian Co. to a Sing. Parent Co. with at least 25% holding	Ordinary credit	i) Ordinary credit ii) Exemption - Income of any approved pension or provident fund or society	i) Ordinary credit ii) Credit for underlying taxes in the case of dividends paid by a Netherlands Co. to a Sing. Parent Co. with at least 25% holding	i) Ordinary cre ii) Credit for ur taxes in the dividends pa New Zealan a Sing. Parer with 10% of paid-up shar capital holdi
GERMANY (Fed. Rep.)	**ISRAEL**	**JAPAN**	**MALAYSIA**	**NETHERLANDS**	**NEW ZEALANI**
i) Ordinary credit a. Dividends other than dividends referred to in ii)a b. Interest c. Royalties - copyright for literary or artistic work - cinematograph d. Income of public entertainers e. Directors' fees ii) Exemption with progression a. Dividends paid by a Sing. Co. to a German Parent Co. with at least 25% holding b. Other income	i) Ordinary credit ii) Credit for underlying taxes in the case of dividends paid by Sing. Co. to a Israeli Parent Co. with 25% holding	Ordinary credit	i) Ordinary credit ii) Exemption - Income of any approved pension or provident fund or society Special provisions are made in respect of the country granting tax credit for remuneration of ships' and aircraft crews, pension and interest	Exemption with progression a. Interest - Sing. tax plus twice the difference between this amount and 10% of the interest b. Royalties - 20% of the amount of royalties c. Other income taxable in Singapore under the treaty Exemption of interest and royalties referred to under a. and b. is not to exceed 50% of the Sing. tax which would have been levied if not for Expansion Incentives Act	i) Exemption v progression - Dividends p a Sing. Co. N.Z. Parent 10% paid-u capital holc ii) Ordinary cre
Exists	Exists (mutual)	Exists		Exists	Exists
Exists	Exists	Exists	Exists	Exists	Exists
Same	Same	Same	Same	Same	Same
Immovable Property - Situs Movable Property - Part of Permanent Establishment - Source Country - Ships & aircraft - Resident Country - Others - Only Resident Country			Royalty Right - Source country may tax	Immovable Property - Situs Movable Property - Royalty Right - Exempt in Source Country - Part of Permanent Establishment - Source Country - Special provisions for shares	
Same	Same	May be taxed in each country according to its laws with credit for other country's tax Short-term employment - exempt	Employment income is taxed in the country where employment is exercised. Short-term employment is exempt	Where services are performed Short-term employment is exempt	Same
Exists	Exists	Exists	Exists	Exists	Exists

Avoidance of Double Taxation – Methods	SINGAPORE i) Ordinary credit ii) Credit for underlying taxes in the case of dividends paid by an Australian Co. to a Sing. Parent Co. with at least 10% share-holding	SINGAPORE i) Ordinary credit ii) Credit for underlying taxes in the case of dividends paid by a Belgian Co. to a Sing. Parent Co. with at least 25% holding	SINGAPORE Ordinary credit	SINGAPORE i) Ordinary credit ii) Credit for underlying taxes in the case of dividends paid by a Danish Co. to a Sing. resident	SINGAPORE i) Ordinary cred ii) Credit for unc taxes in the ca dividends paic French Co. to Sing. Parent. (at least 10% h
	AUSTRALIA i) Ordinary credit ii) Rebate at the average rate of tax payable in Australia in respect of dividends received by an Australian Parent Co. with at least 10% holding	**BELGIUM** i) Exemption from Corporate Income Tax for dividends received by a Belgian Co. from a Sing. Co. if they would have been exempt if both companies are resident in Belgium ii) Exemption from précompte mobilier for dividends received by a Belgian Co. from a Sing. Co., under certain conditions iii) Credit for 15% of the gross amount of a. Dividends, not falling under i) b. Interest (including interest exempt under Expansion Incentives Act) c. Royalties iv) Income which is chargeable under the treaty and not covered under i), ii) and iii) - Exemption with progression - Special provision is made for absence of profits due to set off of losses	**CANADA** i) Ordinary credit ii) Deduction of dividends received out of exempt surplus of a foreign affiliate resident in Sing.	**DENMARK** i) Credit a. Interest - 15% of the gross amount b. Shipping & aircraft - Singapore tax ii) Exemption with progression a. Income from Sing. sources which is taxable in Sing. under the treaty and not included under i) b. Royalties - patent - copyright for scientific work	**FRANCE** i) Ordinary credi a. Dividends oth dividends refer in iii)a b. Interest c. Royalties - patent - copyright for tific work d. Directors' fees e. Income of pub tainers ii) Credit 10% of the gro amount of roy - literary & arti - cinematograp - commercial e iii) Exemption wit progression a. Dividends paid Sing. Co. to a F Parent Co. wit 10% holding b. Other income
Tax Sparing Credit (total or partial)	Exists	Exists	Exists		Exists
Limitation of Relief	If an item is allowed to be taxed in a country and under the country's laws only up to income remitted or received is taxed, the reduction or exemption of taxes is only for that amount	Same	Exists		Exists
Directors' Fees	Resident Country of Co.	Same	Same	Same	Same
Capital Gains		Immovable Property - Situs Movable Property - Part of Permanent Establishment - Source Country - Ships & aircraft - Where effective management is - Other property - Both Resident & Source Country	Immovable Property - Situs Movable Property - Part of Permanent Establishment - Source Country - Ships & aircraft - Resident Country - Shares - Special Provisions - Others - Resident Country	Immovable Property - Situs Movable Property - Royalty Right - Exemp- in Source Country - Part of Permanent Establishment - Source Country - Ships & aircraft - Resident Country - Shares - Special Provisions - Others - Resident Country	Immovable Propert Movable Property - Royalty Right - S Country may tax - Part of Permanent lishment - Source - Ships & aircraft - R Country - Shares - Special Pr - Others - Resident
Personal Services (including professional services)	Where services are performed or exercised. Exception - short-term employment	Same	Where services are performed. Exception - Short-term employment	Same	Same
Exchange of Information	Exists	Exists	Exists	Exists	Exists

6. There is no dividend tax in Singapore. This is recognised in all the tax treaties by the provision of exemption of dividends paid by a Singapore Company from any tax other than the deduction of company tax. Under certain tax treaties when such dividends are paid to companies with certain specified percentages of shareholding, they will also be exempt in the other country. Rebate against Australian tax is provided in the Australian tax treaty and tax credit is granted in U.K. tax treaty for the underlying Singapore company tax. Some treaties provide matching credits [1] for dividends.

7. Interest derived from Singapore and paid to non-residents is subject to a 40 percent rate, which is reduced to 10 percent or 15 percent in a number of tax treaties. Interest paid to certain types of institutions is exempt in some of the treaties. It must be noted that the source rule in Singapore with respect to interest is very wide. Interest is deemed to be derived from Singapore if it is borne directly or indirectly by a person resident in Singapore or a permanent establishment in Singapore or where the funds provided by such loans are brought into or used in Singapore.

8. Royalties paid to non-residents are taxed at 40 percent. Under the tax treaties, a distinction is made between royalties and copyright and cinematographic royalties. Industrial royalties are either completely exempt or the tax is reduced to 15 percent. In the Norwegian tax treaty, exemption is granted also in Norway (resident country). The Israel tax treaty exempts taxation in the source country and limits taxation in the resident country to 15 percent.

9. Tax incentives are either in the Income Tax Act itself or in the Economic Expansion Incentives Act. The effectiveness depends also on the tax treatment in the home country of the investor. For this purpose, tax sparing credit is granted in the tax treaties with Australia, Belgium, Canada, France, Germany, Israel, Japan, Netherlands, New Zealand, Norway, Switzerland and the United Kingdom. Most of the treaties restrict tax sparing credit to interest and/or royalties. Some treaties (e.g. the United Kingdom) grant tax sparing credit even to taxes exempted or reduced under the Economic Expansion Incentives Act.

10. Matching credit is provided in a number of tax treaties for other income than dividends.

1. The Matching Credit is "a credit at a fixed rate or rates which the capital-exporting country grants for certain taxes of a developing country (usually withholding taxes on dividends, interest and occasionally other income from capital). The matching credit may be extended by statute or by treaty. It is not strictly a tax-sparing credit because it applies whether or not the source country waives or reduces its tax. Accordingly, the matching credit is more in the nature of a limited exemption than a device for preserving and reciprocating the tax relief extended by the developing country." — Tax Treaties Between Developed and Developing Countries, Fourth Report (United Nations, New York, 1973) p. 151.

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Countervailing Duties in the United States; Disintegration of the GATT Agreement?

On April 12, 1977, the U.S. Court of Customs rendered a verdict on the case of *Zenith Radio Corp.* v. *The United States*. The Court held that the United States was required to imposing a countervailing duty on certain Japanese electronic products which received an exemption from a Japanese indirect tax when exported, despite the objection by the U.S. Treasury to the imposition of such a duty. Because of the potentially sweeping impact of this case, the opinion of the Court is reproduced here to a large degree. Following the opinion an explanation and an analysis are provided. *

Before RICHARDSON, NEWMAN and BOE, Judges

RICHARDSON, Judge: Plaintiff, a domestic manufacturer of various consumer electronic products, has instituted this action under 19 U.S.C.A., section 1303, for judicial review of the decision of the Secretary of the Treasury, and has moved for summary judgment pursuant to rules 4.12 and 8.2 of the rules of this court; and defendant has cross-moved for summary judgment. Plaintiff contends that the Government of Japan pays or bestows directly or indirectly a bounty or grant upon the exportation from that country of the aforesaid consumer electronic products in the form of the remission of, or exemption from, payment of a consumption tax to which these products would have been subjected had they not been exported. Defendant contends that the Japanese tax remission or exemption does not constitute a bounty or grant within the meaning of section 1303.

The essential facts of the controversy are not in dispute. The Japanese Commodity Tax Law, cited as Commodity Tax Law (March 31, 1962, Law No. 48) as revised, is a single-stage consumption tax which is levied usually at the manufacturing level on a fairly extensive list of consumer goods, inclusive of electronic products of the types manufactured by plaintiff. Rates of tax range generally from 5 to 40 percent. Upon exportation of these products from Japan, the tax is either remitted, if previously paid, or the products are exempted from the payment of the tax.

Plaintiff petitioned the Secretary of the Treasury in 1970, alleging that the exemptions from or refund of the so-called "commodity tax" under the aforementioned Japanese Commodity Tax Law when the said electronic products were exported from Japan amounted to the payment or bestowal of bounties or grants directly or indirectly, upon the manufacture, or production in, or exportation from, Japan of said consumer electronic products. The petition asked the Secretary of the Treasury to impose countervailing duties on these imported products in accordance with section 1303. On January 7, 1976, a "Final Negative Countervailing Duty Determination" in the case of "Certain Consumer Electronic Products From Japan" was published in the Federal Register at the instance of the Acting Commissioner of Customs upon the approval of the Acting Assistant Secretary of the Treasury. This determination stated that "a final determination is hereby made in this proceeding, that ... no bounty or grant is being paid or bestowed, directly or indirectly, within the meaning of section 303, Tariff Act of 1930, as amended (19 U.S.C. 1303), upon the manufacturer (sic), production, or exportation of certain consumer electronic products from Japan".

Plaintiff after giving notice to the Secretary of the Treasury of its intention to contest this determination, which notice was duly published in the Federal Register, then instituted this action for a review of this determination. The motions for summary judgment follow the joining of issue in said action. There is no question here but that the Japanese commodity tax in issue is either remitted when merchandise is exported from Japan if previously paid thereon, or the exported merchandise is not subject to the payment of tax. Plaintiff contends that the forgiveness of the commodity tax on exportation from Japan of the subject electronic products confers a direct or indirect benefit on the exportation of such products. Plaintiff argues:

... The Supreme Court and the special customs tribunals have repeatedly held that the remission of taxes on exportation constitutes the conferral of a bounty or grant within the scope of our countervailing duty law. The legislative history of section 303 of the Tariff Act of 1930, as amended, provides ample support for that position. The forgiveness of the commodity tax on the exportation of the subject electronic products from Japan is clearly a bounty or grant under section 303, and the Secretary of the Treasury should be required to direct the assessment of countervailing duties to offset the bounty or grant so bestowed.

Defendant contends that the Japanese commodity tax is not a bounty or grant within the meaning of section 1303. Defendant argues among other things:

The historical and legislative background of the countervailing duty statute demonstrates that the countervailing duty provision was intended to cover only the excessive remission of taxes directly related to the imported product. For over 75 years the Treasury Department construed the provision as applying only to such excessive remissions. Since at least 1951, Congress has been well informed of the Treasury's practice and has consistently failed to countermand it even though legislative amendments rendering all tax remissions subject to countervailing duty have been considered. Thus, Congress must be deemed to have approved the administrative interpretation.

Section 1303 reads in relevant part:

(a) Levy of Countervailing Duties.
(1) Whenever any country, dependency, colony, province, or other political subdivision of government, person, partnership, association, cartel, or corporation, shall pay or bestow, directly or indirectly, any bounty or grant upon the manufacture or production or export of any article or merchandise manufactured or produced in such country, dependency, colony, province or other political subdivision of government, then upon the importation of

* The analysis is provided by Mr. J. Dobson, J.D., Editor of EUROPEAN TAXATION.

such article or merchandise into the United States, whether the same shall be imported directly from the country of production or otherwise, and whether such article or merchandise is imported in the same condition as when exported from the country of production or has been changed in condition by remanufacture or otherwise, there shall be levied and paid, in all such cases, in addition to any duties otherwise imposed, a duty equal to the net amount of such bounty or grant, however the same be paid or bestowed.

Section 1303 has its genesis in section 5 of the Tariff Act of 1897.

In *Downs* v. *United States*, 187 U.S. 496 (1903), the Supreme Court of the United States held that tax remission is a form of indirect bounty within the meaning of section 5 of the 1897 Act.

The *Downs* case was cited almost immediately by the Board of General Appraisers for the proposition that tax remission upon exportation constitutes the conferral of a bounty or grant under the 1897 Act. See *F.W. Myers & Co.* v. *United States*, 6 Treas. Dec. 260, 264-265, T.D. 24306 (1903). It was also cited for the same proposition in *Notes on Tariff Revision* (1908), a 953-page document prepared for the use of the Committee on Ways and Means, U.S. House of Representatives, under the direction of the clerk of the committee, when the Congress was considering revision of the 1897 Tariff Act.

Section 5 of the 1897 Act was reenacted essentially unchanged as section 6 of the 1909 Tariff Act. The words "province or other political subdivision of government" were added, by the 1909 Act, thus broadening the scope of the statute. Hence, reenactment by Congress of the same language in the aftermath of the *Downs* decision and on the representation made to Congress by so eminent an authority on judicial construction as the assistant counsel of the Treasury Department, represents a classical example of congressional ratification of the judicial construction put upon this statutory language. Indeed, this court said as much in *American Express Company* v. *United States*, 67 Cust. Ct. 141, 150-151, C.D. 4266 (1971), affirmed without reaching this issue, 60 CCPA 86, C.A.D. 1087 (1973), a case involving the construction of section 1303 (prior to amendment by the Trade Act of 1974) as applied to the practice of the Italian Government in its remission of certain internal taxes upon the exportation of transmission tower units to the United States. And inasmuch as this language has been a part of every United States countervailing duty statute dating from 1897, the argument advanced by the Treasury Department that the teachings in *Downs* as to the counter-vailability of tax remission is *dicta*, is without support.

In this connection, the court notes that defendant advances the argument that Congress did not intend that the scope of section 5 of the 1897 Act should be any different than the predecessor statute was under the 1894 Act when non-excessive tax remission was expressly excluded from the countervailing duty measure applied to bounty-fed sugar importations (paragraph 182 1/2, Tariff Act of 1894), and that the legislative history indicative of such congressional intent "apparently had not been brought to the attention of the courts in prior cases". In other words defendant implies that the courts in *Downs* overlooked congressional limitations on the countervailing duty statute preserved for the 1897 Act from the 1894 Act as manifest in congressional debates.

It is true that the congressional proceedings culminating in section 5 of the 1897 Act were not a part of the record before the courts in *Downs*. Where the language of a statute is clear there is no need to resort to congressional debates to ascertain the intention of Congress. There is no indication that the language in section 5 of the 1897 Act lacked clarity or that it troubled the courts in any way in that case, necessitating resort by the courts to legislative history. And as for the congressional debates of the measure to which a large portion of defendant's energies have been directed, the Supreme Court had earlier warned against misdirection caused by reliance on remarks made during congressional debates, and as such, the debates would probably not have been considered relevant by the courts in *Downs*, anyway, given the clarity of the language of section 5.

But even if congressional debates could have been considered in *Downs*, they would not have changed the results reached by the courts in that case. Paragraph 182 1/2 of the 1894 Act had expressly excepted non-excessive tax remissions from the specific countervailing duty applicable to bounty-fed sugar imports while recognizing tax remission to be a form of indirect bounty. And of course, the term "net bounty" as used in the congressional debates on the measure by the 54th Congress clearly referred to the excess over the actual tax remitted. But the term "net amount of ... bounty or grant" introduced into section 5 of the 1897 Act by the 55th Congress is another matter. Even in the House version of the countervailing duty measure which was passed and set to the Senate it is to be seen that the House moved significantly away from the strictures of the countervailing duty provision as passed by the 54th Congress in proposing alternative measures which, if enacted into law would have given the United States the option of countervailing the full bounty or just the excess bounty above the tax remitted. The House version provided that bounty-fed sugar "shall pay, in addition to the foregoing rates, a duty *equal to such bounty, or so much thereof* as may be in excess of any tax collected by such country upon such article, or upon the beet or cane from which it was produced". (Emphasis added.) 30 Cong. Rec. 316 (1897).

The Senate substituted language for the House version which later became section 5 following the House accession to the Senate amendment. And after the Senate version was introduced through the Senate Finance Committee, the term "net bounty" was never used in the debates that followed in reference to the Senate proposal. On the contrary, the full amount of the German bounty (38 cents on refined sugar or 27 cents on raw sugar per hundred weight) was referred to by the senators as the "export bounty".

Since it is clear that the Senate debates indicate an intention on the part of that body of Congress to reach the full amount of the bounty paid under the language it proposed, the term "net amount of ... bounty ..." was obviously intended to apply to nothing less than the full amount of the benefit foreign exporters derived from their governments. But the Senate didn't stop here. In addition, it introduced the words "grant" and "bestow" for the first time in the countervailing duty measure.

As the Board of General Appraisers aptly pointed out with respect to the word "grant" in *Downs* (4 Treas. Dec. 405, T.D. 22984 (1901) at page 408) "While it involves the idea of a favor or benefit conferred by the Government, sometimes of an exclusive character, it does not necessarily embrace the act of appropriating or paying money out of the public treasury. Indeed, the word 'grant', in its broad signification, may well include the remission of a tax already levied and assessed by the authority of Government". And again, as the Supreme Court said in *Nicholas & Co.* v. *United States*, 249 U.S. 34 (1919) at page 39: "If the word 'bounty' has a limited sense the word 'grant' has not. A word of broader significance than 'grant' could not have been used".

There can be no question then, but that the 55th Congress was faced with a different challenge than that which confronted the 54th Congress, and as a consequence, responded to it with equally different legislation. As stated by the former clerk of the House Committee on Ways and Means in *Notes on Tariff Revision*, *supra* at page 834

with respect to section 5 of the 1897 Act, "This section was a new departure in tariff legislation ..."

There are other contentions advanced by the Government in connection with additional legislation enacted by Congress and international commitments of the United States involving policy decisions which do not supersede the acts of Congress. The court finds that the matters dealt with in these contentions do not temper the mandatory character of the countervailing duty statute in issue or illuminate the congressional intent underlying its enactment.

With respect to the Government's contention concerning the United States' commitment under Article VI(4) of Part II of the GATT, [1] it must be pointed out here that this contention has previously been considered and rejected by the courts. In *American Express Company* v. *United States*, this court said with respect to this argument:

... GATT is a trade agreement, which if in conflict with a law of Congress [19 U.S.C.A. § 1303], must yield to the latter.

And our appeals court went even further in that case in regard to this argument when it said [60 CCPA at page 97, footnote 14]:

That holding finds support not only in the reasoning of the Customs Court that a law of Congress prevails over a trade agreement but also in the fact that the United States undertook Part II of the GATT, which includes Article VI(4), "*** to the fullest extent not inconsistent with existing legislation". *Protocol of Provisional Application of the GATT*, 61 Stat. A2051 (1947).

Thus, it becomes readily apparent that although our countervailing duty statute (section 1303) speaks in more general terms of *bounties* and *grants* whereas the countervailing duty provision contained in Article VI(4) of Part II of the GATT refers specifically to exemption from or refund of taxes, the GATT's inconsistency "with existing legislation", has been determined by the construction put upon the statutory terms "bounty" and "grant" by the Supreme Court of the United States in *Downs* v. *United States*, *supra*, in holding that tax abatement or remission comes within the meaning of those terms.

The defendant represents that it has had a longstanding administrative interpretation of the countervailing duty statute which permits it to determine when in its judgment a bounty or grant is excessive and thus should be countervailed. This administrative interpretation is in conflict with the decisions of the Supreme Court of the United States construing the countervailing statute, and must yield. The Secretary of the Treasury, in administering the countervailing duty statute, must discharge his responsibility in accord with the congressional intent in that statute as interpreted by the Supreme Court of the United States.

The language of section 1303 is abundantly clear, having been construed by the courts in decisions which in turn have been approved by Congress. Generally, the scope of the statute has been held by the courts to be extremely broad; specifically, the statute has been held to embrace remissions of indirect taxes on exportation.

It is a familiar rule that long-established administrative practice is determinative only when the meaning of the statute is doubtful. *Pittsburgh Plate Glass Co.* v. *United States*, 2 Ct. Cust. Appls. 389, T.D. 32162 ... Therefore, an administrative practice in plain violation of the terms of the statute cannot be urged as determining the construction that should be given to it. [*United States* v. *Jules Raunheim (Inc.) et al.*, 17 CCPA 425, 431 (1930).]

Admittedly a decision adverse to either party will have certain affects upon domestic industry and lavor. It has been ruled that this court does not have equity jurisdiction, [2] and it would be inappropriate for the court to go beyond the statute governing the issue before it and attempt to balance the equities between industry and labor. Also, if this court were empowered to wade into the uncertain waters of foreign policy it might yield to the tempting protestations of defense counsel and assume the risk of making a determination in this area, but this is an area reserved to the executive and legislative branches of the Government.

The Japanese commodity tax involves the remission of an indirect tax and, as such, is countervailable under section 1303.

Judgment will be entered in accordance with this opinion.

ANALYSIS

In addition to this opinion, two concurring opinions were filed. They speak at more length on some of the issues discussed in the opinion of the Court but do not offer any different conclusions on these issues, so they are not reproduced here.

Reading through the opinion of the court, one finds a number of points which deserve comment. First, it is interesting to note that the *defendant* in this case is the U.S. government. The U.S. Treasury had taken the position that no duty was to be imposed and had defended this position in court against a challenge by a private manufacturer, *Zenith*. Thus, the recent description of this case as a sign of a new wave of U.S. protectionism [3] is erroneous, at least to the extent that it suggests that the U.S. government has supported protectionist measures.

A second, and very significant, point is that *Zenith* won the case on a summary judgment motion. This means that in the opinion of the court there was no genuine issue of fact in this case and that the law required a judgment in favor of the plaintiff. The Court's decision against the defendant did not turn on an unfavorable determination of the factual situation. Accepting all the factual assertions made by the defendant, the plaintiff was still entitled to judgment as a matter of law. The importance of this conclusion can hardly be overemphasized; it strongly indicates that the Court's decision is based on a general principle of law and not on a finding of a special fact situation. This suggests an enormous breadth of applicability of this decision. Any time there is a difference of taxation of domestic sales and export sales to the United States, the Treasury must impose a countervailing duty to the extent of the difference. The reason behind the difference and the economic effects of the duty cannot be taken into account.

The third point to be mentioned, and the principal importance of this decision, is that *all* tax reductions and remissions which apply to exports and not to domestic sales are bounties; it is not necessary that the remissions be in excess of taxes previously imposed. Because of the widespread use of turnover taxes,

1. This provision expressly prohibits contracting parties from levying countervailing duties against each other's products to offset export bounties aiding their exportation where the bounties are in the form of tax remissions or tax exemptions; and the Government maintains that such contractual obligation is binding on the United States.
2. Equity jurisdiction is an authorization for a court to consider additional facts or to grant additional relief beyond what is provided for in the relevant laws. When the remedies provided by law are incomplete, a court of equity may fashion a different remedy based solely on principles of fairness and justice.
3. *De Financieel Ekonomische Tijd*, June 3, 1977, p. 1.

including the mandatory imposition of value added tax by the E.E.C. member countries, this conclusion of the Court threatens to have major importance for trade with the United States. Companies in E.E.C. member countries exporting to the United States could have to pay a countervailing duty equal to the domestic VAT plus normal import duties plus any state and local sales taxes applicable to the sale of their goods in the United States.

In the opinion of the court, international considerations could not reduce the mandatory nature of the obligation of the Secretary of the Treasury to impose countervailing duties. The General Agreement on Tariffs and Trade (GATT) did not alter this obligation, either. Of course, GATT was adopted by the United States subject to existing laws, but even if that were not the case it would have to yield to laws of Congress. Thus, even though GATT declares that remission of indirect taxes is not an export subsidy, the United States is obligated to treat it as such and to impose a countervailing duty. This is clearly in violation of the GATT procedures and it promises to put even more pressure on an agreement already strained severely by the U.S. DISC legislation. [4]

The effects of this case could be extremely wide-sweeping. As has just been suggested, it could force the United States out of GATT. It would mean a countervailing duty on virtually all E.E.C. products. This could be expected to lead to increased tariffs on U.S. goods exported to E.E.C. countries, while the Zenith holding may have the same result with respect to exports to Japan. A major setback for efforts to reduce international trade barriers would result. At present, this decision is being appealed. Also, a similar suit has been instituted in the Court of Customs by U.S. Steel Corp. asking that the Treasury be required to impose a countervailing duty on steel imported from the E.E.C. It is possible that one or both of those actions will result in a return to the situation existing prior to the April 12th decision, where the Treasury imposed countervailing duties only where there was an excess remission of taxes by a foreign government to companies exporting to the United States.

Otherwise, that situation could only be reestablished by an amendment of the countervailing duty statute. Because of the political pressures involved, it is far from certain that the U.S. Congress would be willing to pass such an amendment.

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4. For a discussion of the threat to the effective existence of GATT caused inter alia by the U.S. DISC rules, see *The GATT Panel Reports on Tax Practices in Belgium, France, the Netherlands and the United States* in the May issue of EUROPEAN TAXATION.

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TAX GLOSSARY

by H.W.T. PEPPER *

AGRICULTURAL ABATEMENT — It is fairly common for a country to incorporate special relief measures in its tax code for the benefit of agriculture either because (a) farmers as a class are regarded as having less taxable capacity than the rest of the community, or because (b) the farm "lobby" is able to exert powerful political influence or because (c) it is regarded as economically desirable to provide incentives to encourage agriculture. At one time farmers in Britain paid income tax according to a figure based on the annual value of their land or on actual profit, whichever was less. A substantially reduced rate of death duty was formerly charged in Britain on bequests of agricultural land. In Eire, until recently no income tax at all was charged upon farming income, and in many states the tax payable on the agricultural sector is lower than on the industrial sector either by design, or because the administration is unable to cope fully with the problem of securing proper compliance with tax laws.

"AGRICULTURAL DEPRESSION" — Special relief for agricultural depression used to be a feature of the taxation of farmers in Britain at a time when these taxpayers were taxable on the annual value of their lands and only at their option by reference to actual profits. No special relief is necessary where agriculture is taxable on profits but special consideration, usually on an ad hoc nature, may be called for where other taxes are computed independently of income and there has been a cataclysmic fall in commodity prices or loss by catastrophe such as flood or hurricane. In Britain the Schedule B assessment (arbitrarily based with reference to annual value instead of profits) was reduced proportionately if farmer's rent was reduced — otherwise the farmer was assessed on actual profits.

AIRCREW, TAXATION OF — As in the case of SEAMEN (q.v.) special rules are sometimes employed in determining the tax, particularly where income tax is to be dealt with, for aircrews. Sometimes the place of assessment will be the head office of the airline or charter company, sometimes the residence of the airman, and occasionally the base airport from which the airman is allocated his route or duties. The matter is often covered in the articles of a Double Taxation treaty between two countries where the airline concerned provides air services between the two countries.

AIRPORT TAX — Charges made at airports on departure of passengers, sometimes called Departure Tax, Passenger Charge, Airport Service Charge etc. and levied at a flat rate per head. There may be no charge, or a lower charge for internal flights within the country making the charges. The levy is usually justified as a means of helping to pay for the maintenance of the airport and the passenger terminal facilities, particularly in less developed countries with new or enlarged airports.

ALCABALA — Cascade taxation applied by Spain from the 14th Century, of historical interest because also applied in Spanish settlements overseas and therefore having an influence on more recent sales taxes although the alcabala itself became oppressive after successive rate increases and was abolished in most countries.

ALIENS, TAX TREATMENT — Normally RESIDENCE (q.v.) and sometimes DOMICILE (q.v.) are factors affecting the tax liability of an individual and to a lesser extent, a company. Some countries, however, use nationality as a test for some purposes, for example, the USA taxes its own citizens, resident overseas, on their world incomes, subject to a minor exclusion in the case of income earned abroad, but taxes aliens only on their income arising within the USA (for obvious reasons). Non-resident aliens are, however, entitled to fewer reliefs in respect of their US income, than non-resident US citizens. Britain provides special relief from British income tax for non-resident British subjects which is not available to non-resident aliens.

ALIMONY — The term, often somewhat loosely applied to all types of payments, whether under deed, court order, or voluntary arrangement, by one spouse to another in cases of voluntary or legal separation, or divorce. For income tax a deduction or allowance is usually granted to the payer where the payment is compulsory. Voluntary payments may entitle the payer to the same personal relief for the dependent spouse as would be accorded if they were living together. Tax liability may also arise on the recipient but normally only where the payments are compulsory.

ALLOWANCES — Reliefs, abatements, or exemptions, generally made in computing income tax and some forms of sales tax and death duties. The term 'allowance' is generally used in Britain and countries with similar tax systems, e.g., 'child allowance' is the deduction for a dependent child in Britain. In the USA the term 'exemption' is preferred.

AMALGAMATIONS AND RECONSTRUCTIONS — Capital Gains tax is commonly charged on any surplus realised from the disposal of stock or shares in a company. Where the disposal results from the 'take-over' by one enterprise of another, or from the amalgamation or reconstruction of two or more companies such that the original shareholders remain as shareholders but with shares in a different company, but with effectively the same investment as before, the event is not regarded as a disposal in the gains tax laws of some countries (e.g. Britain). Since capital gains tax is in some cases regarded as a tax on the enjoyment of realised gains in the same way as income tax is a tax on 'spendable' income, some countries do not levy capital gains tax on any realised gains which are re-invested (or 'rolled over') in any manner.

AMERICAN SELLING PRICE (ASP) — The system whereby certain goods (e.g., benzenoid chemicals for dyestuffs) when imported into the USA were assessed for customs duty on the basis of the US selling price instead of the import price. The system of using retail selling prices in the importing country as a reference point for checking the declared import price is in fact

* With the assistance of the staff of the International Bureau of Fiscal Documentation.

little used, although such a system would often be useful to the administration particularly in small countries with limited resources for evaluating imports.

AMNESTY — Special terms sometimes offered to tax evaders at a time when the government is endeavouring to erode tax evasion. The amnesty is usually offered to give evaders an opportunity of declaring past omissions, usually on the basis that they will be guaranteed freedom from prosecution. Sometimes more generous terms, such as freedom from or abatements of penalties are offered, and sometimes an amnesty is offered on the basis of "no question asked", e.g. as to the source of the assets, provided tax is paid (with or without interest or penalties) on income or assets disclosed under the amnesty terms.

AMORTISATION — In general, depreciation of intangible assets, such as patents and trademarks, is called "amortisation".

AMORTISATION METHOD — A method of computing a credit under a value added tax regime where capital goods are purchased which have a useful life in the business for a period exceeding one year. The tax embodied in the price paid for the asset may be credited to the trader over a period of years corresponding with the life of the asset. The alternative method is to allow full credit in the year of purchase — this is known as the INVESTMENT METHOD (q.v.).

ANNUAL TAX — Income tax is often referred to as an annual tax because its structure in most countries is geared to annual computations of income, and reliefs, allowances, and abatements are provided by reference to the amounts appropriate to a year in the life of an individual taxpayer having regard to his responsibilities and outgoings for an average year. In some states, Britain is an example, the constitutional position is such that income tax has to be enacted annually by Parliament to ensure its continuity as an important revenue-raiser.

ANNUAL VALUE — The concept sometimes employed to assess the tax due on some benefit which does not produce a cash income. For example, the annual value of real estate occupied by the owner which may be taxable for income tax or property tax purposes, has been defined as the rent which the property is worth to let by the year, the landlord bearing the burdens normally borne by a landlord (e.g., external repairs) and the tenant bearing the burdens usually borne by a tenant. The concept may also apply to 'fringe benefits' to a director or employee such as free use of a car or yacht the annual value of which is more usually determined by reference to the cost and rate of depreciation plus the cost of maintenance.

ANNUALISATION — Annualisation is a term used in the USA to refer to the process of computing the equivalent annual sum to the profits made by an enterprise for an accounting period shorter than a year, assuming profits are realised at the same rate for the whole year as for the actual period recorded. Such a calculation may be done on a change of accounting date (though the tax payable may be reduced to a proportion of the year's tax appropriate to the actual period of the accounts).

ANNUITY — Annuities may be divided into two classes — "life" annuities and "annuities certain". The former are similar to the pensions of retired employees and may be provided by an employer through a life insurance company or out of a contributory or non-contributory pension fund set up for the purpose. Where provision is made for retirement annuities to employees, etc., under a formal scheme, it is usual for a tax deduction to be allowed for contributions both by employers and employees which reduce the current tax payable by each. The benefits received will become taxable when they commence on retirement of the employee. An "annuity certain" is an annuity for a fixed period of years and may be purchased by the annuitant, e.g., for a lump sum cash payment. The usual tax treatment of such annuities is to separate the capital and interest elements of the annuity and charge tax only on the latter. There have also been examples of provisions being made for taxes to be paid in annuity form, the best example being the Equalisation of Burdens (capital levy) tax imposed in Federal Germany after World War II which could be paid at once or spread over 30 years with the addition of interest. The annuity method may also be used, e.g., by writers, as a method of spreading the income tax burden where a substantial sum is receivable for a particular piece of work which is of high market value. Instead of selling for a lump sum the taxpayer may arrange to receive payment over a lengthy period so as to avoid the concentration or "bunching" of his receipts into a single year when the highest personal tax rate would be payable.

ANTI-AVOIDANCE MEASURES — Measures to combat the legal avoidance of taxation occupy an increasing proportion of the sections embodied in taxation statutes. The main types of measures include those endeavouring to set aside transactions which have a tax avoidance rather than a commercial motive. The oldest of such measures are probably the provisions to aggregate the income or assets of spouses as the simplest type of avoidance would be for the spouse with the higher income or capital to transfer, or purport to do so, some income or capital to the other spouse (see also AGGREGATION). In the case of transactions between associated persons the law may seek to impose arm's length prices (q.v.) for prices determined without relation to market values, etc.

ANTI-DELINQUENCY MEASURES — Following American usage "delinquency" with regards to tax is taken to mean non-payment as distinct from legal avoidance or unlawful evasion. Tax codes commonly include specific measures to compel the payments of tax by fixed dates (subject to sums held over pending the result of objection or appeal). Among other measures there are sometimes penalties for delay in rendering or filing a tax return, and late payment of tax may be penalised by specific penalty which may be related to the amount of tax, as well as interest for the period elapsed since the due date of payment. Collection may be pursued by Court action or by distraint upon business or private assets of the taxpayer or by sequestering sums due to the taxpayer from third parties under a Garnishee Order. In addition to measures prescribed within the taxation statute itself it may also be possible to invoke provisions of the general law with regard to collection of debts.

ANTI-DUMPING DUTIES — This term applies to discriminatory duties on goods alleged to have been 'dumped' (see DUMPING) to counteract the advantage which the exporter will gain by pricing his goods below the prevailing price in his own country of the same goods, and to avoid damage to the producers in the country levying the duties, who are producing the same type of goods.

[to be continued]

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TAIWAN'S LAND TAX POLICY

by George E. Lent *

Perhaps no country has been more influenced by the land tax philosophy of Henry George than the Republic of China. Taiwan's land value tax (LVT) and land value increment tax (LVIT) can be traced directly to the principles for "equalization of land rights" declared by Dr. Sun Yat-sen, the founder of the Republic, who is known to have been a disciple of George. [1] *Dr. Sun's principles were promulgated in the Land Law of 1930, but this law was not introduced in Taiwan until 1945, when it reverted to Chinese rule.* [2]

The Land Law is a comprehensive plan for the implementation of Dr. Sun's principles for equalization of land rights, of which the land taxes comprise only one part (Part IV). Other sections deal with the principles of land rights and limitations on land ownership, procedures for land registration and cadastral survey, general rules for land utilization, and conditions and procedures for land expropriation. It is significant that land taxation forms an integral part of Taiwan's land policy, which is under the direction of the Ministry of Interior Affairs. The Ministry of Finance is charged only with collection of the tax, although it plays an important role in the formulation of land tax policy. A separate Statute for Equalization of Urban Land Rights was enacted in 1954; this supplements the Land Law and clarifies its application to urban property.

Although Dr. Sun inspired Taiwan's approach to the taxation of land, the measures enacted departed in many respects from his announced views. Moreover, the LVT and LVIT are limited to specified urban areas; a rural land tax (RLT) based on presumptive yields is enforced in areas not subject to the LVT, and a separate "house tax" is assessed on the value of improvements in both areas. The system is more complex than the usual references to it would suggest and it has raised many problems both of design of particular taxes and of their interrelationship. The relative importance of these four real estate taxes is shown by their revenue in the fiscal year 1975:

	Revenue (millions of NT$)	*Percentage of total tax revenue* [3]
Rural land tax	*2,179.7*	*2.2*
Land value tax	*1,438.1*	*1.5*
Land value increment tax	*2,616.5*	*2.7*
House tax	*2,896.2*	*3.0*
	9,130.5	*9.4*
Total tax revenue [4]	*96,939.3*	*100.0*

The main purpose of this paper is to examine the role of Taiwan's land taxes as an instrument of land policy.

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Abbreviations used in this article:

LVIT - Land value increment tax
LVT - Land value tax
PSV - Progressive starting value
RLT - Rural land tax

* Senior Advisor, Fiscal Affairs Department, International Monetary Fund. Views expressed represent the opinions of the author and, unless otherwise indicated, should not be interpreted as official Fund views.

1. For a good account of the origins and development of the Republic of China's land tax system, see Wei-hsin King, "Land Taxes of the Republic of China", Bank of China, *Economic Review*, May-June 1969, pp. 1-13, July-August 1969, pp. 7-16. See also, Wei-hsin King, "Urban Land Policy and Land Taxation of the Republic of China", in A.M. Woodruff and J.R. Brown, editors, *Land for the Cities of Asia* (Hartford, Conn., the John C. Lincoln Institute, 1971).

2. According to Wei-hsin King, a land value tax had been introduced in four municipalities (Shanghai, Nanking, Canton, and Chington) and in three prefectures in Kiangsi Province before 1937. By 1948 the tax was in effect in 25 large cities, 601 prefectures, and 678 large counties. "Land Taxes of the Republic of China", International Seminar on Urban Land Use Policy, Taxation and Economic Development, Singapore, December 1974.

3. Includes fiscal monopoly revenue.

4. Id.

I. THE LAND VALUE TAX

Although the amended Land Law of 1945 introduced a tax on the value of all land in Taiwan, its implementation was delayed until 1950. Taiwan had been under Japanese rule for 50 years and the period following retrocession, 1945-50, was marked by serious internal conflict which culminated in the relocation of the Government of the Republic of China to Taipei. At that time only the traditional rural land tax was in effect; this was based on an elaborate system of land classification that reflected agricultural productivity, and its transformation to a land value system posed serious difficulties. The LVT was enforced initially in 88 cities; instead of following the valuation procedures prescribed by the Land Law it was based on transfer values under the Japanese occupation adjusted for price increases. The Statute for Equalization of Urban Land Rights, enacted in 1954, superseded the Land Law and limited the LVT system to specified urban areas. Its tax provisions conformed in most respects to those of the Land Law.

1. Tax base and rates

The LVT is levied at progressive rates on the value of all land that is held by a landowner within the city planning area of a prefect (*hsien*) or special municipality. The law requires the landowner to declare the value of his taxable land; unless this is within 20 percent of the market value, the Government has the authority either to fix the value or to purchase the land at the declared value. In practice, official assessments are made every three years if land values have increased 50 percent or more; these are submitted to the landowner as the basis for his declaration, most of which are accepted at 80 percent. [5]

The progressive rate structure is based on multiples of the so-called progressive starting value (PSV) in each of 21 jurisdictions (Taipei, four cities, and 16 *hsien*). The PSV is the average value of seven ares of land in each jurisdiction (1 are = 100 square meters). Rate brackets start at 1.5 percent of the first PSV and increase for each 500 percent of PSV to a maximum of 7.0 percent:

Aggregate land value:	
Not in excess of PSV	1.5
100- 500 percent of PSV	2.0
500-1,000 percent of PSV	3.0
1,000-1,500 percent of PSV	4.0
1,500-2,000 percent of PSV	5.0
2,000-2,500 percent of PSV	6.0
over 2,500 percent of PSV	7.0

Preferential treatment is given to owner-occupied residential land of up to three ares, which is taxed at 0.7 percent; factory sites are taxed at the standard 1.5 percent rate; agricultural zones and green belt areas are subject to a uniform rate of 1 percent of declared value; and urban land in the enforcement zone that is in agricultural use is taxed at 1.5 percent of declared value. Penalty rates are imposed on vacant land and on land owned by a non-resident of the *hsien* where it is located.

2. The progressive rate structure

The most notable feature of the LVT is its graduated rate structure based on the total value of property of a landowner in each jurisdiction. In this respect the tax departs from the repeated statements of Dr. Sun that the rate should be a flat 1 percent or 2 percent. [6] Rates graduated with the size of land holdings serve both equity and social objectives of the state; these are based both on the desirability of limiting the acquisition and control of land, for speculative and other reasons, and the fact that the value of landholdings reflects ability to pay taxes. Since the incidence of land taxes is on the landowner, their graduation can be justified on much the same grounds as income taxes are graduated. Although no account is taken of debt incurred to finance land acquisitions, the landowner is thereby under further constraint to limit holdings; he will acquire additional land only to the point where the marginal cost (including taxes and cost of capital) equals the expected return on investment, including appreciation in the value of the land, less recapture by the LVIT upon its sale.

Data for the financial year 1974 show that about 43 percent of all LVT revenue was from land assessed at more than the 1.5 percent basic rate (Table I); of this, however, about one half was subject to the lower marginal rates of 2.0 percent to 3.0 percent, mostly at 2.0 percent. Most significant was the concentration in the 7.0 percent marginal rate bracket, which accounted for 16.6 percent of total LVT revenue, at an average rate of 5.4 percent.

Further analysis of landowners subject to marginal rates of 4.0 percent to 7.0 percent discloses that 87 percent was paid by 514 public and private corporations, 3 percent by 56 ancestral worship foundations, and only 10 percent by 302 individuals. The total area owned by these holders accounted for 5.5 percent of all privately-owned urban land subject to the LVT. This concentration in the hands of corporations raises an important question of whether the graduated tax can be defended by the principles indicated above. Has the tax, indeed, successfully limited land holdings of individuals, as the small number of taxpayers in the higher tax brackets suggest? Can progressivity be justified for corporate and foundation investments?

Because of the ease with which property can be transferred to members of the family, the above data undoubtedly conceal the extent of concentration in private ownership. [7] Transfers of land subject to the LVT are not assessed the 7.5 percent deeds tax, and until 1973 gifts were not liable for the LVIT. Moreover, not all urban land is covered by progressive rates; agricultural land lying within the urban enforcement area is taxed at a fixed 1.5 percent of declared value if it

5. About two thirds of the landowners in Taipei declared 8[illegible] percent of the 1974 values announced by the Land Department; the rest declared the announced or greater values.
6. Wei-hsin King, "Land Taxes of the Republic of China", p. 3[illegible]
7. See Wei-hsin King, "Land Taxes on the Republic of China", p. 17.

Table I. Republic of China: Revenues and Tax Bases of Land Value Tax — By Applicable Tax Rates — Fiscal Year 1974

(NT dollar amounts in millions)

Classification	Taxpayers		Area		Assessed Value		Tax Assessed		
	Number	Percent of total	Hectares	Percent of total	Amount	Percent of total	Amount	Percent of total	Percent of assessed value
Publicly-owned land	2,694	0.31	2,265	10.25	10,613.2	12.79	148.2	10.63	1.40
General land	2,641	0.30	2,088	9.46	10,076.2	12.14	140.4	10.07	1.39
Factory site	10	*	118	0.54	420.0	0.51	6.2	0.44	1.48
Agricultural land and greenbelt	15	*	39	0.18	23.9	0.03	0.2	0.02	1.00
Urban agricultural land	28	*	18	0.08	93.0	0.11	1.4	0.10	1.50
Privately-owned land	864,989	99.64	19.306	87.40	71,945.0	86.68	1,239.4	88.90	1.72
Owner-occupied residential land	169,534	19.53	2,121	9.60	9,285.5	11.19	64.9	4.65	0.70
Factory site	2,560	0.29	2,654	12.01	5,556.4	6.69	82.8	5.94	1.49
Agricultural land and greenbelt	13,010	1.50	531	2.40	753.5	0.91	8.1	0.58	1.00
Urban agricultural land	30,903	3.56	1,400	6.34	6,093.0	7.34	91.5	6.56	1.50
Land subject to Progressive Rate									
at 1.5% marginal rate	604,409	69.62	8,208	37.16	25,710.2	30.98	370.9	26.61	1.50
at 2.0% marginal rate	31,445	3.62	2,564	11.61	15,245.6	18.37	263.4	18.89	1.73
at 3.0% marginal rate	1,113	0.13	411	1.86	2,200.8	2.65	46.9	3.36	2.13
at 4.0% marginal rate	266	0.03	176	0.80	976.8	1.18	24.7	1.77	2.53
at 5.0% marginal rate	111	0.01	85	0.39	541.3	0.65	16.7	1.20	3.08
at 6.0% marginal rate	73	0.008	76	0.34	568.1	0.68	20.8	1.49	3.67
at 7.0% marginal rate	186	0.021	782	3.54	4,134.2	4.98	231.9	16.63	5.61
Vacant land surtax	7,322	0.84	194	0.88			9.6	0.69	
Absentee land surtax	4,057	0.47	103	0.46			7.2	0.52	
Land in industrial estate	468	0.05	517	2.34	441.6	0.53	6.6	0.47	1.50
Grand total	868,151	100.00	22,089	100.00	82,999.8	100.00	1,394.1	100.00	1.68

* Less than 0.01 percent.

Source: Ministry of Finance, Department of Taxation.

does not exceed the announced value, and other agricultural land, including that within a city's administrative area, is taxable under the rural land tax. The LVT, therefore, will not become fully effective in equalizing urban land rights until these escape hatches are tightened.

The question of applying graduated rates to corporate land ownership deserves special attention, especially for commercial properties such as hotels, office buildings, and apartments located in high rent areas. A further classification of taxpayers in Taipei shows that nonprivate companies account for the preponderance of the tax at higher graduated rates, especially the 7 percent marginal rate; in fiscal 1975 they paid 81.5 percent of the LVT of corporations subject to this rate. These are quasi-government businesses, including those owned by the Nationalist party, which have extensive land investments. Although the usual principles of progressive taxation are not generally applicable to corporate bodies, they would appear to be no less subject to the control function of land taxes that is intended to equalize urban land rights. Moreover, the form of organization in which land is held would not be an equitable basis for discrimination in respect of such a tax.

One important consideration that militates against the replacement of graduated rates by a flat rate — advocated by some [8] — is the redistribution of the tax burden it would entail. If the present graduated rate structure were replaced by a flat rate system that yielded the same revenue, the burden on a few taxpayers now subject to higher rates would be reduced, while virtually all others would pay higher taxes. For example, a 2 percent rate, as against the 1974 average rate of 1.7 percent, would increase by about one third the average LVT on all but fewer than 2,000 taxpayers, and reduce it by about 45 percent on the small number now subject to a higher rate. As a result, the tax reduction would be capitalized in higher land values for many of these wealthier taxpayers, and they would enjoy a windfall gain.

If progressive taxation of urban property is to be retained, the present graduated rate structure based on multiples of the PSV in each *hsien* should be reformed. It is difficult to justify widely different property tax burdens on the same value of property in different *hsien* except on the basis of differences in the value of municipal services provided — which is not the case. For example, because the 1975 PSV in Taipei is five times that in Taichung, land in Taipei valued at NT$10 million is taxed at less than half the rate on the equivalent value in Taichung (2.0 percent vs. 4.2 percent).

Progression, in principle, should be based on the cumulative value of land holdings of each person in Taiwan. This would require a standard PSV for the entire country. Such a rate system, however, would result in serious revenue losses for all *hsien* whose present PSVs are less

8. See, for example, C. Lowell Harriss, *Land Policy, Land Taxation, and Economic Development, a Report on Land Taxes of the Republic of China* (Taipei, September 1971).

than the average, and would greatly increase revenues for municipalities such as Taipei, Kaohsiung, and Keelung that have very high PSVs (NT$1,880,000, NT$1,125,000, and NT$1,091,000, respectively). There does not appear to be any easy solution to this dilemma. One possibility is to nationalize the land tax revenues (now shared 20 percent with the provincial government) and to redistribute them to the municipalities and *hsien* on the basis of some formula related to assessed values in each prefecture. This would have the effect of increasing land value taxes in the wealthier cities such as Kaohsiung, Keelung, and Taipei, in order to support the less affluent local governments.

3. Preferential rate policy

As was indicated above, land tax policy is characterized by considerable rate differentiation that is intended to implement land policy objectives. Preferential rates are provided to encourage homeownership, industry, and greenbelt areas. Agricultural land located within urban planning areas, also given special tax treatment, is discussed separately below in connection with the rural land tax. The total area of this privately owned land, summarized below, comprises about one third of all taxable urban land area, and its assessed value accounts for more than one quarter of total assessed values:

	Number of taxpayers	*Area (hectares)*	*Assessed value (millions of NT$)*	*Tax rate*
Agricultural and greenbelt	13,010	531	753.4	1.0
Urban agricultural land	30,903	1,400	6,093.0	1.5
Factory sites	2,560	2,654	5,556.4	1.5
Industrial estates	468	517	441.6	1.5
Residential land	169,534	2,121	9,285.5	0.7
Total	216,475	7,223	22,129.9	
Grand total	868,151	22,089	83,000.0	

a. Tax treatment of homeowners

Homewoners are taxed at a rate of 0.7 percent on up to three ares of land — less than half the standard 1.5 percent rate. The principal rationale for such preferential treatment apparently is the encouragement of homeownership. However, the value of the lower rate to the average homeowner is minimal and is not likely to play more than a marginal role in the decision to own a home. In 1974 the average area per occupier of residential land was only 1.25 ares and the average LVT paid was NT$383 (equivalent to US$10). If the standard 1.5 percent rate were applied, the average tax would have been increased to only NT$820. Because of the great number of homeowners, however, LVT revenue in FY 1974 would have been increased by NT$88.4 million, an increase of 6.3 percent in total LVT revenue.

b. Factory sites and industrial estates

Considerably greater area is devoted to factory sites that are not subject to graduated rates. In 1974 there were 2,560 separate sites with an assessed value of NT$5.6 billion, in addition to 468 sites in industrial estates assessed at NT$0.4 billion. While the amount of taxes saved is not known, much of the land otherwise would have been subject to rates of up to 7.0 percent. Even assuming a modest average rate of 3.0 percent, the tax savings in 1974 would have been about NT$46.5 million.

A serious question can be raised, in principle, about the tax discrimination inherent in such preferential treatment. It can be understood only in the context of Taiwan's push for industrialization that has cost many times this revenue in income and other taxes foregone. Whether the tax concessions were justified by the results cannot be answered easily; but it is doubtful if such remissions of property taxes played more than a very minor role in the decision to undertake the manufacturing venture.

4. Special surtaxes

Other land policy objectives are seen in penalty rates that are imposed on absentee owners and on vacant land.

a. Absentee landowners

Lands owned by absentee landowners are taxed at double the rate otherwise payable. [9] In 1974 there were 4,057 absentee owners of 103 hectares, who paid NT$7.2 million in surtax. The relatively small area and revenue — 0.5 percent of the total — suggests that absenteeism is insignificant. It is not known, however, how well this penalty is administered, and it would be a relatively simple matter to escape the penalty by arranging for resident nominees to hold the land. In any event, it is not clear what useful purpose is served by this provision. It may reflect a common prejudice against absentee ownership of agricultural land that was carried over to the urban sector; or it might be seen as a compensatory tax on the division of property between two or more *hsien* so as to avoid graduated rates. Nevertheless, it is difficult to defend such a tax in a modern industrial society that depends on the mobility of capital within a country for its development.

b. Vacant land tax

The Equalization of Urban Land Rights Act imposes a surtax of not less than 200 percent or more than 500 percent on any private land that has been designated as a building site but has not been used for this purpose. Vacant land includes sites where the value of improvements is less than 10 percent of the declared value of the land. The law provided for the implementation of the tax in two stages, with priority given to unimproved land. Owners of vacant land were given three years (two years in Taipei city) to improve it; starting one year later, owners of underimproved land were given five years (one year in Taipei city) to alter, extend, or to reconstruct the building.

The tax on vacant land has had an uncertain life since its introduction in 1968. Following the introductory grace

9. Absentee owners are persons whose legal residence is in a *hsien* or municipality other than where the land is located.

period, revenue reached a peak of NT$21.6 million in 1973 when the tax was suspended because of the shortage of construction materials, and revenue dropped to zero by 1975. During this period the surtax is said to have induced about 50 percent of the landowners notified to improve their land within the prescribed time. [10]

Its limited application can be seen in the relatively small area to which it was applied — only 102.6 hectares by the beginning of 1974, which comprised less than 1 percent of all the land area covered by the LVT.

While justified in principle as an instrument to encourage better land utilization and to deter speculation, it is doubtful if the tax on vacant land was applied vigorously enough to achieve its purpose. The penalty tax appears to have been imposed at the lower end of the permissible scale — 200 percent — as the average rate in 1973 was 3.3 percent. In view of the underassessment of land values and the sharp rise in land prices, this rate could hardly have spurred new construction. In order to make the tax truly effective much higher penalty rates would have been necessary. [11] The three-year waiting period also provides too generous opportunities for speculative gains.

5. How effective are land value taxes?

In 1973, all land value taxes averaged about 1.8 percent of assessed values; the 1974 average rate was about 1.7 percent. However, there is a wide variation in effective rates, with homeowners paying only 0.7 percent and owners of factory sites and agricultural land paying 1.5 percent, the basic rate. About 20 percent of the revenue received from privately owned property was paid by individuals and corporations subject to the 7 percent marginal rate, whose LVT averaged about 6 percent of assessed values. The effectiveness of the LVT in achieving its announced land policy objectives, however, depends on its relationship to current market values. In this respect the LVT has fallen far short of its objectives, since assessments have lagged greatly behind market values. Only one reassessment was made between 1964 and 1974 when new values were declared, and the 1974 revaluation represented an increase of 150 percent over December 31, 1973 assessed values. [12] Even the new 1974 assessed values were estimated at some 85 percent of market values, and in Taipei about two thirds of the property owners declared values equal to 80 percent of the official estimates. It is likely, therefore, that the assessed values for 1974 represented no more than 70-75 percent of current market value.

It would appear from these estimates that the LVT for the fiscal year 1975 averaged no more than 0.5 percent of the market value of land. This ratio will, of course, decline over the next three years until a new assessment is made. The Government announced a 40 percent reduction in tax rates for 1976, with the result that the average tax rate on market values of land will drop to appreciably less than the 0.5 percent estimated above because of continually rising real estate values. This low ratio suggests that land vaue taxes are greatly below their potential and fall far short of the role envisioned for them by Dr. Sun Yat-sen. In view of the rapid appreciation in land values that has taken place over the last decade, tax rates of this level could have had negligible effects on land ownership decisions. [13]

II. THE LAND VALUE INCREMENT TAX

The LVIT originated in the far more revolutionary principle of Equalization of Land Ownership that formed part of Dr. Sun's Principle of Peoples' Livelihood. This was based on his belief that increases in the value of land were created by the community, through no effort of the landowner, and that the state should appropriate any increment in its value realized at the time of its transfer. He proposed that the value of land declared by the owner should be fixed indefinitely as the basis for any compensation on its disposal; all transactions in land would be settled through a state agency that would retain any payment in excess of this declared value.

The framers of the Land Law did not accept these proposals but enacted instead a tax on the increment in value of land realized at the time of its transfer; if land was not transferred within a period of ten years or within five years of the completion of construction in the area, the tax would also be applied on any increase in value. The Equalization of Urban Land Rights Act, 1954, however, significantly modified the Land Law. It limited the tax to increments in price over 1954 values on sales of land located within urban areas subject to the LVT. No tax was applied to unrealized increments on transfers by gift or inheritance, or to increases in value over a five-year or ten-year period. By 1964 land values set in 1954 had become unrealistic and new values were declared on the basis of new assessments. An amendment to the Act also authorized annual adjustment of these 1964 values for price changes.

1. Progressive features of the LVIT

The rate structure of the LVIT deserves special attention because of the nature of its graduation. Rather than being based on the absolute size of the increment, tax rates vary with the percentage increase in the increment over 1964 values or the previous sales price after 1964. Initially, they ranged from 30 percent on increments of less than 100 percent and increased by 20 percentage points for each succeeding 100 percent increment until they reached 100 percent on all increases over 400 percent of the original value. Successive amendments have

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10. Wei-hsin King, "Land Taxes of the Republic of China", p. 18.
11. See Ih-kwei Cheo, "A Preliminary Study of Taxation on Urban Vacant Land in Taiwan", in A.M. Woodruff and J.R. Brown, *Land for the Cities of Asia*, pp. 318, 330.
12. The assessed value of urban land subject to the LVT was raised from NT$82,176.7 million to NT$205,753.0 million as at December 31, 1974.
13. Land values in Taipei increased at an average annual rate of 22.8 percent between 1964 and 1974; adjusted for changes in the general price level, the rate of increase was 15.2 percent. Yuan-hsing Lin, "Index of Land Values in Taipei", Taipei City Bank, Monthly Review, July 1975 (in Chinese).

reduced the initial rate to 20 percent and lowered the maximum marginal rate to 80 percent. The following rate schedule was in effect in 1975:

Percentage increase in increment	*Rate (percent)*
Less than 100	20
100-200	40
200-300	60
over 300	80

Revenue has increased sharply in the last few years, notwithstanding the indexation of the basis, and it has overtaken the LVT in yield. In recent years, LVIT assessments have averaged about 38 percent of the increment in value on taxable sales of privately owned land. In 1975 about 60 percent of the revenue was attributable to transactions subject to the 80 percent rate, with an average tax rate of 57.5 percent (Table 2). However, this rate category accounted for only about one third of the total increase in land values reported (16.9 percent being non-taxable) and 15.6 percent of the number of cases (27.4 percent being non-taxable).

It is unclear what the rationale of the LVIT rate structure is. It implies that the rate of tax should increase with the rate of increase in value of land, regardless of the period of time held, rather than with the size of the gain itself. There is some precedent for this formula in older land tax laws of Denmark and Germany, and in more recent provisions of land increment taxes in Italy and Israel; however, most taxes on increments in land value (for example, those of Korea, Malaysia, New Zealand, and the United Kingdom) have been based on absolute increases in value. [14] If it is intended to arrest speculation in land, the tax may operate perversely since the longer land is held the more it tends to increase in value; although the rate of rise in different sections varies with the direction of land development and other factors, the LVIT makes no distinction as to holding period. No data are available for Taiwan that show the variation in the rate of increase in the land increment realized with the period held, but indirect data support the view expressed above. Most increases in land value reported in 1974 (63.5 percent) arose from *first* transfers since 1964; 46.3 percent of these gains were subject to the 80 percent marginal tax rate as against only 15.6 percent of the gains realized on successive transfers made since 1964.

Although there are many cases of sharp increases in urban land values within a short period of time, even in the most rapidly developing section of Taiwan the average annual increase in land prices (adjusted for price changes) between 1964 and 1974 is estimated at 20.8 percent. [15] It would, therefore, take about four years, on the average, for the gain to increase by more than 100 percent and more than seven years for it to exceed 300 percent and be taxed at the 80 percent marginal rate. It is doubtful if many so-called speculators base their operations on such long-term investments. Those who acquire the land for development, however, may require a long period to carry out improvements.

Increments in value realized from sale of land should be recognized for what they are — capital gains — and should be taxed as capital gains on the absolute amount of appreciation in the value of property that is realized by each person in the taxable year. Because of the special purpose served by the LVIT in the Equalization of Urban Land Rights, it would be desirable to retain this tax as a separate schedule rather than to integrate it with the income tax law. Rates should not be so low as to mitigate unduly their intended purpose of recapturing real increases in land value, nor so high as to deter the sale of land. [16] A rate scale ranging between, say, 30 percent on the first NT$100,000 to 60 percent on increments over NT$1,000,000 would appear to satisfy these requirements and would involve little or no loss of revenue. More than 90 percent of the taxpayers would pay the lowest rate, while the wealthier landowners would have most of their increment captured by the Government. Records show that in many cases increments of over NT$1,000,000 are now taxed no higher than 20 percent because the adjusted increase in value has been less than 100 percent.

2. Tax treatment of homeowners and factories

Gains from the sale of owner-occupied residential land are taxed at 10 percent; if the home is replaced within a specified period, this tax is refunded. The tax paid is relatively small — NT$21.6 million in 1975 on only 2,389 transactions. It is understood that claims for refund are rarely made, so that few sales apparently involve the replacement of a home.

This preferential tax treatment is intended to encourage home ownership. It would also appear to conform with the philosophy of the LVIT that is aimed at speculative gains. It is inconsistent, however, with the ability-to-pay principle of income taxation. If the "roll over" principle were retained and the LVIT were converted to a capital gains tax based on the absolute amount of gains realized, landowners would continue to enjoy deferment of taxes on sales of homes that were replaced. Because of indexation and the generally small land area occupied by a home (1.25 ares), the average increment realized on sale is low (about NT$100,000 in 1975); assuming an average rate of 33 1/3 percent, the LVIT on final sale would amount to about NT$33,300.

The increment on sales of factory lands is taxed at one half the standard rates; this is refunded if the factory site is replaced within a prescribed period. It is not known if factory owners have availed themselves of this provision, which may be of some significance in remov

14. For reviews of land increment tax policy in developing countries, see Juanita D. Amatong, "Taxation of Capital Gains in Developing Countries", IMF *Staff Papers*, XV No. 2 (July 1968) pp. 344-86; George E. Lent, "The Taxation of Land Value", IMF *Staff Papers* XIV No. 1 (March 1967) pp. 89-123.

15. Yuan-hsing Lin, "Index of Land Values in Taipei", pp. 33-42.

16. Others have favored a proportional rate. Harriss, for example, would prefer a flat rate of 40 percent but would not find objectionable a rate schedule graduated between 30 percent and 50 percent. He would favor integration of the LVT with the personal income tax in the long run. C. Lowell Harriss, *op.cit.*, p. 44.

Table 2. Republic of China: Land Value Increment and Tax Revenue — by Applicable Rate — Fiscal Year 1975

(NT dollar amounts in millions)

	Cases		*Land value increment*		*Tax collected*		*Average tax rate (percent)*
	Number	*Percent of total*	*Amount*	*Percent of total*	*Amount*	*Percent of total*	
Exempt	64,625	27.40	1,492.9	16.86	—	—	—
Owner-occupied residential land	2,389	1.01	231.6	2.61	21.6	0.79	10.00
Marginal rate:							
20 percent	89,751	38.05	1,743.5	19.69	332.0	12.18	20.00
40 percent	28,451	12.06	1,493.3	16.86	379.0	13.90	25.38
60 percent	13,990	5.93	1,024.4	11.56	343.3	12.59	33.51
80 percent	36,689	15.55	2,871.0	32.42	1,650.8	60.54	57.50
Total	235,895	100.00	8,856.6	100.00	2,726.8	100.00	

Source: Ministry of Finance, Department of Taxation.

ing possible deterrents to the relocation and decentralization of manufacturing industry.

3. Tax treatment of gifts and bequests

Although the Land Law provided for the taxation of increments in value of land transferred through inheritance or gift (Article 178), only gifts were made subject to tax under the 1954 Act, as amended. Consideration has been given to the extension of the tax to inheritances, but this has been resisted because of the duplication of the estate tax already imposed on such transfers. One proposal is to allow a credit against the estate tax for any LVIT assessed.

Estate and gift taxes now range to a maximum rate of 50 percent on the value of a net estate that exceeds NT$20 million. This lies below the 80 percent top marginal rate of the LVIT, and it is likely that in most estates involving urban land the LVIT would exceed the estate tax applicable. But revenue considerations, although of some importance, would appear to be less relevant than consistency in carrying out the objectives of the LVIT as originally embodied in the Land Act. If transfers of land by gift are made taxable and those at death are not, an incentive is given to the continued holding of land that otherwise might be made available for development. It seems clear, however, that the original 1964 or later declared value should carry over to property transferred at death if the LVIT is not extended to it, so that it would be fully subject to the LVIT if sold by the heirs.

4. Valuation problems

The land value increment is now measured by reference to values of land that are announced every year by the land administration office, and not by the reported sales price of land. This practice was adopted several years ago because of the unreliability of the sales price declared. As a result, virtually all taxable increments are less than the true gain realized on the property. This is due both to the policy of underassessing land and to rises in land values during the year.

In principle, the accuracy of the reported sales price should be self enforcing. This is because the selling price is the buyer's basis for computing future taxable increments on sale. If this price is reduced by collusion between buyer and seller, the buyer is at a possible tax disadvantage in the future unless he is able to extract a share of the seller's tax saving. He may, of course, have no expectation of selling the land in the near future and be indifferent about the value reported, or he may expect to engage in similar underreporting. One of the clearest opportunities for abuse is in the sale of land to a controlled company by the owner/manager.

Some advantage for the present system is believed to result from more accurate reports on sales prices which are used by the land administration for estimating land values. Since landowners are not taxed on actual market values it is claimed that they are less inhibited in reporting sales prices. Another advantage is the avoidance of investigative work that would be involved in checking the validity of reported prices and the litigation that might arise over contested values. One serious problem is the allocation of sales value between land and improvements.

In the absence of reliable data on the size of the differences between present announced values and sales prices, it is not possible to hold an opinion on the preferability of either approach. The present valuation system undoubtedly is losing revenue, but whether the convenience of administration warrants this loss depends largely on the amounts involved. It would appear to be extremely doubtful that this is the case. A policy decision on this matter can be based only on a survey of the differentials between the realized price and the announced value of lands sold.

III. COORDINATION OF LAND TAX POLICY

The effectiveness of land tax policy depends heavily on the relationship of urban land taxes not only to the rural land tax but also to the so-called house tax — a local tax on improvements.

1. Relationship to rural land tax

As was noted above, the LVT and LVIT are now limited to designated city planning areas, but it is the declared policy of the Government to extend the LVT eventually to the entire country. All land not included within the enforcement area of the LVT is subject to the rural land tax (RLT). This is the traditional Chinese tax based on the productivity of land that was continued under the Japanese occupation. All registered lands are classified into 11 categories (e.g., paddy, dry land, pasture land, forest land) and standard outputs were assessed periodically by inspection at harvest season. Each category of land is further graded by its productivity, and uniform cost allowances are made in determining the standards for each class; each grade of each category is then assigned a unit standard tax. Paddy land, for example, is classified into 26 grades, and bracket rates ranging from 2.0 percent to 3.6 percent are assessed on the notional output. This system was retained following the return of Taiwan to the Republic of China, but payment of the tax on paddy land was required to be made in rice. Payments on other categories of land could be made in cash. Assessments continue to be based on the last cadaster completed by the Japanese, in 1944. Since then, however, the conversion rate for collection in kind was raised from 8.85 kg. per unit standard tax to a maximum of 27 kg. in 1966, but since 1972 the Government has reduced it to 22 kg. in order to encourage rural development. [17] Tax revenue in the fiscal year 1975 amounted to NT$2,179.7 million, 2.2 percent of total tax revenue.

Of the total land area of Taiwan, 1,665,560 hectares, or 47 percent, are registered for land tax purposes. Of this area only 161,448 hectares, or about 10 percent, are designated as city planning areas covered by the Act for Equalization of Urban Land Rights, 16 percent of which is in Taipei municipality. But only 16.1 percent of this area — 26,065 hectares — is within the LVT enforcement area, the balance (68.4 percent) is taxed under the RLT or is exempted (15.5 percent). [18]

The rapid growth of cities that has accompanied the industrialization of Taiwan since 1950 has encroached on the bordering agricultural land at a faster rate than the extension of the LVT enforcement area, with the result that sharp tax differentials are created. Between 1964 and 1975 the LVT enforcement area has more than doubled, from 11.2 million hectares to 26.1 million hectares, but this lies substantially within the boundaries of urban and suburban development. Since the non-enforced area is subject to the generally lower rural land tax and escapes the LVIT, speculative activity in fringe areas of the city is stimulated and serious tax inequities arise.

Notwithstanding these differentials, a basic question remains about the wisdom of the Government's objective of extending the area for equalization of land rights, step-by-step, until the rural land tax is replaced by the LVT. The rural land tax has much to commend it, and there is considerable precedent throughout the world for different approaches to the taxation of urban land and rural land in a country. [19] Being based on notional yields that generally are less than actual production, the RLT has an incentive effect in stimulating additional output. Although a fixed land tax has similar incentive effects, the present system probably is better understood in its relationship to farm incomes. Farmers are not as well aware of the value of their land, except for development purposes; indeed, it might be difficult to establish accurate land values if there is little or no turnover, and it might be necessary to capitalize current yields. Perhaps the greatest virtue of the present RLT is that it permits greater flexibility in varying the tax rates with changes in the price of rice and other major farm crops, as has been the case; tax revenue is therefore potentially more elastic with respect to changes in farm income than a land value tax would be.

The discriminatory effects of the RLT system could be mitigated by two different measures: first, the present cadaster based on 1944 yields should be updated to reflect the revolutionary improvements in the culture of paddy and other major crops since then. This administrative measure would permit farm taxes to be greatly increased to reflect improved incomes, without intensifying the discriminatory effects that have resulted from the differential improvements in productivity. Second, amendment of the Land Law to tax increments in value on the sale of all land, whether or not covered by the LVT, would remove the major tax differential between the two classes of land.

2. Taxation of improvements — the house tax

The Land Law provided for a tax on improvements to land other than agricultural improvements (Chapter V), exclusively for local government revenue. What is known as the house tax was enacted by Presidential decree April 11, 1967 and made effective from January 1, 1968. Tax rates now in effect are 1.38 percent on residential housing and 3.0 percent on business structures.

House tax revenue has risen sharply; by fiscal 1971 it overtook LVT revenue and by fiscal 1975 it had risen to slightly less than combined LVT and RLT revenue. Data for fiscal 1972 indicate an average tax rate of 1.6 percent on taxable property, only slightly below the average LVT rate. As in the case of the LVT, assessed values have lagged behind market values.

It seems paradoxical that the tax on improvements to land has emerged to almost equal importance with the tax on land values that had been a basic doctrine of the Republic of China. It is not uncommon, of course, to

17. Wei-hsin King, "Land Taxes of the Republic of China", p. 5
18. The enforcement area is that part of the city planning area lying within municipal limits where the LVT has been put into effect, the remaining city area being subject to the LVT or exempted. Agricultural land lying within the enforcement area is taxed on its value at a rate of 1.5 percent.
19. See George E. Lent: "The Taxation of Agricultural Income in Developing Countries", *Bulletin for International Fiscal Documentation*, August 1973; "The Urban Property Tax in Developing Countries" *Finanzarchiv*, Band 33, Heft 1, 1974.

levy property taxes on the capital value of land and improvements, and a number of countries employ differential rates on land and improvements to land (e.g., Malawi, South Africa, Zambia). But the coexistence of two different property taxes — one on land and the other on improvements to land — administered by two different levels of government raises a question of administrative efficiency. The feasibility of their consolidation would perhaps be complicated by the fact that the house tax is imposed in both rural and urban areas subject to different land taxes, and raises possible issues of reallocation of government revenue sources.

IV. CONCLUSIONS

Perhaps no country has employed Georgian principles of land taxation more consciously as an instrument of land policy than the Republic of China. This doctrine was first enuntiated by Dr. Sun Yat-sen, the founder of the Republic, in his Principles of Equalization of Land Ownership. While their implementation in Taiwan varied somewhat from the structure he envisaged, his principles are embodied in the urban land value tax and the land value increment tax that have been in force in this country since the early 1950s.

1. The Land Value Tax

A unique feature of the LVT is the graduation of rates based on multiples of the average value of seven ares of land in each *hsien* or municipality (PSV). Progressivity can be justified by its purpose of limiting urban land ownership, despite the fact that no recognition is given to indebtedness incurred to purchase the land. The fact that higher graduated rates are paid mostly by private and quasi-public corporations does not invalidate this principle. Moreover, the replacement of graduated rates by a fixed rate — advocated by some — would increase the taxes paid by the great majority of landowners and result in windfall gains to the wealthier. The particular form of progressivity used, however, results in serious discrimination among land holders in different *hsien* owning property of the same value. In principle, progressivity should be based on the cumulative holdings of each person in Taiwan rather than in each *hsien* or municipality. But the adoption of a single standard PSV for the country would result in a serious redistribution of tax revenue among the different jurisdictions that would benefit the wealthier areas and penalize the poorer.

Another questionable policy is the taxation of homeowners and industrial sites at preferential rates. Because land taxes probably play a minor role in the decision to own a home or to build a factory, the cost in revenue greatly exceeds any benefit that may be gained.

The surtax on vacant and underdeveloped land can be justified, in principle, as a means of achieving more effective land use. Partly because of low assessed values and adoption of surtax rates at the lower end of the authorized scale, it is doubtful if it achieved its purpose. The relatively small area exposed to the surtax also suggests that it was not vigorously applied.

Because of lags in assessments in the face of rapidly rising urban land values, and the underassessment bias in the law and its administration, land tax rates probably have not averaged more than 0.5 percent of the market value of the land. Tax rates of this level could have only negligible effects on land use decisions and would therefore fail to achieve the objectives originally envisaged.

2. The Land Value Increment Tax

The LVIT represents a unique approach to the recapture of increments in land value arising from urbanization and economic growth. Its most questionable feature is the graduation of tax rates with the rate of increase of increments in land values. The rationale of this structure is unclear. If it was designed to catch speculative gains, it has failed this objective because the largest rates of increase, in general, are realized on property held for long periods of time. Restructuring of the rate schedule so as to graduate it with the absolute size of gains realized would be more consistent with principles of ability to pay and equity of the tax system. It is also difficult to defend the preferential rate for gains on the sale of a home and the failure to assess tax on transfers at death.

3. Coordination of land tax policy

In limiting the LVIT to designated urban areas subject to the LVT, substantial gains on suburban lands escape tax. Although the LVT area has been greatly expanded since the introduction of the tax, its boundaries tend to lag behind areas ripe for development. There would, therefore, be considerable merit in extending the scope of the LVIT to include all land, whether or not subject to the LVT.

While it still appears to be the policy of the Government to replace the rural land tax, step-by-step, with the LVT, much can be said for retaining the RLT which is based on presumptive yields of different crops in different areas. It has the advantages of familiarity and correlation with farm incomes, as well as greater potential elasticity because of the flexibility with which taxes, paid in kind, can be adjusted to changes in farm prices.

The recently enacted house tax on value of improvements has overtaken all land taxes in revenue importance. While it is not uncommon to levy separate property taxes on land and improvements, their imposition by different jurisdictions in Taiwan raises a serious question of administrative efficiency.

TAXES ON OIL PRODUCTS IN THE E.E.C.

On 22 December, 1976 Mr. Lagorce addressed the following questions to the E.E.C. Commission:

Can the Commission give specific details of the size of the tax component, in each of the Community countries, in the market price of oil products?

Is taxation policy likely to hinder the implementation of a common oil policy?

(Written Question No. 735/76)

On 17 February, 1977 the Commission answered as follows:

1. Taxes on petroleum products generally comprise excise duty and value added tax (VAT). Excise duties are normally fixed as an absolute sum, whereas VAT is calculated as a percentage of prices before tax but including excise duties.

To give an idea of the order of magnitude of taxes on the main categories of petroleum products, excise duties have also been expressed in percentages. In order to do this, since for any given product it is practically impossible to state one single price for each Member State having exactly the same connotations, excise duties on petroleum products have been put at reference levels which reflect average market conditions in Member States as of November 1976.

2. When taxes on petroleum products are different from those on other forms of energy, they can affect the consumer's choice. They can also affect the level of consumption by encouraging energy savings.

The Council has included the problem of the price of energy in its programme of work for the coming year, and this would involve a study of the effects of taxation on energy policy.

EFFECT OF TAXES ON THE MAIN PETROLEUM PRODUCTS IN THE MEMBER STATES

A. FUELS AND GAS OIL USED FOR HEATING

Country	High-grade petrol			Regular petrol		
	VAT	Excise duties (% of pump price)	Total price	VAT	Excise duties (% of pump price)	Total price
B	5.6	50.2	55.8	5.7	51.8	57.5
DK	13.0	44.7	57.7	13.1	46.0	59.1
D	9.9	45.9	55.8	9.9	48.4	58.3
F	15.0	43.5	59.8 (1)	15.0	44.3	60.7 (1)
IRL	9.1	48.8	57.9	9.1	50.0	59.1
I	10.7	61.0	71.7	10.7	61.4	72.1
L	4.8	41.9	46.7	4.8	44.0	48.8
NL	13.8	43.0	56.8	13.8	44.9	58.7
GB	11.1	39.4	50.5	11.1	40.5	51.6

(1) Including certain charges paid into specific funds.

Country	Gas oil used as engine fuel (1 000 l)			Gas oil used for heating (1 000 l)		
	VAT	Excise duties (% of pump price)	Total price	VAT	Excise duties (% of pump price)	Total price
B	12.3	30.6	42.9	5.7	8.8	14.5
DK	13.1	zero	13.1	13.1	zero	13.1
D	9.9	55.8	65.7			(1)
F	15.0	33.9	48.9	15.0	2.5	17.5
IRL	9.1	29.5	38.6	zero	6.2	6.2
I	10.7	16.6	27.3	10.7	4.8	15.5
L	4.8	16.7	21.5	4.8	4.8	9.6
NL	3.8	32.7	36.5	3.8	9.9	13.7
GB	7.4	42.2	49.6	zero	3.2	3.2

(1) This type of fuel is not used for domestic purposes.

B. FUEL OILS

Country	Light fuel oil/kerosene (1 000 l)			Heavy fuel oil (t)		
	VAT	Excise duties (% of consumer price)	Total price	VAT	Excise duties (% of consumer price)	Total price
B	5.7	9.0	14.7	5.6	2.9	8.5
DK	13.0	zero	13.0	13.0	zero	13.0
D	9.9	2.6	12.5	9.9	7.1	17.0
F			(1)	14.9	zero	14.9
IRL	zero	7.0	7.0	zero	7.9	7.9
I			(1)	10.7	1.1	11.8
L			(1)	4.8	2.8	7.6
NL	3.8	6.0	9.8	3.8	6.4	10.2
GB	zero	3.2	3.2	zero	4.9	4.9

(1) This type of fuel is not used for domestic purposes.

NB: Because of differences in national systems, discounts and regional and quality variations it is practically impossible to state one single price for any given product and for each Member State which would have exactly the same connotations. For the percentage calculation of the proportion of taxes in the consumer price of each product, therefore, the excise duties and VAT values have been put at reference levels which reflect average market conditions in the Member States as of November 1976.

Recent Developments in Taxation in Latin America and the Caribbean



by A. Atchabahian*

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1. EFFORTS TOWARDS TAX HARMONISATION

Even though the achievement of such a global goal of structuring a Latin-American common market, proposed as far back as in the early 1950s, still remains on a rather idealistic plane, and even though the progresses attained thus far through the four partial schemes existing in the Western Hemisphere towards some type of subregional economic integration have been very slow and uneven among those four schemes, one of the areas in which they have been elaborated to what could be regarded as a good conceptual framework is related to taxation.

As it will be explained in each one of the four cases, the pace and the means of the works undertaken have been different. However, it must be admitted that they by and large have shown quite clear understanding of the basic ideas underlying any attempt for reaching tax harmonisation among member countries involved in each one of the aforementioned schemes.

a) Latin-American Free Trade Association (LAFTA)

In spite of the fact that the Treaty of Montevideo establishing the Association, signed in February 1960, in strictly technical terms specifically called only for a "free trade zone", it did not rule out the intention of eventually converting it into a common market and even into a broader and more complete form of economic integration.

Thus, taking into consideration the limited scope given by the Treaty to the immediate objectives of the Association, it must be recognized that these objectives have been to a great extent accomplished; the free trade zone has greatly contributed, since its inception, to the increase in the volume of trade among the eleven member countries. Notwithstanding the importance of that factor, it did not actually help to encourage the evolution of the free trade zone into much more advanced stages of economic integration.

Given the special and obvious significance of customs practices to better serve the functioning of the free trade zone, the Association sponsored a programme of annual technical meetings of directors and high officials of customs administrations — including heads of customs training schools — to deal with the entire set of problems connected with their activities [1]. Those meetings have been one of the best instrumental ways to promote among member countries the adoption of the Brussels customs system, as far as customs valuation, nomenclature and techniques are concerned. Special meetings of experts to discuss in depth specific subjects, such as the adoption of a subregional customs nomenclature known as NABALALC (in accordance with the Spanish spelling), adapted from the Brussels nomenclature, have been organized to that end.

On the internal taxes side, the Association has supported the idea of sponsoring similar types of annual meetings among tax administration directors (quite often the meetings have been also attended by officials involved in the tax policy decision-making process). This step has been taken as a means to prepare the conceptual grounds for future developments towards tax harmonisation.

Even though the participants in those meetings are tax officials of their respective countries, they do not commit their own governments to any decision out of the comments made or recommendations approved during the meetings. The discussions on technical matters are held strictly on conceptual terms, trying obviously to reach coincidental conclusions.

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1. The basic need of adjusting customs tariffs of the Association member countries, to foster intra-subregional trade, has been implemented under separate mechanisms placed at higher political levels.

The far-reaching importance that those meetings have had so far cannot be denied in explaining (a) the convienience for undertaking already the fundamental groundwork to achieve a future tax harmonisation; (b) the technical content of the tax devices which can better serve such an objective and which sometimes differ from the tax provisions presently in force in the member countries.

Thus far six of these meetings of directors of internal taxes' administrations have been held; the seventh will be held before the end of 1977. The agenda of those meetings have usually included subjects as follows:

1) a proposal for studies to set the grounds for the harmonisation of tax policies;
2) the adoption of a model tax code, aimed at regulating substantive and procedural aspects of the relationships between taxpayers and tax authorities; such a code would not contain any provision related to the taxable base or the tax rates of any tax in particular, yet it would be applicable in handling the administration of every tax, as to the relationships between the tax authorities vis-á-vis the taxpayer [2];
3) a common classification of taxes and para-taxes, along with a proposal for an efficient setup to gather and analyse tax statistics within the tax administration;
4) taxation on goods and services;
5) taxation on profits of enterprises, regardless of their juridical form;
6) international double taxation;
7) training programmes for tax officials of the member countries' tax administrations.

Furthermore, and specifically with regard to subjects above-mentioned under numbers 4, 5 and 6, meetings of experts were also organized. Thus, in connection with taxation on goods and services two meetings of experts took place and they dealt with the drafting of a model tax on value-added on the one hand, and of another model tax on selective consumptions, on the other, the latter to introduce a certain degree of progressivity to the area of taxation on goods and services, as well as to get a better allocation of resources. Both models of tax laws were approved at the technical level and it must be recognized that in one way or another they have been taken into account by those member countries which have introduced in their tax legislation either one or both of those types of taxes.

As far as taxation on profits of enterprises is concerned, there has also been a meeting of experts which analysed the possibility of defining certain criteria in connection with the fundamental technical principles on which that kind of taxation should be based in order to achieve its harmonisation in the subregion.

On international double taxation three meetings of experts have been held and the fourth is forthcoming (August, 1977). They discussed the subject, in general and particular terms, in so far as it affects tax relations among member countries of the Association, as well as their tax relations with third countries, outside the Association. The experts have also debated the measures to take better advantage of the unilateral tax treatment given to foreign income by capital exporting countries. In their discussions the experts took into consideration the existing models of tax conventions contained in the Decision 40 approved by the Commission of the Cartagena Agreement in 1971 [3]. In a rather detailed analysis the experts dealt specially with the principle of source, its proper application to taxation on profits of enterprises, on net wealth, on investment income and on income from rendering personal services. The allocation of income and expenses between related enterprises was also among the topics discussed.

b) Andean Group

In establishing this subregional body, the Cartagena Agreement signed in May 1969 is one of the most detailed documents in force, aiming emphatically at the far-reaching objective of economic integration.

At the beginning it encompassed five countries — Bolivia, Chile, Colombia, Ecuador and Peru; later in 1973, Venezuela joined the Group. However, presently Chile is no longer a member country; the Chilean Government's decrees numbers 1641 and 1642, enacted on 30 December 1976, provided for, and ratified, the withdrawal of Chile from the Andean Group [4].

Chapter III of the Cartagena Agreement sets forth the provisions related to the harmonisation of economic policies and co-ordination of development planning between member countries. Specifically article 26, section d), of the Agreement calls for the harmonisation, among others, of fiscal policies in the subregion. However, no principles, guidelines or priorities are provided by the Agreement on how to proceed in order to advance towards such an harmonisation.

The highest political body of the Agreement, the Commission, has been empowered by article 29 to determine the necessary procedures and mechanisms to achieve the aforementioned harmonisation and co-ordination. Accordingly, together with other councils, the Commission has created the Fiscal Policy Council.

On the other hand, as article 27 of the Agreement established a deadline, 31 December 1970, for the approval of a common régime of treatment of foreign capital and of trademarks, patents, licenses, and royalties, the Commission has enacted on those matters the Decision 24, sometimes known as the Investment Code of the Andean Group. Article 47 of this Decision 24 says that the Commission "shall approve, at the latest, on 30 No-

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2. Among the member countries of the Association, Argentina, Bolivia, Brazil, Chile, Ecuador, Mexico, Peru and Uruguay have in force laws or codes of this kind.
3. See a detailed study on Decision 40 in the article published in the *Bulletin for International Fiscal Documentation*, August 1974.
4. At the subregional level the Commission of the Cartagena Agreement, on 5 October 1976, had approved an Additional Protocol to the Agreement in order to seek the adoption of a special régime which would keep Chile within the Group; should the efforts to reach that conclusion fail, the Additional Protocol provided that Chile would withdraw as a member of the Andean Group.

vember 1971" a convention related to double taxation between member countries and other countries outside the subregion.

Since the last sentence of article 47, in Decision 24, imposed on the member countries the obligation to refrain themselves from negotiating in the meantime any tax treaty with third parties outside the subregion (and they did comply with this obligation), it implied a clear attempt to build up in the specific area of international double taxation a sort of tax harmonisation.

In that regard, as well as with respect to incentives for the promotion of foreign investment, Decision 24 tries to neutralize any legislative action, on the part of the member countries, that could create new discrepancies and difficulties to the existing ones in the road towards economic policy harmonisation.

On November 1971 Decision 40 was approved, containing both types of model tax conventions above-cited [5].

As a matter of fact no further action has been taken to actually harmonise existing policies or legislation in any other aspect of taxation in the subregion. Nevertheless, several surveys have been undertaken, at the technical level, as a background for eventual political decisions, and discussions have been held on that regard during the first meeting of the aforesaid Fiscal Policy Council, which took place on 24 November 1975.

During such a meeting the analysis was mostly related to the purpose of designing general orientations on fiscal policy harmonisation; some attention was also given to the problem of taxation on goods and services, as well as to tax incentives the member countries have in force, in order to get some progress in their harmonisation.

A second meeting of the Fiscal Policy Council was held on 5 and 6 June 1976, which basically analyzed further the topics initially discussed at the first meeting of the Council.

It was also agreed that there would be an eventual need to provide preferential treatment in fiscal harmonisation matters to the relatively less developed countries of the subregion, that is to say, Bolivia and Ecuador.

The Council further recommended to the Board, the permanent body established by the Cartagena Agreement, the following work programme:

(1) Adoption of common jurisdictional principles applicable in the subregion to taxation on goods and services. In this connection, the Council requested the preparation of a proposal in accordance with the principle of the country of destiny.
(2) Examination of tax aspects contained in the Decisions of the Commission, related to the harmonisation process.
(3) Comparative study of legislation referring to internal taxes on goods and services in the member countries, in order to make them compatible.
(4) Basis for the harmonisation of taxes on motor vehicles and preparation of proposals in accordance with the progress in the Programme of Industrial Development pertaining to that sector.
(5) Basis and orientation for the harmonisation of the following aspects of fiscal policy:
  (a) fiscal incentives and subsidies;
  (b) taxation on enterprises' profits; and
  (c) taxes on income and net wealth of individuals.

During the same second meeting of the Fiscal Policy Council, it was also pointed out that the above-mentioned Decision 40 is not in force in the subregion, because two of the countries still did not complete the procedures required by their legislation to make that Decision effective.

c) Central American Common Market (CACM)

As a result of the Treaty on which this subregional scheme is based and to which in the early 1960s have adhered the five Central American countries — Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua — the only effective internal tax measures based on subregional considerations have been adopted in connection with article VI of the Treaty, whereby the member countries are bound to comply with certain obligations in the area of internal taxes on consumption. Additionally, a protocol was signed on tax incentives, with the purpose to harmonise them in the subregion.

The conflict which in 1969 arose between El Salvador and Honduras has created a crisis still not completely solved in the context of the common market; presently, because of that, Honduras is not a totally active member of the subregional setup.

In the meantime substantive efforts have been made to overcome such a situation, including the adoption of new fundamentals for the structure and the functioning of the common market. In that sense a new treaty has been drafted, which provides for the creation and establishment of the Central American Community; it contains detailed clauses on the different aspects of tax harmonisation of internal taxes, as well as on customs tariffs. As far as the latter is concerned, the General Secretariat of the Central American Common Market has prepared technically sound proposals for the member countries to base their tariffs on the concept of effective protection; however, no concrete steps have been for the time being taken in this regard, apart from broad and profound discussions held in several subregional and national fora.

With respect to taxes on income and on goods and services the existing legislations in the five member countries still differ considerably. This does not mean a lack of consciousness on the convenience for tax harmonisation in the subregion. Thus, as a part of an exhaustive survey of the entire situation of the common market, asked for by its General Secretariat and supported, either financially or technically, by several international agencies,

5. It has to be pointed out that the Additional Protocol mentioned in the previous footnote contemplates that even in the case of its withdrawal from the Group, Chile will still have the rights and the obligations resulting from several Decisions adopted by the Commission; among those Decisions the number 40 is expressly indicated. By means of the Decree 1641, of 30 December 1976, the Chilean Government has ratified this Additional Protocol with no reservations.

a thorough analysis on tax harmonisation for the subregion, with concrete recommendations for actions, was performed during 1972 and 1973.

d) Caribbean Community

This Community was established by a Treaty approved in 1973, its objectives being the achievement of:

(a) the economic integration of the Member States by the establishment of a common market régime;
(b) the co-ordination of the foreign policies of Member States; and
(c) functional co-operation among them.

The Annex to the Treaty deals specially with the establishment of the Caribbean Common Market. Membership of the common market shall be open, article 2 of the Annex says, to: Antigua, Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, Montserrat, St. Kitts-Nevis-Anguila, St. Lucia, St. Vincent, Trinidad and Tobago, and any other state of the Caribbean Region that is, in the opinion of the Conference of Heads of Government, able and willing to exercise the rights and assume the obligations of membership.

Among the countries and territories above listed, article 3 of the Treaty designates Barbados, Guyana, Jamaica and Trinidad and Tobago as More Developed Countries, whereas the others are regarded as Less Developed Countries.

In adopting a "common protective policy", Chapter IV of the Annex provides for the establishment of a Common External Tariff "in respect of all commodities imported from third countries", as article 31 states. On 1 January 1976 such a Common External Tariff entered into effect in the Caribbean Common Market with a new rate structure.

In turn, Chapter VI of the Annex to the Treaty deals with co-ordination of economic policies and development planning. In that Chapter, article 40 provides that Member States:

(1) shall seek to harmonise such legislation and practices as directly affect fiscal incentives to industry;
(2) shall seek also the harmonisation of fiscal incentives to agriculture and tourism with appropriate differentials in favour of the Less Developed Countries; and
(3) agree to study the possibility of approximating income tax systems and rates with respect to companies and individuals.

Finally, Chapter VII of the Annex to the Treaty, in contemplating a "special régime for the Less Developed Countries" provides in articles 54 and 55 that the special needs of those countries shall be taken into consideration for both, the harmonisation of fiscal incentives to industry and the common external tariff, respectively dealt with in articles 40 and 31 of the Annex.

Whereas an agreement on fiscal incentives has been approved, and also ratified by some Member States, no action has been taken with regard to income taxation towards its approximation in the subregion.

Another tax aspect contemplated by the Annex to the Treaty is on intra-regional and extra-regional double taxation agreements; on this article 41 provides:

"1. Member States shall approach their negotiations for agreements for the avoidance of double taxation with countries outside the Common Market on the basis of a set of mutually agreed principles.
"2. With a view to encouraging the regulated movement of capital within the Common Market, particularly to the Less Developed Countries, Member States agree to adopt among themselves agreements for the avoidance of double taxation."

As an instrument for the implementation of section 2 of article 41 just quoted, a draft agreement between the More Developed and the Less Developed Countries of the subregion was prepared; its purpose is the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and for the encouragement of international trade and investment. The final approval of this agreement by the Member States is pending.

2. SOME RELEVANT TAX FEATURES AT THE NATIONAL LEVEL

a) Tax policy as a tool for economic development

At the national level it seems justified to draw as a general conclusion that the goal for more progressive taxation, or a better distribution of the tax burden, which was a distinctive preoccupation in the 1960s and even early 1970s, presently has receded to some extent.

Perhaps the most striking feature as the conceptual background on taxation evolved in governmental circles of developing countries of the Western Hemisphere in the current decade, has been the greater emphasis on the tax policy as a tool for economic development. Scholars in the public finance field have been elaborating on this approach for many years; however the usual analysis was related to each particular type of tax and its effects on development, without paying too much attention to the global consideration of the tax system's effects in general terms.

The trend that is advancing in developing countries of the Western Hemisphere shows, on the one hand, that tax policy-makers with official responsibilities take very much into account such an approach, and attention is given to the tax system as a whole, with its combined effects, so as to design it in a coherent, integrated and co-ordinated manner for developmental purposes, or the other.

As a consequence, the focus on equity aspects of the tax systems, which was prevailing during the 1960s, as we said before, seems somehow lessened as a socio-economic goal, or are not necessarily contained in the proposals for changes in the tax legislation.

It is fair to say that the III Inter-American Conference on Taxation, held in Mexico City (September, 1972), co-sponsored by the Organization of American States and the Inter-American Development Bank, and hosted by the Government of Mexico, has had a certain degree of influence in such a trend. However, it was not intended by the Conference to suggest that growth and development objectives should be served, through taxation, at the expense of equity considerations; on the contrary, the Conference actually proposed the convenience of keeping the adequate balance between both dimensions.

The basic idea maintained by the Conference was that tax policy is one of the many tools of economic policy which is available to serve the attainment of the goals set in a global strategy for the development of each country in a given time; the underlying implication is that the tax system is not an end in itself, that it has to perform an instumental role aimed at co-operating for the achievement of the objectives set forth in accordance with the economic policy adopted for developmental purposes.

During the years following the Conference several seminars and symposia took place in several countries — Ecuador, Guatemala, Costa Rica, El Salvador, Honduras, Dominican Republic — in order to verify the validity of the general and particular tax proposals and recommendations made during the Conference. It would be valid to extract, as general conclusions of those events, that still the Latin-American tax systems have many inconsistencies among the taxes which are parts of them, as well as taxes technically ill-structured in the sense that they have inconvenient or undesirable economic effects; at the same time the proliferation of many and meaningless taxes makes the systems unnecessarily complicated and hard to manage. Furthermore, the tax systems, generally speaking, are not conceived and do not operate in accordance with the action of other instruments of economic policy.

It seems again fair to say, in broad terms, that the conceptual framework of the Conference has been found useful to analyse the tax systems in effect in the developing countries of the Western Hemisphere, in order to assist in the rationalization of their entire structure, evaluate their overall economic effects, with the simultaneous and evident intention of suggesting their simplification. To make the scope of the effort even broader, the analysis undertaken as well as the policy measures recommended for implementing its conclusions, included internal and external taxes as well.

While the attitudes of tax policy decision-makers tended to pay special attention to all of these ideas, the supervening fact of the economic crisis widespread since 1974 for non-oil producing developing countries, made it inevitable to look for rapid and abundant revenue to alleviate the situation.

In that kind of circumstances, as it is very well known, the easy solution, revenue-wise, comes from taxes on consumption, above all on goods and services for which demand is wide and inelastic to the changes in their prices.

Therefore, because of those conjunctural and immediate needs, the scrutiny of each tax system, in order to determine its economic performance and its contribution for the achievement of developmental objectives defined in accordance with a global strategy, seems for the moment as being put aside.

b) Taxation on goods and services: adoption of the value-added taxation

The share of the revenues from taxes on goods and services with respect to the total tax revenues, in most of the Latin-American countries, is still very high. In the relatively more developed countries of the region the predominant tax of this type, in the last decade, has been the sales tax, adopted under different characteristics.

Whenever a situation of fiscal deficit has arisen, the governments have had these taxes in mind to increase revenues. Nevertheless, it must be admitted that lately the recourse has not been merely to augment the rates of existing excise or sales taxes, but rather try to get higher amounts of revenue together with the improvement of the technical structure of those taxes, nothing to say, on the other hand, about the permanent preoccupation for achieving higher standards of efficiency in the tax administration's performance, so as to reduce as much as possible the still sizable levels of tax evasion [6].

It is in that context that the adoption of schemes of taxation on value-added can be explained. In reality, proposals of this type had been formulated in several fora in the Hemisphere, including the above-cited Conference on Taxation in Mexico City.

Among the developing countries in the Hemisphere only four do not have in force a general sales tax, in whatever technical form of implementation; they are: Dominican Republic, Haiti, Trinidad and Tobago and Venezuela.

Another four countries (Barbados, Jamaica, Nicaragua and Paraguay) have a sales tax applied on one stage, meanwhile fourteen countries have in effect a sales tax on multiple stages (Argentina, Bolivia, Brazil, Colombia, Chile, Costa Rica, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Panama, Peru and Uruguay).

Within the latter group, in three countries (El Salvador, Guatemala and Mexico) the tax has cumulative effects, since it is applied in cascade. On the other hand, ten countries have in force a value-added tax in a variety of

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6. With regard to changes in the tax administrations, the recent trend has been characterized by the already existing emphasis on the unification, under one single directorate, of the previously divided administration of taxes, usually along the lines of their direct or indirect character, or keeping a special agency for the income tax administration and a separate one for administering all the other internal taxes.
Guatemala and Uruguay have been the latest countries which took this step of erecting one single directorate for the administration of all their internal taxes, in lieu of the two or three independent tax offices formerly in existence.
As far as the joint administration of internal and external taxes is concerned, one must mention the cases of Panama and Venezuela, where such an approach has started to be in effect quite a long time ago.

modalities but in general with no, or very little, cumulative effect; they are: Argentina, Bolivia, Brazil, Colombia, Costa Rica, Ecuador, Honduras, Panama and Uruguay [7]. As far as Peru is concerned, its tax on goods and services is not precisely or typically on one stage, nor in cascade, but it rather resembles the former; in order to avoid or reduce the cumulative effect, it also provides for a credit with respect to the amount of the tax that the manufacturers pay on inputs they buy.

The prevailing technical pattern of the existing legislations on the value-added tax in those countries is based on the credit method, and tending towards the provision of only one tax rate; the usual recommendation of not granting exemptions is not followed, since at least staple commodities specifically listed by each law are tax exempt in every country. It is also generally provided that exports are entitled to bear no value-added tax.

As another way of mitigating the regressiveness inherent in the value-added tax, some countries (such as Bolivia, Brazil, Costa Rica) have in effect a tax on selective consumptions, usually at rates higher than the general rate applied for the value-added tax.

It should be kept in mind that the tax on selective consumptions is preferably implemented according to the value-added technique, in only one stage of the economic process of production and distribution, generally at the level of the manufacturer or importer of those goods which by law are imposable.

It is worthwhile to mention that a proposal to introduce a tax on selective consumptions was also made at the Conference on Taxation in Mexico City, under the following terms: the rates for the tax have to be structured so as to absorb the non-protective portion of the customs tariff, as far as imported goods are concerned, and implemented equally rated on similar domestic goods, with the obvious purpose of not stimulating the local production of goods regarded non-essential for developmental objectives. In other words, no discrimination would have to be made between domestic and imported goods, as to their tax treatment in this type of taxation.

Aside from the tax described in the preceding paragraph, several of the countries which do not have it in force, use to apply the traditional form, so to speak, of an excise tax, also under a selective criteria. This is the case, at the present time, of Argentina, El Salvador, Nicaragua, among other countries.

Argentina had such a tax for many years, and in 1976 has enlarged the list of imposable goods and services, and converted all the rates into ad-valorem; the rampant Argentinean inflation had made meaningless the tax and meager the revenues collected according to the fixed rates which formerly were in force with respect to some of the taxable goods and services.

El Salvador approved a selective excise tax in 1974, at different rates, ranging from 10 to 30 percent, on imports and on the first domestic sale of certain goods.

The Nicaraguan law was also approved in 1974 and the tax rates vary from 5 to 35 percent on the imports and on sales made by manufacturers of a list of taxable goods.

c) Monetary corrections for tax purposes

Since the wave of high rates of inflation has become a recurrent phenomenon in some Latin-American countries, particularly of the Southern part of the Hemisphere, they have redesigned old devices or incorporated new ones to permit, for tax purposes, realistic determinations of the tax base, and hence of the tax liability, in monetary terms [8].

In that regard, Brazil [9] and Chile [10] and to a lesser extent Argentina [11], Bolivia [12], Colombia [13], Ecuador [14], Paraguay [15], Peru [16], and Uruguay [17] have in effect specific tax provisions which contemplate methods of monetary corrections to avoid the imposition of a tax on amounts of taxable matter affected by inflationary factors. Furthermore, legal provisions have been also approved and are in effect, with respect to the indexation of tax liabilities not paid by the taxpayers in due time; the same adjustment goes for the refund of taxes in favour of the taxpayer.

3. LATIN-AMERICAN AND CARIBBEAN TAXATION IN PERSPECTIVE

As the rise in the public expenditures level is felt, a parallel rise in revenues appears inevitable. Thus every government seeks, consequently, to get additional tax revenues to cope with the ever increasing demand of

7. Chile abolished the exemption in Decree Law 1,606 of December 12, 1976.
8. See by Milka Casanegra de Jantscher, "Taxing Business Profits During Inflation: the Latin American Experience", in *The International Tax Journal*, Winter 1976, pp. 128-146; and by George E. Lent, "Adjustment of Taxable Profits for Inflation" in *Staff Papers* (published by the International Monetary Fund) Vol. XXII, number 3, November 1975, pp. 641-679.
9. Decree 76.186/75, income tax regulations (arts. 239 to 255, 511 and 512).
10. Decree Law 824/74, income tax (arts. 20, 31, 32, 41, for enterprises; arts. 43, 44, 45, 52, 53, 54, 55, 56, 57, for individuals; arts. 17, 18, 62, 72, 95, 96 and 97 applicable for both); Decree Law 830/74, tax code (art. 52); Decree Law 1244/75; Decree Law 1350/75.
11. Law 20.628, income tax (arts. 25, 54, 57, 90, 96 and 110) as amended by laws 21.286 and 21.481; Law 21.281, indexation of tax liabilities and refunds; Law 21.282, tax on net wealth (art. 15); Law 21.284, tax on capital gains (art. 12); Law 21.287, tax on capital of enterprises (art. 17).
12. Decree Law 11.154, tax on business profits (art. 46), as amended by Decree Law 12.853/75; Decree Law 12.852/75 income tax on individuals (art. 3).
13. Decree 2.247/74, taxes on income, on net wealth and on inheritance (arts. 50 to 59).
14. Supreme Decree 1.283/71, contains the income tax law ordinated (art. 39); Supreme Decree 1.410/71, regulations of the tax on business profits (arts. 63 to 66).
15. Decree Law 9.240/49, income tax (art. 100), as amended by Law 672/60.
16. Supreme Decree 314-68-HC, income tax (arts. 1 to 9); Law 18.815/71; Decree Law 21383/76.
17. Decree 114/75, tax on income from industry and commerce (arts. 10, 11, 14 and 16); regulations, Decree 52/75 (arts. 10, 11, 14 and 16). The same decree 114/75 for tax on net wealth (arts. 15, 16, 21, 22, 33, 34, 39, and 43).

public goods, in order to minimize the risks of falling into fiscal deficit situations and eventual inflationary pressures which can be generated in that way.

The developing countries in the Western Hemisphere are no exception to that picture. As in every other part of the world, economically developed and developing as well, Latin-American and Caribbean countries have been always constrained by the political factors in determining what type of taxes they would choose to finance their expenditures.

The existing structures of the tax systems in the region differ considerably one from the other. As far as the presence of the income tax is concerned, for instance, the English-speaking Caribbean countries are the ones in which their income tax legislation makes the respective burden quite high, if due consideration is given to their stage of economic development; among them, in Barbados, Jamaica and Trinidad and Tobago the income tax collection amounted to, in 1973, at least 45 percent of their total tax revenues. Meanwhile, in all the other developing countries in the Hemisphere the traditional structure of the tax systems has consisted of predominant participation of taxes on goods and services, including customs tariffs, and only tending towards increasing share of the revenues from the income tax as the pace of economic development permitted; only in two Latin-American countries have the income tax collection percentages with respect to total tax revenues been, in 1973, higher than thirty percent: Panama, 38.1 percent, and Colombia, 49.5 percent [18].

The fact already insinuated above, in connection with tax systems which include anachronistic or irrational forms of taxation — with earmarked taxes sometimes —, remains still significantly valid in some countries. Fortunately, years ago in several countries the governments decided the abrogation of many taxes of that type.

It seems that this trend is getting increasing attention, so as to have fewer number of taxes, keep those truly important, susceptible of being manipulated effectively as instruments serving objectives of economic development, or as suppliers of abundant revenues. Needless to say that the fewer the taxes the better their administration can be.

From the tax policy point of view that process of simplification of the tax systems would be the most obvious need to fulfil in the purely technical sense, but in the political sense it would have still much more appeal.

What about the remaining parts of the tax systems? We have previously mentioned, among the major areas of taxation, the existing trend with regard to taxes on goods and services; generally speaking those trends are going in the right direction in most of the countries.

Paying now our attention to the income tax area, there would be ample room for changes and improvements in the technical content of the legislations. For example, with respect to tax rates some Central American countries still have in effect progressive rates for taxing business profits — sometimes with no difference from the rates applied to taxable income from individuals —, or very high marginal rates for brackets of income in respect of which actually there is not a single taxpayer. This type of question, among others, should be dealt with so as to enhance the rationality of the income tax legislation and hence the tax system as a whole.

However, the most pressing need, the paramount task to be performed in the Latin-American context is related to the improvement of the tax administrations. There are no definite results of the inquiries about the level of tax evasion in many of those countries; nevertheless, with respect to some of them surveys have been undertaken which revealed that income tax evasion ranges between forty and fifty percent. At any rate, the evasion evidently is there, and in order to realize that fact it would be enough to take into consideration that whenever a tax amnesty or other kind of tax condonation is granted there is a very important amount of collection: it shows somehow the magnitude of the current tax evasion phenomenon.

For some time, in Bolivia it was a sort of tax evaders' "bonus" to have at the end of every year a tax amnesty; the taxpayers were accustomed to that legislation. Presently, Argentina is having another broad pardon of tax evaders, similar to those it has conceded almost every four or five years since 1956; and official estimates of the revenues to be collected from that source every time fall short of the reality, and for the forthcoming case — which is expected to be the last pardon of this kind — the estimates run around 300 million dollars.

To properly tackle this problem a recent quite uniform and vigorous trend is developing, aimed at building up on modern basis a supportive system for the tax administrations, consisting of a good network of information about the taxpayers and their tax behavior. This effort is attempted through the combined and closely co-ordinated actions of sub-systems dealing with tax statistics, automatic data processing and taxpayers registration. An adequate and efficient, really dynamic, setup of this sort must be able to provide the whole picture of economic circumstances that matter with respect to every taxpayer's obligation in connection with any tax which might be applicable to him.

The effective operation of these supportive systems should contribute to greatly reduce the sizable gap between what the tax laws say that taxpayers must pay and what they actually pay.

In other words, even without any change in the existing tax legislation, those improvements in the tax administration would accomplish what in theory the tax laws imply in terms of the distribution of the tax burden among taxpayers, a distribution pattern which so often is frustrated in reality because of the tax evasion factor. Presently that would be the dimension in which can be expected the most significant and far-reaching tax reform in Latin-America.

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18. This excludes the case of Venezuela, where such a percentage was around sixty percent in the same year; it was basically as a result of the taxation on the oil industry, before its nationalization. Individuals and businesses in Venezuela have a low income tax burden.

CONFERENCE DIARY

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31st Annual Congress of I.F.A.: I. Inflation and Taxation; II. Determination of the Taxable Profit of Corporations. Vienna (Austria) October 3-8 (English, French, German, Spanish).

Hawaii Tax Institute: The 14th Annual Tax Meeting (including Tax Shelter Review, Doing Business Abroad — Tax Implications etc.). Waikiki (Hawaii) October 23-28 (English).

NOVEMBER 1977

U.S. Branch of I.F.A.: National Meeting. New York (U.S.A.) November 3-4 (tentatively) (English).

JANUARY 1978

Associated Business Programmes Ltd.: Tax Planning and International Trade; Taxation of Personal Wealth of individuals; Sales Taxes, Value Added Taxes and Double Taxation Conventions. Honolulu (Hawaii) January 22-27 (English).

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32nd Annual Congress of I.F.A.: I. The Taxation of Extractive Industries; II. The Differences in the Tax Treatment between Local and Foreign Investors and the Effects of International Treaties. Sydney (Australia) September 17-23 (English, French, German, Spanish).

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International Fiscal Association (I.F.A.): General Secretariat, Woudenstein, Burg. Oudlaan 50, P.O. Box 1738, Rotterdam (Netherlands).

31st I.F.A. Congress: Secretary c/o Interconvention, P.O. Box 35, A-1095 Vienna (Austria). Non-members of I.F.A. should apply to International Fiscal Association (I.F.A.) in Rotterdam, P.O. Box 1738.

U.S. Branch of I.F.A.: Secretary of U.S. Branch of I.F.A., Suite 44-27, 345 Park Avenue, New York, N.Y. 10022 (U.S.A.).

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THE NETHERLANDS

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BELASTINGBERICHTEN

Editors: J.G. Detiger, J.P. van Franeker and H. Baron van Lawick.
Samsom, Wilhelminalaan 1, Alphen a.d. Rijn.
Supplemented: weekly.

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Gids voor studie en praktijk.
Edited by: C.J. Sleddering, L.G. Schedler, D.B. Bijl, H. van Dijk, R. Hendriks, a.o.
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Supplemented: twice per year.

Loose-leaf publication designed to provide explanation of the Netherlands tax system. The substance and performance of each tax law is dealt with for purposes of study and practice.

DE BELASTINGWETGEVING

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By W.P. van Sikkelerus.
Supplemented: twice of three times per year.

Loose-leaf publication containing text and comment per article of the Dutch General Tax Code, which is intended to codify the general provisions applicable to all taxes in so far as they concern formal law and penal law. The text of and comment on the law concerning administrative procedure in tax affairs are included.

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Loose-leaf publication in 6 volumes designed to provide documentation of the hearings and discussions with respect to the new tax bills in Parliament sessions. The tax bills which are at present laws are the following: the individual income tax law of 1964; the net wealth tax law of 1964; the wage tax law of 1964; the dividend tax law of 1965; the corporate income tax law of 1969. Supplements contain parliamentary discussions and the text of amendments to these laws.

RECHTSPERSONEN

Kluwer, P.O. Box 23, Deventer.
Supplemented: about six times per year.

Loose-leaf publication entitled "Legal Persons" dealing with Book Two of the new Civil Code. It contains recodified text of entity forms. The work aims at containing the plain text of the law and comments thereon by various authors. Taxation problems in relation to the company law are also considered.

SOCIALE VERZEKERINGSWETTEN

Edited by J.J.M. Veraart.
Kluwer, P.O. Box 23, Deventer.
Supplemented: ten times per year.

Loose-leaf publication in 9 volumes dealing exclusively with the Netherlands social security laws, social security contributions and their organization, prepared by various authoritative authors.

STAATS- EN ADMINISTRATIE-RECHTELIJKE WETTEN

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Serie Nederlandse Wetgeving, Part A.
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Supplemented: six times per year.

Loose-leaf publication in three volumes containing text of public and administrative laws of the Netherlands.

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U.S.A.: Treasury Model Income Tax Treaty

of 18 May 1976 as amended

The U.S. Treasury's normal policy is to announce its plans to conclude a tax treaty with a particular country thus giving interested parties the opportunity to send in their comments. However, obstacles for a smooth functioning of this policy are twofold:

1. Treaty negotiations are often scheduled at a very short notice which makes notifying the public impractical, and
2. In many cases such negotiations are extended over a long period of time, sometimes several years, so that earlier comments do not reflect current problems.

In order to give better guidance the Treasury released a Model Income Tax Treaty which will be used as a basis for future negotiations.

CONVENTION BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF . . . . . FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME AND CAPITAL

The Government of the United States of America and the Government of . . . . . , desiring to conclude a convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital, have agreed as follows:

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Article 1
PERSONAL SCOPE

1. Except as otherwise provided in this Convention, this Convention shall apply to persons who are residents of one or both of the Contracting States.

2. This Convention shall not restrict in any manner any exclusion, exemption, deduction, credit, or other allowance now or hereafter accorded—
a) by the laws of either Contracting State, or
b) by any other agreement between the Contracting States.

3. Notwithstanding any provision of this Convention except paragraph 4 of this Article, a Contracting State may tax its residents (as determined under Article 4 (Fiscal Domicile)), and by reason of citizenship may tax its citizens, as if this Convention had not come into effect. For this purpose the term "citizen" shall include a former citizen whose loss of citizenship had as one of its principal purposes the avoidance of income tax, but only for a period of 10 years following such loss.

4. The provisions of paragraph 3 shall not affect:
a) the benefits conferred by a Contracting State under paragraphs 1 b) and 4 of Article 18 (Pensions, etc.), Articles 23 (Relief From Double Taxation), 24 (Non-Discrimination), and 25 (Mutual Agreement Procedure); and
b) the benefits conferred by a Contracting State under Articles 19 (Government Service), 20 (Students and Trainees) and 27 (Effect of Convention on Diplomatic Agents and Consular Officers, Domestic Laws, and Other Treaties), upon individuals who are neither citizens of, nor have immigrant status in, that State.

Comment:

This contains several variations from the OECD Model, the most important being the provision allowing the United States to tax a citizen — or former citizen who renounced his citizenship for tax avoidance purposes within the prior ten years — as if no tax treaty existed. Thus, a U.S. citizen resident in a treaty country could not claim any benefits provided to residents of that country.

Article 2
TAXES COVERED

1. This Convention shall apply to taxes on income and on capital imposed on behalf of a Contracting State.

2. The existing taxes to which this Convention shall apply are:
a) In the United States: the Federal income taxes imposed by the Internal Revenue Code and the excise taxes imposed on insurance premiums paid to foreign insurers and with respect to private foundations, but excluding the accumulated earnings tax and the personal holding company tax.
b) In . . . . . : . . . . . .
. . . . . .

3. The Convention shall apply also to any identical or substantially similar taxes which are imposed by a Contracting State after the date of signature of this Convention in addition to, or in place of, the existing taxes. The competent authorities of the Contracting States shall notify each other of any changes which have been made in their respective taxation laws and shall notify each other of any official published material concerning the application of this Convention, including explanations, regulations, rulings, or judicial decisions.

4. For the purpose of Article 24 (Non-Discrimination), this Convention shall also apply to taxes of every kind and description imposed by a Contracting State or a political subdivision or local authority thereof. For the purpose of Article 26 (Exchange of Information and Administrative Assistance), this Convention shall also apply to taxes of every kind imposed by a Contracting State.

Article 3
GENERAL DEFINITIONS

1. For the purpose of this Convention, unless the context otherwise requires:
a) the term "person" includes an individual, a partnership, a company, an estate, a trust, and any other body of persons;
b) the term "company" means any body corporate or any entity which is treated as a body corporate for tax purposes;
c) the terms "enterprise of a Contracting State" and "enterprise of the other Contracting State" mean respectively an enterprise carried on by a reident of a Contracting State and an enterprise carried on by a resident of the other Contracting State;
d) the term "international traffic" means any transport by a ship or aircraft, except where such transport is solely between places in the other Contracting State.
e) the term "competent authority" means:
(i) in the United States: the Secretary of the Treasury or his delegate, and
(ii) In .....:
.....
f) the term "United States" means the United States of America, but does not include Puerto Rico, the Virgin Islands, Guam or any other United States possession or territory.
g) the term ..... means
.....

2. As regards the application of this Convention by a Contracting State any term not defined therein shall, unless the context otherwise requires and subject to the provisions of Article 25 (Mutual Agreement Procedure), have the meaning which it has under the laws of that State concerning the taxes to which this Convention applies.

Article 4
RESIDENT

1. For purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, citizenship, place of management, place of incorporation, or any other criterion of a similar nature, provided, however, that:
a) this term does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein; and
b) in the case of income derived or paid by a partnership, estate, or trust, this term applies only to the extent that the income derived by such partnership, estate, or trust is subject to tax as the income of a resident of that State, either in its hands or in the hands of its partners or beneficiaries.

2. Where by reason of the provisions of paragraph 1 an individual is a resident of both Contracting States, then his or her status shall be determined as follows:
a) The individual shall be deemed to be a resident of the State in which he or she has a permanent home available; if such individual has a permanent home available in both States, or in neither State, he or she shall be deemed to be a resident of the State with which his or her personal and economic relations are closer (center of vital interests);
b) If the State in which the individual's center of vital interests cannot be determined, he or she shall be deemed to be a resident of the State in which he or she has an habitual abode;
c) If the individual has an habitual abode in both States or in neither of them, he or she is a national;
d) If the individual is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

3. Where by reason of the provisions of paragraph 1 a company is a resident of both Contracting States, then if it is created or organized under the laws of a Contracting State or a political subdivision thereof, it shall be treated as a resident of that State.

4. Where by reason of the provisions of paragraph 1 a person other than an individual or a company is a resident of both Contracting States, the competent authorities of the Contracting States shall by mutual agreement endeavor to settle the question and to determine the mode of application of the Convention to such person.

5. For purposes of this Convention, an individual who is a national of a Contracting State shall also be deemed to be a resident of that State if (a) the individual is an employee of that State or an instrumentality thereof in the other Contracting State or in a third State; (b) the individual is engaged in the performance of governmental functions for the first-mentioned State; and (c) the individual is subjected in the first-mentioned State to the same obligations in respect of taxes on income as are residents of the first-mentioned State. The spouse and minor children residing with the employee and subject to the requirements of (c) above shall also be deemed to be residents of the first-mentioned State.

6. Where under any provision of this Convention income arising in one of the Contracting States is relieved from tax in that Contracting State and, under the law in force in the other Contracting State a person, in respect of the said income, is subject to tax by reference to the amount thereof which is remitted to or received in that other Contracting State and not by reference to the full amount thereof, then the relief to be allowed under this Convention in the first-mentioned Contracting State shall apply only to so much of the income as is remitted to or received in the other Contracting State during the year such income accrues.

Comment:

Unlike the OECD Model, the U.S. Model provides no residency for a partnership, estate or trust separate from that of the persons receiving income from the entity. Also, the U.S. Model would allow a person to be considered a resident of a country if that country taxed him on his world-wide income. Since the United States taxes all citizens on world-wide income, this provision would greatly increase the coverage of the treaty.

Article 5
PERMANENT ESTABLISHMENT

1. For the purposes of this Convention the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

2. The term "permanent establishment" shall include especially:
a) a branch;
b) an office;
c) a factory;
d) a workshop; and
e) a mine, an oil or gas well, a quarry, or any other place of extraction of natural resources.

3. A building site or construction or installation project, or an installation or drilling rig or ship used for the exploration or development of natural resources, const

tutes a permanent establishment only if it lasts more than 24 months.

4. Notwithstanding the preceding provisions of this Article, the term "permanent establishment" shall be deemed not to include:
a) the use of facilities solely for the purpose of storage, display, or delivery of goods or merchandise belonging to the enterprise;
b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;
c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;
d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or of collecting information, for the enterprise;
e) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character;
f) the maintenance of a fixed place of business solely for any combination of the activities mentioned in sub-paragraphs a) to e) of this paragraph.

5. Notwithstanding the provisions of paragraphs 1 and 2, where a person — other than an agent of an independent status to whom paragraph 6 applies — is acting on behalf of an enterprise and has and habitually exercises in a Contracting State an authority to conclude contracts in the name of the enterprise, that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph.

6. An enterprise shall not be deemed to have a permanent establishment in a Contracting State merely because it carries on business in that State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business.

7. The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either company a permanent establishment of the other.

Comment:

This Model requires a construction project to last more than 24 months before it constitutes a permanent establishment; the OECD Model sets the time limit at 12 months and many third world countries favor a period of 6 months.

Article 6
INCOME FROM IMMOVABLE PROPERTY (REAL PROPERTY)

1. Income derived by a resident of a Contracting State from immovable (real) property (including income from agriculture or forestry) situated in the other Contracting State may be taxed in that other State.

2. The term "immovable property" shall have the meaning which it has under the law of the Contracting State in which the property in question is situated. The term shall in any case include property accessory to immovable property, livestock and equipment used in agriculture and forestry, rights to which the provisions of general law respecting landed property apply, usufruct of immovable property and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources; ships, boats and aircraft shall not be regarded as immovable property.

3. The provisions of paragraph 1 shall apply to income derived from the direct use, letting, or use in any form of immovable property.

4. The provisions of paragraphs 1 and 3 shall also apply to the income from immovable property of an enterprise and to income from immovable property used for the performance of independent personal services.

5. A resident of a Contracting State who is subject to tax in the other Contracting State on income from immovable property situated in the other Contracting State may elect for any taxable year to compute the tax on such income on a net basis as if such income were attributable to a permanent establishment in such other State. Any such election shall be binding for the taxable year of the election and all subsequent taxable years unless the competent authorities of the two Contracting States, pursuant to a request by the taxpayer made to the competent authority of the Contracting State in which the taxpayer is a resident, agree to terminate the election.

Comment:

The U.S. Model provides the option, not contained in the OECD Model, of having this income taxed on a net basis as if it were earned through a permanent establishment.

Article 7
BUSINESS PROFITS

1. The business profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the business profits of the enterprise may be taxed in the other State but only so much of them as is attributable to that permanent establishment.

2. Subject to the provisions of paragraph 3, where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the business profits which it might be expected to make if it were a distinct and independent enterprise engaged in the same or similar activities under the same or similar conditions.

3. In determining the business profits of a permanent establishment, there shall be allowed as deductions expenses which are incurred for the purposes of the permanent establishment, including a reasonable allocation of executive and general administrative expenses, research and development expenses, interest, and other expenses incurred for the purposes of the enterprise as a whole (or the part thereof which includes the permanent establishment), whether incurred in the State in which the permanent establishment is situated or elsewhere.

4. No business profits shall be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods or merchandise for the enterprise.

5. For the purposes of the preceding paragraphs, the business profits to be attributed to the permanent establishment shall be determined by the same method year by year unless there is good and sufficient reason to the contrary.

6. Where business profits include items of income which are dealt with separately in other Articles of this Convention, then the provisions of those Articles shall not be affected by the provisions of this Article.

7. For the purposes of this Convention, "business profits" means income derived from any trade or business whether carried on by an individual, company or any other person, or group of persons, including the rental of tangible personal (movable) property, and the rental or licensing of cinema-

tograph films or films or tapes used for radio or television broadcasting.

Comment:

The U.S Model adds research and development expenses and interest to the named expenses which can be allocated to a permanent establishment.

Article 8
SHIPPING AND AIR TRANSPORT

1. Profits of an enterprise of a Contracting State from the operation in international traffic of ships or aircraft shall be taxable only in that State.

2. For purposes of this Article, profits from the operation in international traffic of ships or aircraft include profits derived from the rental on a full or bareboat basis of ships or aircraft if operated in international traffic by the lessee or if such rental profits are incidental to other profits described in paragraph 1.

3. Profits of an enterprise of a Contracting State from the use, maintenance or rental of containers (including trailers, barges and related equipment for the transport of containers) used for the transport in international traffic of goods or merchandise shall be taxable only in that State.

4. The provisions of paragraphs 1 and 3 shall also apply to profits from the participation in a pool, a joint business or an international operating agency.

Article 9
ASSOCIATED ENTERPRISES

1. Where
(a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or
(b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State,
and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

2. Where a Contracting State includes in the profits of an enterprise of that State, and taxes accordingly, profits on which an enterprise of the other Contracting State has been charged to tax in that other State, and the profits so included are profits which would have accrued to the enterprise of the first-mentioned State if the conditions made between the two enterprises had been those which would have been made between independent enterprises, then that other State shall make an appropriate adjustment to the amount of the tax charged therein on those profits. In determining such adjustment, due regard shall be had to the other provisions of this Convention and the competent authorities of the Contracting States shall if necessary consult each other.

3. The provisions of paragraph 1 shall not limit any provisions of the law of either Contracting State which permit the distribution, apportionment or allocation of income, deductions, credits, or allowances between persons owned or controlled directly or indirectly by the same interests when necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such persons.

Article 10
DIVIDENDS

1. Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State.

2. However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident, and according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed:
a) 5 percent of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) which owns, directly or indirectly, 10 percent of the voting stock of the company paying the dividends;
b) 15 percent of the gross amount of the dividends in all other cases.
This paragraph shall not affect the taxation of the company in respect of the profits out of which the dividends are paid.

3. The term "dividends" as used in this Article means income from shares or other rights, not being debt-claims, participating in profits, as well as income from other corporate rights which is subjected to the same taxation treatment as income from shares by the laws of the State of which the company making the distribution is a resident.

4. The provisions of paragraphs 1 and 2 shall not apply if the recipient of the dividends, being a resident of a Contracting State, carries on business in the other Contracting State, of which the company paying the dividends is a resident, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the holding in respect of which the dividends are paid is effectively connected with such permanent establishment or fixed base. In such a case, the provisions of Article 7 (Business Profits) or Article 14 (Independent Personal Services), as the case may be, shall apply.

5. Where a company is a resident of a Contracting State, the other Contracting State may not impose any tax on the dividends paid by the company, except insofar as
a) such dividends are paid to a resident of that other State,
b) the holding in respect of which the dividends are paid is effectively connected with a permanent establishment or a fixed base situated in that other State, or
c) such dividends are paid out of profits attributable to one or more permanent establishments which such company had in that other State, provided that such profits constituted at least 50 percent of such company's gross income from all sources.

Where subparagraph c) applies and subparagraphs a) and b) do not apply, any such tax shall be subject to the limitations of paragraph 2.

Comment:

The OECD Model requires a 25 percent holding before the 5 percent withholding rate applies; this model requires only a 10 percent holding.

Article 11
INTEREST

1. Interest derived and beneficially owned by a resident of a Contracting State shall be taxable only in that State.

2. The term "interest" as used in this Convention means income from debt claims of every kind, whether or not secured by mortgage, and whether or not carrying a right to participate in the debtor's profits, and in particular, income from government securities and income from bonds or debentures, including premiums or prizes attaching to such securities, bonds or debentures. Penalty charges for late payment shall not be regarded as interest for the purpose of this Convention.

3. The provisions of paragraph 1 shall not apply if the beneficial owner of the interest, being a resident of a Contracting State

carries on business in the other Contracting State in which the interest arises, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the debt-claim in respect of which the interest is paid is effectively connected with such permanent establishment or fixed base. In such case the provisions of Article 7 (Business Profits) or Article 14 (Independent Personal Services), as the case may be, shall apply.

4. Interest shall be deemed to arise in a Contracting State when the payer is that State itself, a political subdivision, a local authority or a resident of that State. Where, however, the person paying the interest, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment or a fixed base in connection with which the indebtedness on which the interest is paid was incurred, and such interest is borne by such permanent establishment or fixed base, then such interest shall be deemed to arise in the State in which the permanent establishment or fixed base is situated.

5. Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the interest, having regard to the debt-claim for which it is paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.

6. A Contracting State may not impose any tax on interest paid by a resident of the other Contracting State, except insofar as

a) such interest is paid to a resident of the first-mentioned State,

b) the debt-claim in respect of which the interest is paid is effectively connected with a permanent establishment or a fixed base situated in the first-mentioned State, or

c) such interest arises in the first-mentioned State and is not paid to a resident of such other State.

Comment:

The OECD Model allows a State to impose a tax up to ten percent on interest arising in that State and paid to a resident of the other State; under the U.S. Model only the State in which the recipient of the interest resides may tax the interest payments.

Article 12
ROYALTIES

1. Royalties derived and beneficially owned by a resident of a Contracting State shall be taxable only in that State.

2. The term "royalties" as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work (but not including cinematograph films or films or tapes used for radio or television broadcasting), any patent, trade mark, design or model, plan, secret formula or process, or other like right or property, or for information concerning industrial, commercial or scientific experience. The term "royalties" also includes gains derived from the alienation of any such right or property which are contingent on the productivity, use, or disposition thereof.

3. The provisions of paragraph 1 shall not apply if the beneficial owner of the royalties, being a resident of a Contracting State, carries on business in the other Contracting State in which the royalties arise through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right or property in respect of which the royalties are paid is effectively connected with such permanent establishment or fixed base.

In such case the provisions of Article 7 (Business Profits) or Article 14 (Independent Personal Services), as the case may be, shall apply.

4. Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the royalties, having regard to the use, right or information for which they are paid, exceeds the amount which would have been agreed upon by the payer and the person deriving the royalties in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the law of each Contracting State, due regard being had to the other provisions of this Convention.

Article 13
CAPITAL GAINS

1. Gains derived by a resident of a Contracting State from the alienation of immovable property referred to in Article 6 (Income From Immovable Property) and situated in the other Contracting State may be taxed in that other State.

2. Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services, including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise) or of such fixed base, may be taxed in that other State.

3. Gains derived by an enterprise of a Contracting State from the alienation of ships, aircraft or containers operated by such enterprise in international traffic shall be taxable only in that State, and gains described in Article 12 (Royalties) shall be taxable only in accordance with the provisions of Article 12.

4. Gains from the alienation of any property other than that referred to in paragraphs 1, 2 and 3, shall be taxable only in the Contracting State of which the alienator is a resident.

Article 14
INDEPENDENT PERSONAL SERVICES

Income derived by an individual who is a resident of a Contracting State from the performance of personal services in an independent capacity shall be taxable only in that State unless such services are performed in the other Contracting State and,

a) the individual is present in that other State for a period or periods aggregating more than 183 days in the taxable year concerned, or

b) the individual has a fixed base regularly available to him in that other State for the purpose of performing his activities, but only so much of the income as is attributable to that fixed base may be taxed in such other State.

Article 15
DEPENDENT PERSONAL SERVICES

1. Subject to the provisions of Articles 18 (Pensions, Etc.) and 19 (Government Service), salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State.

2. Notwithstanding the provisions of paragraph 1, remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State if:

a) the recipient is present in the other State for a period or periods not exceeding

in the aggregate 183 days in the taxable year concerned,
b) the remuneration is paid by, or on behalf of, an employer who is not a resident of the other State, and
c) the remuneration is not borne by a permanent establishment or a fixed base which the employer has in the other State.

3. Notwithstanding the preceding provisions of this Article, remuneration derived in respect of an employment as a member of the regular complement of a ship or aircraft operated by an enterprise of a Contracting State in international traffic may be taxed only in that Contracting State.

Article 16
INVESTMENT OR HOLDING COMPANIES

If 25 percent or more of the capital of a company which is a resident of a Contracting State is owned directly or indirectly by individuals who are not residents of that State, and if by reason of special measures the tax imposed by that State on that company with respect to dividends, interest or royalties arising in the other Contracting State is substantially less than the tax generally imposed by the first-mentioned State on corporate business profits, then, notwithstanding the provisions of Articles 10 (Dividends), 11 (Interest), or 12 (Royalties) that other State may tax such dividends, interest or royalties.

For the purposes of this Article, the source of dividends, interest or royalties shall be determined in accordance with paragraph 3 a), b), or c) of Article 23 (Relief from Double Taxation).

Comment:

No such provision exists in the OECD Model to prevent non-resident individuals from establishing a company resident in a Contracting State to take advantage of reduced withholding rates. Such a provision, however, has been included in most recent U.S. treaties.

Article 17
ARTISTES AND ATHLETES

1. Notwithstanding the provisions of Articles 14 (Independent Personal Services) and 15 (Dependent Personal Services), income derived by a resident of a Contracting State as an entertainer, such as a theatre, motion picture, radio or television artiste, or a musician, or as an athlete, from his or her personal activities as such exercised in the other Contracting State, may be taxed in that other State, except where the amount of the gross receipts derived by such entertainer or athlete, including expenses reimbursed to him or her or borne on his or her behalf, from such activities do not exceed fifteen thousand United States dollars ($15,000) or its equivalent in ..... for the taxable year concerned.

2. Where income in respect of activities exercised by an entertainer or an athlete in his or her capacity as such accrues not to that entertainer or athlete but to another person, that income may, notwithstanding the provisions of Articles 7 (Business Profits), 14 (Independent Personal Services), and 15 (Dependent Personal Services), be taxed in the Contracting State in which the activities of the entertainer or athlete are exercised.

For purposes of the preceding sentence, income of an entertainer or athlete shall be deemed not to accrue to another person if it is established that neither the entertainer or athlete, nor persons related thereto, participate directly or indirectly in the profits of such other person in any manner, including the receipt of deferred remuneration, bonuses, fees, dividends, partnership distributions or other distributions.

Comment:

Under the OECD Model artistes and athletes may be taxed by a State if they earn any income for performances within that State; no exemption is provided for gross revenues not exceeding $15,000.

Article 18
PENSIONS, ETC.

1. Subject to the provisions of paragraph 1 of Article 19 (Government Service),
a) pensions and other similar remuneration beneficially derived by a resident of a Contracting State in consideration of past employment shall be taxable only in that State, and
b) social security payments and other public pensions paid by a Contracting State to an individual who is a resident of the other Contracting State or a citizen of the United States shall be taxable only in the first-mentioned Contracting State.

2. Annuities beneficially derived by a resident of a Contracting State shall be taxable only in that State. The term "annuities" as used in this paragraph means a stated sum paid periodically at stated times during life or during a specified number of years, under an obligation to make the payments in return for adequate and full consideration (other than services rendered).

3. Alimony paid to a resident of a Contracting State by a resident of the other Contracting State shall be exempt from tax in the other Contracting State. The term "alimony" as used in this paragraph means periodic payments made pursuant to a written separation agreement or a decree of divorce, separate maintenance, or compulsory support, which payments are taxable to the recipient under the laws of the State of which he is a resident.

4. Periodic payments for the support of a minor child made pursuant to a written separation agreement or a decree of divorce, separate maintenance, or compulsory support, paid by a resident of one of the Contracting States to a resident of the other Contracting State, shall be exempt from tax in both Contracting States.

Article 19
GOVERNMENT SERVICE

1. a) Remuneration, other than a pension, paid by a Contracting State or a political subdivision or a local authority thereof to an individual in respect of services rendered to that State or subdivision or authority shall be taxable only in that State.
b) However, such remuneration shall be taxable only in the other Contracting State if the services are rendered in that State and the individual is a resident of that State who:
(i) is a national of that State; or
(ii) did not become a resident of that State solely for the purpose of rendering the services;
provided that the provisions of clause (ii) shall not apply to the spouse or dependent children of an individual who is receiving remuneration to which the provisions of subparagraph (a) apply and who does not come within the terms of clause (i) or (ii).

2. a) Any pension paid by, or out of funds created by, a Contracting State or a political subdivision or a local authority thereof to an individual in respect of services rendered to that State or subdivision or authority shall be taxable only in that State.
b) However, such pension shall be taxable only in the other Contracting State if the individual is a resident of, and a national of, that State.

3. The provisions of Articles 14 (Independent Personal Services), 15 (Dependent Personal Services), 17 (Artistes and Athletes), and 18 (Pensions, etc.) shall apply to remuneration and pensions in respect of services rendered in connection with a business carried on by a Contracting State or a political subdivision or a local authority thereof.

Article 20
STUDENTS AND TRAINEES

1. Payments which a student, apprentice or business trainee who is or was immediately before visiting a Contracting State a resident of the other Contracting State and who is present in the first-mentioned State for the purpose of his or her full-time education or training receives for the purpose of his or her maintenance, education or training shall not be taxed in that State provided that such payments arise from sources outside that State.

2. An individual to whom paragraph 1 applies may elect to be treated for tax purposes as a resident of the first-mentioned State. The election shall apply to all periods during the taxable year of the election and subsequent taxable years during which the individual qualifies under paragraph 1, and may not be revoked except with the consent of the competent authority of that State.

Comment:

Paragraph 2 of this Article is without an equivalent provision in the OECD Model or in any U.S. treaty.

Article 21
OTHER INCOME

1. Items of income of a resident of a Contracting State, wherever arising, not dealt with in the foregoing Articles of this Convention shall be taxable only in that State.

2. The provisions of paragraph 1 shall not apply to income other than income from immovable property as defined in paragraph 2 of Article 6 (Income From Immovable Property), if the person deriving the income, being a resident of a Contracting State, carries on business in the other Contracting State through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right or property in respect of which the income is paid is effectively connected with such permanent establishment or fixed base. In such case the provisions of Article 7 (Business Profits), Article 14 (Independent Personal Services), or Article 17 (Artistes and Athletes) as the case may be, shall apply.

Article 22
CAPITAL

1. Capital represented by immovable property referred to in Article 6 (Income From Immovable Property), owned by a resident of a Contracting State and situated in the other Contracting State, may be taxed in that other State.

2. Capital represented by movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State or by movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services may be taxed in that other State.

3. Capital represented by ships and aircraft operated by a resident of a Contracting State in international traffic and movable property pertaining to the operation of such ships and aircraft shall be taxable only in that State.

4. All other elements of capital of a resident of a Contracting State shall be taxable only in that State.

Article 23
RELIEF FROM DOUBLE TAXATION

1. In the case of the United States, double taxation shall be avoided as follows: In accordance with the provisions and subject to the limitations of the law of the United States (as it may be amended from time to time without changing the general principle hereof), the United States shall allow to a resident or citizen of the United States as a credit against the United States tax on income or capital the appropriate amount of tax paid to . . . . . ; and, in the case of a United States company owning at least 10 percent of the voting stock of a company which is a resident of . . . . . from which it receives dividends in any taxable year, the United States shall allow as a credit against the United States tax on income the appropriate amount of tax paid to . . . . . by that company with respect to the profits out of which such dividends are paid. Such appropriate amount shall be based upon the amount of tax paid to . . . . . , but the credit shall not exceed the limitations (for the purpose of limiting the credit to the United States tax on income from sources outside of the United States) provided by United States law for the taxable year. For purposes of applying the United States credit in relation to tax paid to . . . . . the taxes referred to in paragraphs 2 b) and 3 of Article 2 (Taxes Covered) shall be considered to be income taxes.

2. In the case of . . . . . , double taxation shall be avoided as follows: In accordance with the provisions and subject to the limiations of the law of . . . . . (as it may be amended from time to time without changing the general principle hereof), the . . . . . shall allow to a resident or citizen of . . . . . as a credit against the . . . . . tax on income or capital the appropriate amount of tax paid to the United States; and in the case of a . . . . . company owning at least 10 percent of the voting stock of a company which is a resident of the United States from which it receives dividends in any taxable year, ... shall allow as a credit against the United States tax on income the appropriate amount of tax paid to the United States by that company with respect to the profits out of which such dividends are paid. Such appropriate amount shall be based upon the amount of tax paid to the United States, but the credit shall not exceed the limitations (for the purpose of limiting the credit to the
tax on income from sources outside of . . . . . provided by law for the taxable year. For purposes of applying the credit in relation to tax paid to the United States the taxes
referred to in paragraphs 2 a) and 3 of Article 2 (Taxes Covered) shall be considered to be income taxes.

3. For the purposes of the preceding paragraphs of this Article, the source of income or profits shall be determined in accordance with the following rules:
a) Dividends, as defined in paragraph 3 of Article 10 (Dividends), shall be deemed to arise in a Contracting State if paid by a company which is a resident of that State or if paragraph 5 c) of Article 10 (Dividends) applies.
b) Interest, as defined in paragraph 2 of Article 11 (Interest), shall be deemed to arise in the State specified in paragraph 4 of Article 11.
c) Royalties, as defined in paragraph 2 of Article 12 (Royalties), shall be deemed to arise in a Contracting State to the extent that such royalties are with respect to the use of, or the right to use, rights or property within that State.
d) Except for income or profits referred to in subparagraphs a), b), or c), and except for income or profits taxed by the United States solely by reason of citizenship in accordance with paragraph 2 of Article 1 (Personal Scope): income or profits derived by a resident of a Contracting State which may be taxed in the other Contracting State in accordance with this Convention shall be deemed to arise in that other Contracting State.

Article 24
NON-DISCRIMINATION

1. Nationals of a Contracting State shall not be subjected in the other State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances are or may be subjected. For purposes of the preceding sentence, nationals who are subject to tax by a Contracting State on world-wide income are not in the same circumstances as nationals who are not so subject. This provision shall, notwithstanding the provisions of Article 1 (Personal Scope), also apply to persons who are not residents of one or both of the Contracting States.

2. The term "nationals" means:
a) in relation to . . . . . ,
. . . . . .
. . . . . ;

b) in relation to the United States, United States citizens.

3. The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favorably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities. This provision shall not be construed as obliging a Contracting State to grant to residents of the other Contracting State any personal allowances, reliefs and reductions for taxation purposes on account of civil status or family responsibilities which it grants to its own residents.

4. Except where the provisions of paragraph 1 of Article 9 (Associated Enterprises), paragraph 5 of Article 11 (Interest), or paragraph 4 of Article 12 (Royalties) apply, interest, royalties and other disbursements paid by an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable profits of such enterprise, be deductible under the same condition as if they had been paid to a resident of the first-mentioned State. For purposes of this paragraph, the term "other disbursements" shall include charges (for amounts expended by such residents for purposes of such enterprise, including a reasonable allocation of executive and general administrative expenses (except to the extent representing the expenses of a type of activity which is not for the benefit of such enterprise, but constitute "stewardship" or "overseeing" functions undertaken for such resident's own benefit as an investor in the enterprise), research and development, and other expenses incurred by such resident for the benefit of a group of related enterprises including such enterprise. Similarly, any debts of an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable capital of such enterprise, be deductible under the same conditions as if they had been contracted to a resident of the first-mentioned State.

5. Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which other similar enterprises of the first-mentioned State are or may be subjected.

6. The provisions of this Article shall, in accordance with the provisions of paragraph 4 of Article 2 (Taxes Covered), apply to taxes of every kind and description imposed by a Contracting State or a political subdivision or local authority thereof.

Article 25
MUTUAL AGREEMENT PROCEDURE

1. Where a person considers that the actions of one or both of the Contracting States result or will result for him or her in taxation not in accordance with the provisions of this Convention, he or she may, irrespective of the remedies provided by the domestic law of those States, present his or her case to the competent authority of the Contracting State of which he or she is a resident or national.

2. The competent authority shall endeavor, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with the Convention.

Any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting States.

3. The competent authorities of the Contracting States shall endeavor to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention. In particular the competent authorities of the Contracting States may agree:
a) to the same attribution of income, deductions, credits or allowances of an enterprise of a Contracting State to its permanent establishment situated in the other Contracting State;
b) to the same allocation of income, deductions, credits, or allowances between persons, including a uniform position on the application of the requirements of paragraph 3 of Article 24 (Non-discrimination);
c) to the same characterization of particular items of income;
d) to the same application of source rules with respect to particular items of income; and
e) to a common meaning of a term.
They may also consult together for the elimination of double taxation in cases not provided for in the Convention.

4. The competent authorities of the Contracting States may communicate with each other directly for the purpose of reaching an agreement in the sense of the preceding paragraphs.

5. The competent authorities of the Contracting States may prescribe regulations to carry out the purposes of this Convention.

Article 26
EXCHANGE OF INFORMATION AND ADMINISTRATIVE ASSISTANCE

1. The competent authorities of the Contracting States shall exchange such information as is necessary for carrying out the provisions of this Convention or of the domestic laws of the Contracting States concerning taxes covered by the Convention insofar as the taxation thereunder is not contrary to the Convention. The exchange of information is not restricted by Article 1 (Personal Scope). Any information received by a Contracting State shall be treated as secret in the same manner as information obtained under the domestic laws of that State and shall be disclosed only to persons or authorities (including courts and administrative bodies) involved in the assessment or collection of, the enforcement or prosecution in respect of, or the determination of appeals in relation to, the taxes covered by the Convention. Such persons or authorities shall use the information only for such purposes. They may disclose the information in public court proceedings or in judicial decisions.

2. In no case shall the provisions of paragraph 1 be construed so as to impose on a Contracting State the obligation:
a) to carry out administrative measures at variance with the laws and administrative practice of that or of the other Contracting State;
b) to supply information which is not obtainable under the laws or in the normal course of the administration of that or of the other Contracting State;
c) to supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or information, the disclosure of which would be contrary to public policy (ordre public).

3. If information is requested by a Contracting State in accordance with this Article, the other Contracting State shall obtain the information to which the request relates in the same manner and to the same extents as if the tax of the first-mentioned

State were the tax of that other State and were being imposed by that other State. If specifically requested by the competent authority of a Contracting State, the competent authority of the other Contracting State shall provide information under this Article in the form of depositions of witnesses and authenticated copies of unedited original documents (including books, papers, statements, records, accounts, or writings), to the same extent such depositions and documents can be obtained under the laws and administrative practices of such other State with respect to its own taxes.

4. Each of the Contracting States shall endeavor to collect on behalf of the other Contracting State such amounts as may be necessary to ensure that relief granted by the present Convention from taxation imposed by such other Contracting State does not enure to the benefit of persons not entitled thereto.

5. Paragraph 4 of this Article shall not impose upon either of the Contracting States the obligation to carry out administrative measures which are of a different nature from those used in the collection of its own tax, or which would be contrary to its sovereignty, security, or public policy.

6. For the purpose of this Article, this Convention shall apply to taxes of every kind imposed by a Contracting State.

Comment:

This Article contains an "assistance in collection" provision which is not contained in the OECD Model.

Article 27
DIPLOMATIC AGENTS AND CONSULAR OFFICERS

Nothing in this Convention shall affect the fiscal privileges of diplomatic agents or consular officers under the general rules of international law or under the provisions of special agreements.

Article 28
ENTRY INTO FORCE

1. This Convention shall be subject to ratification in accordance with the applicable procedures of each Contracting State and instruments of ratification shal be exchanged at . . . . . as soon as possible.

2. The Convention shall enter into force upon the exchange of instruments of ratification and its provisions shall have effect:
a) In respect of tax withheld at the source, to amounts paid or credited on or after the first day of the second month next following the date on which this Convention enters into force,
b) In respect of other taxes, to taxable periods beginning on or after the first day of January next following the date on which this Convention enters into force.

Article 29
TERMINATION

1. In this Convention shall remain in force until terminated by a Contracting State. Either Contracting State may terminate the Convention at any time after 5 years from the date on which this Convention enters into force provided that at least 6 months' prior notice of termination has been given through diplomatic channels. In such event, the Convention shall cease to have effect:
a) In respect of tax withheld at the source, to amounts paid or credited on or after the first day of January next following the expiration of the 6 months' period;
b) In respect of other taxes, to taxable periods beginning on or after the first day of January next following the expiration of the 6 months' period.

DONE at . . . . . in duplicate, in the English and . . . . . languages, the two texts having equal authenticity, this . . . . . day of . . . . . 19...

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List of Tax Treaties. **Pakistan**

concerning comprehensive double taxation treaties on income/capital.

The list is up to date as of December 31, 1976.

Treaty with	Concerning	Concluded	Official Text	Published in the English language in
Austria	income	July 6, 1970	English	SUPP. SER. Section C Raza Naqvi, Vol. I, 1972
Canada [1]	income	February 24, 1976	[2]	
Denmark	income	September 4, 1961	English and Danish	SUPP. SER. Section C IX UN A(1) 98 Raza Naqvi, Vol. I, 1972
France	income	July 22, 1966	English and French	SUPP. SER. Section C IX UN A(1) 265 Treaty Series, Vol. 678, p. 243 Raza Naqvi, Vol. I, 1972
German Federal Republic	income	August 7, 1958	English and German	SUPP. SER. Section C, as amended IX UN A(1) 25 Raza Naqvi, Vol. I, 1972
Additional protocol	income	August 27, 1963	English and German	IX UN A(1) 137 TAXL 1974, Vol. 29
Supplementary agreement	income	January 24, 1970	English and German	IX UN A(1) 254 TAXL 1974, Vol. 29
Ireland	income	April 13, 1973	English	SUPP. SER. Section C TAXL 1975, Vol. 31
Japan	income	February 17, 1959	English	Raza Naqvi, Vol. 1, 1972
Supplementary protocol	income	June 28, 1960	English	Raza Naqvi, Vol. 1, 1972
Malta [1]	income	October 8, 1975	[2]	
Poland [1]	income	October 25, 1974	English	SUPP. SER. Section C
Sweden	income	August 25, 1958	English	IX UN A(1) 18 Raza Naqvi, Vol. I, 1972

1. Not yet in force.
2. Not yet published.

Treaty with	Concerning	Concluded	Official Text	Published in the English language in
Sri Lanka	income, capital	May 19, 1969	English and Sinhala	IX UN A(1) 276 Raza Naqvi, Vol. I, 1972
Switzerland	income	December 30, 1959	English and German	SUPP. SER. Section C, as amended IX UN A(1) 35 Raza Naqvi, Vol. I, 1972
Additional protocol	income	June 15, 1962	English and German	Raza Naqvi, Vol. I, 1972
United Kingdom	income	April 24, 1961	English	SUPP. SER. Section C IX UN A(1) 62 Raza Naqvi, Vol. I, 1972
United States of America	income	July 1, 1959	English	Raza Naqvi, Vol. I, 1972

ABBREVIATIONS:

SUPP. SER. Section C	= Supplementary Service to European Taxation, Section C.
Raza Naqvi	= Raza Naqvi. The Law and Practice of Income-tax in Pakistan. Vol. 1. Fourth Revised Edition. July 1972. Lahore.
TAXL	= Taxation (Lahore) Pakistan.
Treaty Series	= Treaties and international agreements registered or filed and recorded with the Secretariat of the United Nations. In addition to the official text of each agreement, this publication produces a translation in either English or French as the case may be.
UN	= United Nations. Department of Economic and Social Affairs. International Tax Agreements. World Guide. Text of tax treaties exists in an English and a French edition. This publication contains several volumes.

The New O.E.C.D. Report on Government Revenue Statistics*

The O.E.C.D. published a new edition of standardized government revenue statistics. The report is in English and French and is the fifth volume of the annual report of data recording government revenues, including compulsory social security contributions for Member countries of the O.E.C.D. during the years 1965-1974.

This report represents the most comprehensive compilation of national tax revenues so far issued on an internationally comparable basis. It lists receipts from all taxes in O.E.C.D. Member countries according to a standardized O.E.C.D. classification, with a commentary defining the scope of each heading in the classification and a general guide for users of the classification system. In addition to 66 tables giving details of tax revenues on a country-by-country basis, the report contains 28 comparative tables illustrating differences in tax weight, structures and trends as between countries during the ten years up to 1974, and these form the basis of the commentary that is presented in part I of the publication.

A table shows comparisons of total taxes in O.E.C.D. Member countries (including social security contributions) as a ratio of GNP in 1974 and a graph indicates how this ratio has changed since 1965. See tables 1 and 2.

The current edition includes also the updating to 1973 and 1974 of 1972 data on international comparisons of the amount of income taxes and social security contributions paid and family cash benefits received, by a typical worker in various family circumstances in the different O.E.C.D. Member countries. Although international data comparisons of this kind have to be treated with caution, and the limitations to the study are set out in the report, they do provide some insights into governments' varying treatment of different family units — from the single man to the two child family — both in terms of the average and marginal rate of tax imposed and the policy instruments used, whether

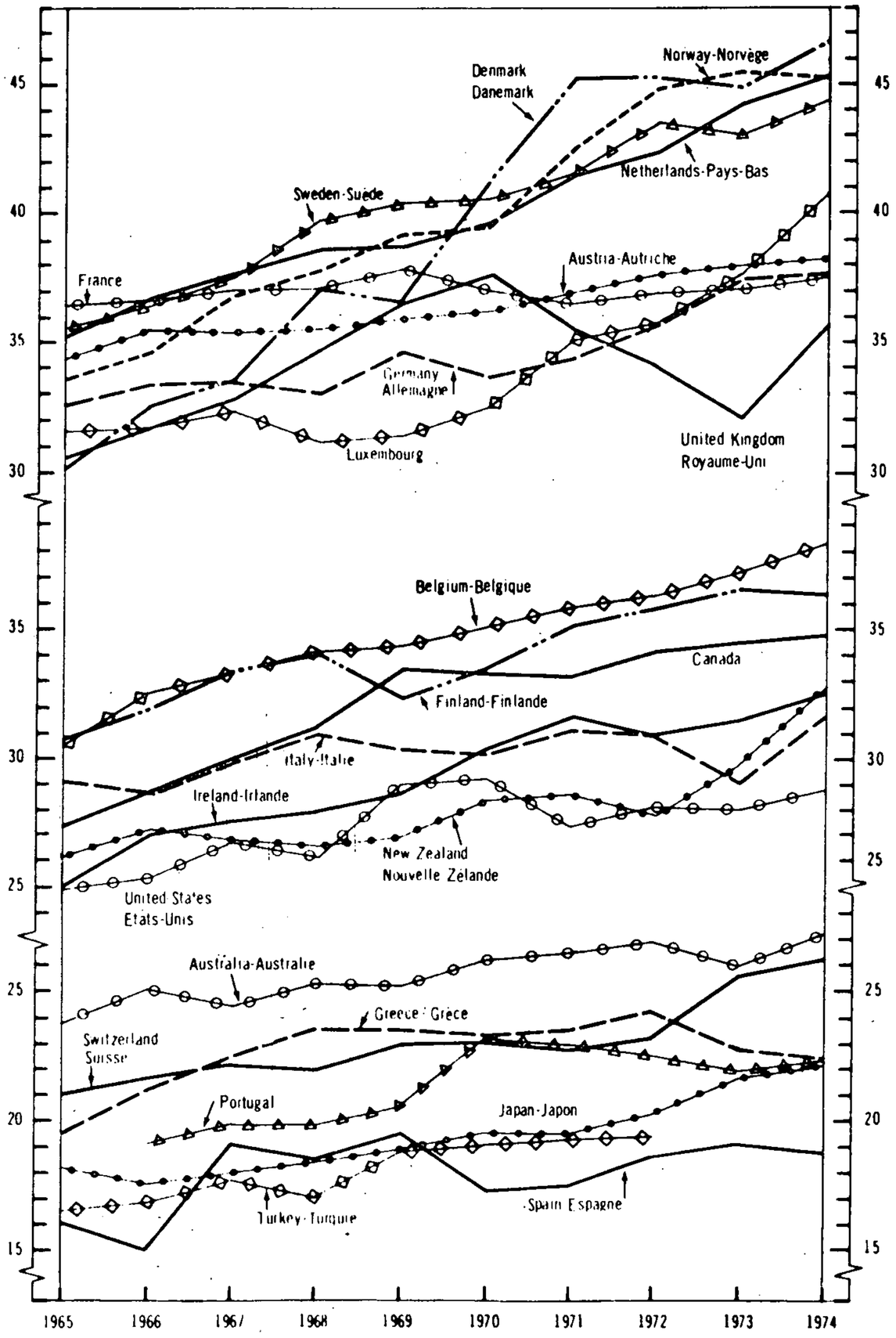
TABLE 1:

Total tax revenue as percentage of GNP

TABLEAU 1:

Total du revenu fiscal en pourcentage du PNB

(1965-1974)



* Revenue Statistics of O.E.C.D. Member Countries 1965-1974: A standardized classification.

Statistiques de recettes publiques des pays membres de l'O.C.D.E. 1965-1974: Une classification normalisée.

Paris, Organisation for Economic Co-operation and Development, 1976. 291 pages.

tax allowances or cash transfers or both. Certain trends are noted, such as the frequency during this period with which allowances against taxable income are replaced by cash transfers as a means of support for dependent children and the fact that high income tax payments are usually accompanied by low social security contributions, and conversely.

Table 3 brings out how the disposable income left to the typical worker has varied during these three inflationary years, while table 4 shows that in most countries, gross earnings have risen more quickly than disposable income, though countries are almost equally divided as between those where a single man's disposable income has risen more quickly than that of a married man with two children and those where the reverse has happened. The tables in the report also indicate that while the relative positions of countries as regards percentage of disposable income retained, have not greatly changed during the period, there are differences in trend as between countries. On average government's tax take has increased by around 1 percent of the worker's disposable income. An earlier version of this report, covering the year 1972 only, was published in the 1974 edition of this report.

TABLE 2:

Total Tax Revenue as Percentage of GNP (including Social Security) 1974

TABLEAU 2:

Total des Recettes Fiscales en pourcentage du PNB (Securité Sociale comprise) 1974

Denmark	— Danemark	46.68
Norway	— Norvège	45.27
Netherlands	— Pays-Bas	45.18
Sweden	— Suède	44.21
Luxembourg	— Luxembourg	40.85
Austria	— Autriche	38.14
Belgium	— Belgique	38.13
Germany	— Allemagne	37.64
France	— France	37.50
Finland	— Finlande	36.29
United Kingdom	— Royaume Uni	35.56
Canada	— Canada	34.79
New Zealand	— Nouv. Zélande	32.69
Ireland	— Irlande	32.43
Italy	— Italie	31.86
United States	— Etas-Unis	28.93
Australia	— Australie	27.18
Switzerland	— Suisse	26.21
Greece	— Grèce	22.43
Portugal	— Portugal	22.35
Japan	— Japon	22.18
Spain	— Espagne	18.83

TABLE 3:

Disposable income as a percentage of gross earnings

TABLEAU 3:

Revenu disponible en pourcentage du salaire brut

COUNTRY/PAYS	Single/Célibataire			Married Couple/Ménage								
				No children/Sans enfants			1 child/1 enfant			2 children/2 enfants		
	1972	1973	1974	1972	1973	1974	1972	1973	1974	1972	1973	1974
Australia — Australie	80.2	81.8	79.4	82.5	84.2	81.5	84.5	86.3	83.4	86.7	88.6	85.5
Austria — Autriche	75.1	76.3	74.6	80.3	80.7	78.9	86.9	88.9	86.2	94.4	96.5	94.9
Belgium — Belgique	78.4	78.0	77.0	78.9	78.5	77.6	84.5	83.9	83.3	94.1	93.2	92.6
Canada — Canada	78.3	78.7	78.7	83.1	83.6	83.3	85.0	85.6	86.1	86.8	87.6	88.8
Denmark — Danemark	60.3	59.2	56.7	66.5	66.1	62.6	69.3	68.8	65.0	72.0	71.4	67.4
Finland — Finlande	69.0	66.5	65.5	74.6	72.2	71.1	77.5	74.7	73.2	80.7	77.5	75.6
France — France	85.2	84.5	85.9	88.9	89.3	88.9	92.9	93.1	92.4	103.1	102.2	101.1
Germany — Allemagne	70.6	68.4	67.3	75.5	74.1	73.5	76.9	75.4	74.7	78.6	77.0	76.3
Greece — Grèce	91.2	91.2	91.7	91.8	91.8	92.3	92.3	91.7	92.7	92.8	91.9	92.9
Ireland — Irlande	77.2	76.1	75.8	81.4	79.7	79.8	85.1	83.4	83.4	89.2	87.5	87.5
Italy — Italie	84.6	83.8	87.8	87.8	86.6	93.2	92.0	90.3	97.3	96.3	93.8	101.5
Japan — Japon	86.1	85.8	86.2	88.4	88.0	88.1	89.9	89.6	89.8	91.4	91.1	91.4
Luxembourg — Luxembourg	75.0	74.1	n.a.	80.8	80.2	n.a.	86.4	85.7	n.a.	92.0	92.2	n.a.
Netherlands — Pays-Bas	67.7	66.2	64.8	69.3	68.3	66.9	73.4	72.2	70.6	77.9	76.8	75.4
New Zealand — Nouvelle Zélande	81.0	79.3	77.4	83.4	81.4	79.9	87.5	85.1	83.0	91.6	88.6	86.1
Norway — Norvège	67.6	65.9	66.7	72.9	71.6	72.7	74.4	73.1	74.0	79.0	77.5	77.8
Portugal — Portugal	92.0	91.0	92.0	92.0	91.0	92.0	98.6	96.7	97.0	105.1	103.9	103.6
Spain — Espagne	94.8	93.8	92.1	96.9	97.2	94.9	100.0	99.5	96.7	102.1	101.8	98.6
Sweden — Suède	60.9	61.6	62.2	66.3	66.6	66.7	69.9	70.3	70.9	73.5	74.0	75.1
Switzerland — Suisse	82.3	79.5	78.1	84.1	81.5	80.4	86.5	84.1	82.7	88.9	86.8	85.1
United Kingdom — Royaume Uni	73.6	72.5	69.2	76.5	75.1	72.3	79.7	77.9	75.4	83.8	81.4	79.1
United States — Etats Unis	76.0	75.0	74.0	80.0	79.0	79.0	83.0	81.0	81.0	85.0	83.0	83.0

Source: Line 13 Table 1A of the Report/Ligne 13 du Tableau 1A du Rapport.

TABLE 4:

Change in gross earnings and disposable income between 1972 and 1974:

TABLEAU 4:

Variation du salaire brut et du revenu disponible entre 1972 et 1974:

Base year:/année de base: 1972 = 100

COUNTRY/PAYS	Gross earnings/Salaire Brut	Disposable income/Revenu disponible	
	Single & 2 child family/ Célibataire et ménage avec 2 enfants	Single/Célibataire	2 child family/ Ménage avec 2 enfants
Australia — Australie	126.8	125.4	125.0
Austria — Autriche	126.4	125.6	127.2
Belgium — Belgique	138.7	136.2	136.5
Canada — Canada	118.8	119.3	121.4
Denmark — Danemark	142.1	133.6	132.9
Finland — Finlande	145.6	138.5	136.5
France — France	132.3	130.3	129.7
Germany — Allemagne	119.4	113.8	115.9
Greece — Grèce	115.0	115.7	115.1
Ireland — Irlande	136.6	134.1	133.9
Italy — Italie	136.9	142.1	144.4
Japan — Japon	148.2	148.4	148.2
Netherlands — Pays-Bas	122.7	117.4	118.7
New Zealand — Nouvelle Zélande	140.3	134.1	132.0
Norway — Norvège	127.5	125.7	125.6
Portugal — Portugal	169.8	169.8	167.3
Spain — Espagne	140.6	136.5	135.7
Sweden — Suède	120.4	122.9	123.1
Switzerland — Suisse	123.9	117.8	118.5
United Kingdom — Royaume-Uni	136.7	128.5	129.0
United States — Etats-Unis	113.8	111.3	111.5

Note:

This table takes account of income taxes and social security contributions paid and cash transfers received. The figures represent nominal, and not real changes in earnings. Readers may refer to table 16 for a description of the changes that have taken place in income tax, social security and cash transfer systems between 1972-74,

Ce tableau tient compte d'une part des impôts sur le revenu des personnes physiques, des cotisations de sécurité sociale et des prestations en espèces reçues des administrations. Les chiffres représentent les variations réelles non nominales, des revenus. Le lecteur trouvera dans le tableau 16 une description des changements intervenus dans les systèmes d'impôt sur le revenu, de sécurité sociale et de prestations en espèces entre 1972 et 1974.

TAX GLOSSARY

by H.W.T. PEPPER *

ANTI-EVASION MEASURES — Measures to combat evasion of tax include both statutory provisions and administrative action. The tax law may provide for deductions or withholding of tax at aource, for the estimation of tax liability in the absence of declaration or returns from the taxpayer, and may require third parties to provide information regarding payments to taxpayers and place the onus of proof on a taxpayer to dislodge or reduce assessments that have had to be made in the absence of information required from the taxpayer. Administrative action will include comparison of capital growth with declared income (see ACCRETION, NET) and the critical examination of information, provided by the taxpayer himself and from other sources, to determine whether the income declared fairly represents taxable income.

ANTI-POLLUTION TAX — Taxes levied on the act of polluting the atmosphere, rivers, etc., or upon substances or articles likely to cause 'pollution'. A recent example of such taxation is the proposal made by the U.S. President on 8th February 1972 for an anti-pollution tax on sulphur dioxide emissions, the tax to be proportionate to the sulphur content in the materials consumed which cause such omissions. A further proposal has been made by the City of New York to tax non-returnable containers with emphasis on plastic containers. The proposal is currently being protested by manufacturers of plastics who argue that other substances used to make containers are equally to blame for 'pollution'. Norway also has a special tax on non-returnable containers which constitute potential pollution material.

APPEALS — Part of the process of determining the tax liability. Where a tax declaration has not been rendered, or there is a dispute on some point of fact or law which cannot be resolved by the taxpayer and tax department, an assessment may be made by the department in the figures it considers tax may be due. The taxpayer then normally has an opportunity to appeal against the assessment to an independent tribunal set up to determine tax disputes, or to the Courts. Sometimes there is a preliminary stage known as an 'objection' which may be handled less formally than an appeal and provide a means of settling more summarily the less difficult disputes.

APPOINTED DAY — Sometimes a tax provision is introduced in legislation in advance of its coming into legal force. This may apply particularly to some non-controversial matter such as the reconstruction of the provisions governing depreciation, where it is intended to give taxpayers ample time to study the new provisions and adjust to them before they come into force. In such cases the law may contain a provision also to cover the date of its coming into force, or may leave the matter open by saying this will happen on an 'appointed day' to be announced later by Government.

APPORTIONMENT OF INCOME — The term may refer to cases where the settlement of income by a parent upon a minor child is set aside by the tax law as a 'tax avoidance' device, in which case the income in question will be apportioned to the parent for the purpose of determining his personal tax liability. The term also refers to the allocation of the income of an accounting period in cases where there is some change in taxation on a date which falls within the accounting period so that income before that date and income after the date have to be dealt with differently for tax purposes.

APPRECIATION — Appreciation of capital is the increase in value of personal or real property. In general, this increase is not subject to income tax, unless the relevant asset is alienated, but e.g. in Italy immovable property companies are subject to tax on appreciation of real property after each ten years of ownership. Another example of a tax on the appreciation of property through development, before realisation takes place is the FIRST LETTING TAX (q.v.) imposed in Britain on the first letting of new property where the developer obtains his reward by securing for himself an income instead of a realisation gain.

APPRENTICESHIP TAX — Not a very common type of tax; it has been used as a payroll tax on employers, usually of small amount, where the government has set up apprenticeship schemes at its own expense in order to raise the quality of new employee entrants to the new industries it is encouraging. A tax of this kind was introduced in France in 1925 and is now levied at 1 percent. The revenue is not hypothecated but the government spends at least as much as the sum yielded on training and technical schools. Certain employers, e.g., private schools, farmers and artisans, are exempt and other employers are given credit for their own expenditure on technical training, apprenticeship etc.

APPROVED SCHEME — Sometimes where tax relief is provided for certain types of payment in principle, e.g., share incentive schemes for executive employees, pension schemes for the self-employed, the Administration retains control by restricting relief to payments to 'approved' schemes. In the course of approving the schemes the administration may ensure that they are not used for tax avoidance.

ARBITRAGE — This term is applied to the process of buying and selling the same commodity, which may include money, or securities, in different markets where a gap has been opened between the respective prices for the commodity in the markets greater than the difference justified by the cost of freight, transfer costs etc. The person undertaking the arbitrage dealing is normally taxable in his country of residence.

ARMORIAL BEARINGS TAX — A levy in Britain, imposed in 1798, which survived well into the 20th century, whereby an annual tax was charged on the use or display of a coat-of-arms by persons entitled to do so, e.g., on carriages or other vehicles.

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* With the assistance of the staff of the International Bureau of Fiscal Documentation.

ARM'S LENGTH PRICE — Where transactions are entered into by two persons one of whom controls the other or both of whom are controlled by a third, the price and terms at which the transaction is undertaken may differ from the ordinary commercial terms which would prevail if the parties were strangers to each other. The price in the latter circumstances would normally be the 'arm's length price' or open market price and is a concept of importance in anti-avoidance provisions in tax laws, double taxation treaties etc. (see also ANTI-AVOIDANCE MEASURES).

ARRANGEMENT "B" — The system whereby BUILDING SOCIETIES (q.v.) in Britain pay a compounded tax rate for their depositors' tax liability on interest. The society pays tax at a composite rate computed by reference to the depositors' average marginal rates. The interest received by the depositors is not charged to any further income tax at the standard rate. If the depositor is chargeable to tax at the higher personal rates, his interest is grossed-up to a figure taking into account standard rate tax (35 percent for 1976-77) and charged to the higher rate of tax, with, however, a deduction of the 35 percent tax already 'compounded'. No refund is due to taxpayers who are liable to personal tax at less than the collective rate. The system is embodied in an arrangement with the British Board of Inland Revenue.

ARTIFICIAL TRANSACTIONS — In efforts to reduce tax liability by 'legal avoidance' some taxpayers enter into complicated and tortuous arrangements which have a certain 'artificiality' about them, i.e., they are not the ordinary way of doing business. Accordingly some states enact laws to set aside 'artificial transactions' the main purpose of which is to avoid tax. The concept is a difficult one, however, since the transactions entered into are usually quite 'real' and legally effective, so that Courts of Law may not accept a plea of artificiality by the Tax Department.

ARTISAN'S TAX — A term sometimes used to denote a tax on the services provided by artisans working on their own account as entrepreneurs, e.g. plumbers, carpenters, electricians; and distinguished from other professionals such as doctors, lawyers, architects, and accountants, who are members of the 'liberal' professions and often exempted from taxes on services.

ASPREY COMMITTEE — Committee set up in 1972 to review the Australian Federal tax system.

ASSESSED TAXES — Taxes which existed in Britain in the 18th and 19th centuries and broadly were chargeable on expenditure measured by the value of residence, number of servants, carriages and horses, and the sum spent on hair-powder, etc. of interest historically as a crude fore-runner of Expenditure Tax (q.v.). (See also EXTERNAL EVIDENCE OF MEANS.)

ASSESSED VALUE — The value upon which tax is charged, and this applies particularly to property taxes and rating systems, may not be the market value or annual value, but that figure reduced by various allowances such as for maintenance, management, depreciation. Moreover, since re-valuations commonly take place only at 5-yearly or some such intervals, values are generally out-of-date (i.e. too low). It is also customary for the assessed value of a property built some years after the last revaluation year to be made, not on current value, but in accordance with values prevailing in the revaluation year. In this way values of property of different ages within the same taxation area will be consistent with each other; this of course makes for equity in tax burdens. (See also TONE OF THE LIST.)

ASSESSEE — The person assessed to a tax.

ASSESSMENT — The term applied to the act of computing the tax due and also to the document or record in which the details of the calculation and tax are noted. The term is sometimes related to estimation of tax made in the absence of a return or declaration by the taxpayer, the assessment being made so that the process of collection will not be delayed because of the taxpayer's non-co-operation or delinquency.

ASSESSMENT, BASIS OF — The basis for calculating tax, e.g., for income tax, the sum due for the tax or fiscal year may be computed on the income of the previous or current year, or for the trader's accounting year.

ASSESSMENT, SELF- — 'Self-assessment' is the term usually applied to tax regimes under which the taxpayer is expected to submit a calculation of the tax due from him and, usually, to accompany his calculation with payment of the account he regards as due. The system is normally adopted for all types of sales tax but only in a proportion of countries in respect of income tax.

ASSESSOR — The person assessing taxation upon taxpayers. In Britain the term had also a specific reference to an official who was responsible for determining the income of a taxpayer by personal observation, and whatever other information was available to him, on request by the Inspector of Taxes.

ASSET DEPRECIATION RANGE — A system used in the U.S.A. allowing the taxpayer an annual option in respect of qualifying assets required in the year to decide the useful life of each asset for depreciation purposes. The 'life' chosen may be 20 percent below or above the 'guideline' life fixed by the tax department. The system offers some degree of flexibility although falling short of 'free depreciation' (q.v.).

ASSETS, REPLACEMENT OF — Where business assets are not subject to allowances for depreciation, perhaps because they are too small to warrant relatively complicated treatment, they may be dealt with on a 'replacement basis', i.e., the cost each year of replacing worn-out items will be allowed as a deduction from profits. The procedure will usually be very informal and the trader may merely be asked to confirm that his total stock of replaceable items has not increased over that of the previous year (since a 'replacement' allowance could not extend to additional assets). (See also STOCK BASIS.)

ASSETS, USE OF — Among FRINGE BENEFITS (q.v.) and PERQUISITES (q.v.) which may be granted to a director or employee by the employer, may be the free use (or use at a nominal charge) of assets, e.g., a colour TV set or other domestic equipment, a motor car not required for business use, etc. Some states levy tax on the value of such 'benefits in kind', for example, in Britain a charge of 10 percent per annum of the value of such assets is made on the person who benefits.

ASSOCIATED COMPANY — An associated company is similar to an AFFILIATE COMPANY (q.v.), the criterion varying from one country to another and from one purpose to another, i.e. in some circumstances a 51 percent stockholding majority is sufficient, in others 80 percent or even 100 percent is needed. The concept is sometimes used in anti-avoidance measures t

group together the trading results of what are essentially a single enterprise, sometimes to benefit the taxpayer so that he may obtain relief when one part of the total enterprise is making losses while the rest is in profit.

ASSURANCE, LIFE — It ais fairly common for deductions to be provided in tax codes in respect of premiums paid on life assurance policies. The practice in the U.K. was approved by the Royal Commission on Taxation of 1920. The grounds of approval were that life assurance was the only method by which a taxpayer could provide immediate security such that his widow and children would become entitled to a lump sum of money, which was substantial in relation to the annual premium, in the event of his premature death. The relief for life assurance premiums is often comparatively generous because it is not usual to tax the capital sum which becomes payable when the policy matures whether at death or, in the case of an endowment policy, at the end of the period of time during which the premiums are payable.

ATTENDANCE FEES — Remuneration paid to those persons (e.g. members of the Board of Directors of a company) present at a meeting. In France attendance fees (jetons de présence) are the normal remuneration of company directors and may even be granted to directors which have not attended meetings. For French tax purposes they are treated as income from movable property (like dividends).

AUDIT OFFICE ('DESK') — The term is used in connection with tax enforcement in the U.S.A.; 'audit' refers to the investigation of the taxpayers' books and accounts and/or the general accuracy of their returns and declarations either as a routine operation, or where evasion is suspected. Where this work is done in the tax office, it is known as a 'desk' or office audit.

AUDIT OUTDOOR ('FIELD') — An audit carried out on the taxpayer's premises, or elsewhere in the 'field' outside the tax office.

AUDIT REQUIREMENTS — It is fairly usual for the tax administration to demand a certain standard of audit, e.g. by a qualified independent auditor, to certify that accounts rendered by a taxpayer in support of his declaration of profits or income are correct. The requirement may be embodied in the tax law but more often is not and it is usual to expect a higher standard for the larger businesses than for small ones, and to exercise discretion as to what may reasonably be sought from the smaller traders. An element of 'compulsion' may, however, be attained by establishing a practice within the tax department, which is likely to be upheld by the tax appeal tribunal as to what standards of accounting and audit may be expected of taxpayers when rendering their tax declarations

AUSGLEICHSTEUER — A compensating or equalising tax formerly imposed in Federal Germany during the existence of the cascade tax (Umsatzsteuer) and applied to imports which would otherwise have escaped some of the stages of taxation to which local products would be subject. Now only of historical interest as a fore-runner of the 'border adjustments' necessary under V.A.T. (q.v.) or single stage sales.

AUSSCHÜTTUNGSBELASTUNG — Tax, levied at a rate of 36 percent, on dividends and other distributions to individual and corporate shareholders, as introduced by the new German Corporate Income Tax Reform Law, which entered into force on January 1, 1977. The tax is effected by a 20 percent refund in the case that the original tax burden amounted to 56 percent (normal tax rate under the new law) or by an increase up to 36 percent in the case that the distribution originated from exempt income or income taxed at a lower rate

AUSSENSTEUERGESETZ — German law enacted in 1972 containing provisions as regarding the fight against tax evasion and the change of residence to low tax countries.

AUTHOR'S COPYRIGHT AND ROYALTIES — See COPYRIGHT AND ROYALTIES.

AUXILIARY — Term sometimes applied to materials such as fuels, lubricants, catalysts, used in production but not physically embodied in the product. V.A.T. systems allow an 'automatic' credit for most of such elements and other sales tax systems sometimes provide export rebates (q.v.) to compensate the producer who exports.

AVERAGING — Because income and expenditures may fluctuate from year to year, such that more taxation may be payable by a taxpayer over a period of years if his net income were level rather than subject to peaks and troughs, provisions for averaging income for tax purposes are occasionally encountered. Examples in the U.K. include the provisions (which were terminated by the 1925 Budget) whereby trading profits were taxable on the basis of the 3-year average of previous profits. Taxpayers were also charged (under schedule A) in respect of national income from the owner-occupation of residential property and relief was due on the basis of a five-year average of previous maintenance expenditure (in statistical terms the foregoing relief was calculated respectively on the bases of three-point and five-point moving averages). Where certain individuals have become entitled to very large sums over a short period which would be unlikely to recur (e.g. a successful boxer, author, or playwright) some countries have adopted provisions enabling income to be averaged over a period of years so as to avoid the inequity of charging tax at very high marginal rates on income arising in a short period which would in practice represent lifetime earnings. In the case of authors a successful book might represent the fruits of many year's research when income was nil or minimal and the success might not be repeated in subsequent endeavors. The boxer might remain champion only for a limited period and in each case the argument for spreading is clearly a strong one.

AVOIDANCE — The term used, in contrast to 'evasion', to denote the reduction of tax liability by legal means, e.g. by arranging business or personal affairs to take advantage of reliefs or anomalies or loopholes in the tax law. Among the best-known examples are — (a) vertical integration in business or industry to reduce reliability to a cascade tax, (b) transfer of business or investment income from individuals to limited companies when the highest rate of tax applicable to individuals is higher than the rate applied to companies; and (c) gifts inter vivos to reduce liability to wealth or capital taxes including death duties. (See also ANTI-AVOIDANCE MEASURES.)

AVOIR FISCAL — A term used in France to describe for example the relief to the shareholder on his dividends in respect of tax paid by the company on the income out of which the dividends have been paid.

[to be continued]

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A comprehensive appraisal of the continent with up-to-date political and economic analysis and essential information. London, Africa Guide Company, 1976. 311 pp. (B. 10.815)

AUSTRALIA

AUSTRALIAN INCOME TAX GUIDE

Being the twenty-second edition of Gunn's Guide to Commonwealth Income Tax. By E.F. Mannix and D.W. Harris. Sydney, Butterworths, 1977. 755 pp.
Explanation of the Australian income tax (individual and companies) as of December 31, 1976. (B. 100.369)

AUSTRIA

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By Erich Hruschka and Anton Schmoll. Vienna, Wirtschaftsverlag Dr. Anton Orac, 1977. 128 pp. ÖS. 270.-.
Collection of essays on the management and promotion of small and medium sized enterprises in the case of market fluctuations. The following topics, inter alia, are discussed: the effects of recession, the cooperation with big enterprises, economic efficiency within the scope of research and development, personal planning etc. (B 100.374)

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By Paul Harff and Manfred Stöckmann. Vienna, Wirtschaftsverlag Dr. Anton Orac, Bielefeld, Gieseking Wirtschaftsverlag, 1977. 262 pp., ÖS. 190.-.
Reference book to statistics and its applications to the economy and economic life. The following subjects are discussed: basic principles of statistics, descriptive statistics and determining statistics. (B. 100.375)

DENMARK

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Paris, Organisation for Economic Co-operation and Development, 1977. 68 pp., Fr.Frs. 10.-. (B. 100.380)

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By M. Roy Saunders. London, Butterworths, 1977. 334 pp., £ 12.-.
Study on tax planning affecting international trade in Europe. Each chapter is a separate study of a country's tax legislation, the major countries involved being the United Kingdom, France, Germany, Belgium, Luxembourg, Switzerland and the Netherlands. Three other tax regimes are also dealt with (the Channel Islands, Liechtenstein and the Netherlands Antilles) since they are closely affiliated to one of the above countries situated in Europe. (B. 100.397)

FRANCE

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1977-78 Edition. London, Financial Times, Ltd., 10 Bolt Court, Fleet Street, London EC4A-3HL, 1977. 700 pp., $ 37.50 via surface mail, $ 52.50 via airmail.
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— by *Oliver Oldman and Richard Bird*

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International Fiscal Association (I.F.A.): General Secretariat, Woudenstein, Burg. Oudlaan 50, P.O. Box 1738, Rotterdam (Netherlands).

31st I.F.A. Congress: Secretary c/o Interconvention, P.O. Box 35, A-1095 Vienna (Austria). Non-members of I.F.A. should apply to International Fiscal Association (I.F.A.) in Rotterdam, P.O. Box 1738.

Practising Law Institute: 810 Seventh Avenue, New York, N.Y. 10019 (U.S.A.).

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Das Einkommensteuergesetz, nach dem Stande vom Jänner 1977.
Vienna, Im Selbstverlag der Verfasser, 1977. 463 pp.
9th edition of a book containing the text of and comments on the Austrian individual income tax as it was effective on January 1, 1977. The texts of a number of other relevant laws and extensive index are appended.
(13 F 56)

DOLLAK, K., J. JODL, R. KALLINA.

Das Umsatzsteuergesetz. Nach dem Stande vom 1. März 1977.
Sechste Auflage. Vienna, Peter Linde, 1977. 342 pp.
6th revised edition of a textbook on the Austrian Turnover Tax Law. An introductory comment, the texts of Regulatory Ordinances and Ministerial Rulings are included as well. The book is updated as per March 1, 1977
(13 F 59)

WESTERMAYER, H.

ABC des Oesterreichischen Steuerrechts; eine gemeinverständliche Darstellung der Steuern. 7. Auflage.
Vienna, Peter Linde, 1977. 244 pp.
Seventh revised edition of general tax guide explaining the tax laws as they were effective on January 1, 1977. Numerous examples clarify the impact of the laws. A tax glossary is included. (13 F 54)

For loose-leaf publications, see issue No. 3, 1977, pages 127 and 128.

Editorial

Problems and perspectives

Government policies reflect the philosophies regarding current socio-economic problems arising from unemployment and inflation. Taxation is one of the principal tools used in the struggle to counteract these forces which threaten to disrupt society. Whereas tax policy is essentially restricted to national levels, recession is an international phenomenon resulting to a large extent from a reduction in trade between countries and the resulting decrease in investment activities.

What is being done, domestically and internationally, to improve the situation? In the area of taxation there are certain positive indicators worth mentioning in this special issue of the *Bulletin*.

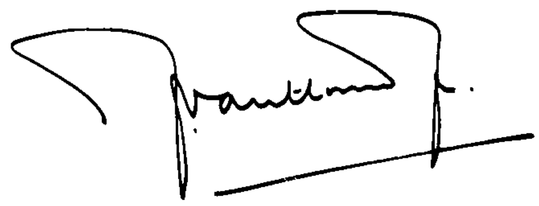
The 31st Congress of the International Fiscal Association (I.F.A.), to be held in Vienna from October 3rd to 8th, 1977, will discuss *Inflation and Taxation* as one of the two main subjects. The discussion will be based on a detailed General Report and on National Reports from 24 countries. These reports focus mainly on the adjustments of the tax provisions to mitigate the consequences of inflation although the Belgian, French and German reports also discuss measures combating inflation. The very least one may expect from this gathering of tax experts from all over the world is a thorough comparative analysis of the problems and of the possible contribution of taxation to help solve them.

Austria being I.F.A.'s host country it was deemed appropriate to publish in this issue certain basic and factual information on Austrian taxation. Austria's young and energetic Vice-Chancellor and Minister of Finance describes the essence of the Government's tax policy. Certain fundamental legal principles are discussed by Professor Dr. Gerold Stoll who shows, inter alia, the relationship between his country's domestic tax law and the basic rules of international tax law as they have developed in recent years. Together with some illustrative material provided by the Bureau, these two contributions are important in acquainting those who attend the Congress with these crucial elements of Austrian taxation. It is, therefore, with warm feelings of gratitude that the editors of the *Bulletin* publish these articles.

International trade and investment are being activated in various parts of the world. The Socialist countries of Eastern Europe recently introduced several types of tax measures aiming at facilitating business dealings with the rest of the world. Joint ventures, business representations, the provision of loans and the transfer of technology will benefit from special tax measures and from the numerous double taxation agreements on which this special issue reports in the form of a succinct survey.

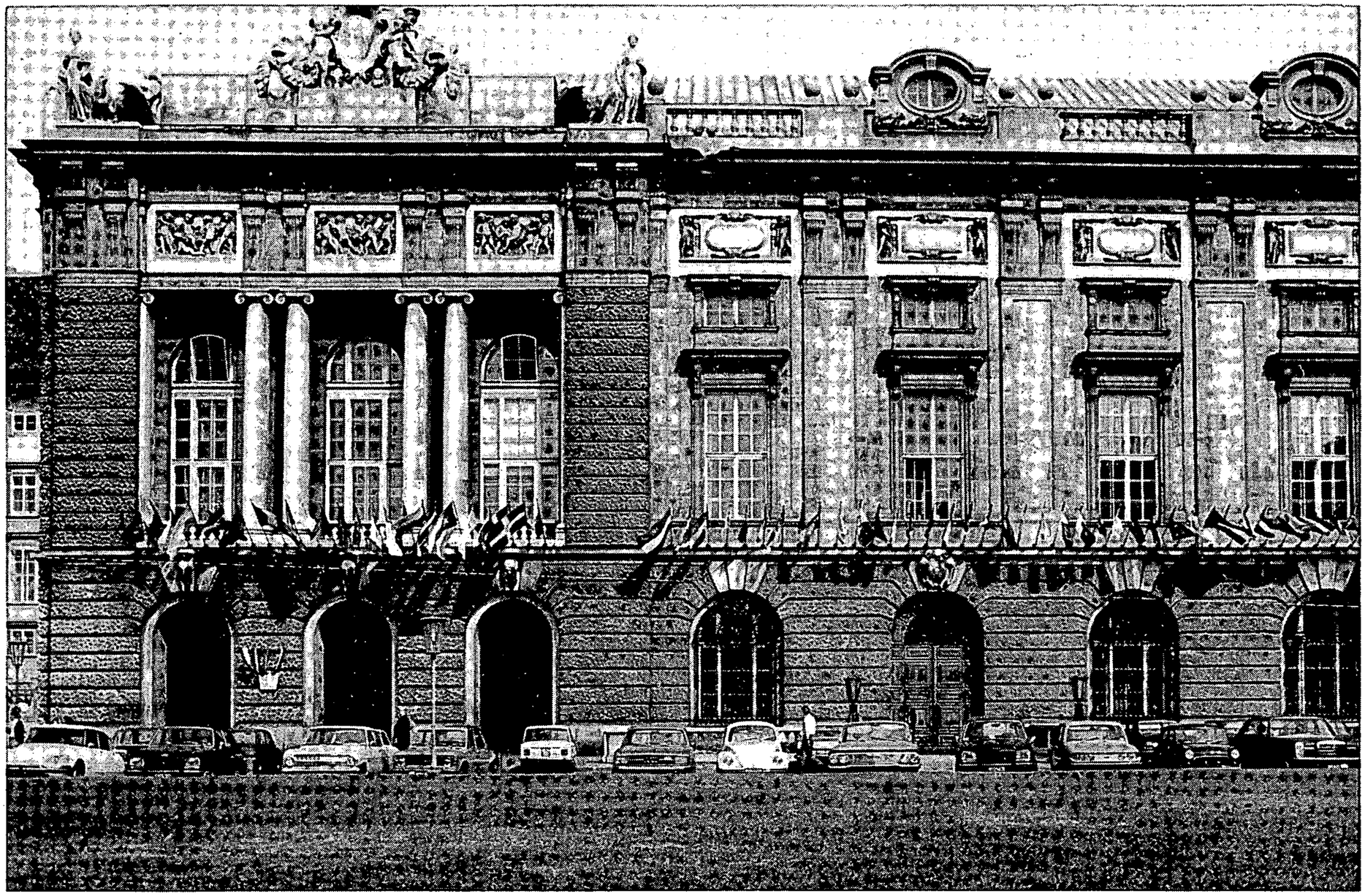
The *Bulletin* has already reported on developments in other parts of the world and will continue to do so. The countries of the Middle East offer enormous opportunities for business in the context of their policies for structural development. A new loose-leaf publication of the *International Bureau of Fiscal Documentation* on "Taxes and Investment in the Middle East" will be published just before the Congress. In this issue of the *Bulletin* a note on tax reform in Egypt shows what the leanings are. In the Far East interesting things are happening as appears from brief reports on India and Singapore submitted by the Bulletin's correspondents. In Latin America the Interamerican Centre of Tax Administrators (C.I.A.T., with headquarters in Panama City) is very active as is shown in a brief report from Professor Valdés Costa.

The nature of the many things that are happening in the area of taxation and on which one issue of a monthly magazine cannot report comprehensively, is such that — despite all problems with which countries and peoples are faced — there is room for some optimism. Many of the developments are more than just a reaction: they often open up perspectives which are worth noting and pursuing.



J. van Hoorn Jr.

IFA INTERNATIONAL FISCAL ASSOCIATION NEWS



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XXXIer KONGRESS

Thema I

Inflation and Besteuerung

Thema II

Die Bemessung des steuerpflichtigen Einkommens von Kapitalgesellschaften

XXXIst CONGRESS

Subject I

Inflation and taxation

Subject II

Determination of the taxable profits of corporations

XXXIe CONGRES

Sujet I

L'inflation et la fiscalité

Sujet II

La détermination du bénéfice imposable des sociétés de capitaux

Welche Bedeutung spielt das Steuerwesen in der österreichischen Wirtschaft?



Dkfm. Dr. HANNES ANDROSCH ~ Vize Kanzler ~ Bundesminister für Finanzen

Die Einhebung von Steuern und die Ausgestaltung des Steuertarifs waren seit jeher ein heftig umstrittenes Thema der gesellschaftlichen Diskussion.

Der Mensch des Mittelalters befasste sich insbesondere mit der Frage, ob es überhaupt moralisch sei, Steuern einzuheben. So überschreibt Thomas von Aquin in seiner "*Summa theologiae*" des Kapitel über die Steuereinhebung mit "*Kann Raub ohne Sünde geschehen?*". Die Frage wird unter Hinweis auf die gemeinnützigen Aufgaben des Herrschers und der Beschränkung auf das durch die Beachtung der "Gerechtigkeit" abgesteckte Gebiet bejaht.

Im absolutistischen Staat rechtfertigt das Ideal des starken Staates die Besteuerung.

"*Ein Fürst, welcher keinen schatz im kasten hat, sondern sich auf die gutwilligkeit seiner unterthanen und länders verlassen will, der gehet auf steltzen: Denn der unterthanen gemüther seynd hinckende hunde, mit welchen man keine gewisse hasen fangen kann.*"
(Welhelm Freyherr von Schröder: Fürstliche Schatz- und Rent-Cammer).

Heute hat sich die Haltung der Finanzpolitik insofern geändert, als der Staatsbürger nicht mehr nur als Einnahmequelle oder als Wirtschaftsubjekt, dessen Entscheidungen zu respektieren sind, betrachtet wird, sondern als "potentieller Träger staatspolitisch erwünschter Verhaltensweisen" (G.B. Schmölders).

Aus dieser Sicht ist auch die heutige Betrachtung der Steuern und der Steuerpolitik zu verstehen.

Steuern haben viele Funktionen zu erfüllen.

Neben der Finanzwirtschaftlichen, also der Funktion, Einnahmen zur Deckung der Ausgaben zu beschaffen, haben sie auch die Funktion, die Einkommensverteilung zu beeinflussen. Dazu eignet sich vor allem die progressive Gestaltung des Tarifs oder auch die Einführung von Absetzbeträgen, Freibeträgen, Freigrenzen usw., die an bestimmte soziale Indikatoren gebunden sind. Aufgrund der immer vorhandenen Steuerlücken, aber auch, um das Steuersystem nicht allzu kasuistisch zu gestalten, ist die Umverteilung über Abgaben nur begrenzt möglich. Steuerpolitik und Ausgabenpolitik sind hier komplementär zu sehen, da auch über die Struktur der Ausgaben die Einkommensverteilung stark beeinflusst

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Hannes Androsch wurde am 18. April 1938 in Wien geboren. Nach Besuch der Hochschule für Welthandel erwarb er mit einer Arbeit über Fragen der Steuerbilanz und der Bilanztheorien das Diplom und mit einer Dissertationsarbeit über Investitionsplanung das Doktorat.

Dkfm. Dr. Androsch war von 1956 bis 1966 als Revisionsassistent und nachher in freiberuflicher Tätigkeit als beeideter Buchprüfer und Steuerberater tätig. Im SPÖ Parlamentsklub war Androsch von 1963 bis 1966 als Sekretär für Wirtschaftsfragen und anschliessend als Konsulent des sozialistischen Abgeordnetenklubs tätig. Der sozialistischen Bewegung gehört Dkfm. Dr. Androsch seit seiner Jugend an. 1967 wurde er als Abgeordneter in den Nationalrat gewählt. Er ist verheiratet und Vater von zwei Kindern.

Am 21. April 1970 wurde Dkfm. Dr. Androsch als Finanzminister in die Bundesregierung berufen. Mit 32 Jahren war er damit der jüngste Finanzminister Österreichs.

Während seiner bisherigen Amtszeit hat Finanzminister Androsch wesentliche Akzente in der Entwicklung der österreichischen Wirtschaft gesetzt. Seit dem Jahre 1970 war er wie noch kein anderer Finanzminister vor ihm mit dem Problem einer instabilen Währungswelt konfrontiert, wobei er den Schilling zu einer der stabilsten Währungen der Welt machen konnte. 1972 wurde die Integration Österreichs in den europäischen Markt durch das Arrangement mit den Europäischen Gemeinschaften vollzogen. Neben der Umstellung des alten Umsatzsteuersystems auf die europakonforme "Mehrwertsteuer" im Jahre 1973 erfolgte noch eine Reihe von Einkommens- und Lohnsteuerreformen, darunter die grundlegende Neufassung des Einkommensteuergesetzes im Jahre 1972 und das Inkrafttreten eines neuen Finanzausgleiches mit Beginn 1973. Durch einen auf Arbeitsplatzsicherung und Stabilität ausgerichteten Wirtschaftskurs gelang es Finanzminister Androsch, dass die Folgen des schwersten konjunkturellen Rückschlages, dem die westlichen Industriestaaten sich seit dem Zweitem Weltkrieg gegenübersahen, die Österreichische Wirtschaft nur in einem abgeschwächten Masse berührten. Die mit 1. Oktober 1976 wirksam gewordene Ernennung zum Vizekanzler ist die Bestätigung für den Erfolg dieses wirtschaftspolitischen Kurses.

werden kann. Die Steuern und die Ausgestaltung des Steuersystems können auch allgemeinen wirtschaftspolitischen oder gesellschaftspolitischen Zielvorstellungen angepasst werden. So können z.B. zur Erhöhung der Investitionsneigung (Abschreibungsvorschriften, Steuerrabatte etc.) oder zur Konsumbeeinflussung sowohl hinsichtlich des Niveaus des Konsums (Sparförderung) als auch in bezug auf die Konsumstruktur (gestaffelte Steuersätze bei Verbrauchssteuern, zusätzliche oder ausschliessliche Besteuerung bestimmter Verbrauchsgüter) steuerliche Anreize gegeben werden.

Steuerliche Regelungen können auch zur Verhinderung von Umweltschäden und zur Forcierung des Rohstoffsparens beitragen.

Eine Funktion der Steuer, aber auch anderer Einnahmen, die leider meistens übersehen wird, ist die Informationsfunktion. Einerseits bilden die verschiedenen Steuerstatistiken eine wichtige Grundlage für die Erstellung der volkswirtschaftlichen Gesamtrechnung vergangener Jahre (ex post-Information), andererseits können gewisse Steuern und Einnahmen als Konjunkturindikatoren herangezogen werden. Wichtig für eine "ex ante-Information" sind relativ schnell reagierende Grössen wie Lohnsteuer, Beiträge zum Familienlastenausgleich, Lohnsummensteuer und zum Teil auch einige Verbrauchssteuern. Aus diesem Grunde ist darauf zu achten, den Informationsgehalt von (Steuer)Einnahmen nicht durch zu viele Sonderregelungen innerhalb der Steuergesetzgebung zu verwässern.

Derzeit liegt der Anteil der Steuern und Steuerähnlichen Einnahmen am Bruttonationalprodukt bei rund 39%. Vor 10 Jahren hat er noch 35% betragen. Die Kluft zwischen politischer Verantwortung und wirtschaftlichem Nutzen führte dazu, dass diese Steigerung vor allem dem Bund angelastet wird. Zwar hebt der Bund rund 70% der Steuern ein, der Anteil am Bruttonationalprodukt ihm verbleibender Steuereinnahmen ist jedoch von 14,8% im Jahr 1970 auf 14,1% im Jahr 1976 gesunken. Die Erhöhung der Steuerquote ist vor allem den Sozialversicherungsträgern, aber auch anderen Gebietskörperschaften zugute gekommen.

Im Jahre 1976 betrug der Anteil der Steuern an den Gesamteinnahmen des Bundes lediglich 57,8%, und nur 46,3% der Gesamtausgaben waren durch das dem Bund verbleibende Steueraufkommen gedeckt.

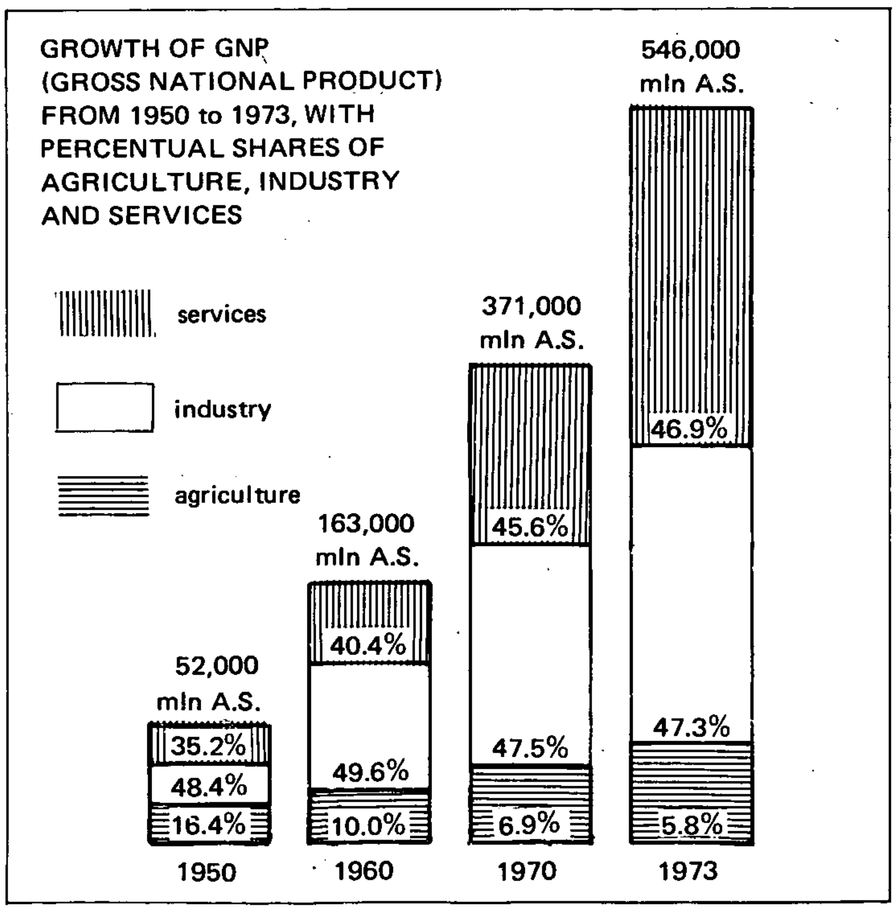
Als Folge der antizyklischen Budgetpolitik zur Bekämpfung von Rezession und Arbeitslosigkeit erhöhte sich der Anteil des Bruttodefizits auf 42,8% der Nettosteuereinnahmen, die Finanzschuld ist auf 60,3% der Gesamtausgaben angewachsen.

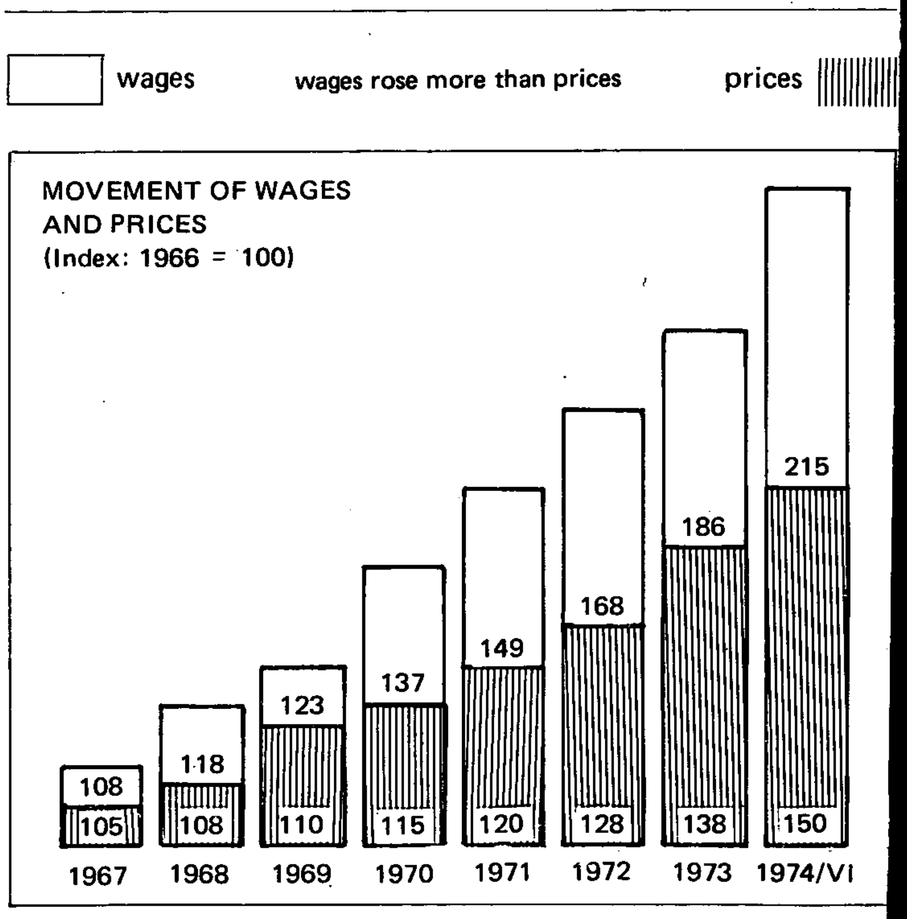
Das bedeutet aber, dass von der budgetären Lage her kein Spielraum für unzeitgemässe und übergrosse Steuersenkungen gegeben ist.

Andererseits ist die Gefahr gegeben, dass durch die Besteuerung Grenzen erreicht werden, die selbst in Ländern mit hoher Steuermoral zu Reaktionen der Verweigerung und Abstinenz geführt haben. Wie bei allen psychologischen Grenzen gibt es keine Möglichkeit, ihre genaue Lage auszuloten. Hat man sie einmal erkannt, dann hat man sie auch bereits überschritten.

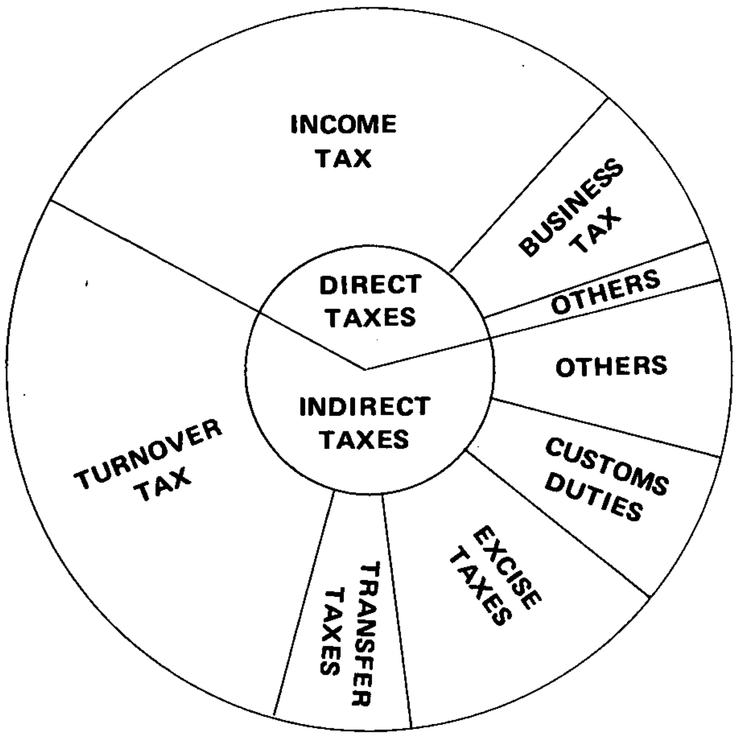
Eine Wiederherstellung des konjunkturpolitischen Spielraums der Budgetpolitik hat daher vorrangig bei den Ausgaben anzusetzen. Die entsprechenden Schritte dazu wurden bereits eingeleitet.

The illustrations in this Section on Austria are taken from: HANDBUCH FÜR INVESTORENINFORMATION (Handbook for investor's information), published by "Bundesministerium für Handel, Gewerbe und Industrie" (Federal Ministry for Trade, Business and Industry), 2nd ed., Vienna, 1976.





FEDERAL TAXES IN AUSTRIA



DIRECT TAXES	45%	**INDIRECT TAXES**	55%
		Turnover tax	26%
Income tax	33%	Excise taxes	12%
Business tax	7%	Customs duties	5%
Others (inter alia net worth tax)	5%	Transfer taxes	4%
		Others	8%

Das österreichische Steuerinstrumentarium ist stark differenziert. Es reicht von den Monopolabgaben, die noch aus der Zeit des Absolutismus stammen, bis zur Mehrwertsteuer, die 1973 eingeführt wurde.

Finanzwirtschaftliche und verteilungspolitische Zielsetzungen stehen vor allem bei den gewinnabhängigen Steuern, also bei veranlagter Einkommensteuer, Körperschaftssteuer und Gewerbesteuer im Vordergrund.

Kernstück ordnungspolitischer Zielsetzungen auf dem Gebiet der Einkommen- und Körperschaftsbesteuerung stellt das auch im internationalen Vergleich als reichhaltig zu bezeichnende Instrumentarium an Investitionsbegünstigungen dar. So ist für Unternehmen mit kontinuierlichem Investitionsvolumen die Begünstigung der vorzeitigen Abschreibung besonders bedeutsam. Die vorzeitige Abschreibung ist grundzätzlich mit 50 v.H. der jeweiligen Anschaffungs- oder Herstellungskosten von abnutzbaren Anlagegütern begrenzt, ihre Inanspruchnahme bewirkt einen kräftigen Steuerstundungseffekt. Aufgrund der vorhandenen statistischen Unterlagen kann das Ausmass der von den Unternehmen 1977 in Anspruch genommenen vorzeitigen Abschreibung auf etwa 16 Mrd S geschätzt werden.

Die vorzeitige Abschreibung wurde in letzter Zeit verstärkt als Instrument für struktur- und konjunkturpolitische Massnahmen eingesetzt. So wurde durch die Einkommensteuergesetznovelle 1974, mit der vor allem konjunkturstabilisierende Massnahmen gesetzt werden sollten, die vorzeitige Abschreibung für unbewegliche Wirtschaftsgüter grundsätzlich abgeschafft. Für bestimmte Massnahmen war sie aber weiterhin zulässig, so etwa für Investitionen im Interesse des Umweltschutzes und für strukturverbessernde Investitionen im Rahmen der Frendenverkehrswirtschaft. Als flankierende Massnahme zur Abschaffung der vorzeitigen Abschreibung wurde andererseits die Abschreibungsdauer für Betriebsgebäude wesentlich — und zwar in der Regel auf 20 Jahre — verkürzt.

Die kritische Situation der Bauwirtschaft zu Beginn des Jahres 1976 veranlasste die Bundesregierung, expansive Massnahmen speziell für diesen Sektor zu treffen. Für Bauvorhaben, mit deren Ausführung ab Beginn des Kalenderjahres 1976 begonnen wurde, wurde eine befristete 50%ige vorzeitige Abschreibung der Herstellungskosten für die Kalenderjahre 1976 und 1977 eingeführt. Zusammen mit weiteren Massnahmen wurde dadurch eine nicht unwesentliche Erhöhung des Gesamtbauvolumens für das Jahr 1976 bewirkt. Für die Jahre 1978 und 1979 ist eine Verlängerung der vorzeitigen Abschreibungsmöglichkeit für Gebäude mit reduzierten Sätzen (30% bzw. 25%) vorgesehen.

Wahlweise zur vorzeitigen Abschreibung kann auch der sogenannte Investitionsfreibetrag in Anspruch genommen werden, der im Effekt einer Abschreibung vom Wiederbeschaffungswert gleichkommt. Auch dieses Instrument differenziert hinsichtlich seines Ausmasses nicht nach beweglichen und unbeweglichen Wirtschaftsgütern und verringert dadurch den Anreiz zu rein steuerlich motivierten Anschaffungen, die aber in Wahrheit Fehlinvestitionen darstellen.

Für Unternehmen, die zwar kontinuierlich investieren, deren Investitionen aber eine äusserst lange Bauzeit erfordern (z.B. Kraftwerksbauten), können die Investitionsbegünstigungen der vorzeitigen Abschreibung bzw. des Investitionsfreibetrags bereits von den auf die einzelnen Herstellungsjahre entfallenden Teilbeträgen der Herstellungskosten vorgenommen werden.

Unternehmen ohne kontinuierlichen Investitionsbedarf steht die Möglichkeit des steuerfreien Ansparens der Mittel für künftige Investitionen in Form einer sogenannten Investitionsrücklage offen, die mit einem bestimmten Prozentsatz des Gewinns begrenzt ist.

Bei Unternehmen, die betriebsbedingt nur über ein relativ kleines Investitionsvolumen verfügen, soll durch die Begünstigung des nichtentnommenen Gewinns eine Stärkung der Eigenkapitalbasis bewirkt werden.

Bei der Veräusserung von Gütern werden als Folge von Unterbewertungen, aber auch zum Teil als Folge des Nominalwertprinzips stille Reserven frei. Ohne steuerliche Vorkehrungen würde die Anpassung des Kapitalstocks behindert werden. Daher können solche stille Rücklagen, falls eine bestimmte Mindestbetriebszugehörigkeit gegeben ist, begünstigt aufgelöst werden. (Übertragung der aufgedeckten stillen Rücklagen auf die Anschaffungskosten anderer Wirtschaftsgüter, zum Teil auch ermässigte Steuersätze).

Währen diese Massnahme primär der Förderung der Mobilität des Kapitals dient, haben strukturpolitische Erwägungen zur Schaffung des "Strukturverbesserungsgesetzes" geführt, das für die verschiedensten Abgaben

von den allgemeinen steuerlichen Bestimmungen abweichende Regelungen trifft. Dadurch soll den Unternehmen die erforderliche Strukturanpassung ermöglicht bzw. erleichtert werden. Das ursprünglich auf zwei Jahre befristete Gesetz wurde — mit Ausnahme eines Artikels — bereits mehrfach verlängert und ist derzeit bereits in Kraft. Eine weitere Verlängerung nach Ablauf dieses Jahres ist vorgesehen.

Durch Massnahmen auf steuerlichem Sektor wird auch die Exportwirtschaft gefördert. So ist etwa eine pauschale Wertberichtigung von Exportforderungen als Ausgleich für allfällige Finanzierungsengpässe aufgrund der langen Zahlungsziele im Export vorgesehen. Entsprechend der zunehmenden Multilaterisierung im Aussenhandel ist für bestimmte Beteiligungsinvestitionen österreichischer Unternehmer im Ausland eine entsprechende steuerliche Begünstigung vorgesehen.

Steuerliche Massnahmen beeinflussen auch den Kapitalmarkt. So hebt die steuerliche Förderung für die Anschaffung von festverzinslichen Wertpapieren die Nachfrage am Anleihemarkt; Auswirkungen auf den Kapitalmarkt gehen auch von der begünstigten Ausgabe von Aktien bei Kapitalerhöhungen aus. Als mittelbare Förderung kommen noch verschiedene Steuerbefreiungen von Zinsen aus begünstigt angeschafften Wertpapieren hinzu.

Verbrauchssteuern werden üblicherweise den indirekten Steuern zugezählt, die als überwälzbar angesehen werden, im Gegensatz zu den direkten Steuern, die als nicht überwälzbar betrachtet werden.

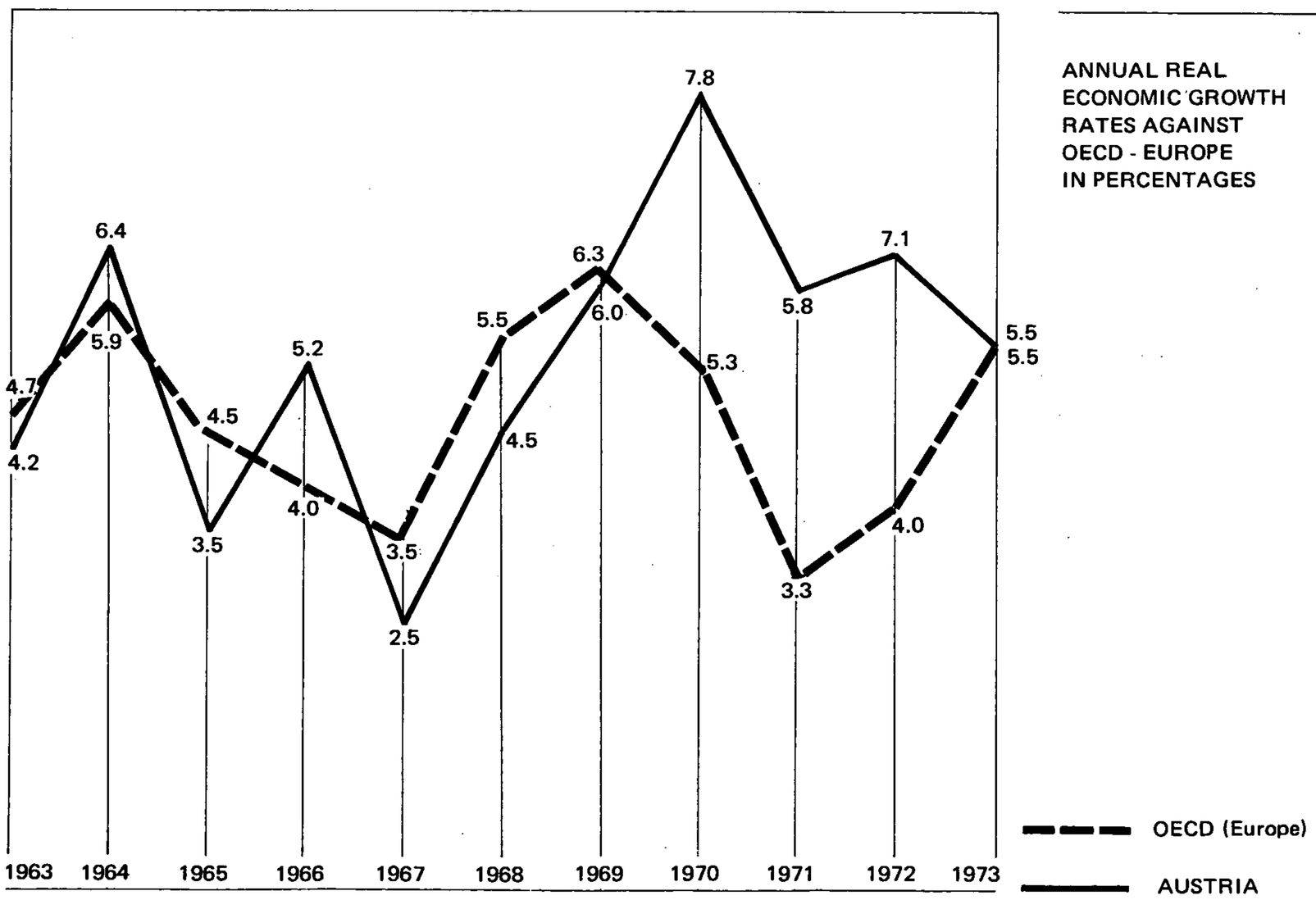
Diese Unterscheidung ist insofern problematisch, als sie erstens fliessend ist und zweitens die Überwälzbarkeit auch von der jeweiligen wirtschaflichen Situation abhängt. So können in Boomzeiten Einkommens- und Vermögenssteuern relativ leicht auf die Preise aufgerechnet werden, während Erhöhungen von indirekten Steuern in Rezessionszeiten meist nicht voll weitergegeben werden können. In Österreich ist der Anteil von direkten und indirekten Steuern am gesamten Steueraufkommen in den letzten Jahren praktisch konstant geblieben.

Stark zurückgegangen ist die fiskalische Bedeutung der Zölle. Seit dem Jahr 1967 sind die Zölle für industrielle Fertigwaren aus den Mitgliedsstaaten der Europäischen Freihandelsassosiation (EFTA) beseitigt. Mit dem 1. Juli 1977 haben die Zollsenkungen für industrielle Erzeugnisse aus der Europäischen Gemeinschaft (EG) ihre letzte Etappe erreicht. Damit werden rund 73% der österreichischen Importe und rund 60% der österreichischen Exporte im "grossen europäischen Freihandelsraum" abgewickelt.

Allein der Zollabbau gegenüber der EG verursacht heuer einen Einnahmenausfall im Vergleich zum Zollniveau von 1970 von etwa 9 Mrd S.

Allerdings ist der Verzicht auf Zolleinnahmen längerfristig gesehen kein "Verlustgeschäft". Die Erfahrung hat gezeigt, dass die Beseitigung von tariflichen und nicht-tariflichen Handelshindernissen zu einer wesentlichen Belebung des Aussenhandels führt.

Selbst dort, wo der Verzicht auf Eingangsabgaben einseitig, z.B. als unilaterale Massnahme zugunsten der



Exporte der Entwicklungsländer erfolgte, kann eine Zunahme des Warenaustauschs registriert werden. Während noch im Jahr 1974 der Anteil der österreichischen Exporte in Entwicklungsländer 8,5 Prozent betrug, erhöhte er sich im Folgejahr bereits auf 11,5 Prozent. Auch 1976 war eine deutlich steigende Tendenz zu verzeichnen.

Der materielle Wohlstand, das eng geknüpfte soziale Netz einerseits, das in vielen Bereichen unterentwickelte Bewusstsein für die Kosten öffentlicher Einrichtungen andererseits, legen es nahe, für die Erstellung öffentlicher Leistungen in Zukunft vermehrt den Benützern die Kosten zuzurechnen, wobei sozial differenziert werden soll.

Die Steuerpolitik und das Steuerwesen haben in Österreich, wie in allen modernen Industriestaaten, eine grosse Bedeutung. Ihre kontinuierliche, zweckgerichtete Anpassung an die sich ändernden wirtschaftlichen Verhältnisse, seien sie national oder international verursacht, ist notwendig.

Ziel ist ein harmonisches Zusammenspiel aller Bereiche der Wirtschaftspolitik zur Erreichung der Gesamtstabilität.

The role of taxation in the Austrian economy

VICE CHANCELLOR
FEDERAL MINISTER OF FINANCE
DR. HANNES ANDROSCH

Hannes Androsch was born in Vienna on April 18, 1938. He studied at the School for World Trade and received his diploma from that institution with a paper on questions of the fiscal balance sheet and theory of balance sheets and his doctorate with a thesis on investment planning.

From 1956 to 1966 Dr. Androsch worked as an auditor, and thereafter as a chartered accountant and tax consultant. In the Austrian Socialist Party he was the Secretary with responsibility for economic matters and latterly consultant to The Socialist Members of Parliament Group from 1963 to 1966. He has belonged to the socialist movement from his youth and in 1967 was elected as a member of parliament. He is married with two children.

On April 21, 1970 at the age of 32, he was appointed Federal Finance Minister, the youngest Finance Minister which Austria has ever had.

During his term of office as Finance Minister, Dr. Androsch placed considerable emphasis on the development of the Austrian economy. Since 1970 he was, unlike any other finance minister before him, confronted with the problem of an unstable currency situation and succeeded in making the Austrian schilling one of the most stable currencies in the world. In 1972 the integration of Austria into the European Market was completed by virtue of the Arrangement with the E.E.C. Besides bringing Austria into line with the European system of value added tax by changing to that system from the old turnover tax system in 1973, a number of income and wage tax reforms took place including a basic revision of the income tax law in 1972 and the introduction of a new interstate financial adjustment at the beginning of 1973. By steering an economic course aimed at security of employment and stability Dr. Androsch succeeded in greatly restricting the effects on the Austrian economy of the worst economic recession facing Western industrial states since the Second World War. His appointment as Vice Chancellor on October 1, 1976 is the acknowledgement of the success of this economic course.

The levying of taxes and the structure of the rate schedule have from time immemorial been a highly controversial topic of general discussion.

In the Middle Ages the question which people asked themselves in particular was whether from a moral point of view, taxes could be levied at all. In his "*Summa theologiae*" Thomas Aquinas entitles the chapter on taxation "*Can robbery take place without sin?*" The question is answered in the affirmative with references to the obligation of the ruler to care for the common good, subject to the principle of justice being observed.

In a state governed by an absolute ruler taxation is justified by the ideal of the powerful state.

"*A monarch who has no treasure in his coffers but relies on the goodwill of his subjects and lands is in a perilous position; for the minds of subjects are like faulty tools with which one cannot produce good work.*"
(Wilhelm Freyherr von Schröder: Fürstliche Schatz und Rent-Cammer)

At the present day finance policy has changed to the extent that the citizen is no longer merely regarded as a source of income or an economic entity whose decisions should be respected but as the "potential implementer of politically desirable goals".
(G.B. Schmölders)

It is from this angle that taxes and tax policy should be considered and understood.

Taxes fulfil many functions:

As well as fulfilling a financial function, i.e. providing revenue to cover expenditure, they also have the function of influencing the distribution of income. The progressivity of the tax schedule as well as the introduction of deductions, amounts exempt from tax, exemption limits etc., which are linked to certain social indications, are particularly useful in this respect. Because of ever-present tax loopholes, but also in order to avoid creating an all too casuistic tax system, a redistribution of income through means of taxes is only possible to a limited extent. Tax policy and expenditure policy must be looked at together here since redistribution of income can be strongly influenced by means of state expenditure. Taxes and the form which the tax system takes can also be adapted to conform to the general objectives of economic and social policy. Thus, for example, tax incentives may be given in order to encourage investment (provisions relating to depreciation, reduced rates of tax etc.) or in order to influence consumption, both as regards the level of consumption (encouragements to save) and the pattern of consumption (differential rates of consumption taxes, additional or exclusive taxation of particular consumer goods).

Tax provisions can also help in preventing damage to the environment and in enforcing the saving of raw materials.

One function of tax, but also of other forms of revenue, which is unfortunately generally overlooked, is its function in relation to the provision of information. On the other hand the various tax statistics form an important basis in drawing up the economic balance sheet for previous years (ex post-information) and on the other hand certain kinds of taxes and revenue can be referred to as economic indicators. Amounts which respond relatively quickly such as wages tax, social security payments, payroll tax and also to a certain extent certain consumption taxes are important for purposes of "ex ante-information". For this reason care should be taken not to water down the information content of (tax) revenue by including too many special rules in the tax legislation.

At the moment, taxes and assimilated revenue account for around 39 percent of the gross national product. Only ten years ago this amounted to 35 percent. The gap between political responsibility and economic benefit has meant, moreover, that this increase was principally laid at the door of the Federation. While it is true that around 70 percent of taxes are levied by the Federation, the tax revenue attributable to the Federation expressed as a proportion of the gross national product dropped from 14,8 percent in 1970 to 14.1 percent in 1976. It is the social security bodies and also other territorial administrative bodies which have in the main benefited from the increase in the tax quota.

In 1976 taxes accounted for only 57.8 percent of total Federal revenue and only 46.3 percent of total expenditure was covered by tax revenue attributable to the Federation.

As a result of the anti-cyclical Budget policy used to combat the recession and unemployment, the gross budget deficit increased to 42.8 percent of net tax revenue, while the financial debt has increased to 60.3 percent of total expenditure.

This means, however, that no leeway is allowed in the budgetary situation for inopportune and excessive reductions in taxation.

On the other hand, the danger exists that taxation will reach such limits, that even in countries with a high tax morality people will refuse or abstain from paying taxes. As is the case with all psychological limits there is no possibility of fixing them exactly for once one recognises that they exist then they have already been overstepped.

A reintroduction of the economic policy margin in matters of budget policy must in the first place be linked to expenditure. The necessary steps to achieve this have already been initiated.

There is a wide-ranging variety of tax tools available to the Austrian authorities. These range from the monopoly taxes dating from the time of absolute government to the value added tax introduced in 1973.

Objectives of economic and income redistribution policy are of major importance, particularly where the profit related taxes, i.e. assessed income tax, corporation tax and trade tax, are concerned.

With respect to income and corporate taxation the focal point in achieving regulatory objectives is the range of investment incentives which, even in an international context, can be described as comprehensive. Thus, the advantage of accelerated depreciation is of particular importance to enterprises which invest continuously. In principle, accelerated depreciation is limited to 50 percent of the original cost price or production cost of depreciable capital goods and by taking advantage of it enterprises may enjoy significant deferral of their taxes. On the basis of available statistical data the extent to which enterprises took advantage of the possibility of accelerated depreciation in 1977 is estimated at around 16 milliard Austrian schillings.

Recently, accelerated depreciation has been used more intensively as a tool for carrying out measures of structural or cyclical policy. Thus, as part of the measures aimed in particular at stabilising the economy introduced in the 1974 amendment to the income tax law, accelerated depreciation for immovable business assets was basically abolished. In certain cases, however, it was still allowed as, for instance, in the case of investment in projects for the protection of the environment and investment aimed at improving the structure of the tourist industry. On the other hand a measure accompanying the abolition of accelerated depreciation shortened the depreciation period for industrial buildings and that to 20 years, in general.

The critical situation in the building industry at the beginning of 1976 caused the Federal government to introduce measures designed to encourage expansion specially for this sector. For building projects started after the beginning of the 1976 calendar year a 50 percent accelerated depreciation of production costs was introduced limited to the calendar years 1976 and 1977. This, together with further measures, led to a not inconsiderable increase in the total amount of building carried out in the year 1976. An extension of the possibility for accelerated depreciation for buildings has been provided for the years 1978 and 1979, but at reduced rates (30 percent and 25 percent, respectively).

As an alternative to accelerated depreciation the so-called investment exemption may also be claimed; this, in effect, is equivalent to depreciating the replacement value. The amount of this exemption does not vary for movable and immovable business assets and as a result reduces the incentive to acquire assets purely for tax reasons — assets which, in truth, represent a non-investment.

Enterprises which invest continuously but the construction of whose investments takes an extremely long time to complete (e.g. power station works) may apply the investment incentives of accelerated depreciation and the investment exemption to that part of the construction costs relating to individual years of construction.

Enterprises which do not require continuity of investment have the possibility open to them of making tax-free savings of funds for future investment in the form of so-called investment reserves; this is limited to a certain percentage of profits, however.

In the case of enterprises which because of the size of their business only have a relatively small amount of investment resources at their disposal, a strengthening of their equity should result from the favourable tax treatment of non-distributed profits.

As a result of undervaluations and also to a certain extent of the nominal value principle, hidden reserves will be released on the alienation of assets. Whithout the existence of special tax measures adjustments to avoid capital erosion would be impeded. Thus, where there is a certain minimum relationship with the business such hidden reserves can be favourably dissolved (debiting undisclosed hidden reserves to acquisition costs of other business assets, to a certain extent, also, reduced tax rates).

While this measure serves primarily to encourage the mobility of capital, considerations of economic policy relating to reconstructions led to the passing of the Structural Improvement Law (Strukturverbesserungsgesetz); this Law contains rules for the various taxes which differ from the general provisions of taxation. As a result, this should enable the required reconstruction to take place or facilitate it. While the Law originally applied for a period of two years it has — with the exception of one article — already been extended more than once and is at the present time in force. A further extension is expected after the end of this year.

The export industry is also stimulated as a result of measures relating to taxation. Thus, a rough adjustment of value is provided for claims in connection with export transactions as compensation for possible financial bottlenecks resulting from long terms of payments in the export industry. As a result of the increase in multilateral foreign trade favourable tax treatment is provided fo

certain capital participations by Austrian enterprises abroad.

Tax measures also influence the capital market. Thus, the tax incentive given for the acquisition of fixed interest securities increases demand on the bond market; issues of shares on capital increases which benefit from incentives also have consequences on the capital market. In addition there are also various indirect incentives in the form of tax exemptions for interest from securities acquired under this incentive.

Consumption taxes are usually considered as indirect taxes, which are deemed to be capable of being shifted, in contrast to direct taxes which are not regarded as such.

This distinction is problematic to the extent that it is in the first place fluid and in the second place, whether the tax can be passed on depends on the economic situation at the time. Thus, in boom situations income and net worth taxes can relatively easily be shifted in prices, while in times of recession increases in indirect taxes cannot generally be passed on completely. In Austria, the proportion of direct and indirect taxes in total tax revenue has remained virtually constant over the last few years.

The significance, from a fiscal point of view, of customs duties has decreased greatly. Since 1967 customs duties on manufactured products from the Member States of the European Free Trade Association (EFTA) have been abolished. On July 1, 1977 reductions of customs duties on industrial products from the European Community (EEC) reached their final stage. Therewith, around 73 percent of Austrian imports and 60 percent of Austrian exports will be effected within the framework of the "European free trade area" in its widest context.

The reduction in customs duties vis-a-vis the EEC alone will cause a drop in revenue this year of around 9 milliard schillings as compared to revenue from customs duties in 1970.

To be sure, the waiving of revenue from customs duties cannot, from a long term point of view, be seen as a "loss transaction". Experience has shown that removal of tariff and non-tariff restrictions on trade lead to a considerable invigoration of the foreign trade situation.

Even where the waiving of import duties was unilateral e.g. when a unilateral measure resulted in benefits for exports of developing countries, an increase in trade can be noted. While in 1974 Austrian exports accounted for 8.5 percent of exports to developing countries, this had already increased in the following year to 11.5 percent. In 1976, too, a clear upward tendency was to be observed.

Material prosperity and the tightly knit social structure on the one hand, and an underdeveloped consciousness in many areas as to the cost of public institutions on the other make it clear that when public services are set up in the future the costs will have to be charged to a greater extent to the users of such services, but at the same time, for social reasons, differentiations will have to be made.

In Austria, as in all modern industrial states, tax policy and taxation are of great significance. Their continual and appropriate adjustment to changes in economic relationships, whether on the national or international level, is vital.

A harmonious co-operation between all areas of economic policy is aimed at in order to achieve all-round stability.

Importance de la fiscalité dans l'économie autrichienne

DR. HANNES ANDROSCH
VICE-CHANCELIER
MINISTRE FEDERAL DES FINANCES

L'imposition de contributions et la structure des taux a toujours été un sujet de discussions très contreversé dans la Société.

Au moyen-âge on se préoccupait surtout de la question de savoir si d'un point de vue moral, l'imposition de contributions était même admissible. C'est ainsi que le chapitre traitant de la fiscalité dans l'ouvrage de Thomas d'Aquin "*Summa theologiae*" est intitulé: "*Peut-il y avoir brigandage sans péché?*" L'auteur y répond par l'affirmative en renvoyant à l'obligation qu'avait le souverain de tenir compte du bien commun tout en respectant le principe d'équité.

Dans un Etat de régime absolu l'imposition est justifiée par l'idéal d'Etat puissant.

"*Un monarque sans trésor qui s'appuie sur la bonne volonté de ses sujets et sur ses provinces est comme un homme qui marche sur des échasses, car les esprits des sujets ressemblent à des chiens boîteux incapables de rattrapper le lièvre pourchassé*" (Wilhelm Freyherr Von Schröder: Fürstliche Schatz- und Rent-Cammer).

De nos jours la politique financière a évolué dans la mesure où le citoyen n'est plus considéré comme source de revenu ou entité économique, dont les décisions doivent être respectées, mais

Hannes Androsch est né le 18 avril 1938 à Vienne. Etudiant de "la Hochschule für Welthandel", il obtient son diplôme en faisant une étude sur la question des bilans fiscaux et des théories des bilans, son doctorat porte sur la planification des investissements.

Dr. Androsch est réviseur de 1956 à 1966 et travaille ensuite indépendamment comme expert comptable et conseiller fiscal. Dans le groupe parlementaire du SPÖ (Parti socialiste autrichien) Hannes Androsch occupe successivement de 1963 à 1966 le poste de secrétaire aux questions économiques puis de conseiller du groupe de députés socialistes; le Dr. Androsch appartient depuis sa jeunesse au mouvement socialiste. Il est élu député au Conseil National en 1967. Il est marié et père de deux enfants.

Le 21 avril 1970 Dr. Androsch est appelé au poste de Ministre des Finances du Gouvernement Fédéral; à 32 ans il est le plus jeune Ministre des Finances autrichien.

Le Ministre des Finances Hannes Androsch a mis essentiellement l'accent sur le développement de l'économie autrichienne. A partir de 1970 il est confronté comme aucun autre ministre des finances avant lui au problème de l'instabilité du monde monétaire où il a pu faire du Schilling l'une des monnaies les plus stables du monde. L'intégration de l'Autriche dans le Marché Européen est réalisé en 1972 par l'accord avec la Communauté Européenne. A côté de la réforme de l'ancien système de l'impôt sur le chiffre d'affaires en 1973, necessaire pour s'adapter au système européen de la TVA, a lieu une série de réformes de l'impôt sur le revenu et de l'impôt sur les salaires. On notera parmi elles en 1972 transformation complète de la loi de l'impôt sur le revenu et au début de 1973 l'entrée en vigueur d'un nouveau système de péréquation financière entre les différents états de la Fédération. Le ministre des Finances Androsch réussit, par une politique économique fondée sur la sécurité de l'emploi et la stabilité, à ce que l'économie autrichienne ne soit touchée que faiblement par les conséquences de la crise économique la plus grave que les Etats industriels de l'Europe de l'Ouest ont connu depuis la deuxième guerre mondiale. La consécration du succès de la voie suivie par la politique économique est la nomination de Hannes Androsch au poste de Vice Chancelier de 1er octobre 1976.

"comme quelqu'un qui pourrait assumer une attitude politique exemplaire" (G.B. Schmölders).

C'est dans cette optique qu'il fait ajourd'hui examiner la fiscalité et la politique fiscale.

Les impôts remplissent de nombreuses fonctions.

A côté du rôle qu'ils tiennent dans le régime financier, à savoir créer des recettes pour couvrir les dépenses, ils ont aussi pour mission d'influencer la répartition des revenus. C'est avant tout la progressivité des taux ou l'application, en relation avec certains facteurs sociaux, de déductions, d'abattements, d'exemptions etc. qui jouent un rôle prépondérant à cet égard. En raison des lacunes d'imposition toujours inévitables, mais aussi pour éviter un système d'imposition pas trop casuistique, la possibilité de redistribution des revenus par l'intermédiaire de l'impôt est limitée. La politique fiscale et la politique des dépenses doivent être considérées ici comme complémentaires, la répartition des revenus pouvant être fortement influencée par la structure des dépenses. Les impôts et la forme que revêt le système fiscal peuvent également être adaptés aux buts poursuivis par la politique économique ou sociale. Ainsi par exemple des facilités fiscales pourront être accordées pour encourager la tendance aux investissements (des dispositions concernant les amortissements, des réductions d'impôt etc.) ou pour influencer la consommation aussi bien en ce qui concerne son niveau (encouragement à l'épargne) que sa structure (tarifs progressifs applicables aux impôts de consommation, imposition complémentaire ou unique de certains biens de consommation).

Des dispositions fiscales peuvent aussi jouer un rôle dans la prévention de la pollution et autres dégradations de l'environnement et contribuer à la sauvegarde des matières premières.

L'impôt a également une autre fonction (valable aussi pour d'autres recettes) malheureusement souvent négligée, celle de fournir des informations. Les différentes statisques fiscales constituent d'une part une base importante pour le redressement du bilan économique national des années passées ("information ex-post") et d'autre part certains impôts et autres recettes peuvent être considérés comme des indicateurs conjoncturels. Des montants qui se modifient relativement vite comme ceux provenant des différents impôts et taxes perçus sur les salaires, des contributions de sécurité sociale, et dans une certaine mesure quelques impôts de consommation sont importants pour une "information ex-ante". C'est pourquoi on doit éviter de noyer l'information provenant des recettes fiscales par de trop nombreuses règles d'exceptions à l'intérieur de la législation fiscale.

Actuellement les impôts et les recettes para-fiscales correspondent à 39 pour cent du produit national brut. Il y a 10 ans ils ne correspondaient qu'à 35 pour cent. En raison du fossé qui sépare la responsabilité politique des bénéfices économiques cette augmentation s'est trouvée essentiellement à la charge de la Fédération. Bien que la Fédération perçoive environ 70 pour cent des impôts, la part des recettes fiscales lui revenant finalement et correspondant au produit national brut est tombé de 14,8 pour cent en 1970 à 14,1 pour cent en 1976. Non seulement les organisations de sécurité sociale mais également d'autres institutions administratives régionales sont les principales bénéficiaires de l'augmentation de la charge fiscale.

En 1976 le montant des impôts ne représentaient que 57,8 pour cent des cettes publiques alors que seulement 46,3 pour cent des dépenses publiques étaient couvertes par les recettes fiscales revenant à la Fédération.

En raison de la politique budgétaire anti-cyclique menée pour lutter contre la récession et le chômage, le déficit brut s'est élevé à 42,8 pour cent des recettes fiscales nettes et la dette financière s'est élevée à 60,3 pour cent des dépenses publiques.

Ceci signifie qu'en matière budgétaire, aucune marge n'est laissée pour une réduction d'impôts inopportune et excessive.

D'autre part il existe le danger que la fiscalité atteigne des limites, qui, même dans des pays à haute moralité fiscale, ont donné lieu à des réactions entraînant le refus ou l'abstention de paiement d'impôts.

Comme toutes les limites psychologiques il n'est pas possible de les déterminer exactement. Au moment où on les reconnaît, elles ont déjà été dépassées.

Afin de rétablir la marge politico-conjoncturelle de la polique budgétaire il y a lieu de prendre des mesures dans le cadre des dépenses; une amorce a déjà en lieu en ce sens.

L'appareil fiscal autrichien est très différencié. Cela va des taxes de monopole, qui datent de la période de l'absolutisme, à la taxe sur la valeur ajoutée qui a été introduite en 1973.

Des objectifs financiers et de politique de redistribution des revenus se poursuivent surtout par rapport aux impôts portant sur les bénéfices, à savoir l'impôt direct sur le revenu, l'impôt sur les sociétés et la patente.

L'éventail des mesures d'encouragements aux investissements, qui même au niveau international est considéré comme étant abondant, représente, en matière d'imposition sur le revenu et les sociétés, l'essentiel des objectifs politiques. Par exemple, la mesure d'encouragement que constitue l'amortissement accéléré est d'une importance particulière pour les entreprises qui effectuent des investissements de façon continue. En principe l'amortissement accéléré est limité à 50 pour cent du prix d'achat original ou des coûts de production des biens d'investissements amortissables et son emploi permet un report d'imposition important. Sur la base de données statistiques, on peut estimer à environ 16 milliards de Schillings le montant des amortissements accélérés dont ont pu bénéficier les entreprises en 1977.

Ces derniers temps l'amortissement accéléré a été plus fréquemment utilisé comme instrument de mesures structurelles et conjoncturelles. Ainsi la loi modifiant, en 1974, la loi des impôts sur le revenu qui avait surtout pour but d'introduire des mesures de stabilisation conjoncturelle a supprimé en principe l'application de l'amortissement accéléré pour les biens d'exploitation immobiliers. Mais il restait néanmoins applicable dans certains cas, ainsi par exemple pour les investissements pour la protection de l'environnement et ceux d'amélioration des structures dans le domaine de l'industrie touristique. D'un autre côté, comme mesure complémentaire à la suppression de l'amortissement accéléré, la durée d'amortissement pour les bâtiments d'entreprises a été considérablement raccourcie; elle est en général de 20 ans.

La situation critique dans le domaine de la construction au début de l'année 1976 a amené le gouvernement fédéral à prendre des mesures expansionnistes dans ce secteur. Pour les projets de construction commencés au début de l'année civile 1976, un amortissement accéléré de 50 pour cent été introduit pour les coûts de production; son application est limitée aux années 1976 et 1977. Ceci a permis, en combinaison avec d'autres mesures, une augmentation considérable de la construction pour l'année 1976. Une prolongation de la possibilité d'amortissement accéléré applicable aux bâtiments est prévue pour les années 1978 et 1979, mais à des taux respectivement à 30 pour cent et 25 pour cent.

Il est également possible au lieu de l'application de l'amortissement accéléré, de demander ce qui l'on appelle une "exemption d'investissement" qui produit le même effet qu'un amortissement sur la base de la valeur de remplacement. Le montant de cette exemption ne varie pas selon qu'il s'agit de biens mobiliers ou immobiliers et réduit par la-même une incitation aux acquisitions de biens pour des raisons purement fiscales, qui ne sont en réalité que des investissements fallacieux.

Pour les entreprises qui effectuent en permanence des investissements nécessitant une très longue période d'exécution (par exemple des constructions de stations d'électricité), les encouragements aux investissements par l'intermédiaire d'amortissements

accélérés ou d'exemptions d'investissements pourront déjà être appliqués aux montants des frais de production correspondants à chaque année de production.

Les entreprises qui n'ont pas à effectuer en permanence des investissements ont la possibilité de constituer une forme de provision non imposable destinée aux investissements futurs sous la forme d'une "provision pour investissement", toutefois limitée à un certain pourcentage du bénéfice.

Pour les entreprises qui ne disposent, relativement, que d'un faible volume d'investissements l'avantage des bénéfices non-distribués permettra la consolidation du capital propre.

Lors de la cession de biens des réserves occultes sont révélées par suite de sous-estimations et, dans une certaine mesure, par suite de l'application du principe de la valeur nominale. Le redressement du capital ne serait pas possible sans l'existence de dispositions fiscales appropriées. C'est pourquoi lorsqu'il existe un certain rattachement à l'entreprise, il sera possible de liquider favorablement ces réserves occultes. (Transfert des réserves occultes révélées sur les prix d'acquisition d'autres biens de l'entreprise, dans une certaine mesure réductions de taux d'imposition.)

Alors que cette mesure a surtout pour but d'encourager la mobilité du capital, des considérations politico-structurelles ont conduit au vote d'une "loi d'amélioration des structures" (Strukturverbesserungsgesetz), loi contenant des mesures pour différents impôts qui s'écartent des dispositions fiscales générales. Ceci devra rendre possible, voire faciliter l'adaption des structures des entreprises. Alors que cette loi ne devait être à l'origine applicable que pendant deux ans, elle a déjà été prolongée plusieurs fois (à l'exception d'un article) et est encore actuellement en vigueur. Une autre prolongation est prévue l'année prochaine.

L'industrie d'exportation est, elle aussi, encouragée par des mesures à caractère fiscal. Ainsi une réévaluation forfaitaire des créances d'exportation est prévue comme compensation à des "bouchons" financiers éventuels dus aux longs délais de paiements dans le domaine d'exportations. En raison d'une augmentation croissante du commerce avec l'extérieur, un encouragement fiscal approprié est prévu pour certains investissements en participations réalisés par les entrepreneurs autrichiens à l'étranger.

Les mesures fiscales influencent également le marché des capitaux. Ainsi l'encouragement fiscal applicable à l'acquisition de valeurs mobilières à intérêts fixes stimule la demande sur le marché des emprunts; l'émission d'actions correspondante à l'augmentation de capital et bénéficiant d'un régime de faveur a également des conséquences sur le marché des capitaux. Différentes exonérations fiscales applicables aux intérêts sur les valeurs mobilières acquises sous un régime de faveur viennent s'ajouter indirectement aux mesures d'encouragement.

Les impôts de consommation sont généralement classés dans la catégorie des impôts indirects qui sont considérés comme pouvant être répercutés, à la différence des impôts directs qui ne le sont pas.

Cette distinction est dans une certaine mesure source de problèmes; elle est tout d'abord instable, la possibilité de transfert dépend en outre de la situation économique du moment. Ainsi dans les périodes d'expansion les impôts sur le revenu et le capital peuvent être plus ou moins facilement répercutés sur les prix, tandis que dans les périodes de récession les augmentations des impôts indirects ne peuvent généralement pas être complètement transférées. En Autriche la proportion des impôts directs et indirects à la recette fiscale totale est pratiquement restée constante au cours de ces dernières années.

L'importance fiscale des droits de douane s'est considérablement réduite. A partir de 1967 les droits de douane portant sur les produits finis industriels en provenance des Etats membres de l'Association Européenne de Libre Echange (AELE) ont été supprimés. A partir du 1er juillet 1977 les réductions des droits de douane pour les produits industriels en provenance de la Communauté Européenne (C.E.) sont entrées dans leur dernière étape. Environ 73 pour cent des importations autrichiennes et environ 60 pour cent des exportations autrichiennes seront ainsi réalisées dans la zone européenne de libre échange prise au sens large.

La réduction des droits de douane vis-à-vis de la C.E. est à l'origine actuellement d'une chute des recettes d'environ 9 milliards de Schillings par rapport au niveau des droits de douane perçus en 1970.

A long terme, le renonciation aux recettes tirées de la perception des droits de douane n'est d'ailleurs pas une opération à pertes. L'expérience a montré que la suppression de restrictions commerciales tarifaires et non-tarifaires stimule considérablement le commerce extérieur.

Même lorsque la renonciation aux droits d'entrée est unilatérale, par example comme mesure en faveur des exportations des pays en voie de développement, on peut constater un accroissement des échanges commerciaux. Alors qu'en 1974 la part des exportations autrichiennes vers les pays en voie de développement était de 8,5 pour cent, l'année suivante elle était déjà de 11,5 pour cent. En 1976 également on pouvait noter une tendance très nette à l'augmentation.

Le bien-être matériel, une structure sociale aux mailles serrées d'une part, une conscience peu développé dans de nombreux domaines quant aux coûts des institutions publiques d'autre part, révèlent la nécessité, lors de la création de services publics ultérieurs, de mettre une plus grande partie des frais à la charge des usagers sans oublier de tenir compte des différences sociales.

La politique fiscale et la fiscalité tiennent en Autriche une place importante comme dans tous les pays industriels modernes. Leur adaptation permanent et adéquate aux modifications des relations économiques, qu'elles soient d'origine nationale ou internationale, est nécessaire.

Une coopération harmonieuse de tous les domaines de la politique économique est le but qu'il faut se donner pour tendre vers une stabilité générale.

Grundbelange der österreichischen Steuerrechtsordnung insbesondere in ihrem Verhältnis zum internationalen Steuervertragsrecht*



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Dr. Gerold Stoll
Wien

Dr. Gerold Stoll: *geboren 1925 zu Wien, Studium für Rechtswissenschaften an der Universität Wien, nach Promotion (1948) Eintritt in die österreichische Abgabenverwaltung des Bundes, ab 1949 in der Mittelinstanz, ab 1958 im Bundesministerium für Finanzen tätig, zuletzt als Abteilungsleiter (Sektionsrat) für Abgabenverfahrensrecht einschliesslich Legistik verantwortlich. 1967 Habilitation an der rechts- und staatswissenschaftlichen Fakultät der Universität Graz für Finanzrecht, Ende 1968 Berufung an die Rechtswissenschaftliche Fakultät der Universität Wien als Ordinarius für Finanzrecht, Vorstand am Institut für Staats- und Verwaltungsrecht; hier u.a. Präses der staatswissenschaftlichen Staatsprüfungskommission.*
1973 zum korrespondierenden, 1974 zum wirklichen Mitglied der österreichischen Akademie der Wissenschaften gewählt.
Herausgeber der Reihe "Schriften zum österreichischen Abgabenrecht" (Wirtschaftsverlag ORAC, Wien). Bisher 13 Bände erschienen.

Hauptsächliche Publikationen (neben Fachartikeln)

a) Rentenbesteuerung, Monographie, 2. Auflage 1967; 3. Auflage in Vorbereitung;
Ermessen im Steuerrecht, 1970.
Die Besteuerung der Genossenschaften, Wien 1972.
Das Steuerschuldverhältnis in seiner grundlegenden Bedeutung, Wien 1972.
Leasing, Steuerrechtliche Beurteilungsgrundsätze, 2. Auflage, 1977
Ertragsbesteuerung der Personengesellschaften, 1977.

b) Gemeinsam mit Min. Rat. Dr. Franz REEGER
Kommentar zur Abgabenexekutionsordnung, 1963.
Kommentar zur Bundesabgabenordnung, 1965.
Handbuch zur Bundesabgabenordnung, 5. Auflage 1975.

c) Gemeinsam mit Univ. Prof. Dr. Walther KASTNER
Die Gesellschaft mit beschränkter Haftung u. Co KG im Handels-, Gewerbe- und Steuerrecht, 2. Auflage, 1977.

Es entspricht den Regeln der Gastfreundschaft, gerne gesehene Gäste in ihre neue ungewohnte Umgebung einzuführen, um ihnen hier ein Zurechtfinden zu erleichtern.
Ich habe nun den ehrenvollen Auftrag angenommen, den sehr willkommenen Teilnehmern des XXXI. IFA-Kongresses eine vergleichsweise ähnliche Führung anzubieten. Mit ihrer Hilfe soll ein Einblick in die Grundbelange der österreichischen Steuerrechtsordnung, vor allem der österreichischen Finanzverfassung, des Verhältnisses der Abkommen zur Vermeidung der Doppelbesteuerung (also des Völkerrechtes) zum innerstaatlichen Recht, des österreichischen Abgabenverwaltungsverfahrens- und Organisationsrechtes, sowie des administrativen und gerichtlichen Rechtsschutzes in Steuersachen verschafft werden.
Dass diese Einführung nur in groben Grundzügen und skizzenhaft erfolgen kann, liegt an den mir von den Veranstaltern aus verständlichen redaktionellen Gründen gesetzten engen Grenzen.

I. Doppelbesteuerungsabkommen und das innerstaatliche Recht Österreichs

Doppelbesteuerungsabkommen stellen primär eine Rechtsquelle des Völkerrechtes dar. Die von den Vertragstaaten eingegangenen völkerrechtlichen Verpflichtungen müssen jedoch in ihrem Staatsgebiet vollzogen werden; das Doppelbesteuerungsabkommen muss daher in der innerstaatlichen Rechtsordnung der Vertragstaaten zur Geltung gebracht werden. Diese Eingliederung eines zwischenstaatlichen Vertrages in den innerstaatlichen Normenbereich ist im Völkerrecht nicht besonders geregelt; es handelt sich hiebei sonach um ein allgemeines staatsrechtliches Problem, das in der Folge am Beispiel Österreichs behandelt wird.
Neben dieser allgemeinen Frage der Aufnahme eines zwischenstaatlichen Vertrages in die innerstaatliche Rechtsordnung, ergeben sich bei der Anwendung von Doppelbesteuerungsabkommen noch zahlreiche andere Berührungspunkte mit dem innerstaatlichen Abgabenrecht, die teilweise im internationalen Steuervertragsrecht selbst und teilweise durch die nationale Auslegungspraxis einer Klärung zugeführt worden sind.

* See for English version 368 — Version française, voir page 381

A. DIE AUFNAHME DES DOPPELBESTEURUNGS-ABKOMMENS IN DIE INNERSTAATLICHE RECHTSORDNUNG

Wie bereits ausgeführt ist es Sache des nationalen Rechtes zu bestimmen, in welcher Weise einem zwischenstaatlichen Vertrag innerstaatlich Geltung verschafft wird. In Österreich sind die hiefür massgebenden Rechtsregeln im Bundes-Verfassungsgesetz (B-VG) in der Fassung von 1929 [1] enthalten; sie wurden zuletzt durch eine Novelle im Jahr 1964 (BGBl. Nr. 59/1964) in einzelnen Punkten ergänzt und verbessert.

Im Zusammenhang mit einer verfassungsgemässen Einordnung eines Doppelbesteuerungsabkommens in die innerstaatliche Rechtsordnung stellen sich mehrere Fragen:

1. *Welches staatliche Organ ist befugt, ein Doppelbesteuerungsabkommen abzuschliessen?*
2. *Kann der Vertragsabschluss uno actu erfolgen, oder ist ein Ratifikationsverfahren erforderlich?*
3. *Nach welcher Methode erfolgt die Aufnahme in die innerstaatliche Rechtsordnung (generelle oder spezielle Transformationsmethode)?*
4. *Welchen Rang besitzt ein Doppelbesteuerungsabkommen im Stufenbau der innerstaatlichen Rechtsordnung?*
5. *Welche Rechtsfolgen treffen ein Doppelbesteuerungsabkommen, das unter Verletzung des innerstaatlichen Rechts zustandegekommen ist?*
6. *Welche Auswirkungen ergeben sich aus dem föderalistischen Aufbau Österreichs auf den Abschluss eines Doppelbesteuerungsabkommens?*

1. Das zum Abschluss eines Doppelbesteuerungsabkommens berufene Staatsorgan

Nach der österreichischen Bundesverfassung steht das Recht zum Abschluss von Staatsverträgen grundsätzlich nur dem Bundespräsidenten zu (Art. 65 Abs. 1). Die Bundesverfassung räumt allerdings dem Bundespräsidenten die Befugnis ein, auch die Bundesregierung und die einzelnen Bundesminister zum Abschluss solcher Staatsverträge zu ermächtigen, die weder gesetzändernder noch gesetzesergänzender noch politischer Art sind. Von dieser Befugnis hat der Bundespräsident bereits bei Inkrafttreten der Bundesverfassung im Jahr 1920 Gebrauch gemacht und hat zum Abschluss von "Regierungsübereinkommen" die Bundesregierung, zum Abschluss von "Ressortübereinkommen" den sachlich zuständigen Bundesminister im Einvernehmen mit dem Bundesminister für Auswärtige Angelegenheiten und zum Abschluss von "Verwaltungsübereinkommen" den sachlich zuständigen Bundesminister ermächtigt (Art. 66 Abs. 2 B-VG. und die darauf fussende Entschliessung des Bundespräsidenten vom 31. Dezember 1920, BGBl. Nr. 49/1921).

Die innerstaatliche Abschlussberechtigung für einen Staatsvertrag hängt sonach in erster Linie davon ab, ob es sich um einen gesetzändernden (oder gesetzesergänzenden oder politischen) Staatsvertrag handelt. Hinsichtlich der österreichischen Doppelbesteuerungsabkommen wurde diese Frage bisher stets bejaht. Es existiert wohl eine Bestimmung des innerstaatlichen Abgabenrechtes (§ 48 der Bundesabgabenordnung) [2] die den Bundesminister für Finanzen ermächtigt, Doppelbesteuerungen zu beseitigen; und zwar nicht nur im Einzelfall durch Erlassung eines Bescheides sondern auch in genereller Form durch Setzung von auf Verordnungsstufe stehenden Rechtsakten. Es ist allerdings bisher noch nie der Versuch unternommen worden, den Abschluss eines Doppelbesteuerungsabkommens als Vollziehung dieser dem Bundesminister für Finanzen eingeräumten Ermächtigung anzusehen und demgemäss das Doppelbesteuerungsabkommen in der Form eines nicht gesetzändernden Ressortübereinkommens abzuschliessen (die zitierte Bestimmung des § 48 der Bundesabgabenordnung würde vor allem keine hinreichende gesetzliche Deckung für die Aufnahme bestimmter Nebenbestimmungen eines Doppelbesteuerungsabkommens bieten, wie z.B. der Bestimmung über den Nachrichtenaustausch oder des Diskriminierungsverbotes). Lediglich in Fällen von Doppelbesteuerungsvereinbarungen in speziellen Bereichen (z.B. der Luftfahrt) wird § 48 der Bundesabgabenordnung als gesetzliche Grundlage für den Abschluss von Ressortübereinkommen herangezogen.

Die allgemeinen Doppelbesteuerungsabkommen stellen somit einen gesetzändernden Staatsvertrag dar der verfassungsgemäss nur vom Bundespräsidenten abgeschlossen werden kann.

1. Bundesgesetzblatt (= BGBl.) Nr. 1/1930.
2. BAO., BGBl. Nr. 194/1961.

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Im Vertragsabschlussverfahren eines Doppelbesteuerungsabkommens können — wie bei allen anderen Gesetzändernden Staatsverträgen — drei Hauptphasen unterschieden werden:

1. die Phase der Vertragsverhandlungen und der Unterzeichnung (Vorverfahren);
2. die parlamentarische Genehmigung;
3. die Ratifikation (endgültiger Vertragsabschluss).

Es wird in Österreich die Auffassung vertreten, [3] dass das *gesamte* Vertragsabschlussverfahren, also einschliesslich sämtlicher Handlungen im blossen Vorverfahren, dem Bundespräsidenten obliegt. Da der Bundespräsident naturgemäss nicht in der Lage ist, alle gesetzändernden Staatsvertragsverhandlungen persönlich zu führen und alle Staatsverträgen persönlich zu unterzeichnen, muss er sich hiezu jeweils eines Bevollmächtigten bedienen.

Im Zusammenhang mit der Auswahl eines geeigneten Verhandlungsbevollmächtigten ergibt sich nach der österreichischen staatsrechtlichen Kompetenzstruktur eine weitere Frage. Da die Aushandlung eines Doppelbesteuerungsabkommens zweifellos eine "auswärtige Angelegenheit" darstellt, wäre der Verhandlungsbevollmächtigte an sich aus dem Ressort des Bundesministers für Auswärtige Angelegenheiten auszuwählen. Seit jeher wurden aber mit Rücksicht auf die besonders enge Verflechtung eines Doppelbesteuerungsabkommens mit dem innerstaatlichen Steuerrecht die Vertragsverhandlungen von einem Vertreter des Bundesministers für Finanzen geleitet. Dieses interne Kompetenzproblem ist mittlerweile auf Gesetzesebene gelöst worden (Bundesministeriengesetz 1973, BGBl. Nr. 389/1973). Nunmehr fällt wohl den allgemeinen Grundsätzen entsprechend auch die Verhandlung von Doppelbesteuerungsabkommen in den Zuständigkeitsbereich des Bundesministers für Auswärtige Angelegenheiten; doch kann dieser die Kompetenz hiefür an den Bundesminister für Finanzen übertragen. Dies ist auch tatsächlich mit Verordnung des Bundesministers für Auswärtige Angelegenheiten vom 3. Juli 1974, BGBl. Nr. 388/1974, geschehen, sodass heute Doppelbesteuerungsverhandlungen nach wie vor — nach gehöriger Bevollmächtigung durch den Bundespräsidenten — von einem Vertreter des Bundesministers für Finanzen geführt werden.

Werden mit einem anderen Staat Vereinbarungen über die blosse Durchführung eines bereits bestehenden Doppelbesteuerungsabkommens getroffen, so wird einer solchen staatsvertraglichen Vereinbarung kein gesetzändernder (oder gesetzesergänzender oder politischer) Inhalt beigemessen. Solche Durchführungsvereinbarungen werden daher als Ressortübereinkommen abgeschlossen und können demzufolge auf österreichischer Seite gemäss der vorzitierten Entschliessung des Bundespräsidenten vom Bundesminister für Finanzen (oder einem von ihm bevollmächtigten Beamten seines Ressorts) im Einvernehmen mit dem Bundesminister für Auswärtige Angelegenheiten abgeschlossen werden.

In einzelnen Fällen werden mit dem Finanzressort des anderen Staates die Modalitäten der Durchführung eines Doppelbesteuerungsabkommens im Korrespondenzweg ausgehandelt, ohne dass das Ergebnis dieser brieflichen Verhandlungen in einer formellen Staatsvertragsurkunde zusammengefasst wird. Es wird lediglich vorgesehen, dass das vereinbarte Durchführungsverfahren durch korrespondierende Durchführungsverordnungen in den beiden Staaten in Rechtswirksamkeit gesetzt wird. Auch in solchen Fällen muss wohl angenommen werden, dass die im Briefwechsel stehenden Finanzbehörden der beiden Staaten als Organe ihres Staates handeln und demzufolge nicht nur eine an die Finanzverwaltungen adressierte sondern eine die beiden Staaten als solche bindende Willenseinigung herbeigeführt haben, die als Staatsvertrag (im weiteren Sinn) anzusehen ist. Derartige im formlosen Korrespondenzverkehr erzielte Vereinbarungen erzeugen aber keine unmittelbaren Rechtswirkungen für den einzelnen Steuerpflichtigen und sind daher aus österreichischer Sicht der Gruppe der "Verwaltungsübereinkommen" zuzuordnen; gemäss der vorzitierten Entschliessung des Bundespräsidenten ist für deren Abschluss allein der Bundesminister für Finanzen — ohne Mitbefassung des Bundesministers für Auswärtige Angelegenheiten — zuständig.

2. Das Abschlussverfahren

Das Völkerrecht unterscheidet beim Abschluss von Staatsverträgen zwischen zwei Verfahren. In dem einen Fall führt bereits die Unterzeichnung des Vertrages durch das vertragschliessende Organ eines Vertragstaates die Bindung dieses Staates an den Vertragsinhalt herbei. Im anderen Fall gibt das vertragsunterzeichnende Organ seine Willenserklärung mit der Massgabe ab, dass erst eine nachfolgende Genehmigung (Ratifikation), verbunden mit dem Austausch oder der Hinterlegung der Ratifikationsurkunden die Bindung des von ihm vertretenen Staates herbeiführen soll.

Nach der österreichischen Bundesverfassung bedürfen gesetzändernde (gesetzesergänzende und politische) Staatsverträge der Parlamentarischen Genehmigung (Art. 50 Abs. 2 B-VG.) und können demnach nur im letztgenannten Verfahren (ratifikationsgebundenes Verfahren) abgeschlossen werden. Da auch Doppelbesteuerungsabkommen zu den gesetzändernden Staatsverträgen zählen, kommt sonach auch hiefür nur eine Unterzeichnung unter Ratifikationsvorbehalt in Frage.

Nach positivem Abschluss des parlamentarischen Genehmigungsverfahrens ist wie im innerstaatlichen Gesetzgebungsverfahren noch die Setzung eines Abschlussaktes durch den Bundespräsidenten erforderlich; durch seine Unterschrift billigt er das verfassungsgemässe Zustandekommen des Staatsvertrages. Dieser Rechtsakt des Bundespräsidenten bedarf sodann zu seiner Gültigkeit — ebenfalls wie im innerstaatlichen Gesetzgebungsverfahren — noch der Gegenzeichnung durch den Bundeskanzler oder den zuständigen Bundesminister.

Diese Erteilung der innerstaatlichen verfassungsgemässen Genehmigung des Abkommens muss dem anderen Vertragstaat bekanntgegeben werden. Es geschieht dies im Zuge des traditionell-feierlichen Austausches der Ratifikationsurkunden; erst damit ist der zwischenstaatliche Vertrag zustandegekommen.

Von diesem Zeitpunkt des Vertragsabschlusses ist der Zeitpunkt des Inkrafttretens, also der Zeitpunkt der erstmaligen Anwendung des Vertrages, zu underscheiden. Die in den österreichischen Doppelbesteuerungsabkommen enthaltenen Inkrafttretensklauseln sehen hiefür regelmässig eine bestimmte Frist vor, die eine vorherige

3. Z.B. *Öhlinger*, Der völkerrechtliche Vertrag im staatlichen Recht, 249.

Erfüllung der innerstaatlichen Inkrafttretensvoraussetzung — die Kundmachung im Bundesgesetzblatt — ermöglichen soll. Die österreichischen Finanzämter dürfen erst bei Veranlagungen, die sie nach der Kundmachung des Doppelbesteuerungsabkommens durchführen, die Bestimmungen des neuen Doppelbesteuerungsabkommen anwenden. Fehlt eine derartige Inkrafttretensfrist — einzelne wenige Doppelbesteuerungsabkommen sehen ein Inkrafttreten mit dem Austausch der Ratifikationsurkunden, also noch vor Vertragskundmachung im Bundesgesetzblatt, vor — so kommt es zu einer Inkrafttretensdiskrepanz zwischen Völkerrecht und innerstaatlichem Recht. Est könnte hier der eigenartige Fall eintreten, dass ein Doppelbesteuerungsabkommen, an das Österreich gemäss dem Völkerrecht bereits gebunden is, von den Finanzämtern noch nicht angewendet werden dürfte. Eine solche Diskrepanz zwischen völkerrechtlichem und innerstaatlichem Inkrafttretenszeitpunkt ist jedoch nur von theoretischer Bedeutung, da sämtliche Doppelbesteuerungsabkommen neben dem Zeitpunkt des Inkrafttretens noch einen weiteren Zeitpunkt bestimmen; nämlich den des Beginnes jenes Zeitraumes, für den erstmals das Abkommen anzuwenden ist. Dieser Wirksamkeitsbeginn, der regelmässig mit Beginn eines Steuerjahres festgelegt wird, lässt die oben aufgezeigte Problematik bedeutungslos erscheinen. Denn das Finanzamt wird mit der Durchführung der Steuerveranlagung jenes Jahres, das vom Wirksamkeitsbeginn des Abkommens erfasst ist, solange zuwarten, bis das Doppelbesteuerungsabkommen im Bundesgesetzblatt erschienen ist.

Staatsverträge, die keiner parlamentarischen Genehmigung unterliegen (nicht gesetzändernde, gesetzesergänzende, politische Verträge) können entweder im einfachen Verfahren (*uno actu*) oder im ratifikationsgebundenen Verfahren abgeschlossen werden. Soweit im Bereich des zwischenstaatlichen Steuerrechts solche staatsvertragliche Vereinbarungen abgeschlossen werden (Durchführungsvereinbarungen zu Doppelbesteuerungsabkommen), geschieht dies schon aus verwaltungsökonomischen Gründen stets im einfachen Verfahren. Es gibt indessen Fälle, in denen solche Vereinbarungen nach dem internen Recht des anderen Vertragstaates nur im ratifikationsgebundenen Verfahren zustandekommen dürfen; diesfalls würde auch auf österreichischer Seite dieses Verfahren gewählt. So wurde beispielsweise das österreichisch-deutsche Abkommen über eine gegenseitige Kraftfahrzeugsteuerbefreiung im grenzüberschreitenden Strassenverkehr,[4] das auf österreichischer Seite auf Grund einer bereits im Kraftfahrzeugsteuergesetz[5] vorgesehenen Steuerbefreiung keinen gesetzändernden Charakter hatte und sonach in der Form eines Ressortübereinkommens hätte abgeschlossen werden können, mit Rücksicht auf die Wünsche des deutschen Vertragspartners im zusammengesetzen Verfahren abgeschlossen.

3. Methode der Transformation

Staatsverträge begründen als völkerrechtliche Rechtsquellen unmittelbar nur zwischen Staaten beziehungsweise zwischen anderen Völkerrechtssubjekten Rechte und Pflichten. Demnach sind die unmittelbaren Normadressaten von Staatsverträgen in der Regel die Staaten. Die Staaten sind jedoch verpflichtet, in ihrem räumlichen Geltungsbereich die vertraglich geschaffenen Völkerrechtsnormen zu vollziehen. Das Völkerrecht überlässt es dabei dem nationalen Recht, die Methode zu bezeichnen, mit der das Völkerrecht im innerstaatlichen Recht durchgesetzt werden soll. In der Praxis bieten sich als Weg für die Eingliederung eines Staatsvertrages in die innerstaatliche Rechtsordnung zwei Methoden an. Die Transformation völkerrechtlicher Normen in Landesrecht ohne ein besonderes Verfahren (generelle Transformation) und die Umwandlung von Völkerrecht in innerstaatliches Recht durch spezielle legistische Massnahmen (spezielle Transformation).

Die österreichische Bundesverfassung hat sich so wie der Grossteil der kontinentaleuropäischen Rechtsordnungen zur Methode der generellen Transformation entschlossen. Die von Österreich abgeschlossenen Doppelbesteuerungsabkommen und die hiezu unterzeichneten Durchführungsvereinbarungen erzeugen daher als solche unmittelbare Rechtswirkungen in der innerstaatlichen Rechtsordnung, ohne dass ihre innerstaatliche Geltung von der Erlassung spezieller Rechtsvorschriften abhängt.

Die Bekennung der österreichischen Rechtsordnung zum Prinzip der generellen Transformation bringt allerdings den Nachteil mit sich, dass infolge der unveränderten und direkten Übernahme staatsvertraglicher Normen das unkontrollierte Einfliessen von der österreichischen Rechtsordnung artfremden Rechtes in Österreich nur schwer abgewendet werden kann. Durch die immer stärker werdende zwischenstaatliche Verflechtung sowie durch die oft gegebene Notwendigkeit, Vereinbarungen beizutreten oder international anerkannte Vertragsformulierungen zu übernehmen, ist es selbstverständlich unmöglich, nur Staatsverträge abzuschliessen, die der Rechtsauffassung aller Vertragstaaten gerecht werden.

Der österreichische Verfassungsgesetzgeber hat daher anlässlich einer Novellierung der Bundesverfassung im Jahr 1964 erstmals auch die Möglichkeit einer speziellen Transformation wahlweise zugelassen. Artikel 50 Absatz 2 B-VG. sieht in seiner nunmehr geänderten Fassung vor, dass der Nationalrat im Zuge des parlamentarischen Genehmigungsverfahrens eines gesetzändernden (gesetzesergänzenden oder politischen) Staatsvertrages die Erfüllung dieses Vertrages durch Erlassung von Gesetzen beschliessen kann. Bei Staatsverträgen, die keiner parlamentarischen Genehmigung bedürfen, obliegt die Anordnung der speziellen Transformation dem Bundespräsidenten oder dem sonst zum Vertragsabschluss berechtigten staatlichen Organ (Art. 65 Abs. 1 in Verbindung mit Art. 66 Abs. 2 B-VG.).

Auf dem Gebiet des Doppelbesteuerungsrechtes wurde bisher noch keine Notwendigkeit erblickt, die Erfüllung der völkerrechtlich übernommenen Verpflichtungen durch besondere Erfüllungsgesetze oder Erfüllungsverordnungen sicherzustellen; Doppelbesteuerungsabkommen und Durchführungsvereinbarungen werden daher auch nach der Verfassungsreform des Jahres 1964 ausschliesslich im Wege der generellen Transformation in die innerstaatliche Rechtsordnung aufgenommen. Dass auf ein spezielles Transformationsverfahren bei Doppelbesteuerungsabkommen verzichtet werden kann ist sicherlich zu einem erheblichen Teil darauf zurückzuführen, dass die jüngeren österreichischen Doppelbesteuerungsabkommen durchwegs auf dem Muster-

4. BGBl. Nr. 128/1971.
5. BGBl. Nr. 110/1952.

abkommen der OECD beruhen und die österreichische Administration Gelegenheit hatte, bereits bei den Beratungen in den zuständigen OECD-Gremien auf die möglichste Vermeidung von Regelungen hinzuwirken, die mit der österreichischen Rechtsordnung nicht in Einklang zu bringen sind.

LIST OF INCOME TAX TREATIES

concluded by

AUSTRIA

Treaty with	*Date of conclusion*	
Belgium	December 29, 1971	1)
Brazil	May 24, 1975	3)
Canada *	December 9, 1976	
Denmark	October 23, 1961	1) 2)
Protocol	October 29, 1970	
Egypt	October 16, 1962	1) 2) 3)
Faroe Islands **	July 11 and 14, 1967	2)
Finland	October 8, 1963	1) 2) 3)
Protocol	September 21, 1970	3)
France	October 8, 1959	1) 2)
Protocol	October 30, 1970	1)
Germany	October 4, 1954	1) 3)
Greece	September 22, 1970	1) 3)
Hungary	February 25, 1975	3)
India	September 24, 1963	1) 2) 3)
Ireland	May 24, 1966	1) 3)
Israel	January 29, 1970	2) 3)
Italy	October 31, 1925	1) 3)
Japan	December 20, 1961	1) 2) 3)
Liechtenstein	November 5, 1969	2) 3)
Luxembourg	October 18, 1962	1) 2) 3)
Netherlands	September 1, 1970	3)
Norway	February 25, 1960	1) 2)
Protocol	December 16, 1970	
Pakistan	July 6, 1970	3)
Poland	October 2, 1974	3)
Portugal	December 29, 1970	1) 3)
Romania *	September 30, 1976	
Spain	December 20, 1966	1) 3)
Sweden	May 14, 1959	1)
Protocol	April 6, 1970	
Switzerland	January 30, 1974	3)
Turkey	November 3, 1970	3)
United Kingdom	April 30, 1969	1) 2) 3)
United States	October 25, 1956	1) 2)
Yugoslavia *	May 7, 1975	3)

* = not yet in force.

** = exchange of notes: extension of Denmark — Austria treaty.

1) = published in the English language in: United Nations. Department of Economic and Social Affairs. International Tax Agreements. World Guide.

2) = published in the English language in: Treaties and international agreements registered or filed with the Secretariat of the United Nations.

3) = published in the English language in: Supplementary Service to European Taxation, Sec. C.

4. Der Rang der Doppelbesteuerungsabkommen in der innerstaatlichen Rechtsordnung

Die innerstaatliche Rechtsordnung Österreichs wird in der Gliederung eines Stufenbaues gesehen, an dessen Spitze die Verfassungsgesetze stehen; die zweite Stufe wird aus den einfachen Gesetzen gebildet; die dritte Stufe nehmen die Verordnungen ein. Die Rechtsnormen der jeweils höheren Stufe müssen für die Normen der niedrigeren Stufe volle Deckung bieten.

Bei der Aufnahme eines Doppelbesteuerungsabkommens in dieses Gefüge der innerstaatlichen Rechtsordnung stellt sich die Frage, in welcher Weise der zwischenstaatliche Vertrag in dieses Gliederungsschema eingepasst werden soll.

Einst war die Auffassung vertreten worden, dass Staatsverträge nur den Rang von Verfassungsrecht einnehmen könnten; diese Auffassung stützte sich auf den Grundsatz des *pacta sunt servanda*, dem im Völkerrecht allgemeine Anerkennung beschieden ist [6] Nach der heute herrschenden Auffassung kann der Staatsvertrag auf jeder der drei Stufen des österreichischen Stufenbaumodells stehen. Staatsvertragliche Bestimmungen, denen Verfassungsrang zukommen soll, müssten als "verfassungsändernd" bezeichnet sein und jene qualifizierte parlamentarische Zustimmung erhalten, die für innerstaatliche verfassungsrechtliche Bestimmungen erforderlich ist; alle anderen Staatsverträge, denen die parlamentarische Genehmigung erteilt wurde, erhalten den Rang einfacher Bundesgesetze; alle übrigen Staatsverträge stehen auf der Rangstufe von Verordnungen.

Die von Österreich abgeschlossenen Doppelbesteuerungsabkommen wurden bisher stets als nicht verfassungsändernd oder verfassungsergänzend behandelt und geniessen daher in der innerstaatlichen Rechtsordnung den Rang einfacher Bundesgesetze.

Diese Auffassung bringt aber zwei Probleme mit sich. Einerseits bedingt diese Rangzuordnung, dass das Doppelbesteuerungsabkommen mit sämtlichen Bestimmungen durch die bestehende Verfassungsrechtslage gedeckt sein muss. Fehlt es an einer solchen Deckung, so zieht dies die Gefahr einer Staatsvertragsprüfung durch den Verfassungsgerichtshof nach sich, die in der weiteren Folge zur Aufhebung des Abkommens führen könnte. Die Frage der Verfassungskonformität eines Staatsvertrages ist aber im Einzelfall oft nich sehr einfach zu beantworten. So wurde beispielsweise bereits bezweifelt ob der "Studentenartikel" (Artikel 20 des OECD Musterabkommens) mit dem Artikel 18 B-VG. in volle Übereinstimmung stehe. Nach dieser Verfassungsbestimmung darf die gesamte staatliche Verwaltung nu auf Grund der Gesetze ausgeübt werden. Dies wird unte anderem dahingehend verstanden, dass die verwendete gesetzlichen Begriffe so bestimmt sein müssen, dass si einen der Vollziehung fähigen Inhalt umschreiben Gesetze, die diesem Erfordernis nicht entsprechen, sin verfassungswidrig. Es wurde nun behauptet, dass der in "Studentenartikel" eines Doppelbesteuerungsabkom

6. Vgl. *Kunz*, Völkerrechtliche Bemerkungen zur österreichischen Bundesverfassung, S. 320.

mens verwendete Begriff "Student" viel zu unbestimmt sei; es sei z.B. nicht erkennbar, ob dieser Begriff nur Hochschulstudenten umfasse oder auch Mittelschüler einschliese.

Ein zweites Problem besteht im Bereich der Derogationswirkung. Mit der Transformation eines Doppelbesteuerungsabkommens in die innerstaatliche Rechtsordnung derogiert dieser Vertrag allen entgegenstehenden Bestimmungen des nationalen Abgabenrechts; diese Derogationswirkung beruht auf dem Grundsatz, dass das spätere einfache Bundesgesetz das frühere einfache Bundesgesetz aufhebt (*lex posterior derogat legi priori*). Diese Derogationswirkung eines Doppelbesteuerungsabkommens kann wohl als unbestritten angesehen werden. Weniger Klarheit herrscht über die Frage, ob auch einem Doppelbesteuerungsabkommen durch nachfolgende Änderungen im innerstaatlichen Abgabenrecht derogiert werden kann. Im Grunde wird diese Wirkung als möglich angesehen. [7] Damit wird aber das Problem aktuell, ob beispielsweise der 1973 neu eingeführte Einkommensteuerabzug für Nichtansässige für Vergütungen auf Grund von Arbeitergestellungsverträgen den entgegenstehenden Bestimmungen früherer Doppelbesteuerungsabkommen (Betriebstättenregel) derogieren könne.

Die österreichische Finanzverwaltung hat versucht, dieses Problem auf dem Boden der Rechtsprechung des österreichischen Verwaltungsgerichtshofes zu lösen, der in den Bestimmungen der Doppelbesteuerungsabkommen im Verhältnis zum innerstaatlichen Abgabenrecht eine *lex specialis* erblickt (bgl. Erkenntnis des Verwaltungsgerichtshofes vom 28. Juni 1963, Zl. 2312/61). In Verfolgung dieser Auffassung geht die Meinung der Finanzverwaltung dahin, dass nach dem Grundsatz *lex specialis derogat legi generali* auch eine spätere innerstaatliche Norm dem gleichrangingen Doppelbesteuerungsabkommen in seinem speziellen Anwendungsbereich nicht derogieren könne. Bezogen auf den obgenannten Fall bedeutet dies, dass Arbeitergestellungsvergütungen an ausländische Unternehmen auch nach Einführung des neuen Steuerabzuges in Anwendung des Betriebstättenartikels der bestehenden Doppelbesteuerungsabkommen steuerfrei ausbezahlt werden können.

Die zur Durchführung eines Doppelbesteuerungsabkommens abgeschlossenen Durchführungsvereinbarungen stehen als parlamentarisch nicht genehmigungspflichtige Staatsverträge auf der Rangstufe von Verordnungen.

5. Rechtsfolgen eines rechtswidrigen Vertragsabschlusses

Wird ein internationaler Vertrag abgeschlossen, der gemessen an der innerstaatlichen Rechtsordnung mit Fehlern behaftet ist, so stellt sich heute wohl kaum mehr die Frage, ob dadurch die völkerrechtliche Gültigkeit des Vertrages gefährdet sein könnte. Derartige Meinungen wurde noch von den Redaktoren der österreichischen Bundesverfassung vertreten, [8] haben sich jedoch nicht durchzusetzen vermocht. Nach Völkerrecht kann jeder Staat darauf vertrauen, dass ein Staat, der mit einem anderen Staat einen Vertrag abschliesst, seine einschlägigen Verfassungsbestimmungen ordnungsgemäss auslegt und anwendet. Ein Staat, der bona fide mit einem anderen Staat einen Vertrag abschliesst, ohne die Beschränkung der "treaty making power" des für diesen Staat auftretenden Organs zu kennen, hat Anspruch auf Schadenersatz, wenn dieser Staat die Verbindlichkeit des Vertrages nicht nachträglich anerkennt. [9]

Erfüllt vom Gedanken der Rechtssicherheit kennt die österreichische Rechtsordnung aber auch im innerstaatlichen Bereich keine ungültigen, d.h. absolut nichtigen, Akte sondern kennt nur vernichtbare Akte. Daraus folgt, dass ein rechtswidrig abgeschlossenes Doppelbesteuerungsabkommen im innerstaatlichen Bereich zunächst voll rechtsgültig ist. Es macht dabei keinen Unterschied, ob die Rechtswidrigkeit auf verfahrensrechtlichem Gebiet liegt (z.B. ein gesetzänderndes Abkommen wurde nicht der parlamentarischen Genehmigung zugeführt) oder inhaltlich verursacht ist (z.B. eine Bestimmung des Doppelbesteuerungsabkommens steht mit der Verfassungsrechtslage nicht im Einklang).

Die Bundesverfassung sieht seit der Verfassungsreform des Jahres 1964 allerdings die Möglichkeit eines Prüfungsverfahrens vor dem österreichischen Verfassungsgerichtshof vor.

Wird vom Verfassungsgerichtshof einem Aufhebungsantrag stattgegeben und die Rechtswidrigkeit des Abkommens festgestellt, so ist der Vertrag im innerstaatlichen Rechtsbereich nach der Kundmachung dieser Entscheidung unanwendbar. Der Verfassungsgerichtshof kann für den Eintritt dieser innerstaatlichen Unanwendbarkeit eine Frist setzen, die bei gesetzändernden (gesetzesergänzenden und politischen) Staatsverträgen zwei Jahre, in allen übrigen Fällen ein Jahr nicht überschreiten darf.

Diese Verfassungsrechtslage erklärt, warum die österreichischen Verhandlungsdelegationen bei Verhandlungen über Doppelbesteuerungsabkommen stets bemüht sind, Kündigungsbeschränkungen (z.B. "der Vertrag kann frühestens vor Ablauf von fünf Jahren gekündigt werden") von den Doppelbesteuerungsabkommen fernzuhalten. Denn sollte tatsächlich einmal eine Rechtswidrigkeit eines österreichischen Doppelbesteuerungsabkommens festgestellt werden, so soll der österreichischen Regierung nicht die Möglichkeit genommen werden, notfalls im Wege einer Vertragskündigung einen mit der innerstaatlichen Rechtslage übereinstimmenden völkerrechtlichen Rechtszustand herbeizuführen.

6. Doppelbesteuerungsabkommen und der bundesstaatliche Aufbau Österreichs

Österreich ist ein Bundesstaat, in dem sowohl die Gesetzgebung als auch die Verwaltung zwischen dem Bund und den Ländern aufgeteilt ist. Diese Aufteilung umfasst

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7. Vgl. *Öhlinger*, Der völkerrechtliche Vertrag im staatlichen Recht, S. 225.
8. *Kelsen-Merkl-Fröhlich*, Die Bundesverfassung vom 1. Oktober 1920, Bemerkungen zu Art. 50.
9. Vgl. *Verdross*, Völkerrecht [4], S. 105.

auch das Abgabenwesen; hier ist allerdings zu beachten, dass der Hauptanteil des Gesamtabgabenaufkommens in Österreich (rund 95%) aus den "Bundessteuern" stammt. Die Bundessteuern werden durch die Bundesgesetzgebung geregelt und werden in der Regel auch durch Bundesbehörden (die Bundesfinanzverwaltung) erhoben. Der Abgabenertrag der wichtigsten Bundessteuern (insb. Umsatzsteuer und Einkommensteuer) muss allerdings mit den anderen Gebietskörperschaften (Bundesländer und Gemeinden) geteilt werden.

Da sich der sachliche Anwendungsbereich der Doppelbesteuerungsabkommen in der Hauptsache nur auf die Bundessteuern bezieht, ergeben sich aus dem föderalistischen Aufbau Österreichs im allgemeinen keine nennenswerten Probleme.

Nur in drei Fällen beziehen sich Doppelbesteuerungsabkommen auf die Steuern der anderen Gebietskörperschaften: im Fall der Gewerbesteuer (soweit diese für die Gemeinden erhoben wird), im Fall der Lohnsummensteuer und im Fall der Grundsteuer.

Obwohl diese drei Abgaben formal der Gruppe der "Gemeindeabgaben" zuzurechnen sind (da daran den Gemeinden die Ertragshoheit zusteht), ist — abweichend vom Regelfall — die Gesetzgebungskompetenz daran nicht den Bundesländern sondern dem Bund übertragen, sodass sich auch hier für den Abschluss von Doppelbesteuerungsabkommen keine besonderen Probleme ergeben. Hinzukommt, dass hinsichtlich der Landes- und Gemeindeabgaben durch eine Bestimmung des Finanzverfassungsgesetzes 1948, BGBl. Nr. 45, (§ 7 Abs. 4) dem Bund die Zuständigkeit eingeräumt wird, für die Verhinderung von Doppelbesteuerungen, für die Anpassung solcher Abgaben an die Bestimmungen des zwischenstaatlichen Steuerrechts und für die Verhinderung von Erschwerungen des Verkehrs oder der wirtschaftlichen Beziehungen im Verhältnis zum Ausland zu sorgen.

Die einzige praktische Auswirkung des bundesstaatlichen Aufbaues Österreichs auf den Abschluss von Doppelbesteuerungsabkommen ergibt sich aus der Verpflichtung des Bundes, den Ertrag seiner Bundessteuern mit den Bundesländern und den Gemeinden zu teilen. Wenn daher durch den Abschluss eines Doppelbesteuerungsabkommen oder durch irgend eine andere Massnahme des Bundes eine Verringerung der Ertragsanteile der Bundesländer oder der Gemeinden eintreten könnte, so muss zeitgerecht hierüber mit den betroffenen Gebietskörperschaften verhandelt werden (§ 5 des Finanzausgleichsgesetzes 1973, BGBl. Nr. 445/1972).

B. BESONDERE BEZIEHUNGEN DES DOPPELBESTEUERUNGSABKOMMENS ZUR INNERSTAATLICHEN STEUERRECHTSORDNUNG

Neben der zunächst besprochenen allgemeinen Frage der Eingliederung eines zwischenstaatlichen Vertrages in die innerstaatliche Rechtsordnung ergeben sich bei Doppelbesteuerungsabkommen noch einige andere Berührungspunkte mit der innerstaatlichen Steuerrechtsordnung, die einer besonderen Abklärung bedürfen. Von der österreichischen Anwendungspraxis der Doppelbesteuerungsabkommen her betrachtet, lassen sich diese Fragen wie folgt zusammenfassen:

1. *Können durch ein Doppelbesteuerungsabkommen Besteuerungsrechte geschaffen werden, die im innerstaatlichen Steuerrecht nicht vorgesehen sind?*
2. *Nimmt das Doppelbesteuerungsabkommen darauf Einfluss, in welcher Art und Weise die vertraglich zugewiesenen Besteuerungsrechte geltend gemacht werden?*
3. *Kann innerstaatliches Recht für die Auslegung von Doppelbesteuerungsabkommen herangezogen werden?*
4. *Können die Bestimmungen der Doppelbesteuerungsabkommen für die Auslegung von innerstaatlichem Steuerrecht herangezogen werden?*

1. Keine Schaffung neuer Steuerquellen

Es kommt vor, dass ein Doppelbesteuerungsabkommen Österreich ein Besteuerungsrecht zuteilt, dessen Erfassung in der innerstaatlichen Steuerrechtsordnung nicht vorgesehen ist. So wird beispielsweise durch Artikel 11 Abs. 2 des österreichisch-schweizerischen Doppelbesteuerungsabkommens, BGBl Nr. 63/1975, dem Quellenstaat von Zinsen ein 5%iges Besteuerungsrecht zugeteilt. Wird daher von einem in der Schweiz ansässigen Geldgeber einem österreichischen Unternehmen ein Kredit eingeräumt, so wäre Österreich gemäss dem Doppelbesteuerungsabkommen berechtigt, die gezahlten Zinsen mit einer 5%igen Steuer zu erfassen. Nach innerstaatlichem Steuerrecht (vgl. § 98 des Einkommensteuergesetzes 1972, BGBl. Nr. 440/1972) können indessen an Nichtansässige gezahlte Zinsen nur dann einer Besteuerung unterzogen werden, wenn sie im Inland hypothekarisch sichergestellt sind. Wenn dies nicht der Fall ist, so stellt sich die Frage, ob nun die österreichischen Abgabenbehörden zur Erhebung einer 5%igen Steuer berechtigt sind, wie dies im Doppelbesteuerungsabkommen — das wie oben erwähnt mit dem österreichischen Einkommensteuergesetz ranggleich ist — vorgesehen ist.

Diese Frage wurde bisher in Österreich stets verneint. Es hatte sich mit dieser Problematik bereits auch der österreichische Verfassungsgerichtshof befasst, der in seiner diesbezüglichen Entscheidung (vgl. Erkenntnis vom 11. März 1965, B 210, 211/1964) hiezu im wesentlichen ausführt, dass die primäre Aufgabe eines Doppelbesteuerungsabkommens in der Aufteilung der Besteuerungsrechte besteht und dass die Wirkung eines Doppelbesteuerungsabkommens sonach über eine blosse Einschränkung des bestehenden nationalen Steuerrechtes nicht hinausgehen kann. Der Verfassungsgerichtshof folgert daraus, dass das einem Vertragstaat zugewiesene Steuergut von diesem nur dann besteuert werden kann, wenn dies sein innerstaatliches Steuerrecht zulässt.

Diese Einstellung über die Wirkung eines Doppelbesteuerungsabkommens auf das innerstaatliche Steuerrecht, die auf eine Judikatur des ehemaligen Deutschen Reiches zurückgeht, blieb allerdings nicht völlig frei von Kritik. [10] Zweifel über ihre Rechtfertigung werden vor allem dann auftreten, wenn sie zur Ursache von Doppel*nicht*besteuerungen wird.

10. Vgl. *Kruse* in der Österreichischen Steuerzeitung 1975 S. 200, Anm. 70.

Wenn beipielsweise ein deutsches Unternehmen in Österreich aus reinen Anlagegründen Liegenschaftsbesitz erwirbt und diesen nicht für eigengewerbliche Zwecke nutzt (wenn dieser Liegenschaftsbesitz sonach kein Betriebsvermögen einer inländischen Betriebstätte des deutschen Unternehmens bildet) und wenn dieser Liegenschaftsbesitz nach 6 Jahren veräussert wird, so teilt Artikel 3 des österreichisch-deutschen Doppelbesteuerungsabkommens (BGBl. Nr. 221/1955), Österreich das Recht zu, den hiebei realisierten Veräusserungsgewinn zu besteuern. Nach innerstaatlichem Einkommensteuerrecht dürfen die von einem ausländischen Unternehmen erzielten Gewinne nur insoweit besteuert werden, als sie einer inländischen Betriebstätte des ausländischen Unternehmens zuzurechnen sind, oder soweit sie aus der Veräusserung von inländischem Grundvermögen vor Ablauf einer fünfjährigen Frist (Spekulationsfrist) stammen; einzelne andere Fälle der Besteuerung von Gewinnen ausländischer Unternehmen, die in § 98 des Einkommensteuergesetzes taxativ aufgezählt sind, sind im vorliegenden Fall ohne Bedeuting. Unter den gegebenen Umständen ist Österreich sonach auf Grund des Doppelbesteuerungsabkommens berechtigt, die aus der Veräusserung des Liegenschaftsbesitzes stammenden Gewinne zu besteuern, wird daran aber durch sein innerstaatliches Recht gehindert; umgekehrt, hätte wohl die Bundesrepublik Deutschland nach innerstaatlichem Recht eine Besteuerungsmöglichkeit (unbeschränkte Steuerpflicht), wird aber an der Ausübung dieses Rechtes durch die Bestimmungen des Doppelbesteuerungsabkommens gehindert.

2. Massgeblichkeit des innerstaatlichen Rechts bei der Geltendmachung der vertraglich zugewiesenen Besteuerungsansprüche

Gemäss dem vorbesprochenen Grundsatz, dass ein Doppelbesteuerungsabkommen innerstaatliche Besteuerungsrechte nur einschränken nicht aber schaffen kann, lässt sich die Frage, *ob* in einem internationalen Besteuerungsfall Österreich einen Besteuerungsanspruch hat, immer nur in gemeinsamer Anwendung sowohl des zwischenstaatlichen als auch des innerstaatlichen Rechtes lösen. Die weitere Frage, *wie* ein vertraglich und innerstaatlich bestehender Besteuerungsanspruch realisiert wird, ist jedoch ausschliesslich auf der Grundlage des innerstaatlichen Rechts zu entscheiden.

Dieser Grundsatz erlangte beispielsweise in folgendem Fall praktische Bedeutung: Gemäss Artikel VII des österreichisch-amerikanischen Doppelbesteuerungsabkommens (BGBl. Nr. 232/1957) dürfen aus amerikanischen Quellen stammende Zinsen in Österreich besteuert werden. Ein in Österreich ansässiger Steuerpflichtiger, der Zinsen aus amerikanischen Staats- und Kommunalobligationen bezog, bestritt die Steuerberechtigung Österreichs mit dem Hinweis, dass diese Zinsen nach amerikanischem Recht Steuerfreiheit geniessen und dass dieser Umstand gemäss dem österreichisch-amerikanischen Doppelbesteuerungsabkommen auch bei der Besteuerung in Österreich zu beachten sei. Auf der Grundlage des oberwähnten Grundsatzes vertrat die österreichische Finanzverwaltung die Auffassung, dass das Doppelbesteuerungsabkommen Österreich das Recht zur Besteuerung der amerikanischen Zinsen zugeteilt habe, dass es aber in keiner Weise darauf Einfluss nehme, in welcher Höhe der steuerpflichtige Betrag der Auslandseinkünfte von den österreichischen Steuerbehörden ermittelt wird. Die im amerikanischen Einkommensteuerrecht vorgesehenen steuerlichen Begünstigungen können daher keine Auswirkungen auf die Ermittlung des steuerpflichtigen Einkommens in Österreich haben. In diesem Besteuerungsfall war der österreichische Verwaltungsgerichtshof zur Lösung des Rechtsstreites angerufen worden, der jedoch mit seinem Erkenntnis vom 7. Mai 1966, Zl. 417/1966, die Auffassung der österreichischen Finanzverwaltung bestätigt hat.

Der hier erörterte Grundsatz erlangt auch im Zusammenhang mit der Erfassung ausländischer Einkünfte für Zwecke des Progressionsvorbehaltes einige Bedeutung. Es ist häufig zu beobachten, dass bei der Einreichung der Einkommensteuererklärungen die im Ausland erzielten und für Zwecke des Progressionsvorbehaltes in Österreich zu erfassenden Auslandseinkünfte mit jenem Betrag angegeben werden, der im ausländischen Steuerbescheid festgestellt wurde. Auch hier wird zu beachten sein, dass diese Vorgangsweise nur solange akzeptabel ist, als in den Einkommensermittlungsvorschriften der beiden Länder keine erheblichen Unterschiede bestehen. Denn der hier besprochene Grundsatz verlangt, dass Auslandseinkünfte immer nach österreichischem Recht ermittelt werden müssen.

Ein Anwendungsbereich dieses Grundsatzes liegt auch in den Fällen des Doppelwohnsitzes. Ein Steuerpflichtiger mit Wohnsitz in der BRD verfügt in Österreich über einen Zweitwohnsitz (der Mittelpunkt seiner Lebensinteressen liegt in der BRD); seine einzigen Einkünfte aus österreichischen Quellen bestehen aus Einkünften aus der Vermietung von inländischen Wohnungen. Da der Steuerpflichtige in Österreich einen steuerlichen Wohnsitz hat, ist er nach innerstaatlichem Recht hier unbeschränkt steuerpflichtig; dies hat zur Folge, dass auch seine aus der BRD sowie aus anderen Staaten stammenden Einkünfte der österreichischen Einkommensteuer unterliegen. Diese unbeschränkte Steuerpflicht verschafft dem Steuerpflichtigen hingegen auch gewisse steuerliche Vorteile (z.B. die Abzugsfähigkeit von Lebensversicherungsprämien, die Abzugsfähigkeit von bestimmten aussergewöhnlichen Belastungen wie Krankenhauskosten, die Anwendung bestimmter Steuerabsetzbeträge), die für die nur mit bestimmten Inlandseinkünften besteuerten Nichtansässigen (beschränkt Steuerpflichtigen) nicht gewährt werden. Das österreichisch-deutsche Doppelbesteuerungsabkommen erteilt Österreich die Berechtigung, die inländischen Mieteinkünfte zu besteuern; es schliesst Österreich aber davon aus, auch die deutschen und die anderen ausländischen Einkünfte steuerlich zu erfassen. Es könnte nun sehr wohl die Meinung vertreten werden, dass durch eine zwischenstaatliche Reduzierung der Steuerpflicht auf jenes Mass der Nichtansässigen auch die steuerlichen Vorteile auf jenes Mass verringert werden müssten. Die Anwendung des hier besprochenen Grundsatzes führt indessen zum gegenteiligen Ergebnis, dass nämlich das Doppelbesteuerungsabkommen in keiner Weise bei der Lösung der Frage eingreift, *wie* die inländischen Mieteinkünfte in Österreich zu besteuern sind; diese Frage kann einzig und allein nur durch Anwendung des innerstaatlichen Rechts gelöst werden. Und da das innerstaatliche Einkommensteuerrecht die mit der unbeschränkten Steuerpflicht verknüpften steuerlichen Vorteile unabhängig davon zugesteht, ob diese unbeschränkte Steuerpflicht durch einen Hauptwohnsitz oder durch einen Zweitwohnsitz entstanden ist, besteht keine rechtliche Möglichkeit, die genannten steuerlichen Vorteile dem Steuerpflichtigen vorzuenthalten.

Ergänzend wäre aber zu bemerken, dass Österreich auf dem innerstaatlichen Gesetzgebungsweg bereits einen ersten Schritt zur Beseitigung dieses unerfreulichen Zustandes unternommen hat: auf dem Gebiet der Ver-

mögensbesteuerung wurden erst jüngst die ebenfalls mit der unbeschränkten Steuerpflicht verknüpften Vermögensteuerfreibeträge in allen Fällen gestrichen, in denen ein in Österreich wohnhafter Steuerpflichtiger auf Grund eines Doppelbesteuerungsabkommens als in einem anderen Staat ansässig behandelt wird (vgl. Vermögensteuergesetznovelle 1976, BGBl. Nr. 665/1976, Z. 1).

3. Massgeblichkeit des innerstaatlichen Rechts für die Auslegung von Doppelbesteuerungsabkommen

Dieser Grundsatz wird von der österreichischen Finanzverwaltung aus Artikel 3 Abs. 2 des OECD-Musterabkommens zur Vermeidung der Doppelbesteuerung des Einkommens und des Vermögens abgeleitet. Diese Bestimmung lautet:

"Bei Anwendung des Abkommens durch einen Vertragstaat hat, wenn der Zusammenhang nichts anderes erfordert, jeder nicht anders definierte Ausdruck die Bedeutung, die ihm nach dem Recht dieses Staates über die Steuern zukommt, welche Gegenstand des Abkommens sind."

Die Bedeutung dieses Grundsatzes erweist sich in folgendem Fall: Ein schweizerisches Unternehmen errichtet in Österreich ein Gebäude, das in der Folge an ein deutsches Unternehmen vermietet wird. Das deutsche Unternehmen vermietet die Räumlichkeiten an österreichische Unternehmen weiter. Eine inländische Betriebstätte wird dadurch für das deutsche Unternehmen in Österreich nicht begründet. Dass die vom deutschen Unternehmen an das schweizerische Unternehmen gezahlten Mietentgelte gemäss der Zuteilungsregel für Einkünfte aus unbeweglichem Vermögen in Österreich besteuert werden dürfen, unterliegt keinem Zweifel. Schwieriger ist aber die Frage zu beantworten, ob auch die vom deutschen Unternehmen in Österreich vereinnahmten Mietentgelte in Österreich steuerlich erfasst werden dürfen. Durch Artikel 3 des österreichisch-deutschen Doppelbesteuerungsabkommens werden die Einkünfte aus in Österreich gelegenem unbeweglichem Vermögen der österreichischen Besteuerung überlassen. Es ist daher zu entscheiden, ob ein Untermietvertrag als Vermietung eines — als bewegliches Wirtschaftsgut anzusehenden — Bestandrechtes gilt oder steuerlich als Mietvertrag über unbewegliches Vermögen anzusehen ist. Das österreichisch-deutsche Doppelbesteuerungsabkommen enthält hiezu keine besonderen Bestimmungen. Österreich wird bei der Beurteilung dieser Frage von seinem innerstaatlichen Recht auszugehen haben, das diese Frage im letztgenannten Sinn entscheidet. [11]

Es versteht sich von selbst, dass dieser Auslegungsgrundsatz dort eine Schranke finden muss, wo das Abkommen selbst ausdrücklich etwas anderes vorsieht. Es wäre daher unzulässig, die "Dividendenregel" eines Doppelbesteuerungsabkommens in Österreich nicht auf die Gewinnausschüttungen von Gesellschaften mit beschränkter Haftung anzuwenden, weil nach österreichischer Rechtsprache nur die Gewinnausschüttungen von Aktiengesellschaften als "Dividenden" bezeichnet werden. Denn in diesem Fall bestimmt das Doppelbesteuerungsabkommen selbst, dass der Dividendenbegriff auf die Gewinnausschüttungen aller Kapitalgesellschaften Anwendung findet.

4. Unmassgeblichkeit des zwischenstaatlichen Steuerrechts für die Auslegung des innerstaatlichen Steuerrechts

Aus dem vorbesprochenen Grundsatz, dass innerstaatliches Recht für die Auslegung des zwischenstaatlichen Steuerrechts heranzuziehen ist, kann nicht geschlossen werden, dass auch eine Beeinflussung in umgekehrter Richtung möglich wäre.

Wenn daher ein schweizerisches Unternehmen in Österreich ein blosses Informationsbüro unterhält, das nach den Bestimmungen des österreichisch-schweizerischen Doppelbesteuerungsabkommens (Art. 5 lit. e) nicht als Betriebstätte zu qualifizieren ist, so liegt die einzige Auswirkung dieser Begriffsdefinition im Bereich des zwischenstaatlichen Steuerrechts, das Österreich unter Heranziehung dieser Definition die Einkommens- und Vermögensbesteuerungsrechte an dieser inländischen Einrichtung des schweizerischen Unternehmens entzieht. Es wäre unrichtig zu argumentieren, dass dieser Informationsstelle auch im Bereich der Umsatzsteuer keine Betriebstätteneigenschaft zukomme. § 12 Umsatzsteuergesetz, BGBl. Nr. 223/1972, knüpft die Berechtigung eines ausländischen Unternehmens zum Vorsteuerabzug unter anderem an die Voraussetzung, dass das ausländische Unternehmen in Österreich über eine Betriebstätte verfügt. Bei der Auslegung dieses im Umsatzsteuerrecht verwendeten Betriebstättenbegriffes muss auf innerstaatliches Recht (vgl. § 29 BAO.) zurückgegriffen werden; nach innerstaatlichem Recht bilden zweifellos auch derartige Informationsstellen eine Betriebstätte. Es wäre daher unzulässig, dem schweizerischen Unternehmen unter Hinweis auf die Begriffsbestimmungen des österreichisch-schweizerischen Doppelbesteuerungsabkommens den Vorsteuerabzug zu versagen.

Aber auch für die Frage, ob die Einkommenssteuerpflicht der in der Informationsstelle tätigen Dienstnehmer im Veranlagungsverfahren oder im Lohnsteuerabzugsverfahren zu erfolgen hat, bleibt die Regelung des Doppelbesteuerungsabkommens ohne Auswirkung. Wohl sieht das inländische Einkommensteuergesetz die Möglichkeit eines Lohnsteuerabzuges nur in jenen Fällen vor, in denen der Arbeitgeber in Österreich über eine Betriebstätte (§ 81) verfügt; die Beurteilung ob die Informationsstelle eine Betriebstätte für Zwecke des Lohnsteuerabzugsverfahrens darstellt, ist aber wieder nicht nach den Bestimmungen des Doppelbesteuerungsabkommens sondern ausschliesslich nach den Bestimmungen des innerstaatlichen Rechts vorzunehmen.

C. ZUSAMMENFASSUNG

Ohne hier eine Aussage über das Verhältnis von Völkerrecht zum innerstaatlichen Recht im Sinne einer monistischen oder dualistischen Theorie abgeben zu wollen, muss doch festgestellt werden, dass es sich hiebei um zwei verschiedene Normenbereiche handelt, die allerdings zahlreiche Berührungspunkte haben. Über dies

11. Vgl. *Schubert-Pokorny-Schuch*, Einkommensteuerhandbuch, Anm. 22 zu § 98 und Erkenntnis des Verwaltungsgerichtshofes vom 16. März 1971, Zl. 1357/1970.

Berührungspunkte am Beispiel Österreichs zu sprechen, war das Ziel der vorliegenden Arbeit.

Doppelbesteuerungsabkommen sind primär ein Bestandteil der Völkerrechtsordnung. Einer der wichtigsten Bezugspunkte zur innerstaatlichen Rechtsordnung ergibt sich aus der Tatsache, dass der zwischenstaatlichen Vereinbarung im Bereich des innerstaatlichen Rechts Geltung verschafft werden muss; dies führt zum Problem der Eingliederung eines Doppelbesteuerungsabkommens in die innerstaatliche Rechtsordnung. In Österreich geschieht diese Eingliederung im Falle von Doppelbesteuerungsabkommen im Wege der generellen Transformation; die spezielle Transformationsmethode wäre wahlweise möglich, doch wurde davon im Bereich des Doppelbesteuerungsvertragsrechtes noch kein Gebrauch gemacht. Eine ordnungsgemässe Transformation erfordert die Beachtung mehrerer verfassungsmässiger Voraussetzungen: Doppelbesteuerungsabkommen dürfen nur vom Bundespräsidenten abgeschlossen werden; sie bedürfen als gesetzändernde Staatsverträge der parlamentarischen Genehmigung und dürfen daher nicht *una actu* sondern nur unter Ratifikationsvorbehalt unterzeichnet werden. Doppelbesteuerungsabkommen nehmen im Stufenbau der österreichischen Rechtsordnung den Rang einfacher Bundesgesetze ein und müssen daher inhaltlich verfassungskonform sein. Rechtswidrigkeiten beim Abschluss oder im Inhalt eines Doppelbesteuerungsabkommens führen nicht zu dessen Nichtigkeit; rechtswidrige Doppelbesteuerungsabkommen können aber vom Verfassungsgerichtshof (mit Wirkung *ex nunc*) aufgehoben werden; die Aufhebung beziehlt sich aber nur auf den innerstaatlichen Rechtsbereich und berührt in keiner Weise die völkerrechtliche Verbindlichkeit des Vertrages.

Einzelne weitere Berührungspunkte, die in der Praxis der Anwendung der Doppelbesteuerungsabkommen einer Lösung zugeführt werden mussten, können wie folgt zusammengefasst werden: das Doppelbesteuerungsabkommen kann keine Besteuerungsrechte schaffen, die im innerstaatlichen Recht nich vorgesehen sind; die Art und Weise, wie die vertraglich zugeteilten Besteuerungsrechte geltend gemacht werden, richtet sich ausschliesslich nach innerstaatlichem Recht; Doppelbesteuerungsabkommen sind unter Heranziehung des innerstaatlichen Rechts auszulegen; für die Auslegung der innerstaatlichen Abgabenvorschriften kann indessen nicht auf das Doppelbesteuerungsabkommen zurückgegriffen werden.

OVERVIEW OF THE MAIN FEDERAL TAXES IN AUSTRIA

					Rates
FEDERAL TAXES	DIRECT TAXES	INCOME TAX	– Individual income tax		23 - 62 percent
			– Withholding tax on wages		
			– Corporate income tax		30 - 55 percent (reduced by one-half in the case of distributed profits)
			– Withholding tax on capital income (dividends, certain types of interest)		20 percent
		BUSINESS TAX	– On business income		5 percent (multiplicator: 3.31 - 3.47)
			– On business capital		0.1 percent (multiplicator: 3.31 - 3.47)
			– On payroll		0.2 percent (multiplicator: approx. 10)
		NET WORTH TAX			1 percent
			– Substitute inheritance tax		0.5 percent
	INDIRECT TAXES	TURNOVER TAX (V.A.T.)			Normal rate: 18 percent Reduced rate: 8 percent
		TRANSFER TAXES	– Real property acquisition tax		2 - 8 percent
			– Motor vehicles tax		
			– Inheritance and gift tax		2 - 60 percent
			– Capital transfer taxes:		
				– Capital tax	2 percent
				– Securities tax	0.5 - 2 percent
				– Stock exchange turnover tax	0.02 - 0.5 percent
		EXCISE TAXES			
		CUSTOMS DUTIES			

II. Die Durchsetzung der Abgabenansprüche und der Rechtsschutz im österreichischen Abgabenverfahren

(unter besonderer Berücksichtigung der sich aus zwischenstaatlichen Regelungen ergebenden Konfliktsmöglichkeiten)

A. ABGABENVERWALTUNGSORGANISATION

Ein leitender und beherrschender Grundsatz der österreichischen Verfassung ist das bundesstaatliche Prinzip. [12] In seiner Verwirklichung finden sich Gesetzgebung und Vollziehung auf Bund und Länder verteilt (die Gerichtsbarkeit ist allerdings allein dem Bund vorbehalten) und die Länder sind berechtigt, an der Bundesgesetzgebung mitzuwirken (suspensives Einspruchsrecht in der zweiten, der Länder-Kammer). Die Aufgaben der Verwaltung des Bundes werden nur zum Teil durch eigene Bundesbehörden — in unmittelbarer Bundesverwaltung — besorgt (z.B. Abgaben-, Monopol-, Patent-, Post-, Militär-Wesen). Die meisten Verwaltungsangelegenheiten des Bundes werden in mittelbarer Bundesverwaltung, durch die Behörden der Länder (Landeshauptmann und die ihm unterstellten Landesbehörden, Bezirksverwaltungsbehörden) besorgt; diese sind in diesem Bereich ihrer Tätigkeit funktionell Bundesbehörden und daher insoweit den Organen (Zentralstellen) des Bundes gegenüber weisungsgebunden.

Auf unterster territorialer Organisationsstufe stehen die Gemeinden; diese sind (ebenso wie Bund und Länder) Gebietskörperschaften mit dem Recht auf Selbstverwaltung und zugleich Verwaltungssprengel. Ähnlich wie den Ländern verfassungsrechtlich Aufgaben zugewiesen werden, die sie in Unabhängigkeit von Organen des Bundes besorgen, werden auch den Gemeinden Verwaltungsagenden übertragen, die sie frei von Weisungen des Bundes und des Landes zu erfüllen haben (autonomer, eigener Wirkungsbereich). Ebenso aber wie den Ländern und ihren Behörden ein Verwaltungshandeln für den Bund aufgetragen werden kann (mittelbare Bundesverwaltung), kann auch den Gemeinden die Besorgung von staatlichen Aufgaben überantwortet werden, die sie nicht in ihrer Stellung als Selbstverwaltungskörper, sondern in ihrer Eigenschaft als staatlicher Verwaltungssprengel (übertragener Wirkungsbereich) zu erfüllen haben.

Es zeigt sich sohin, dass in Österreich die Gesetzgebung allein vom Bund und den Ländern, die Verwaltung hingegen vom Bund, den Ländern und auch von den Gemeinden zu besorgen ist, wobei die Länder und Gemeinden in bestimmten Angelegenheiten hingegen als Auftragsverwaltung, nämlich im übertragenen Wirkungsbereich und damit weisungsgebunden (funktionell als Behörden der übergeordneten Gebietskörperschaften) ihre Tätigkeiten entfalten.

Wenn auch in vielen Angelegenheiten Verwaltungsaufgaben der höherrangigen Gebietskörperschaften auf Behörden der untergeordneten Gebietskörperschaften übertragen werden können (eine gegenläufige Übertragung ist mit Zustimmung der belasteten Gebietskörperschaft möglich, jedoch selten) so zeigt sich doch — abgesehen von der Verleihung der Gesetzgebungsbefugnisse — auch von der Organisation der behördlichen Tätigkeit gesehen, das föderalistische Prinzip verwirklicht. Dieser Befund lässt nun erwarten, dass es dem Bund, dan Ländern und den Gemeinden, also den Gebietskörperschaften für sich obliegt, für die Deckung der mit ihren Aufgaben verbundenen Kosten insbesondere durch Erhebung eigener Abgaben zu sorgen. Diese systemgerechte idealtypische Lösung (Trennsystem) ist verfassungsrechtlich vorgezeichnet, [13] sie findet sich jedoch nicht verwirklicht. Der Grund hiefür ist historisch zu erklären: Lediglich der Bund verfügt über eine bestens eingespielte und schlagkräftige Abgaben-Verwaltungsbehördenorganisation mist einem fachlich auf hoher Stufe stehenden Beamtenkorps. Es erschiene nun unzweckmässig neben einer traditionell gut funktionierenden Verwaltung eine Parellelorganisationen der Länder und Gemeinden aufzubauen. Aus diesem Grund wurde die Erhebung der gewichtigeren und bedeutenderen Abgaben den Abgabenbehörden des Bundes zugewiesen. [14] Ungeachtet der potentiellen Abgabenhoheit der Länder und der Gemeinden verwalten diese ihren beschränkten Erhebungsmöglichkeiten entsprechend nur kleinere weniger ergiebige Abgaben. Das Gesamtabgabenaufkommen Österreichs wird im Ausmass von etwa 95% von den Abgabenbehörden des Bundes erzielt. Dem bundesstaatlichen Prinzip und der verfassungsgesetzlichen Bestandsgarantie aller Gebietskörperschaften [15] Rechnung tragend erfolgt die materielle Absicherung der Länder und Gemeinden durch Einräumung angemessener Beteiligungen am Erfolg des Abgabenaufkommens des Bundes (also Verbundsystem) sowie durch besondere Finanzzuweisungen und Zuschüsse.

Wenn es also um die klassischen Steuern vom Einkommen, Ertrag, Umsatz und Vermögen sowie um die üblichen Verkehrsteuern wie auch um die Verbrauchsteuern, Monopole und Zölle geht, werden nur die Abgabenbehörden des Bundes tätig.

12. Art. 2 B-VG.; bzgl. Begriffsdarstellung und weiterführender Literaturhinweise s. *Ermacora*, Österreichische Verfassungslehre Wien 1970, 251; *Walter*, Österreichisches Bundesverfassungsrecht, Wien 1972, 107; *Walter-Mayer*, Grundriss des österreichischen Bundesverfassungsrechts, Wien 1976, 45.

13. § 2 Finanz-Verfassungsgesetz (F-VG.) 1948, BGBl. Nr. 45/1948.

14. Gem. § 3 F-VG. obliegt die Verteilung der Besteuerungsrechte und der Abgabenerträge der Bundesgesetzgebung (es ergehen sogenannte Finanzausgleichsgesetze, zuletzt BGBl. Nr. 445/1973); s. *Melichar*, Die österreichische Finanzverfassung, und *Wissgott*, Der Finanzausgleich in Österreich, in Handbuch der österreichischen Finanzwirtschaft hrsg. v. Andreae, Innsbruck 1970, 13 bzw. 59.

15. § 4 F-VG. 1948.

Der Aufbau und die organisatorische Gestaltung der Abgabenverwaltung des Bundes sind im BG. v. 13.12. 1974 BGBl. Nr 18/1975 (Abgabenverwaltungsorganisationsgesetz — AVOG) in Verbindung mit dem Bundesministeriengesetz 1973 BGBl. Nr. 389/1973 umschrieben. Demnach nehmen von ausdrücklichen gesetzlichen Ausnahmen abgesehen die zur Realisierung der Abgabenansprüche erforderlichen Amtshandlungen durchwegs die *Finanzämter* wahr, das sich die im wesentlichen auf Bezirksebene errichteten Behörden erster Instanz. Die Aufgaben des Zollwesens nehmen in unterster Stufe *Zollämter* wahr.

Als Behörden der Mittelinstanz sind (im wesentlichen auf Landesebene) die *Finanzlandesdirektionen* eingerichtet; sie sind weisungsberechtigte Oberbehörden gegenüber den Finanz- und Zollämtern. Die Finanzlandesdirektionen sind auch Rechtsmittelbehörden. Funktionell erstinstanzliche Entscheidungen obliegen diesen Behörden nur in Ausnahmsfällen (insbesonders etwa in Verbrauchsteuer- und Zollangelegenheiten).

Die Besorgung der Geschäfte der obersten Abgabenverwaltung des Bundes obliegt dem *Bundesministerium für Finanzen* (BMF.). Auf abgabenrechtlichem Gebiet hat es insbesondere die Angelegenheiten der Finanzverfassung, des Finanzausgleiches, des Bundeshaushaltes und der Legislative zu betreuen, also auch für die Erstellung von Gesetzesentwürfen zu diesen Materien zu sorgen. Das BMF. hat nur in den seltensten (gesetzlich ausdrücklich vorgesehenen) Fällen mit Bescheid zu erledigende verwaltungsbehördliche Aufgaben zu erfüllen; ihm kommt vornehmlich Organisations- und Weisungsgewalt zu.

Funktionell erstinstanzlich entscheidet das BMF. in hier interessierenden Angelegenheiten des zwischenstaatlichen Steuerrechtes etwa über Antrag mit einer (individuellen) Anordnung bestimmte Steuergegenstände ganz oder teilweise aus der Abgabepflicht auszuscheiden oder ausländische, auf solche Gegenstände entfallende Abgaben ganz oder teilweise auf inländische Abgaben anzurechnen (§ 48 BAO) unter der Voraussetzung, dass Doppelbesteuerungsabkommen nicht bestehen oder diese der Doppelbesteuerung im Einzelfall nicht wirksam zu begegnen vermögen. Auch für die Genehmigung der Anrechnung ausländischer auf im Ausland gelegene Sachen entfallende Erbschaftsteuern des Belegenheitsstaates auf die österreichische Erbschafts- und Schenkungsteuer [16] ist das BMF. zuständig. Schliesslich werden auch "Zuzugsbegünstigungen" vom BMF. bescheidmässig auf den Gebieten der Einkommen- und Vermögensteuer gewährt, [17] und zwar wenn Personen ihren Wohnsitz in das Inland verlegen ohne hier erwerbstätig zu werden (diese Begünstigung läuft auf eine Beschränkung der unbeschränkten Steuerpflicht hinaus, die durch die Wohnsitznahme in Österreich begründet wird). Dem BMF. als oberster Finanzbehörde obliegt auch die Einleitung und Abführung eines Verständigungsverfahrens mit Vertragsstaaten (vgl. Art. 25 des OECD-Musterabkommens und Verträge).

Da der abgabenbehördliche Instanzenzug bei den Finanzlandesdirektionen endet, kommt dem BMF. nicht die Funktion einer Rechtsmittelbehörde zu. Ein administrativer Instanzenzug besteht also nur, wenn Finanzoder Zollämter entscheiden; er reicht nur bis zur Finanzlandesdirektion. Entscheidet diese — sei es als Rechtsmittelbehörde oder kraft eigener Zuständigkeit funktionell erstinstanzlich — ist ein verwaltungsbehördliches Rechtsmittelverfahren ebensowenig vorgesehen, wie wenn das BMF. eine Entscheidung trifft.

Da die in Form von Abkommen zur Vermeidung der Doppelbesteuerung in Erscheinung tretenden Vorschriften nach ihrer parlamentarischen Behandlung innerstaatliches Recht bilden, macht es für die Behördenzuständigkeit keinen Unterschied, ob sie autonomes Steuerrecht oder auf Verträge zurückzuführende Vorschriften anzuwenden haben. Die vorstehend skizzierten Zuständigkeitsregelungen gelten daher ohne Rücksicht auf die Quellen des materiellen Steuerrechtes. Für Besteuerungsfälle mit über die Grenzen Österreichs hinausgehenden Wirkungen, also insbesondere für Doppelbesteuerungsfälle oder für Angelegenheiten, in denen zwischenstaatliches (bilaterales oder multilaterales Vertragsrecht) zur Anwendung kommt, sind weder besondere Behörden noch generell besondere Zuständigkeiten vorgesehen.

B. VERWALTUNGSBEHÖRDLICHE DURCHSETZUNG ABGABENRECHTLICHER ANSPRÜCHE, VERFAHRENSGRUNDSÄTZE

Im österreichischen Abgabenrecht entsteht (ebenso wie beispielsweise nach deutschem Recht) der Abgabenanspruch als Forderung aus dem öffentlich-rechtlichen Abgabenschuldverhältnis (ebenso korrespondierend die Abgabenschuld des Abgabepflichtigen) mit Verwirklichung des Abgabentatbestandes. Wenn also im Seinsbereich eine konkrete Handlung gesetzt wird, die dem abstrakten Steuertatbestand entspricht, ist die normativ vorgesehene mit dem Steuertatbestand verbundene Steuerrechtsfolge verwirklicht. [18] Damit ist nicht nur dem Gebot der Tatbestandsmässigkeit der Besteuerung Rechnung getragen und der Grundsatz der Gesetzmässigkeit der Verwaltung [19] im Steuerrecht ausdrücklich festgehalten, sondern gleichzeitig zum Ausdruck gebracht, dass das öffentlichrechtliche Schuldverhältnis mit der vermögensrechtlichen Wirkung der Entstehung einer Forderung auf der Seite des Abgabengläubigers und einer entsprechenden Verpflichtung des Abgabenschuldners nicht erst mit der behördlichen Festsetzung, sondern allein und schon aus einem einer abstrakt generellen Umschreibung im Steuertatbestand entsprechenden Verhalten entsteht. Die abgabenbehördlichen Schritte, die die bescheidmässige Festsetzung [20] zum Ziele haben, münden aus dieser Sicht gesehen in einen

16. § 6 Abs. 3 Erbschafts- und SchenkungssteuerG. 1955 BGBl. Nr. 141/1955.
17. § 103 EinkommensteuerG. 1972 und § 10 VermögensteuerG. 1954.
18. § 4 Abs. 1 BAO; *Stoll*, Steuerschuldverhältnis, Wien 1972, 13.
19. Art. 18 B-VG, § 5 F-VG.
20. Die meisten und zwar die Hauptsteuern werden bescheidmässig festgesetzt. Daneben gibt es auch Abzugs- und Selbstberechnungsabgaben, bei denen die Abgabenbehörden nur im Falle von Berechnungs- und Entrichtungsmängeln einschreiten.

Verwaltungsakt deklarativer Natur, denn nicht der Abgabenbescheid begründet das Steuerschuldverhältnis, sondern er ist das Instrument der Realisierung der bereits entstandenen Abgabenschuld und damit die den Grundsätzen eines rechtsstaatlichen Verfahrens Rechnungtragende Bedingung für die Durchsetzung der Leistungsverpflichtung (Leistungsgebot, Titelbescheid für die Abgabenexekution).

Der öffentlich-rechtlichen Natur des Abgabenanspruches und dem Gebot der Tatbestandsmässigkeit der Besteuerung sowie dem in der österreichischen Verfassung verankerten Gebot der Abführung eines rechtsstaatlichen Grundsätzen entsprechenden Verwaltungsverfahrens muss das Abgabenverfahren [21] diesen Grundprinzipien Rechnung tragend abgewickelt werden. Folgende tragende Verfahrensgrundsätze sollen im folgenden eine skizzenhafte Andeutung erfahren:

Im Vordergrund steht der *Grundsatz der Amtswegigkeit*, die Offizialmaxime; dies bedeutet, dass das Abgabenverfahren — von auf dem Antragsprinzip beruhenden Verfahrensarten (zB bestimmte Zollangelegenheiten) abgesehen — von Amtswegen einzuleiten, abzuwickeln und zu beenden ist, dass es also Aufgabe der Behörde ist, die für die Besteuerung entscheidenden Sachverhalte festzustellen, wobei für die Partei eine korrespondierende Mitwirkungspflicht besteht; sie ist unter Strafsanktion verhalten, ihre für die Besteuerung relevanten Verhältnisse uneingeschränkt und wahrheitsgemäss offenzulegen. Zufolge der gesetzlichen Verankerung des Amtswegigkeits- und auch des Untersuchungsgrundsatzes ist also der Behörde die gesamte Sachverhaltsermittlung (Sachverhaltsbehauptung und Beweisführung) zur Pflicht gemacht, was bedeutet, dass die Abgabenbehörde nicht nur das Vorliegen von anspruchsbegründenden sondern auch anspruchsverneinende oder anspruchsmindernde Tatumständen festzustellen und von Amtswegen zu berücksichtigen hat. Da nach allgemeinen Prozessgrundsätzen Unmögliches, Unzumutbares und Unnötiges nicht verlangt werden kann, findet die Verpflichtung der Abgabenbehörde, einen Sachverhalt von Amtswegen zu ermitteln, der nur im Zusammenwirken mit der Partei geklärt werden kann, Grenzen, wenn die Partei zur Mitwirkung der Wahrheitsfindung nicht bereit ist. Einen nach dem Gesamtbild aussergewöhnlichen und daher von vornherein nicht zu vermutenden Sachverhalt wird jedenfalls die Partei nachzuweisen haben. Insbesondere wenn es sich um Sachverhaltselemente handelt, die im Ausland ihre Wurzeln haben oder dort verwirklicht wurden, ist die Mitwirkungspflicht der Partei in dem Masse höher als die Pflicht der Behörde zur amtswegigen Erforschung des Sachverhaltes wegen Fehlens der ihr sonst zu Gebote stehenden Ermittlungsmöglichkeiten geringer wird. Wenn also der Abgabepflichtige seine Mitwirkungspflicht nicht erfüllt, kann die Abgabenbehörde auf die ihr zur Verfügung stehenden Unterlagen und naheliegenden Anhaltspunkte greifen, ohne dass sie verpflichtet wäre, auf alle erdenklichen Möglichkeiten der Sachverhaltsgestaltungen bedacht zu nehmen und die nur irgendwie möglicherweise in Betracht kommenden Tatumstände zu beweisen.

Damit ist der *Grundsatz der freien Beweiswürdigung* berührt, dessen Wesen wie in jedem modernen Verfahrensbereich darin zu sehen ist, dass die Behörde unter sorgfältiger Berücksichtigung der Ergebnisse des Ermittlungsverfahrens nach freier Überzeugung zu beurteilen hat, ob eine Tatsache als erwiesen anzunehmen ist oder nicht. Freie Beweiswürdigung verschafft nicht Freiheit von den Regeln der Erkenntnisgewinnung. Die Schlussfolgerungen, die von gegebenen zweifelsfrei anzunehmenden Tatsachen auf das Bestehen oder Nichtbestehen eines Sachverhaltes gezogen werden, müssen den Denkgesetzen entsprechen. Es ist eine logische gedankliche Verknüpfung von einer Erkenntnisstufe zur anderen erforderlich, die angestellten Erwägungen und Folgerungen (Denkvorgänge) müssen schlüssig sein, sie sind den Parteien gegenüber offenzulegen und damit der Nachprüfung zugänglich zu machen, wie überhaupt vor Abschluss jedes Ermittlungsverfahrens den Parteien Gelegenheit zu geben is, zur Wahrung ihrer Interessen zu den Sachverhaltsannahmen der Behörde Stellung zu nehmen, um durch Gegenvorstellungen, Einwendungen, begründete Hinweise usw zur Wahrheitsfindung beizutragen (*Grundsatz der Gewährung des Parteigehörs*). Dem Interesse der rechtzeitigen Geltendmachung und Verteidigung berechtigter Interessen wie aber auch dem Interesse der richtigen Ermittlung des tatsächlichen Sachverhaltes dient die *Akteneinsicht*, die den Parteien (mit Rechtsanpruch) insoweit gewährt wird, als hiedurch dritte Personen nicht Schaden erleiden (interne Behördenschriftstücke sind ebenfalls ausgenommen).

Dem Verfahrensziel entsprechend, das auf die Erfassung des öffentlich-rechtlichen Schuldverhältnisses und seine bescheidmässige Feststellung gerichtet ist, sind die den Anspruch berührenden Sachverhalte in ihren tatsächlichen Dimensionen auszuforschen. Nicht die von den Parteien herangetragenen, allenfalls einvernehmlich ausser Streit gestellte Sachverhaltsannahmen sind entscheidend (konventionelle Wahrheit), sondern allein die *materielle Wahrheit* ist auszuforschen und der Besteuerung zugrundezulegen.

Im Abgabenverfahren herrscht weitgehend das *Prinzip der Schriftlichkeit*. Anbringen der Parteien und Behördenerledigungen sind grundsätzlich schriftlich auszufertigen, mündliche Parteianträge aber auch mündliche Erledigungen sind vorgesehen, sie bilden aber die Ausnahme. Das Abgabenverfahren ist *nicht öffentlich*. Die der Behörde bekanntgegebenen oder von ihr ermittelten Verhältnisse unterliegen besonders strengen (strafrechtlich sanktionierten) *Geheimhaltungsverpflichtungen*.

Soweit die materiellen Abgabengesetze nicht ausdrücklich besondere Fristen normieren, mit deren Verstreichen Ansprüche erlöschen, hat die Abgabenbehörde bis zur Rechtskraft (also auch noch im Rechtsmittelverfahren) auf Parteienanträge, Vorbringen tatsächlicher und rechtlicher Art usw einzugehen, dies selbst dann, wenn diese Vorstellungen verschuldetermassen bis dahin nicht erhoben wurden (*kein Novenverbot*, keine Kontumazierung; sohin kein Rechtsverlust etwa bei Versäumung der Erklärungsfristen u.ä.).

Die Parteien sind berechtigt, nicht hingegen in der Art eines Anwaltszwanges verpflichtet, sich im Abgabenverfahren vertreten zu lassen (*Vertretungsbefugnis*). Zur geschäftsmässigen Vertretung vor österreichischen Abgabenbehörden sind aber nu

21. Zum österreichischen Abgabenverfahren s. insbes. *Reeger/Stoll*, Kommentar zur Bundesabgabenordnung, Wien 1966 und Die Bundesabgabenordnung [5] (Handbuch) Wien 1975; sowie *Lager*, Bundesabgabenordnung, Wien 1975.

hiezu "befugte" Personen berechtigt. Das sind vor allem die nach österreichischen berufsrechtlichen Vorschriften tätigen Rechtsanwälte, Patentanwälte und Notare sowie die nach inländischem Recht (Wirtschaftstreuhänderberufsordnung BGBl. Nr. 125/1955) zugelassenen Wirtschaftstreuhänder (Steuerberater, Beeidete Buchprüfer, Wirtschaftsprüfer). Eine im Ausland erworbene Befugnis dieser Art berechtigt nicht zur Parteienvertretung in Österreich, weil dies das österreichische Recht nicht vorsieht, diesbezüglich zwischenstaatliche Abkommen aber nicht bestehen.

Festgesetzte Abgaben, die nicht spätestens am Fälligkeitstag (in der Regel mit Ablauf eines Monates nach Bescheidzustellung) entrichtet werden, sind vollstreckbar. Ein gegen den Abgabenbescheid eingebrachtes Rechtsmittel hat keine aufschiebende Wirkung, die zwangsweise Einbringung kann also durch Beschreitung des Rechtsmittelweges nicht verhindert werden. Wäre aber die termingerechte Entrichtung der Abgabe für den Abgabepflichtigen mit erheblichen Härten verbunden, kann die Abgabenbehörde mit Bescheid (Ermessen) den Zeitpunkt der Abgabenentrichtung hinausschieben (Stundung) oder die Entrichtung in Raten bewilligen, dies aber nur unter der Voraussetzung, dass durch die Zufristung die Einbringlichkeit der Abgaben nicht gefährdet wird.

Ebenso wie die Kosten für die Tätigkeit der Abgabenbehörden von Amtswegen zu tragen sind (gilt auch für das Rechtsmittelverfahren) haben auch die Parteien die ihnen im Abgabenverfahren erwachsenen Kosten selbst zu bestreiten (Prinzip der Selbsttragung, wechselseitige Kosten-Ersatzansprüche gewährt das Gesetz nicht). Kostenpflicht besteht in Ausnahmsfällen, uzw im Zoll-, Verbrauchsteuer-, Monopol- und Exekutionsverfahren.

C. RECHTSSCHUTZ IN ABGABENANGELEGENHEITEN

1. Administratives Rechtsmittelverfahren

Gegen Bescheide der Abgabenbehörden erster Instanz (Finanzämter, Zollämter) ist (von geringfügigen unbedeutenden Ausnahmen abgesehen) das Rechtsmittel der Berufung gegeben. Die Berufungsfrist beträgt einen Monat; die Berufungsfrist kann aus berücksichtigungswürdigen Gründen, erforderlichenfalls auch wiederholt verlängert werden. (Bei Postaufgabe innerhalb der Frist gilt diese als gewahrt, auch wenn die Berufung erst später bei der Behörde einlangt.) Die Berufung kann bei der Abgabenbehörde, die den angefochtenen Bescheid erlassen hat, oder auch bei der zur Entscheidung über die Berufung zuständigen Finanzlandesdirektion eingebracht werden.

Ist die Berufung unzulässig erfolgt eine *Zurückweisung*, ohne dass die Behörde in die Sache einzugehen hat. Eine aus formellen Gründen gebotene Zurückweisung wird verfügt, wenn die Berufung nicht fristgerecht eingebracht wurde, oder wenn sie nicht zulässig ist, weil etwa ein Rechtsmittel ausdrücklich ausgeschlossen ist, bei einer *res judicata*, wenn auf Einbringung einer Berufung wirksam verzichtet wurde oder weil der Berufungswerber nicht aktiv legitimiert ist.

Formgebrechen der Berufung (zB fehlende Unterschrift, keine Bevollmächtigung) sowie bestimmte inhaltliche Mängel (Fehlen der Erklärung inwieweit der Bescheid angefochten wird und welche Änderungen beantragt werden, Fehlen einer Begründung) berechtigen nicht zur Zurückweisung; die Abgabenbehörde hat vielmehr dem Berufungswerber die Behebung dieser Mängel mit dem Hinweis aufzutragen, dass das Unterlassen der Sanierung mit Ablauf einer angemessenen Frist mit der Fiktion der Zurücknahme der Berufung verbunden ist.

Ist die Berufung sonach fristgerecht, zulässig und mängelfrei, hat in ihrer Erledigung eine Sachentscheidung zu ergehen. Diese meritorische Entscheidung tritt an die Stelle des angefochtenen Bescheides und kann gegenüber dem Erstbescheid in jeder Richtung abweichen (kein Verbot einer *reformatio in peius*). In der Sache unbegründete Berufungen werden abgewiesen.

Die Behörde, die den angefochtenen Bescheid erlassen hat, also die Behörde erster Instanz, kann zunächst selbst über das Rechtsmittel entscheiden. Eine solche *Berufungsvorentscheidung* dient der Verwaltungsvereinfachung. Insbesondere dann, wenn die Bescheidbehörde die Fehlerhaftigkeit ihres eigenen Bescheides erkennt, kann sie dem berechtigten Berufungsbegehren stattgeben, ohne dass die Oberbehörde befasst und damit belastet werden muss. Eine Berufungsvorentscheidung ist nicht obligatorisch. Die Behörde erster Instanz kann — ohne eine Vorentscheidung zu fällen — die Berufung der Rechtsmittelbehörde (Finanzlandesdirektion) zur unmittelbaren Entscheidung vorlegen. Ist hingegen eine Berufungsvorentscheidung ergangen und stellt der — nicht zufrieden gestellte — Berufungswerber innerhalb einer Frist von einem Monat den Antrag auf Entscheidung der Oberbehörde, so wird die Berufungsvorentscheidung wirkungslos. Beantragt der Berufungswerber die Entscheidung der Finanzlandesdirektion nicht, wirkt die Berufungsvorentscheidung wie eine endgültige Erledigung über die Berufung, allein diese Entscheidung (nicht auch der angefochtene Bescheid) gehören künftig dem Rechtsbestand an.

Wenn das Finanzamt eine Berufungsvorentscheidung nicht erlassen hat oder wenn dies wohl geschehen ist, diese durch einen diesbezüglichen Antrag der Partei aber ausser Wirksamkeit getreten ist, hat die *Finanzlandesdirektion* [22] über die Berufung abzusprechen. Auch diese Entscheidung ist eine meritorische. Die Finanzlandesdirektion hat unter neuer, eigener Verantwortung einen Sachbescheid zu erlassen, der an die Stelle des angefochtenen Bescheides tritt. Die Rechtsmittelbehörde hat im Berufungsverfahren die verfahrensrechtlichen Obliegenheiten und Befugnisse der Abgabenbehörde erster Instanz.

Sie hat daher erforderlichenfalls ein Ermittlungsverfahren neu durchzuführen oder das erstinstanzliche Ermittlungsverfahren zu ergänzen und hat selbst Beweise aufzunehmen. Sie ist an den Inhalt der erstinstanzlichen Bescheides nicht gebunden. Sie kann also den Bescheid in jeder Richtung abändern (sohin auch verbösern), sie ist in ihrer Entscheidungsbefugnis auch nicht an die Berufungspunkte gebunden und kann in ihrer Entscheidung den Anfechtungsbereich der Berufung überschrei-

22. In bestimmten Fällen, insbes. in Angelegenheiten der Einkommen-, Körperschaft-, Gewerbe-, Umsatz- und Vermögensteuer entscheidet die Finanzlandesdirektion durch Senate. Diese Berufungssenate sind nicht selbständige Behörden oder (zufolge verfassungsrechtlicher Weisungsfreistellung des Laienelementes) gar Gerichte oder gerichtsähnliche Behörden, sondern bloss Organe der Abgabenbehörde zweiter Instanz, also der Finanzlandesdirektionen.

ten. Die Rechtsmittelentscheidung des österreichischen Abgabenverfahrens ist also eine durch formelle Schranken oder durch Vorentscheidungen nicht begrenzbare Vollentscheidung, sie ist in tatsächlichen und rechtlichen Belangen so zu treffen, als erginge in der Angelegenheit eine erste Entscheidung.

Die Berufungsentscheidung ersetzt denn auch den ursprünglichen angefochtenen Bescheid, sie allein gehört künftighin dem Rechtsbestand an.

Erwähnt sei, dass es verfahrensrechtlich und zuständigkeitstechnisch keinen Unterschied macht, ob Angelegenheiten des innerstaatlichen oder des zwischenstaatlichen (internationalen) Abgabenrechtes in Verhandlung stehen. Es macht auch — sowohl im erstinstanzlichen, als auch im zweitinstanzlichen (Rechtsmittel-)Verfahren — keinen Unterschied, ob Österreicher oder Ausländer, im Inland oder im Ausland Ansässige Parteien des Verfahrens sind.

2. Gerichtlicher Rechtsschutz [23]

In Österreich obliegt der gerichtliche Rechtsschutz des Einzelnen gegenüber der behördlichen Verwaltungstätigkeit des Staates nicht den ordentlichen Gerichten, er ist im wesentlichen im *Verwaltungsgerichtshof* konzentriert. [24] Diese Konzentration ist mehrdimensional. Der Verwaltungsgerichtshof ist zur Kontrolle der verwaltungsbehördlichen Tätigkeit des Bundes, der Länder und Gemeinden berufen (keine Länder- Verwaltungsgerichte), er ist in seiner gerichtsorganisatorischen Monopolstellung für Beschwerden gegen Verwaltungen aller Art zuständig (es sind also keine Sonderverwaltungsgerichte etwa in Sozial- oder Finanzangelegenheiten eingerichtet) und schliesslich ist die Verwaltungsgerichtsbarkeit einstufig, d.h. der Verwaltungsgerichtshof entscheidet als einzige Instanz.

Im Interesse der Garantie der Verfassung ist ein weiterer Gerichtshof des öffentlichen Rechtes eingerichtet und dem Verwaltungsgerichtshof an die Seite gestellt (keine Über- oder Unterordnung); es ist dies der *Verfassungsgerichtshof*. Dieser hat neben vielfältigen verfassungsgesetzlich vorgesehenen Agenden auch die Aufgabe eines Sonderverwaltungsgerichtes zu erfüllen. Demnach hat der Verfassungsgerichtshof auch über Beschwerden gegen letztinstanzliche Bescheide der Verwaltungsbehörden zu entscheiden, ist jedoch hiezu nur insoweit befugt (und damit seine Zuständigkeit abgegrenzt), als der Beschwerdeführer in einem verfassungsgesetzlich gewährleisteten Recht verletzt zu sein behauptet [25], (etwa bei Verletzung der Grund- und Freiheitsrechte) wird hingegen die Verletzung sonstiger subjektiver Rechte behauptet, ist die Beschwerde an den Verwaltungsgerichtshof zu richten (bei Gesetzwidrigkeit, Verordnungswidrigkeit eines Bescheides). Auch die Stellung des Verfassungsgerichtshofes ist — auf seinen Zuständigkeitsbereich bezogen — gleich der des Verwaltungsgerichtshofes, monopolartig und zentralisiert.

Sowohl der Verfassungsgerichtshof wie auch der Verwaltungsgerichtshof sind Gerichte im technischen Sinn, die Gerichtsbarkeit wird durch (unabsetzbare, unversetzbare und weisungsfreie) Richter ausgeübt. Im Bescheidprüfungsverfahren sind Beschwerdeführer und belangte Behörde (Behörde, die in letzter Instanz den angefochtenen Bescheid erlassen hat) gleichberechtigte Parteien.

Die Gerichtsbarkeit der geschilderten Art kann erst nach abschliessender Befassung der Verwaltungsbehörden mit der Angelegenheit, also nach Erschöpfung des administrativen Instanzenzuges, in Anspruch genommen werden. Es handelt sich also um eine *a posteriori* - Gerichtsbarkeit. Die Aufgaben der beiden Gerichtshöfe des öffentlichen Rechts bestehen nun nicht etwa darin, dass sie den Verwaltungsbehörden nachgeschaltet, eine letzte, endgültige Sachentscheidung zu fällen hätten. Sie haben vielmehr lediglich Kontrollfunktionen gegenüber den Verwaltungsbehörden wahrzunehmen. Diese Aufgabe erfüllen die Gerechtshöfe in der Weise, dass sie dann, wenn der in Beschwerde gezogene Bescheid Vorschriften — des von den Gerichtshöfen ihrer Zuständigkeit nach wahrzunehmenden Ranges — verletzen, auf Aufhebung (Kassation) erkennen oder im Falle der Verneinung einer Rechtsverletzung die Beschwerde abweisen. Dringt die Beschwerde durch, ergeht also nicht eine neue meritorische Entscheidung des Gerichtes mit der Wirkung, dass sie an die Stelle des angefochtenen Bescheides tritt. Die stattgebende, in der Sache ergehende Erledigung des Gerichtshofes erschöpft sich vielmehr in der Aufhebung des angefochtenen Bescheides. Es obliegt sodann der belangten Verwaltungsbehörde, also der Behörde deren Entscheidung aufgehoben wurde, die neuerliche Sachentscheidung (Ersatzbescheid) zu fällen, wobei eine Bindung an die im aufhebenden Erkenntnis zum Ausdruck gebrachte Rechtsauffassung des Höchstgerichtes besteht.

Zu erwähnen ist auch an dieser Stelle, dass die angedeutete Zuständigkeit der Gerichte gegeben ist, gleichgültig ob innerstaatliches autonomes oder internationales Abgabenrecht zur Anwendung kommt. Es ist auch im allgemeinen gleichgültig, ob die den Rechtsschutz der Gerichtshöfe in Anspruch nehmenden Parteien Inländer oder Ausländer, im Inland oder im Ausland ansässige physische oder juristische Personen sind.

Die Beschwerde ist innerhalb einer (unerstreckbaren) Frist von 6 Wochen, die ab Zustellung des letztinstanzlichen Bescheides läuft, unmittelbar beim Gerichtshof einzubringen. Die Beschwerde hat keine aufschiebende Wirkung; diese kann aber über besonderen Antrag vom Gerichtshof zuerkannt werden, wenn durch die ansonsten zu erwartende Vollstreckung ein nicht mehr gutzumachender Schaden eintreten würde und öffentliche Rücksichten die sofortige Vollstreckung des Bescheides nicht gebieten.

a) Die Verwaltungsgerichtshofbeschwerde [26]

Zu den Erfordernissen, die die Beschwerde an den Verwaltungsgerichtshof aufzuweisen hat, damit der Gerichtshof ein konkretes Verfahren einleiten kann, gehören neben der Bezeichnung des angefochtenen Ver-

23. *Winkler*, Der gerichtliche Rechtschutz des Einzelnen gegenüber der vollziehenden Gewalt in Österreich, in: Gerichtsschutz gegen die Exekutive II 835; *Melichar*, Die Überprüfung von Abgabenbescheiden durch die beiden Gerichtshöfe d. öffentl. Rechts, FJ 1976, 144.

24. Art. 129-136 B-VG; Verwaltungsgerichtshofgesetz, 1965 BGBl. Nr. 2; *Ermacora*, Verfassungslehre 186, 392; *Walter*, Bundesverfassungsrecht 661; *Walter-Mayer*, Grundriss des österr. Bundesverfassungsrechts 236.

25. Art. 144 B-VG; Verfassungsgerichtshofgesetz 1953 BGBl. Nr. 85; *Ermacora*, Verfassungslehre 183, 229, 327, 388; *Walter*, Bundesverfassungsrecht 710, 736, 788; *Walter-Mayer*, Grundriss 254.

26. *Ringhofer*, Der Verwaltungsgerichtshof, Graz-Wien-Köln 1955.

waltungsaktes und der Behörde, die den Bescheid erlassen hat, sowie neben einer Sachverhaltsdarstellung, einem bestimmten Anfechtungsbegehren und einer Begründung auch die Bezeichnung des subjektiven) Rechtes, in dem der Beschwerdeführer verletzt zu sein behauptet (Beschwerdepunkte). Damit ist der Prozessgegenstand festgelegt, nur über die hievon berührten Fragen ist in der Sachentscheidung des Gerichtshofes abzusprechen, der Gerichtshof kann über den von der Partei hiedurch abgegrenzten Anfechtungsbereich nicht hinausgehen.

Die Beschwerdeschrift bedarf der Unterschrift eines (inländischen) Rechtsanwaltes; [27] ansonst besteht relativer Anwaltszwang: Die Parteien können im Verfahren ihre Sache selbst führen, wenn sie sich aber vertreten lassen wollen, können sie ihr Mandat nur einem inländischen Anwalt (nicht etwa auch einem Wirtschaftstreuhänder) geben.

Es entspricht den Aufgaben des Verwaltungsgerichtshofes als Kontrollinstanz, dass er den Bescheid auf Grund des von der belangten Behörde angenommenen Sachverhaltes zu prüfen hat. Diese Sachverhaltsbindung besteht nur dann nicht, wenn der von der Behörde angenommene Sachverhalt in sich widersprüchlich ist, mit den Erfahrungen des Lebens nicht in Einklang zu bringen ist, die Schlussfolgerungen der Behörde, die zur Sachverhaltsannahme führten, den Denkgesetzen widersprechen oder das Verfahren, das der Sachverhaltsermittlung diente, mangelhaft war; auch diesfalls ermittelt aber der Gerichtshof den Sachverhalt nicht selbst, sondern hebt den Bescheid auf. Es obliegt sodann der belangten Behörde das Sachverhaltsermittlungsverfahren zu ergänzen und einen neuerlichen Bescheid zu erlassen. Besteht kein Aufhebungsgrund der angeführten Art so ergibt sich aus der Sachverhaltsbindung des Gerichtshofes auch für die Partei das Verbot, im Verwaltungsgerichtshofverfahren Neuerungen in Bezug auf die tatsächlichen Verhältnisse vorzubringen (Novenverbot), also das Verbot, im vorangegangenn Verwaltungsverfahren unberücksichtigt gebliebene Tatsachen zum Gegenstand des Gerichtsverfahrens zu machen.

Hat sich der Bescheidinhalt mit Rechtsvorschriften in Widerspruch gesetzt, wird der in Beschwerde gezogene Bescheid aufgehoben. Eine solche mit der Aufhebung bedrohte Rechtswidrigkeit liegt nicht vor, soweit der Bescheid auf einer Ermessensbestimmung beruht und die Behörde im Sinne des Gesetzes ihre Entscheidung getroffen hat. Erweisen sich somit mehrere Entscheidungen mit dem vom Gesetz erklärten oder aus ihm ableitbaren Sinn vereinbar und hat die Behörde aus sachlich vertretbaren Gründen eine dieser Entscheidungsmöglichkeiten ausgewählt, greift der Gerichtshof nicht ein, mag auch eine andere Lösung zweckmässiger sein (seine Aufgabe steht in der Rechtskontrolle, nicht in einer Zweckmässigkeitsprüfung).

Wurde ein angefochtener Bescheid von einer unzuständigen Behörde erlassen, so ist der Bescheid der Aufhebung verfallen (auch wenn dieser Mangel nicht geltend gemacht wird); im Bescheidmangel der Unzuständigkeit liegt nämlich auch eine Grundrechtsverletzung (Entzug des gesetzlichen Richters im weitesten Sinn verstanden), weshalb die Aufhebung jedenfalls, und zwar auch dann erfolgt, wenn der Bescheid ansonsten inhaltlich nicht rechtswidrig erscheint (was diesfalls nicht mehr zu prüfen ist).

Die Verletzung anderer Verfahrensvorschriften als solcher über die Zuständigkeit führt (abgesehen vom Mangel der Aktenwidrigkeit oder Ergänzungsbedürftigkeit des Sachverhaltes) nur dann zur Aufhebung, wenn die Einhaltung der verletzten Verfahrensvorschriften zu einem anderen Bescheid hätte führen können (Erfordernis der Wesentlichkeit des Verfahrensmangels).

Die im Verfahren obsiegende Partei hat Anspruch auf Kostenersatz durch die unterliegende Partei (durch Verordnung ist eine Kostenpauschalierung vorgesehen).

b. Die Verfassungsgerichtshofbeschwerde [28]

Über in letzter Instanz ergangene bescheidmässige Massnahmen einer Verwaltungsbehörde (so auch einer Abgabenbehörde) hat der Verfassungsgerichtshof zu erkennen, wenn der Beschwerdeführer behauptet, durch den Bescheid in einem verfassungsgesetzlich gewährleisteten Recht verletzt zu sein, oder wenn er behauptet, dass der Bescheid durch Anwendung einer gesetzwidrigen Verordnung, eines verfassungswidrigen Gesetzes oder eines rechtswidrigen Staatsvertrages seine subjektiven Rechte verletzt habe.

Die Beschwerden haben den Sachverhalt anzugeben und die Behauptung der die Zuständigkeit des Gerichtshofes begründenden Rechtsverletzung zu enthalten (für den Verfassungsgerichtshof bedeuten im Gegensatz zum Verwaltungsgerichtshof diese Punkte nicht den Prozessrahmen, sind einmal die Prozessvoraussetzungen erfüllt, prüft der Verfassungsgerichtshof, ob irgendein verfassungsgesetzlich gewährleistetes Recht des Beschwerdeführers verletzt worden ist). Die Beschwerden sind durch einen bevollmächtigten (inländischen) Rechtsanwalt einzubringen; die Partei kann sich im Verfahren durch ihn (nicht auch durch andere Personen) vertreten lassen (absoluter Anwaltszwang).

Der Verfassungsgerichtshof prüft also, ob der bekämpfte Verwaltungsakt den Einzelnen in einem verfassungsgesetzlich gewährleisteten (also in einem von der Verfassung eingeräumten subjektiven) Recht verletzt hat; hiezu gehören in Österreich insbesondere die in Verfassungsrang stehenden Grund- und Freiheitsrechte. [29]

Ein Abgabenbescheid kann den Abgabenpflichtigen vor allem in seinem Recht auf *Gleichheit vor dem Gesetz* verletzen. Die Verletzung des Gleichheitsrechtes (Art. 2 Staatsgrundgesetz v. 21.12.1867 RGBl. Nr. 142 und Art. 7 B-VG.) [30] kann immer nur durch Vergleich mit Massnahmen gegenüber anderen beurteilt und festgestellt werden. Durch die Vollzugstätigkeit kann eine Verletzung des verfassungsgesetzlichen Rechtes auf Gleichheit vor dem Gesetz praktisch nur erfolgen, wenn die Behörde aus unsachlichen Gründen, die nur in der Person der Partei liegen, diese anders behandelt als andere Personen, wenn die Behörde also willkürlich handelt (die Behörde setzt sich bewusst oder leichtfertig über gesetzliche Bestimmungen hinweg um die Partei zu benachteiligen, dies kann durch qualifizierte Verletzung

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27. *Schimetschek*, Zur Frage der Mitwirkung von Wirtschaftstreuhändern im Verwaltungsgerichtshofverfahren, Finanz-Journal 1977, 33.
28. *Ermacora*, Der Verfassungsgerichtshof, Graz-Wien-Köln, 1956.
29. *Ermacora*, Handbuch der Grundfreiheiten und Menschenrechte, Wien 1963.
30. Hiezu s. insbes. *Kneuker*, Die Bindung des Steuergesetzgebers an den Gleichheitssatz der Bundesverfassung, ÖStZ 1966, 217 und *Gassner*, Gleichheitssatz und Steuerrecht, Veröffentlichungen des Instituts für Finanzwissenschaft u. Steuerrecht, Wien 1970, Mr. 69.

materiell- oder verfahrensrechtlicher Vorschriften geschehen) oder schliesslich, wenn die Behörde der anzuwendenden Norm einen Inhalt unterstellt, der, wenn ihn die Norm tatsächlich hätte, diese mit Gleichheitssatzwidrigkeit belasten würde. Der Gleichheitsgrundsatz gewährt grundsätzlich nur österreichischen Staatsbürgern und inländischen juristischen Personen ein subjektives (und damit in dem hier besprochenen Sinn verfolgbares) Recht.

Im gegebenen Zusammenhang ist auch auf das Grundrecht der *Unverletzlichkeit des Eigentums* [31] hinzuweisen (Art. 5 Staatsgrundgesetz und Art. 1 des Zusatzprotokolles zur Menschenrechtskonvention BGBl. Nr. 210/1958). Diese verfassungsgesetzliche Garantie steht allerdings unter Gesetzesvorbehalt. Beeinträchtigungen privater Vermögensrechte sind sohin durch die einfache Gesetzgebung zulässig, soweit dadurch der Wesenskern des Grundrechtes nicht verletzt wird (das bedeutet, dass das Privateigentum als Institution des objektiven Rechtes jedenfalls unantastbar ist). Abgabenvorschreibungen führen nun immer zu einem Eigentumseingriff. Ist die anzuwendende Norm aus dem Gesichtswinkel des verfassungsrechtlich garantierten Eigentumsschutzes unbedenklich, könnte ein verfassungswidriger Eigentumseingriff durch einen Bescheid dann vorliegen, wenn dieser so fehlerhalt ist, dass er auf der Stufe der Gesetzlosigkeit oder im Wege einer Gesetzesauslegung zustandegekommen ist, die ausserhalb des Rahmens üblicher tolerierbarer Fehlerkalküle liegt, die Gesetzesauslegung sich also geradezu als denkunmöglich darstellt. Blosse Unrichtigkeiten üblicher Art, Fehlerhaftigkeiten, die nicht den Anschein der Gesetzlosigkeit oder Scheinanwendung erwecken und die Rechtsfindung nicht als denkunmöglich erscheinen lasses, führen nicht zur Verfassungswidrigkeit wohl aber zur "Rechtswidrigkeit" des Bescheides, die Wahrnehmung solcher Gründe fällt aber in die Zuständigkeit des Verwaltungsgerichtshofes.

Der verfassungsrechtliche Schutz des Eigentums kommt auch Ausländern sowie ausländischen juristischen Personen zu.

In Österreich versteht man das verfassungsgesetzlich geschützte *Recht auf den gesetzlichen Richter* (Art. 83 Abs. 2 B-VG.) auch als Recht auf den Schutz und die Wahrung der gesetzlich begründeten Zuständigkeiten der Verwaltungsbehörden. Das Einschreiten unzuständiger Behörden wie auch das Ablehnen einer gesetzlich vorgesehenen Entscheidung einer zuständigen Behörde (rechtswidrige Zurückweisung eines begründeten Sachbegehrens) kann sohin (auch) vor dem Verfassungsgerichtshof geltend gemacht werden.

Erkennt der Verfassungsgerichtshof auf Verletzung verfassungsgesetzlich gewährleisteter Rechte wird der Bescheid aufgehoben; die Verwaltungssache wird in die Lage zurückversetzt, in der sie sich vor Erlassung des Bescheides befunden hat. Die Verwaltungsbehörden sind verpflichtet unverzüglich den der Rechtsanschauung des Gerichtshofes entsprechenden Rechtszustand herzustellen.

Der unterliegenden Partei kann der Ersatz der Prozesskosten auferlegt werden.

3. Verfassungsgerichtliche Normenprüfung [32]

Der Verfassungsgerichtshof hat auch unter bestimmten Voraussetzungen Normen dahin zu überprüfen, ob sie mit Vorschriften höherer Stufe in Einklang stehen (Art. 139, 140, 140a B-VG.). Stehen sohin Verordnungen in Widerspruch mit Gesetzen oder mit Verfassungsbestimmungen oder widersprechen einfache Gesetze der Verfassungsordnung, so hat der Verfassungsgerichtshof die aus dem Stufenbaugedanken heraus (Merkl) fehlerhafte — weil mit der höherrangigen Norm unvereinbare — Regelung aufzuheben. Der Verfassungsgerichtshof hat diese Aufgabe im allgemeinen nicht von Amtswegen wahrzunehmen. Es bedarf entsprechender (verfassungsgesetzlich vorgesehener) Anträge.

Da im Abgabenrecht generelle Normen durch Bescheide konkretisiert werden, erübrigt sich der Hinweis auf die durch die Novelle 1975 BGBl. Nr. 302/1975 eingeführte Befugnis von Individuen, eine Normenprüfung zu beantragen, wenn sie unmittelbar durch fehlerhafte Normen in ihren Rechten verletzt zu sein behaupten. Es sollen hier lediglich die in Abgabensachen möglichen Hauptanwendungsfälle in gebotener Kürze geschildert werden.

Demnach leitet der Verfassungsgerichtshof ein Normenprüfungsverfahren ein, wenn er selbst in einem Bescheidprüfungsverfahren eine Vorschrift anzuwenden hätte, von der er vermutet, dass sie mit Normen höherer Stufe in Widerspruch steht (einzige Ausnahme vom vorstehend angedeuteten Antragsprinzip) oder wenn der Verwaltungsgerichtshof gegen eine von ihm anzuwendende Regel Bedenken der Rechtsverletzung der soeben geschilderten Art hat und einen Antrag auf Normenprüfung an den Verfassungsgerichtshof stellt. Die Partei hat kein formelles auf Normenkontrolle gerichtetes Antragsrecht. Es bleibt ihr aber (im Verwaltungs- oder Verfassungsgerichtshof-Verfahren) unbenommen, auf Verfassungswidrigkeiten der anzuwendenden Vorschriften hinzuweisen und damit den Verwaltungsgerichtshof zur entsprechenden Antragstellung bzw den Verfassungsgerichtshof zur amtswegigen Einleitung des Normenprüfungsverfahrens zu motivieren.

Das Prüfungsverfahren setzt also die Präjudizialität der in Frage gestellten Norm für den Bescheid voraus (Inzidentalprinzip). Die Prüfung des Verfassungsgerichtshofes und auch die allfällige Aufhebung erstreckt sich denn auch nur auf die Normenteile, die in der anhängigen Rechtssache anzuwenden wären. Nur bei festgestellter Unzuständigkeit des Normensetzungsorganes und bei Kundmachungsmängeln kann die Norm insgesamt aufgehoben werden; dies gilt auch, wenn eine Verordnung zur Gänze einer gesetzlichen Grundlage entbehrt (also bei extrem schwerwiegenden Mängeln der Rechtserzeugung).

Die Aufhebung der für den Bescheid präjudiziellen Vorschrift bedeutet für den Anlassfall, dass dem Bescheid nunmehr die Rechtsgrundlage mangelt und dass sohin

31. *Adamovich*, Eigentum und Eigentumsbeschränkung im Spannungsfeld von Verfassung und Rechtspolitik, Die Industrie 1973 Nr. 12, 20; *Stolzlechner*, Abgabengesetze und Eigentumsgarantie, ÖZW 1975, 33.

32. *Ermacora*, Verfassungslehre 345; *Walter*, Bundesverfassungsrecht 731, 743, 751; *Walter-Mayer*, Grundriss 265, 270, 274.

auch der Bescheid der Aufhebung verfallen ist. Der von der Verwaltungsbehörde zu erlassende (Ersatz-)Bescheid ist so zu gestalten, als hätte die aufgehobene Norm niemals bestanden (*ex tunc* Wirkung). Auf alle übrigen von der aufgehobenen Vorschrift berührten Fälle, die noch nicht rechtskräftig sind (die Rechtskraft wird durch normaufhebende Erkenntnisse von vornherein nicht berührt, keine Nichtigkeitsfeststellung, sondern rechtsgestaltende Aufhebung), sind, soweit sie Sachverhalte zum Gegenstand haben, die sich vor Aufhebungswirksamkeit ereignet haben, die aufgehobenen Vorschriften weiterhin anzuwenden (der Gerichtshof kann hievon eine Ausnahme vorsehen); die Wirksamkeit der Aufhebung tritt mit Kundmachung des aufhebenden Erkenntnisses des Verfassungsgerichtshofes oder mit Ablauf einer von ihm (bei Verordnungen höchstens mit sechs Monaten, bei Gesetzen höchstens mit einem Jahr) gesetzten Frist ein (Vermeidung einer Legisvakanz, der zuständigen Gesetzgeber kann durch Erlassung neuer Vorschriften die Rechtskontinuität wahren). Abgesehen vom Anlassfall kommt sohin erst den nach Aufhebungswirsamkeit entstandenen Sachverhalten das Ausserkrafttreten der aufgehobenen Norm zugute.

Gründe, die zur Aufhebung von generellen Normen führen, sind hauptsächlich Fehler im Rechtserzeugungsverfahren, aber auch Verletzungen des Gleichheitsgrundsatzes werden immer wieder festgestellt und entsprechend sanktioniert. Eine Überprüfung von Abgabenvorschriften aus dem Blickwinkel des *Grundrechtes der Unverletzlichkeit des Eigentums* wird vom Verfassungsgerichtshof regelmässig abgelehnt. Dieser unter Gesetzesvorbehalt stehende Grundsatz wird im historischen Sinn verstanden; der Gerichtshof geht davon aus, dass ein Abgaben*gesetz* in das Grundrecht nicht eingreifen kann, es sei denn, es liege ein Missbrauch der Abgabenformen vor. Es wird aber versucht Unzukömmlichkeiten durch eine dynamische Interpretation des *Gleichheitssatzes* zu begegnen. Dies ist für Abgabenvorschriften der am meisten beanspruchte Gesetzesprüfungsmasstab. Demnach besteht für die Gesetzgebung die Verpflichtung, andere als objektive Unterscheidungsmerkmale bei einer rechtlichen Behandlung der Staatsbürger beiseite zu lassen. Differenzierungen sind natürlich zulässig, diese müssen aber mit tatsächlichen Unterschieden der zu regelnden Materie in einen vernünftigen Zusammenhang zu bringen sein. Unterschiedliche Regelungen, Grenzziehungen aber auch Gleichschaltungen müssen im Prinzipiellen einer vernünftigen Erfahrung gerecht werden, sind sie sachfremd, sind sie sachlich nicht zu rechtfertigen, dann verstösst der Gesetzgeber gegen den Gleichheitssatz. Der Verfassungsgerichtshof überprüft hiebei nicht, ob die Unterschiede bewirkende Regelung tatsächlich sachgerecht ist, sondern nur, ob sie abstrakt gerechtfertigt werden kann. Daher machen nicht schon jedes Versehen des Gesetzgebers, jede Unstimmigkeit, Ungereimtheit, Unvollkommenheit oder Widersprüchlichkeit sowie rechtspolitische Fehlleistungen ein Gesetz verfassungswidrig; dem Gleichheitssatz widerspricht es nur dann, wenn die Regelungen auf unsachlichen, einem Exzess gleichkommende Entscheidungen des Gesetzgebers beruhen.

In Österreich ist — anders als etwa in der Bundesrepublik Deutschland — die Sachlichkeit einer Vorschrift nicht daran zu messen, ob und welchem Grade sie der Ordnungsstruktur des privaten Rechtes entspricht. Dem Gesetzgeber ist es nach der Rechtsprechung nicht verwehrt im Bereich des Steuerrechtes ein eigenes Anknüpfungs- und Ordnungssystem zu errichten und sogar innerhalb dieses von ihm geschaffenen Ordnungssystems einzelne Tatbestände auf eine nicht systemgemässe Art zu regeln, wenn sachliche Gründe dies rechtfertigen. Der Grundsatz der *Steuergerechtigkeit* hat keinen Verfassungsrang, doch müssen die gesetzlichen Regelungen das Bestreben des Gesetzgebers erkennen lassen, dem allgemeinen Gleichheitssatz Rechnung zu tragen (gemessen am positiven Verfassungsrecht wird sohin Steuergerechtigkeit als Steuergleichmässigkeit verstanden).

Da in Österreich in den hier interessierenden Belangen *Staatsverträge* aus verfassungsrechtlicher Sicht (je nach ihrem Regelungsinhalt und ihrer derogatorischen Kraft) auf der Stufe von Verordnungen oder Gesetzen stehend gesehen werden (Abkommen zur Vermeidung der Doppelbesteuerung [33] werden innerstaatlich wie Gesetze in Kraft gesetzt und entfalten dieselbe Wirkung), erkennt der Verfassungsgerichtshof über die Rechtswidrigkeit von Staatsverträgen im Wesentlichen nach den gleichen Regeln, wie über die Fehlerhaftigkeit autonomer Normen (Art. 140a B-VG.). Steht nun ein in das innerstaatliche Recht auf Verordnungs- oder Gesetzesstufe eingeordneter Staatsvertrag mit Vorschriften höheren Ranges in Widerspruch, wird die Rechtswidrigkeit des Staatsvertrages festgestellt (keine Aufhebung, da ansonsten Beeinträchtigung der völkerrechtlichen Normativwirkung, diese soll nicht beeinträchtigt werden). Die Wirkungen eines solchen Prüfungs- und Aufhebungsverfahrens sind innerstaatlich im wesentlichen dieselben, wie die, die im Falle der Aufhebung autonomer österreichischer Vorschriften eintreten.

Der Feststellung der Rechtswidrigkeit des Staatsvertrages durch den Verfassungsgerichtshof und damit der mit Kundmachung einsetzenden Unanwendbarkeit im österreichischen Rechtsbereich wird eine entsprechende (auf völkerrechtlicher Basis zu gewinnende) Änderung des Vertrages nachzufolgen haben, damit ein dem österreichischen Verfassungsrecht entsprechender Vertragsinhalt der Transformation in den innerstaatlichen Rechtsbestand zugeführt werden kann.

33. Bzgl. Abkommen zur Vermeidung der Doppelbesteuerung s. *Philipp-Pollak*, Internationales Steuerrecht [2], Wien 1976; *Loukota*, Uber das Verhältnis zwischen internationalem und nationalem Steuerrecht, Finanz-Journal 1976, 105.

Basic features of the Austrian tax law and their relationship to international tax treaty law

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The rules of good hospitality call for familiarizing welcomed guests with their new and unknown surroundings in order to facilitate their comfortable adjustment.

In that sense I have the honor and privilege to give guidance to the very welcome participants of the XXXIst IFA-Congress and to explain to them the basic features of the Austrian tax law, in particular those of the Austrian Fiscal Constitution, the relationship between double taxation conventions (i.e. international law) and internal law, the rules of the Austrian tax proceedings and the organization of the tax administration as well as the basic features of the administrative and judicial protection of taxpayers.

It is obvious that for editorial reasons this outline has to be a brief and very rough one on that subject.

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I. DOUBLE TAXATION CONVENTIONS AND THE INTERNAL LAW OF AUSTRIA

Double taxation conventions are primarily a source of international law; but the obligations incurred by the Contracting States on the international level have to be fulfilled in their respective territories. This requires an appropriate incorporation of the double taxation convention into the internal system of law. That subject is not specifically regulated by international law; it is therefore a general problem of the internal state law. This problem will be discussed below in the case of Austria.

Apart from that general question of incorporating an international treaty into an internal legislation system, there can be found some more specific connections between a double taxation convention and national tax law; such specific relations are partly regulated by the international tax law itself and are partly clarified through national interpretation practices.

A. THE INCORPORATION OF A DOUBLE TAXATION CONVENTION INTO INTERNAL LAW

As already pointed out, it is the task of internal state law to provide the rules which are necessary for a proper transformation of an international convention into internal law. In Austria the respective regulations are embodied in the Federal Constitution, as amended in 1929;[1] they have been completed and improved as to some specific points by an amendment made in 1964 (Bundesgesetzblatt No. 59/1964).

When looking at the problem of incorporating a double taxation convention into the internal state law system several particular questions will arise:

1. *Who has the treaty making power with respect to double taxation conventions?*
2. *Can the convention be concluded* uno actu *or must a ratification procedure be applied?*
3. *Which method is used for the incorporation into internal law (general or special method of transformation)?*
4. *What is the rank of a double taxation convention within that scheme of internal legislation?*
5. *What are the legal consequences when a double taxation convention has not been concluded in accordance with internal law?*
6. *What are the effects of the federal structure of Austria on double taxation conventions?*

1. The treaty making power with respect to double taxation conventions

According to the Austrian Constitution the treaty making power is in principle vested in the Federal President (Article 65 para. 1); the Federal President may, however delegate his treaty making power to the Federal Government and to the competent Federal Ministers but only in the case of treaties which neither involve any changes or supplement to internal legislation nor are of a political character. This delegation right has been used by the Federal President since the Austrian Constitution went into effect in 1920; he has delegated his treaty making power to the Federal Government with respect to inter-governmental agreements ("Re

1. Bundesgesetzblatt (Federal Gazette) No. 1/1930.

gierungsübereinkommen"), to the competent Federal Minister in agreement with the Federal Minister of Foreign Affairs with respect to inter-departmental agreements ("Ressortübereinkommen"), and to the competent Federal Minister with respect to inter-agency agreements ("Verwaltungsübereinkommen") (cf. the Resolution of the Federal President of December 31, 1920, Bundesgesetzblatt No. 49/1921, based on Article 66 para. 2 of the Constitution).

The internal authority to conclude an international convention depends therefore in the first instance on whether the convention will change internal legislation (or will supplement it or has a political character) or not. Regarding the Austrian double taxation conventions this question has always been answered in the affirmative. It is true that there exists a provision in the internal tax law (§ 48 of the Federal Procedure Act) [2] which authorizes the Federal Minister of Finance to avoid double taxation; this authorization is not restricted to individual tax cases but might also be taken as a basis for the issuance of general ordinances. However until now no attempt has been made to classify the conclusion of a double taxation convention as a mere executory act of that authorization thereby grouping a double taxation convention with the non-law changing treaties (in fact, the rule of § 48 of the Federal Procedure Act would probably not constitute a sufficient basis for some secondary provisions of a double taxation convention, such as the exchange of information article or the non-discrimination article). Only in the case of double taxation agreements in particular areas (e.g. air transport) would § 48 of the Federal Procedure Act be taken as the legal basis for the conclusion of a non law-changing inter-departmental agreement ("Ressortübereinkommen").

The comprehensive double taxation conventions are therefore considered as law-changing treaties which can only be concluded by the Federal President according to the Constitution.

As with all other law-changing treaties one can distinguish between three main stages in the procedure of concluding a double taxation convention:

1. the stage of negotiations and signature (preliminary proceedings);
2. the approval by parliament;
3. the ratification (the definite conclusion of the convention).

It is the prevailing opinion in Austria [3], that the *whole* procedure, including all activities at the preliminary stage, has to be carried out by the Federal President. This being physically impossible, the Federal President will have to appoint plenipotentiaries to negotiate and sign.

A further problem has been raised by the Austrian governmental structure regarding the nomination of the negotiator of double taxation conventions. International negotiations begun with the aim of concluding a double taxation convention are certainly part of the external affairs of the Republic of Austria, therefore it seems quite reasonable that the negotiator should be a representative of the Federal Minister of Foreign Affairs. Traditionally, however, due to the particularly close relationship of double taxation conventions to internal tax law, double taxation convention negotiations had always been led by a representative of the Minister of Finance. That internal problem of competence has meanwhile been solved by legislation (cf. the Federal Act distributing the competences between the ministerial departments, Bundesgesetzblatt No. 389/1973). The competence for double taxation conventions according to general principles belongs to the Federal Minister of Foreign Affairs who is, however, entitled to transfer that competence to the Federal Minister of Finance. Such transfer of competence in double taxation matters has actually been effectuated by the ordinance of the Federal Minister of Foreign Affairs of July 3, 1974, Bundesgesetzblatt No. 388/1974. Thus, I present once again a representative of the Federal Minister of Finance has the responsibility for the conduct of international double taxation negotiations, after being duly so authorized by the Federal President.

If a treaty is concluded with a foreign country merely on the application of an existing double taxation convention, then such an international agreement would usually not involve any changes in the internal law (nor does it supplement internal laws nor is it of a political nature). Such agreements are therefore considered as inter-departmental agreements ("Ressortübereinkommen") which

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In 1973 he was chosen as a corresponding member of the Academy of Sciences of Austria and in 1974 was elected a permanent member of this organization.

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Major publications (in addition to articles on special subjects):

a) *Rentenbesteuerung (Tax treatment of periodical payments, monograph), 2nd ed. 1967; 3rd ed. in preparation.*
Ermessen im Steuerrecht (Discretionary power in tax law), Vienna 1970.
Die Besteuerung der Genossenschaften (Taxation of cooperative societies), Vienna 1972.
Das Steuerschuldverhältnis in seiner grundlegenden Bedeuting (The fundamentals of tax liability).
Leasing, Steuerrechtliche Beurteilungsgrundsätze (Sale and lease back, the appreciation of its principles), 2nd ed. 1977.
Ertragsbesteuerung der Personengesellschaften (The taxation of income of so-called "Personengesellschaften", i.e. partnerships and the like), 1977.

b) *Joint publications with Min. Rat. Dr. Franz Reeger:*
Kommentar zur Abgabenexecutionsordnung (Commentary on the law on the enforcement of taxes), 1963.
Kommentar zur Bundesabgabenordnung (Commentary on the Fiscal Code), 1965.
Handbuch zur Bundesabgabenordnung (Manual of the Fiscal Code), 5th ed. 1975.

c) *Joint publication with Professor Dr. Walter Korstner:*
Die Gesellschaft mit beschränkter Haftung u. Co. KG in Handels-, Gewerbe- und Steuerrecht (The treatment of "limited liability companies & Co (limited partnerships)" in commercial and tax law), 2nd ed. 1977.

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2. Bundesgesetzblatt No. 194/1961.
3. Cf. *Ohlinger*, Der völkerrechtliche Vertrag im staatlichen Recht, 249.

can be concluded according to the above-cited Resolution of the Federal President by the Federal Minister of Finance (or a representative authorized by him) in agreement with the Federal Minister of Foreign Affairs.

It occurs that an agreement on the mode of application of an existing double taxation convention is reached with the finance administration of the other Contracting State by informal correspondence; the results of such negotiations are not embodied in a formal signed document; it is merely envisaged that the agreed mode of application should enter into force in the two States by the issuance of parallel internal ordinances. The finance administrations are thereby obviously acting on behalf of the two States and the agreement reached by them will not only be of relevance to the tax authorities but will have a binding force on the two States as such, i.e. their agreement will have to be considered as an international treaty (in its broadest sense). Such international arrangements have no immediate effect on the legal position of the individual taxpayer (this effect will be created by the envisaged internal ordinances); they address themselves only to agencies of the two States; under the Austrian legal structure they are therefore grouped with the non law-changing interagency agreements ("Verwaltungsübereinkommen"). By virtue of the above cited Resolution of the Federal President such agreements may be concluded by the Federal Minister of Finance without his being obliged to consult with the Federal Minister of Foreign Affairs.

2. The treaty-making procedure

International law distinguishes between two different types of procedure. In one case the signature alone constitutes the binding force of the treaty for the Contracting States. In the other case the duly authorized signing agent declares his willingness to conclude the treaty only under the reservation that the State on behalf of which he is acting shall be bound by a subsequent ratification (in connection with the exchange or the deposit of the instruments of ratification).

Under the Austrian Constitution the class of law-changing, law-supplementing and political treaties requires an approval by Parliament (Art. 50 para. 2 of the Constitution) and may therefore only be concluded under the last-mentioned procedure (ratification procedure). Since double taxation conventions belong to that class, they can also only be signed under the reservation of a subsequent ratification.

After having obtained the necessary approval from Parliament, the Constitution requires — similar to the internal legislative procedure — a final act of the Federal President: he has to certify by his signature that the convention now fulfills all constitutional requirements. Again as in the internal legislative procedure this act of the Federal President will only be valid if it is countersigned by the Federal Chancellor or by the competent Federal Minister.

The other Contracting State must then be notified of the national ratification of the convention. This is done in historic solemnity by the exchange of the instruments of ratification; only now is the convention definitely concluded.

The date of entry into force has to be distringuished from that date of ratification. Between those two dates a certain delay is usually provided for in the double taxation conventions to allow the fulfillment of the national requirements for the entry into force on the level of internal law (promulgation in the Bundesgesetzblatt). Under internal law the tax authorities would not be entitled to apply the provisions of the new convention in their assessments made before the date of internal promulgation. The absence of such delay between those two dates might produce a discrepancy between international and national law with respect to the date of entry into force; in fact, there exist some Austrian conventions which entered into force on the international level of law exactly on the day of the exchange of the instruments of ratification. Under such circumstances there might be created the strange situation where a double taxation convention which already has a binding force on the international level of law can not yet be applied by the Austrian tax authorities. Such discrepancies are, however, of a rather limited practical importance since all double taxation conventions set out a further relevant date, i.e. the beginning of the period *for* which the convention has to be applied. This beginning date of the effectiveness of the convention corresponds usually to the beginning of the fiscal year and renders the problem of differing dates of entry into force a very harmless one. The tax office will simply have to postpone a little the assessment of those years which are covered by the Convention until the convention has been published in the Bundesgesetzblatt.

Conventions which are not subject to parliamentary approval (treaties not being law-changing, law-supplementing or political) may be concluded both ways, either *uno actu* or under the ratification procedure. Such treaties in the area of international tax law (especially agreements on the mode of application of double taxation conventions) are for reasons of administrative efficiency always concluded by using the simpler *uno actu* method. It might, however occur that such agreements need a ratification procedure under the internal law of the other contracting State. This happened e.g. with the Austro-German convention on the vehicle's taxation in international traffic. [4] This treaty had on the Austrian side no law-changing effect (due to an appropriate tax exemption provision in the Austrian Vehicle's Tax Act [5]) and could have been concluded *uno actu* in the form of a "Ressortübereinkommen"; because of the German position the ratification procedure had been adopted also by the Austrians.

3. The method of transformation

International treaties are a source of international law and as such they establish rights and obligations only between States and other subjects of international law. Principally they address themselves to States. The States, however, are obligated to execute the contractual commitments in their territories. International law does not contain any regulations concerning the method to be used by the States for such internal execution of treaty law. In practice there are two methods available for the incorporation of treaty law into the national legal structure: an unconditional and general transformation into internal law without any specific legal disposition (general transformation) and a transformation into internal law by special legal action (special transformation).

Like most continental European systems of law the Austrian Constitution has adopted the method of general transformation. The Austrian double taxation conventions and their application agreements are therefore valid as such on the level of internal law; their applicability does not depend on the issue of any legal regulation.

One of the disadvantages of the general transformation method can be seen in the fact that this method makes it very difficult to keep the internal law free from provisions which do not fit well with the internal system of law. Due to increasing international cooperation and due to the frequently arising necessity to accede to existing conventions or to adopt internationally accepted treaty provisions, it is obviously impossible to negotiate only with regard to conventions which are entirely in harmony with the legal philosophy of all contracting States.

The Austrian constitutional legislature has therefore introduced the possibility of using alternatively the method of special transformation by means of the 1964 amendment to the Federal Constitution. Article 50 para. 2 of the Federal Constitution sets out in its amended version that Parliament may in the course of the approval procedure of law-changing, law-supplementing or political treaties decide that the treaty has to be fulfilled by the issu

4. Bundesgesetzblatt No. 128/1971.
5. Bundesgesetzblatt No. 110/1952.

ence of a special law. In the case of other treaties which are not subject to parliamentary control the decision to use the method of special transformation has to be made by the Federal President or by any other agent having the treaty-making power (Article 65 para. 1 and Article 66 para. 2 of the Federal Constitution).

In the area of the avoidance of international double taxation it has not been necessary to protect the international commitments by passing special laws or special ordinances; therefore double taxation conventions and agreements on the mode of application of tax treaties are transformed into internal law by using only the general transformation method since the said amendment of the Constitution. This fortunate situation is certainly to some extent due to the fact that the later Austrian double taxation conventions are all based on the OECD Model Convention; the Austrian finance administration had the opportunity to take part in the elaboration of that Model Convention in the Fiscal Affairs Committee of OECD and to attempt there to omit or redraft provisions which could not have been brought in accordance with the national system of law.

4. The rank of double taxation conventions in internal law

The Austrian internal hierarchic system of law is seen as a graduated scale of legal provisions; the top grade is composed of constitutional law; the second grade is formed by ordinary law and the third grade is composed of ordinances. The legal provisions of the higher grade have to supply full authority for the issue of the provisions of the lower grades.

In the context of the transformation of a double taxation convention into internal law the question arises which rank should be attributed to the convention within the hierarchic framework of that internal scheme of law.

The former opinion was that international treaties must rank with constitutional law; this theory was based on the fact that all international agreements are anchored in the maxim "*pacta sunt servanda*", which is one of the generally accepted rules of international law. [6] The prevailing interpretation of today is that in Austria international agreements may rank on each of the three levels of law. Treaty provisions of constitutional rank must be expressly identified as changing constitutional law and must meet with the approval by Parliament necessary for internal constitutional law. Other treaty provisions which are submitted for parliamentary approval enjoy the rank of ordinary federal law; the remaining treaties have the rank of ordinances.

The Austrian double taxation conventions are not regarded as involving any changes on the level of constitutional law and are therefore allocated to the rank of ordinary law.

This position brings up two problems. First, this rank implies that all provisions of the double taxation convention must be covered by the Constitution; that is to say, they must find a sufficient legal basis in constitutional law. A lack of such conformity with constitutional law could lead to a review of the convention before the Constitutional Court which might finally result in a cancellation of the unconstitutional treaty provisions. This question of conformity with the Constitution is sometimes not very easy to answer. It has already been argued that, e.g. the "students article" of a double taxation convention (Art. 20 of the OECD Model Convention) possibly conflicts with Article 18 of the Constitution. This constitutional provision states that governmental administration can only be exercised by virtue of law; the interpretation of that rule says — inter alia — that the provisions of ordinary law must be exactly determined so that a proper execution is possible; legal provisions which do not meet such a requirement are in conflict with the Constitution. As far as the students article is concerned, it was claimed that the term student is much too uncertain since it is not sufficiently clear whether that term comprises only, e.g., academic scholars of universities, or also of lower grades.

The second problem concerns the derogative effect of law. Double taxation conventions cancel the applicability of opposing provisions of internal tax law within their field of application and in accordance with the principle "*lex posterior derogat legi priori*". It appears that this derogative effect of double taxation conventions meets general consent. But some doubts may arise whether subsequently issued national tax law has the legal power to alter preceding treaty provisions. [7] Such possibility is not denied. Under those circumstances the question has to be resolved whether e.g. the new income tax deduction introduced in 1973 for non-residents on remuneration for the supply of manpower, which is in conflict with the permanent establishment rule of double taxation conventions, could have a derogative effect on the contrary provisions of previously concluded double taxation conventions.

The Austrian tax administration has tried to find a solution for that issue on the grounds of the jurisdiction of the Administrative Court which regards double taxation conventions in relation to national tax law as a "*lex specialis*" (cf. dec. of June 28, 1963, Zl. 2312/61). Pursuant to that opinion the Austrian tax administration argues that with reference to the principle of "*lex specialis derogat legi generali*" a subsequently issued tax law can not exercise a derogative authority on preceding treaty provisions in their special field of application. That means for the above described case that remuneration for the supply of manpower can — due to the permanent establishment rule of the existing double taxation conventions — be paid tax free to foreign enterprises.

Agreements concluded for the mode of application of double taxation conventions are put as to rank on the level of ordinances since they are not submitted to Parliament for approval.

5. Legal consequences of illegal conventions

If an international treaty has failed to fulfill all necessary requirements established by national law, then it would hardly be claimed today that this might affect the international validity of the treaty. Such opinion had once been favoured by the framers of the Austrian Constitution [8] but had not found general support later on. According to international law any State may trust in the principle that a treaty concluding country is correctly applying and interpreting its internal constitution. A country which concludes bona fide a treaty with another State without knowledge of the limitation of the treaty making power of the agents acting for that other State may claim indemnity if such other State does not accept the commitments of the treaty. [9]

For the sake of juridical security also the Austrian internal system of law does not have legal acts which are nul and void but only acts which can be annulled. Consequently, an unlawful international convention will first be valid also on the internal level of law, regardless of whether the unlawfulness is due to a failure in procedure (e.g. a law-changing treaty had not been submitted to parliament) or is due to illegal treaty regulations (e.g. a treaty provision is not covered by the Constitution).

Since the amendment of the Austrian Constitution in 1964 there exists the possibility of judicial review of the constitutionality of an international convention before the Constitutional Court.

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6. Cf. *Kunz*, Völkerrechtliche Bemerkungen zur österreichischen Bundesverfassung, 320.
7. Cf. *Ohlinger*, Der völkerrechtliche Vertrag im staatlichen Recht, 225.
8. Cf. *Kelsen-Fröhlich-Merkl*, Die Bundesverfassung vom 1. Oktober 1920, Bemerkungen zu Art. 50.
9. Cf. *Verdross*, Völkerrecht [4], 105.

If the Constitutional Court grants a request for annulment and declares the treaty to be illegal, then the treaty will cease to be applicable on the internal level of law from the date of promulgation of such decision; the Court might also state a delay for the entry of inapplicability. This delay must not exceed two years in the case of law-changing (law-supplementing or political) treaties and one year in all other cases.

This legal situation explains why Austrian delegations are always anxious to avoid any limitations of denouncement clauses like "the convention may not be denounced before the expiry of a period of five years. . ." in their double taxation negotiations. Because once a provision of a double taxation convention is annulled by the Constitutional Court the Austrian Government must have the opportunity to make such treaty provisions compatible with internal law; if necessary this may be done by way of denunciation.

6. Double taxation conventions and the federal structure of Austria

Austria is a federal State whose legislative as well as administrative power is divided between the Central (Federal) State and the Federal Länder. This applies also for tax matters. However, attention must be drawn to the fact that by far the main part of the total Austrian tax receipts (95 percent) is derived from "Federal Taxes" ("Bundessteuern"). Federal Taxes are regulated by federal law and are usually collected through federal agencies (the Federal Tax Administration). The yield of the most important Federal taxes (especially value added tax and income tax) does not go entirely to the federal budget but has to be shared with the other political subdivisions (Federal Länder and Communities).

The scope of double taxation conventions in general comprises only Federal Taxes; therefore there are no significant problems due to the federal structure of Austria.

There are only three cases where a double taxation convention applies to taxes which are not federal: in the case of the tax on commercial and industrial enterprises (Gewerbesteuer), but only for that part which is levied for the Communities (Gemeinden); in the case of the tax on the sum of wages (Lohnsummensteuer); and in the case of the land tax (Grundsteuer).

Although those three taxes are formally taxes of the Communities (Gemeindeabgaben) (because the Communities have an unconditional claim on the tax proceeds), the legislative power for those taxes is, deviating from the general principle, not attributed to the Federal Länder but to the Central State. The conclusion of a double taxation convention by the Central State therefore does not create any difficulties even for those three taxes. In addition, as regards the taxes of the political subdivisions a specific provision of the Austrian Fiscal Constitution, Bundesgesetzblatt No. 45/1948 (§ 7 para. 4), has transferred to the Central State the competence to act for the avoidance of double taxation, to harmonize such taxes with the rules of international tax law and to avoid impediments in relation to foreign countries.

The only practical effect of the federal structure of Austria on double taxation conventions results from the obligation of the Central State to share the yield of its most important Federal Taxes with its political subdivisions. If the conclusion of a double taxation convention or any other action on the central level might reduce the political subdivisions' share in the yield of Federal Taxes, then negotiations have to be opened in due course with the subdivisions concerned (§ 5 of the Finanzausgleichsgesetz 1973, Bundesgesetzblatt No. 445/1972).

B. SPECIAL RELATIONS BETWEEN DOUBLE TAXATION CONVENTIONS AND INTERNAL TAX LAW

Besides the rather general question of incorporation of double taxation conventions into domestic legislation which has already been discussed, there are to be found some more specific relations between double taxation law and internal tax law which also require appropriate clarification. Seen from the Austrian practice of application of double taxation conventions, those issues could be summarized as follows:

1. *Are double taxation conventions a source of taxation rights which have not been established by the internal tax law?*
2. *Does a double taxation convention influence the manner of execution of taxation rights attributed to Austria?*
3. *Is internal tax law of any relevance for the interpretation of double taxation conventions?*
4. *Are double taxation conventions of any relevance for the interpretation of internal tax law?*

1. The double taxation conventions are not creating new taxation rights

It sometimes happens that a double taxation convention attributes taxation rights to Austria which are not known under internal tax law. To explain that by an example, Article 11 para. 2 of the Austro-Swiss double taxation convention (Bundesgesetzblatt No. 63/1975) provides a 5 percent taxation right on interest payments to the source country. If a creditor resident in Switzerland has granted a loan to an Austrian enterprise, then the double taxation convention gives Austria the right to levy a 5 percent tax on the interest paid for such loan. Under internal law (cf. § 98 of the Income Tax Act 1972, Bundesgesetzblatt No. 440/1972) such interest paid to a non-resident would only be taxable, if it was secured by a mortgage in Austria. If this is not the case then the question arises whether the Austrian tax authorities are entitled to collect the 5 percent tax as provided in the double taxation convention which, as explained above, has equal rank with the Income Tax Act.

In Austria this question has always been answered in a negative sense. That interpretation problem has also been discussed before the Constitutional Court (decision of March 11, 1965, B 210, 211/1964). It is said in that decision that the principal task of a double taxation convention consists of the division of the taxation rights between the two Contracting States; therefore the only effect of a double taxation convention is restricted to a cut down of national taxation rights. The Constitutional Court concludes that a taxable item, the taxation of which is allocated by the convention to a contracting State, may only be taxed in that State if this is permitted by its internal law.

This theory about the effects of double taxation conventions on internal tax law had already been developed by the judiciary in the former German Reich (cf. judgement of the German Reichsfinanzhof of October 3, 1935 III A 267/34, Reichssteuerblatt 1935, page 199); yet it is not without criticism. [10] Doubts about its justification will arise especially in those cases where it leads to a double- *non*-taxation.

If, for example, a German enterprise has acquired real estate in Austria which is not used for the industrial or commercial activities of that enterprise (and which therefore does not constitute a permanent establishment of that enterprise) and if such real estate is sold after 6 years, then article 3 of the Austro-German double taxation convention, Bundesgesetzblatt No. 221/1955, gives Austria the taxation right on the capital gains realized by that transaction. Under domestic law, gains realized by a foreign enterprise in Austria are only taxable if they are attributable to a permanent establishment of that foreign enterprise in Austria or if they result from the disposal of Austrian real estate within five years after acquisition (speculative gains period); some other very specified cases of taxation of a foreign enterprise, as established in § 98 of the Income Tax Act, are of no interest for the present case. Under those circumstances Austria would be entitled to tax the gains derived from the alienation of the Austrian immovable

10. Cf. *Kruse* in Österreichische Steuerzeitung 1975, 200, Anm. 70.

property by virtue of the Convention but is not allowed to do so by its internal law; on the other side, Germany does have the taxation right under its internal law (unlimited tax liability) but would not be allowed to exercise that right because of the rules of the double taxation convention.

2. The relevance of national law for the execution of taxation rights attributed by the convention

According to the principle that a double taxation convention can only restrict national taxation rights but has not the legal power to create new taxation rights, the question of *whether* a taxation right can be exercised by Austria in a given international taxation case has to be resolved by application of international *and* national law; the further question of *how* such taxation may be realised has to be answered by the sole application of national law.

This rule had for instance some importance in the following case: interest derived from sources in the United States of America are taxable in Austria by virtue of Article VII of the Austro-American double taxation convention, Bundesgesetzblatt No. 232/1957. A taxpayer resident in Austria, who received interest income from US state bonds and municipal bonds contested his Austrian tax liability with the argument that such interest income is tax free under US income tax law; he claimed that according to the double taxation convention the Austrian tax authorities were bound to respect that tax exemption. The position of the Austrian tax administration was governed by the above rule and it was argued that the double taxation convention allocated the taxation right to Austria but in no way prescribes how the taxable amount of foreign income has to be ascertained by the Austrian tax authorities. Therefore the tax concessions granted by the US income tax law can be of no importance for the determination of taxable income in Austria. This case was brought before the Austrian Administrative Court but the Court's decision (decision of May 27, 1977, Zl. 417/1966) was in favour of the arguments of the tax administration.

The present rule shows some significance also in connection with the calculation of exempt foreign income for purposes of the computation of the progressive Austrian income tax on non-exempt income. One can frequently observe that taxpayers declare their exempt foreign income as the amount stated in the tax notice of the foreign tax office. This practice seems, however, only acceptable if the provisions for the determination of taxable income are similar in the two countries; strictly speaking, the present interpretation rule would require that in all cases foreign income has to be recomputed on the basis of Austrian income tax law.

Another area for an application of that rule may be found in cases of double residence. If, for example, a taxpayer is resident in Germany and has a secondary residence in Austria (the center of vital interests being in Germany) and his sole income from Austrian sources consists of rental income from the lease of Austrian dwelling houses, then he has a fiscal domicile in Austria and is consequently subject to "unlimited tax liability" under internal law, which means that his German income and income from other countries also would be liable to Austrian income tax. On the other hand, unlimited tax liability also grants to the taxpayer certain tax advantages (e.g. deductibility of life insurance premiums, of certain extraordinary burdens like hospital expenses, the application of certain tax credit amounts etc.) which are not available for non-resident taxpayers as those tax subjects are only liable to Austrian tax as to their income from Austrian sources (limited tax liability). Now, the Austro-German tax convention gives Austria the right to tax the domestic rental income but excludes Austria from a taxation of German and other foreign income. It could therefore very well be argued that if the taxpayer's tax liability is reduced by the convention to the small tax liability of non-residents then there should similarly be a reduction of those tax advantages which are granted to non-residents. The application of the present interpretation rule instead produces the converse result stating that the convention does not interfere with the question of *how* the rental income of the German taxpayer is taxed in Austria; this question has to be settled by internal law. Under internal Austrian law the tax advantages connected with unlimited tax liability are the same regardless of whether the tax liability is based on principal residence or is based on secondary residence. Therefore there would be no valid argument to refuse the said tax advantages to the taxpayer.

It should be noted that Austria has already taken a first step to eliminate that undesirable situation on the level of its internal legislation. In the field of capital taxation the tax exempt amounts which are equally related to unlimited tax liability have been cancelled in all cases where a taxpayer domiciled in Austria is treated as a resident of a foreign country by a double taxation convention (cf. Amendment of the Capital Tax Act in 1976, Bundesgesetzblatt No. 665/1976, fig. 1).

3. The relevance of internal law for the interpretation of double taxation conventions

The principle that national law has to be applied for the interpretation of double taxation convention is arrived at from Article 3 para. 2 of the OECD Model Convention by the Austrian tax administration. This provision says:

> *"As regards the application of the Convention by a Contracting State any term not otherwise defined shall, unless the context otherwise requires, have the meaning which it has under the laws of that Contracting State relating to the taxes which are the subject of the Convention."*

The practical importance of that rule shall be demonstrated in the following case: a Swiss enterprise constructed an apartment building in Austria which is leased to a German enterprise. The German enterprise subleases the flats to Austrians. This does not create as such a permanent establishment for the German enterprise. Under those circumstances there is obviously no doubt that the rents paid by the German enterprise to the Swiss enterprise are taxable in Austria in accordance with the immovable property rule of the Austro-Swiss double taxation convention. It becomes, however, a bit ambiguous whether the German enterprise also may be taxed with respect to the rentals received from the Austrian sublessees. Article 3 of the Austro-German double taxation convention provides that income derived from immovable property situated in Austria may be taxed in Austria. So the question arises whether a sublease-contract should be regarded as the lease of the rights of a leasing contract — which would mean the lease of intangible *movable* property — or if it should be regarded as a lease of immovable property; this question is not specifically dealt with in the Austro-German convention. The Austrian tax authorities are bound to decide that question solely on the basis of internal law which settles this question in the last-mentioned sense. [11]

Naturally, this interpretation rule is not applicable where the convention has expressly stated otherwise. It would therefore not be permitted to refuse the application of the "dividend-rule" of double taxation conventions for profit distributions of companies with limited liability because under Austrian law only profit distributions of joint stock companies are called "dividends". In that case the convention itself has defined the term "dividends" as including the distributions of profits of all "Kapitalgesellschaften".

4. International tax law has no relevance to the interpretation of national tax law

It would certainly be wrong to conclude from the afore-mentioned rule stating the relevance of internal law for the interpreta-

11. Cf. *Schubert-Pokorny-Schuch*, Einkommensteuerhandbuch Anm. 22 to § 98; and decision of the Administrative Court of March 16, 1971, Zl. 1357/1970).

tion of double taxation conventions that there is also an influence exerted in the opposite direction from international law upon national tax law.

If a Swiss enterprise has established an agency solely for the supply of information in Austria, then this agency would not be considered to be a permanent establishment under the definitions of the Austro-Swiss double taxation convention (Art. 5 lit. e). But this definition can only be valid on the international law level; which precludes Austria from any income or capital taxation of that agency. It would not seem to be justified to draw the conclusion that this agency does not constitute a permanent establishment for the purpose of the Value Added Tax either. Under the Austrian Value Added Tax Act 1972, Bundesgesetzblatt No. 223/1972 (§ 12) foreign enterprises are entitled to claim a deduction or refund from "input tax" ("Vorsteuer") under the condition (inter alia) that they have a permanent establishment in Austria. For the interpretation of the term "permanent establishment", as used in the VAT-Act, only internal law can be employed; according to internal law (§ 29 of the Federal Procedure Act, Bundesgesetzblatt No. 194/1961) such agencies are also treated as permanent establishments; it would therefore not be permitted to refuse a deduction of "input tax" to the Swiss enterprise by reference to the definitions of the Austro-Swiss double taxation convention.

The permanent establishment definition of the double taxation convention must also remain without relevance for the question of whether the employees of that agency have to pay their income tax by assessment or by deduction at the source. The Income Tax Act provides a deduction system only if the employer has a permanent establishment (§ 81 of the Income Tax Act) in Austria. Again the determination of whether the agency constitutes a permanent establishment for wage tax purposes can not be based on treaty definitions but solely on the definitions of internal law.

C. SUMMARY

Without touching the problems of the relations between international law and national law in the sense of a monistic or dualistic theory, it seems to be a matter of fact that these are two different areas of law which, however, have some connections. It was the purpose of this article to outline such connecting relations in the field of international avoidance of double taxation in the case of Austria.

Double taxation conventions are primarily a source of international law. One of the most important relations between treaty law and national law is due to the fact that treaty law has to be enforced in the territories of the Contracting States which requires an incorporation of treaty law into the national system of law. In the case of Austria, treaty law is incorporated by using the method of general transformation; the method of special transformation could be employed alternatively but has not yet been applied with regard to double taxation conventions. For a proper transformation into national law certain requirements established by the Constitution have to be observed: double taxation conventions may only be concluded by the Federal President; they are changing internal law and therefore need an approval by parliament; this implied that they cannot be concluded *uno acto* but need a ratification clause. Double taxation conventions have the rank of ordinary federal law; their regulations must therefore be in full agreement with the Austrian constitutional law. Any illegality in the concluding procedure or in the substance of treaty regulations does not make the convention nul and void but could lead to a repeal (having effect *ex nunc*) by the Constitutional Court; such annullment refers only to the national validity of the convention and does not affect the binding force on the level of international law.

Some further links between international tax treaty law and national law which have to be clarified for a proper application of double taxation conventions can be summarized as follows: double taxation conventions do not create taxation rights which are not established by national law; the manner in which taxation rights attributed by the convention have to be exercised can only be decided by the national law; double taxation conventions have to be interpreted along the lines of internal law, but double taxation conventions are not used for the interpretation of national law.

II. THE ENFORCEMENT OF PUBLIC TAX CLAIMS AND THE LEGAL PROTECTION OF AUSTRIAN TAXPAYERS (UNDER SPECIAL CONSIDERATION OF POSSIBLE INTERFERENCE WITH INTERNATIONAL TAX LAW)

A. THE ORGANISATION OF THE TAX ADMINISTRATION

Federalism[12] is a guiding and predominant principle of the Austrian Constitution. Federalism in that sense means that the legislative power as well as the executive power are divided between the Central State ("Bund") and the Federal Länder ("Bundesländer") — the judicial power, however, being exclusively reserved to the Central State; further, the Federal Länder are entitled to cooperation in the framing of federal legislation (they have a suspending veto in the second — Federal — Chamber of Parliament). The administration of the Central State is only in part exercised directly through federal agencies (this applies e.g. to matters of taxation, state monopolies, patent affairs, and to post and military administration). The main part of the governmental affairs of the Central State is, however, administered by using the "indirect federal administration system" ("mittelbare Bundesverwaltung"), according to which agencies of the Federal Länder (the Governors of the Federal Länder and their subordinate offices and district offices) are charged with the execution of the administrative power of the Central State; in that particular function the agencies of the Federal Länder are acting on behalf of the Central State and are therefore, in that respect, subject to orders and instructions of the central administrative bodies of the federal government.

The lowest level of the administrative organisation of Austria is constituted by the Communities ("Gemeinden"); they are, like the Central State and Federal Länder, territorial entities ("Gebietskörperschaften"); they are given jurisdiction over their local affairs but they are also units of state administration. Just as certain areas of jurisdiction have been accorded to the Federal Länder by the Constitution (which may be exercised fully independently from agencies of the Central State), certain powers have also been assigned to the Communities which may be exercised

12. Art. 2 of the Federal Constitution; definition of the term and references to further literature cf. *Ermacora*, Österreichische Verfassungslehre, Wien 1970, 251; *Walter*, Österreichisches Bundesverfassungsrecht, Wien 1972, 107; *Walter-Mayer*, Grundriss des österreichischen Bundesverfassungsrechts, Wien 1976, 45.

equally without intervention of the Central State or of the Federal Länder (autonomous jurisdiction). But as the Federal Länder are to a certain extent held to act also on behalf of the Central State ("indirect federal administration system") also the Communities are charged with some duties which are not related to their autonomous jurisdiction but result from their function as an administrative unit of the State (deferred jurisdiction).

Along these lines, in Austria the legislative power is divided only between the Central State and the Federal Länder, whereas the administrative power is attributed to all three levels of government, to the Central State, the Federal Länder and the Communities; activities of the Federal Länder and of the Communities performed within the scope of deferred jurisdiction are subject to orders and instructions of the superior government.

In spite of the fact that inferior territorial entities of the State ("Gebietskörperschaften") might be charged with administrative duties on behalf of the superior territorial entity (an upwards transfer of duties from the inferior entity to the superior entity would be permitted if the entity so charged agrees; but this occurs very rarely) it appears that the principle of federalism has been successfully accomplished not only with regard to the distribution of the legislative powers but also with respect to the organisation of the administration. Following that concept of federalism, one is inclined to assume that it is the responsibility of the territorial entities of Austria to raise their own revenue necessary to cover the cost of their administrative activities; especially by means of collecting their own taxes. Such solution, which corresponds to the federal system, is outlined in the Constitution[13] but has not been adopted in practice. This may be explained historically: only the Central State has always had a very effective administrative body at its disposal for raising tax revenue, which is well organized and staffed with well trained personnel. It has not been found feasible to establish another similar organisation on the level of the Federal Länder and the Communities. This is the simple reason why the tax administration of the Central State has always collected the more important and significant taxes[14]. In spite of their virtual sovereignty in tax matters, as provided by the Constitution, the Federal Länder and the Communities administer only some minor taxes; this is due to their restricted tax collecting machinery. From the total tax revenue of Austria approximately 95 percent is levied by the tax administration of the Central State. In pursuance of the principle of federalism and according to the constitutional obligation to maintain all territorial entities[15] the financial maintenance is secured by granting to the Federal Länder and to the Communities an appropriate share of the yield of the taxes levied by the Central State and by according to them certain financial transfers and contributions.

The classic taxes on income, turnover, capital, and taxes on certain transactions as well as the taxes on consumption, state monopolies' duties and customs duties, are all levied through the tax authorities of the Central State.

The statutory regulations of the organisation of the tax administration of the Central State are set out in the Federal Tax Act of December 13, 1974 Bundesgesetzblatt No. 18/1975 (Abgabenverwaltungsorganisationsgesetz — AVOG) and partly in the Federal Act dividing jurisdiction among the Federal Ministries of 1973 (Bundesministeriengesetz 1973), Bundesgesetzblatt No. 389/1973. If certain exceptional cases, as specified by law, are admitted the enforcement of the public tax claims is on the local level ("first instance") conducted by *tax offices* ("Finanzämter"). Customs are on the local level collected by *customs offices* ("Zollämter").

The intermediate instance, basically on the level of the Federal Länder, is composed of the *Regional Finance Directorates* ("Finanzlandesdirektionen"); in relation to the finance offices and to the customs offices they are superior and have directing authority; they are, further, the appellate authority. Activities of a mere "first instance character" are assigned only in very rare cases to the Regional Finance Directorates (in particular in consumption tax affairs and with respect to customs duties).

The supreme administrative authority in tax matters is vested in the *Federal Ministry of Finance* ("Bundesministerium für Finanzen"). As regards financial affairs it is in particular responsible for matters concerning the Fiscal Constitution, concerning the fiscal equalisation between the Central State and its political subdivisions ("Finanzausgleich"), concerning the Federal Budget and concerning legislative measures like the preparation of government bills with respect to such matters. Only very exceptionally (if explicitly prescribed by law) would the Federal Ministry make a decision in an individual tax case because its predominant function is its supreme organising and directing power.

"First instance decisions", which are of interest here, are rendered by the Federal Ministry of Finance in international tax affairs; in the absence of double taxation conventions or if such conventions fail to eliminate international double taxation the Ministry of Finance may grant upon request of the taxpayer an exclusion from taxation of certain elements of the tax base or that foreign taxes charged on such elements be credited wholly or partly against Austrian tax (§ 48 of the Federal Procedure Act); further, it falls under the jurisdiction of the Ministry of Finance to allow credit for foreign inheritance or gift taxes[16] to Austrian tax with respect to assets situated abroad. Finally, the Ministry of Finance may issue "immigration tax privileges" ("Zuzugsbegünstigungen") in the field of income and capital taxation[17] if taxpayers have moved their domicile from a foreign country to Austria and are not gainfully employed in Austria (roughly speaking, this tax privilege tends to mitigate the effects of unlimited tax liability created by taking up residence in Austria). Due to its capacity as the supreme administrative body of the Austrian tax administration the Ministry of Finance has to act in mutual agreement procedures under double taxation conventions (cf. art. 25 of the OECD Draft Convention and the respective bilateral conventions).

The "Land" Finance Directorates are the last instance for taxpayer appeals; the Federal Ministry of Finance is not organised as an appellate authority. Therefore, in Austria, redress to higher administrative instance may only be sought as to decisions of Finance Offices or of Customs Offices; the remedy of an ordinary administrative appeal would not be available as to decisions of the "Land" Finance Directorates or of the Federal Ministry of Finance; regardless of whether such decisions are rendered on appealed cases or have a mere "first instance character".

Tax provisions of double taxation conventions form part of the internal tax law system after approval by Parliament; the source of tax law (national or international) therefore does not affect the jurisdiction of the tax authorities. Neither any special agencies are established nor do any special rules of competency exist with regard to international tax cases, i.e. especially cases of international double taxation conventions or other cases where international bilateral or multilateral treaties have to be applied.

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13. § 2 Fiscal Constitution 1948, BGBl. Nr. 45/1948.
14. Pursuant to § 3 of the Fiscal Constitution it is the federal legislature which distributes the taxation rights and the tax proceeds (for that purpose are passed "Finanzausgleichsgesetze", the last being promulgated under BGBl. No. 445/1973); cf. *Melichar*, Die österreichische Finanzverfassung, and *Wissgott*, Der Finanzausgleich in Österreich, in Handbuch der österreichischen Finanzwirtschaft, edited by Andreae, Insbruck 1970, 13 and 59.
15. § 4 of the Fiscal Constitution 1948.
16. § 6 para. 3 Inheritance and Gift Tax Act 1955, BGBl. No. 141/1955.
17. § 103 Income Tax Act 1972 and § 10 Capital Tax Act 1954.

B. THE ADMINISTRATIVE ENFORCEMENT OF PUBLIC TAX CLAIMS; BASIC RULES OF PROCEDURE

Under Austrian tax law — as e.g. under German law — the tax claim is a claim of public law inherent in the State against the taxpayer (who incurs a corresponding tax liability) which comes into being upon the fulfillment of all respective conditions as set out in the tax law. This means that it is the factual action of the taxpayer which for itself constitutes the tax claim of the State if such action conforms with the abstract rule of a provision of tax law[18]. This concept is based on the idea of a pure "law-bound-taxation" ("Gebot der Tatbestandmässigkeit der Besteuerung") and on the fundamental principle that the whole administration must be exercised only by virtue of law;[19] it is therefore not the delivery of the tax notice but only the action of the taxpayer covered by a rule of tax law which constitutes both the tax claim of the government and the tax liability of the taxpayer. From that view the activities of the tax authority which end up in the delivery of the tax notice[20] are only of a declarative nature and do not create any tax liability as such; the tax notice for itself does not create the public tax claim but is only an administrative vehicle to enforce an already existing tax claim and it is a prerequisite for possible subsequent compelling actions against the taxpayer (a call to pay and the basis for an execution order).

The rules of tax procedure[21] had to be shaped with a view to the specific character of tax claims as being claims of public law; they have to respond to the principle of a "law-bound-taxation" (Tatbestandmässigkeit der Besteuerung) and should meet the requirements of an administrative procedure which in its entirety is prescribed by statutory law. In that sense the following basic procedural rules can be outlined:

A predominant feature of the Austrian tax procedure can be seen in the principle that the tax authorities are acting *ex officio*, which means that — omitting certain proceedings which are only opened upon request (e.g. certain customs proceedings) — it is the tax authority which opens, directs and closes the tax proceedings and it is the responsibility of the tax authority to find out all the facts relevant to a proper determination of the tax; the taxpayer is obliged to cooperate; he is bound to disclose in full the truth and, without any restriction the facts which are material for taxation purposes; failures to meet such obligations would be sanctioned by penalties. Due to the legally provided *ex officio* principle the tax authority is concerned with the entire fact finding process (statement of the relevant facts and production of appropriate proof); accordingly, the tax authority has to consider not only facts in favour of the public tax claim but also circumstances which reduce or might even deny the tax liability. In line with the general procedural rule that nobody shall demand unrealizable or irrelevant action the obligation assigned to the tax authority to ascertain *ex officio* the relevant state of facts will be limited where a taxpayer is not willing to render appropriate cooperation. If the taxpayer refers to extraordinary and therefore unusual facts the burden of proof will rest upon him. The taxpayer's obligation to cooperate increases in international tax cases while the corresponding obligation of the tax authority to inquisitorial fact finding decreases; here the tax authority does not possess such manifold administrative remedies for the ascertainment of the facts as in domestic taxation cases. If the taxpayer fails to meet his obligation for cooperation, the tax authority would be entitled to determine the tax claim upon the material at hand as well as upon reasonable assumptions without taking into consideration all possible eventualities and without being obliged to prove all facts of reference.

This leads to the principle of the *free appreciation of evidence* ("freie Beweiswürdigung") which — like in any other modern procedural system — means in its core that the authority autonomously decides after careful examination of the outcome of its investigations whether the fact in question has been proved or not. Free appreciation of evidence does, however, not mean liberation from the rules of logic. If the existence or nonexistence of the fact at issue is inferred from some other properly proved collateral facts, then such inference must follow the rules of logic. There must remain a correct and rational relationship between the individual steps of reasoning, the respective considerations and assumptions must be conclusive and the taxpayer must be notified in order to enable a verification of the arguments of the tax authority. Before the closing of any tax proceedings the taxpayer must be given the opportunity to comment on the fact findings of the tax authority and to present his own views on the facts and to lodge objections, so that a most accurate ascertainment of the truth is secured *(Principle of hearing the taxpayer)*. To enable a proper defence of the taxpayer's rights but also for the sake of a most correct fact finding the taxpayer has been accorded the *right to consult the official files*; this right is granted so long as it would not be to the detriment of third persons (internal pleadings of the authority are also excluded from consultation).

The ultimate goal of tax proceedings is a lawful determination of the public tax claim; this requires that all circumstances which are of relevance have to be properly cleared up. Hence, neither assumptions brought forward by the taxpayer nor facts being agreed upon (conventional truth) will have final importance; it is only the *actual truth* (materielle Wahrheit) which has to be discovered and has to be the basis of the taxation.

Tax procedure is largely governed by the *principle of writing*. Accordingly, requests of the taxpayer have to submitted and decisions and other closing actions of the tax authority have to be delivered in writing; oral requests and oral decisions are admitted only in very exceptional cases. The proceedings are *not open to the public*. The facts disclosed to or ascertained by the tax authorities are subject to a very strict *confidential treatment* (infringements would be sanctioned under criminal law).

As far as the tax law does not set out time limits the disregard of which would cancel certain rights of the taxpayer, the tax authorities have to take cognizance of requests and statements of the taxpayer with regard to questions of fact and of law until the tax decision has become final (this applies also for appealed cases); it does not matter whether or not it was the fault of the taxpayer that such requests and statements had not been submitted earlier (no prohibition for references to new facts; contumacy does not affect tax liability; thus e.g. no waiver of rights by late submissions of tax returns).

Taxpayers have the right to appoint a representative for the tax proceedings but they are not obliged to do so in the sense of a compulsory system of lawyer representation (*right to be represented*). Not everybody is allowed to act on behalf of a taxpayer before the tax authorities on a professional basis; lawfully admitted thereto are only attorneys at law, patent lawyers, notaries acting within their professional charter and chartered accountants (chartered according to the Wirtschaftstreuhänderberufsordnung BGBl. No. 125/1955: Steuerberater, Beeidete Buchprüfer, Wirtschaftsprüfer). If such qualifications have been acquired abroad then this would not be an entitlement to represent taxpayers in Austria, since this is neither provided in internal law nor in international agreements.

Tax claims which have been decreed by tax notice and which are not paid in time (one month after the tax notice has been served upon the taxpayer) are ready for execution. Appealing against the tax notice would not postpone execution. However, if a due pay

18. § 4 para. 1 of the Federal Procedure Act; *Stoll*, Steuerschuldverhältnis Wien, 1972, 13;
19. Art. 18 of the Federal Constitution, § 5 of the Fiscal Constitution
20. Most taxes, in particular the principal taxes, are assessed by servin a tax notice; in addition, also the system of tax withholding and self assess ment is known by the Austrian tax law; here the tax authorities woul only intervene in case of deficiencies in computation or payment.
21. With regard to the Austrian tax proceedings reference is made t *Reeger-Stoll*, Kommentar zur Bundesabgabenordnung, Wien 1966 an Die Bundesabgabenordnung (Manual) Wien 1975 and *Lager*, Bunde abgabenordnung, Wien 1975.

ment would invoke substantial hardship for the taxpayer then the tax authority may decide (at its free discretion) that the date of payment be postponed (tax respite) or that the tax due might be paid by installments, provided that those concessions would not jeopardize the final collection of tax.

All costs of the activities of the tax authorities (including costs incurred in appealed cases) are borne by the tax administration whereas costs incurred by the taxpayer during the tax proceedings are borne by the taxpayer (principle of self-payment, damages for the cost of proceedings are unknown with regard to both the tax administration and the taxpayer). Only in certain exceptional cases (customs and consumption tax proceedings, proceedings in matters of the State Monopolies and executionary proceedings) would a refund of cost from the taxpayer to the tax administration take place.

C. LEGAL PROTECTION OF THE TAXPAYER

1. Administrative appeals

The ordinary legal remedy against administrative orders ("Bescheide") of local tax authorities (tax authorities in the first instance: Finance Offices and Customs Offices) is called appeal ("Berufung"), the use of which would be disallowed only in very rare cases. The time limit for filing an appeal is one month; if reasonably justified it can be extended and even re-extended. If an appeal is submitted in due course by mail, then it is deemed to have been lodged in time even if it was received by the tax authority at a later date. The appeal may be filed with the tax authority which has rendered the contested order or may be submitted to the competent "Land" Finance Directorate.

If a taxpayer has filed an impermissible appeal the tax authority would *reject* it ("zurückweisen") without going into the substance of the matter. A rejection would be spelled out, for example if the appeal was not filed in time or if it was disallowed because a remedy had been excluded by law or if the case has been already adjudicated ("*res judicata*") or if the taxpayer has made a lawful waiver of his right of appeal or because the taxpayer is not the person who is entitled to lodge the appeal.

If an appeal fails to meet all formal requirements (e.g. omission of the signature or of a due authorization of the preparer of the appeal) or if there are some other defects (no statement in which points of the tax notice are contested or in which modifications are wanted, lack of reasoning) the tax authority would not be allowed to reject but would instead be obliged to call the taxpayer for appropriate amendments stating that the appeal would be deemed to have been withdrawn if the amendments are not submitted within a reasonably fixed period of time.

If the appellant has a valid right for appeal and if his appeal has been filed in time and if it corresponds to the required formalities, then the authority will have to decide on the issue. Such decision on the merits would replace completely the appealed order and could modify the former ruling without any restraints (no prohibition of a "*reformatio in peius*"). Unfounded appeals would be refused ("Abweisung").

The authority which has passed the complainted order (i.e. the local district office) has the opportunity to render first its own decision on the submitted appeal. Such "*pre-decision*" ("Berufungsvorentscheidung") on the appeal helps to economize tax administration. Especially where the authority for its part recognizes a fault in its own order it will make use of such possibility in order to satisfy the taxpayer without being obliged to refer to the higher authority. But in lieu of this the local district office would be free to refer the appeal immediately to the appellate authority ("Land" Finance Directorate) without passing a pre-decision. If a taxpayer is dissatisfied with a pre-decision rendered by the local district office he may apply within one month to the superior authority ("Land" Finance Directorate) for a decision in his tax case; such action of the taxpayer would remove the pre-decision. If the taxpayer does not file such application, then the pre-decision would become final and would furthermore replace the complainted order.

If the local district office has not rendered a pre-decision, or if this has been done but upon due application of the taxpayer to the appellate authority the pre-decision has been removed, then the Land Finance Directorate[22] will have to settle the dispute. The decision of the "Land" Finance Directorate will be on the merits. It has to deliver a new decision on the facts which replace the appealed order. During the proceedings of appeal the "Land" Finance Directorate exercises the rights and bears the procedural obligations of a first instance authority. It may, if necessary, reopen a new fact finding procedure or may solely supplement the facts ascertained by the local district office and it has on its part to find evidence. The "Land" Finance Directorate is in no way affected by the ruling of the appealed order and it may therefore modify it in any regard even to the detriment of the appellant. The appellate authority is, further, not required to restrain itself to the disputed points of the case and can therefore reconsider issues already agreed upon. Under the Austrian tax procedure the decision of the appellate authority is therefore neither barred by formal restrictions nor affected by previous rulings in the case; broadly speaking it has to be rendered with regard to points of fact and of law as if it was the very first decision in the tax case; it replaces completely the complainted order.

It is worth noting that it is immaterial for jurisdiction and proceedings in appealed cases whether the case is purely domestic or international; further it does not matter, neither before the local district office nor before the appellate instance whether the appellant is an Austrian citizen or not, resident in Austria or not.

2. Judicial protection[23]

Under Austrian law the judicial protection of the individual against actions of the administration has not been put in the hands of ordinary courts but has been centralized in the *Administrative Court*[24]. This centralization is multiple. First, the Administrative Court has to deal with complaints against the activities of administrative authorities of the Central State, of the Federal Länder and of the Communities (there have not been established similar courts on the level of the political subdivisions); second, it is the central institution for redresses against administrative orders of all branches of governmental administration (there do not exist special courts e.g. in social welfare or in fiscal matters); third, the jurisdiction of the Court is final, there is no further appeal available to superior courts.

For the sake of a most effective guarantee of constitutional rights a further Court of public law has been established beside the Administrative Court; the *Constitutional Court* (being neither inferior nor superior to the Administrative Court). In addition to

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22. Appeals in specific matters, especially matters of income tax, corporation tax, tax on commercial and industrial enterprises, value added tax and capital tax are decided before Senates of Appeal established at the "Land" Finance Directorate. Such Senates of Appeal are not separate authorities (though they are not subject to directions and some members of the Senate are not officers of the finance administration) nor are they courts or like institutions; they are simply a very specialized department of the "Land" Finance Directorate.

23. *Winkler*, Der gerichtliche Rechtschutz des Einzelnen gegenüber der vollziehenden Gewalt in Österreich, in: Gerichtsschutz gegen die Exekutive II 835; *Melichar*, Die Überprüfung von Abgabenbescheiden durch die beiden Gerichtshöfe des öffentl. Rechts, FJ 1976, 144.

24. Art. 129-136 of the Federal Constitution; Verwaltungsgerichtshofgesetz 1965, BGBl. No. 2; *Ermacora*, Verfassungslehre, 186, 392; *Walter*, Bundesverfassungsrecht 661, *Walter-Mayer*, Grundriss des österr. Bundesverfassungsrechts, 236.

the many functions assigned to it by the Constitution the Constitutional Court operates also as a special administrative court. In the discharge of that function the Constitutional Court has to deal with complaints against final administrative orders after all administrative remedies have been exhausted; but its jurisdiction is limited to issues of alleged violation of constitutional rights[25] (violation of Civil Rights); if the complainant seeks redress against infringements of other rights (if administrative orders are in conflict with ordinary law or with ordinances) then he has to apply to the Administrative Court. The Constitutional Court has a centralized position which is comparable with that of the Administrative Court.

Both, the Constitutional Court as well as the Administrative Court are "courts" in its proper sense; jurisdiction is exercised by judges which may neither be dismissed or removed nor are subject to any directions. In the proceedings before the Courts the complainant and the sued authority (the authority which has passed the final complainted order) are parties with equal procedural rights.

Redress may be sought before the Courts only after the whole appellate machinery of the administration has been run through and only after the administrative decision has become final. Jurisdiction is thus exercised "*a posteriori*". It is not the purpose of the two supreme Courts of public law to act in lieu of the administration and to pass a decision on the facts itself; their function is solely a supervising one and in the discharge of that function they simply quash the complainted order if it is found to be unlawful, or they reject the appeal if a violation of law could not be proven. Accordingly, the Courts' decision would not be rendered on the merits, and would therefore only annul the complainted order but could not replace it. Instead, it would be rendered to the authority which lost the dispute which would render a new decision; in doing this, it is bound by the ruling of the supreme Court.

It should be noted here that it is immaterial for the jurisdiction of the two Courts whether the case requires the application of domestic law or of international tax law; it is, further, in general not important whether the appellant is an Austrian citizen, a legal entity or an individual resident in Austria or not.

The complaint has to be lodged before the Court within a time period of 6 weeks (which cannot be extended) after the final administrative order has been served. The enforcement of the complainted order would not be suspended by filing a complaint, except the Court itself would grant a suspending effect upon special request of the complainant if the enforcement of the administrative order would cause irrevocable damage and if public interest would not require immediate execution.

a) Complaints to the Administrative Court[26]

To enable the Administrative Court to open judicial proceedings, complaints (Beschwerden) to the Court have to meet certain requirements: a proper specification of the complainted administrative order and of the authority which has delivered that order, a description of the state of facts, a certain demand, a statement of the grounds on which the complaint is founded and a reference to the right which the complainant asserts to have been deprived of. The review of the taxation case would then be limited to those points which have been brought to the attention of the Court; the Court would not be in the position to take up questions which have not been contested in the complaint.

Complaints to the Court must be signed by an Austrian attorney at law;[27] but the obligation to be represented by a lawyer is, with regard to further procedural steps, not strict; the appellant may very well defend his case in person before the Court; but if he wnats to be represented this is only permitted through an Austrian attorney at law (even chartered accountants would be excluded from representation).

According to its mere supervising jurisdiction the Administrative Court has to reconsider the legality of the complainted order upon the facts as ascertained by the administrative authority. This obligation to accept the facts reported by the sued authority would be removed only if the stated facts are inconsistent or repugnant, or if they do not correspond to human experience of every day life or if inferences of facts have been made contrary to the basic rules of logic or if the conduct of the fact-finding procedure has been wrongful. But even in such cases the Court would not make the necessary investigations on its part but would only quash the defective order of the administrative authority. The sued authority would then be in charge to reopen the fact-finding procedure and to deliver a new decision. In the absence of such deficiencies in the previous fact-finding proceedings the Court would be obliged to adhere to the facts as stated; this would imply for the parties involved in the litigation the corresponding prohibition to refer to new points of fact which had not been considered in the former administrative proceedings.

If the Court holds that the appealed order has violated a provision of law then it would quash the unlawful order. However, it does not constitute a violation of law if the complainted order has been rendered by virtue of discretionary powers specifically accorded by law. The Court would not intervene if the authority has chosen in the lawful discharge of is discretionary powers and for equitable reasons one particular solution out of several ones which would have been in line with the law; this would even be true if the adoption of another solution would have been more feasible; that position is due to the fact that the Court is charged with the supervision of administrative actions with regard to lawfulness but not to efficiency.

If the appealed order has been rendered by an authority without jurisdiction then this would in any case lead to its cancellation, even if such default had not been raised by the appellant, because incompetency of the authority would be considered as a failure which is like a deprivation of the individual's Civil Right to the due judge. Therefore, in cases of incompetency a cancellation is inevitable, even if the appealed order had otherwise been in full accordance with the law.

A violation of procedural rules, other than rules of competency, would (omitting repugnant fact-findings of the sued authority or fact-findings which require supplementary investigations) only give rise to an annulment of the appealed order if a proper application of such procedural provisions would have caused a different decision of the sued authority (principle of the substantiality of deficiencies in procedure).

The successful party is entitled to claim a refund of the cost of the proceedings from the losing party (costs are fixed by ordinance).

b) Complaints to the Constitutional Court[28]

Final orders which have been rendered by the administration after the whole administrative machinery has been run through may be tried before the Constitutional Court if the appellant avers that such order has deprived him of rights secured by the Constitution or if an allegation is made that the order is based on illegal ordinances or unconstitutional law or on illegal international treaties.

Any complaint so filed has to be accompanied by a statement of the relevant facts and by a specification of the rights which the complainant asserts to have been deprived of in order to constitute the jurisdiction of the Court. In contrast to the Administrative Court proceedings pleadings of the complainant would not restrict Court jurisdiction; if once the prerequisites for Court jurisdiction are given, the Constitutional Court will on its part give thought to any violation of constitutional law in the com

25. Art. 144 of the Federal Constitution; Verfassungsgreichtshofgeset 1953, BGBl. Nr. 85, *Ermacora*, Verfassungslehre, 183, 229, 327, 38 *Walter*, Bundesverfassungsrecht 710, 736, 788; *Walter-Mayer*, Grundri 254.
26. *Ringhofer*, Der Verwaltungsgerichtshof, Graz-Wien-Köln, 1955.
27. *Schmitschek*, Zur Frage der Mitwirking von Wirtschaftstreuhände im Verwaltungsgerichtshofverfahren, FJ 1977, 33.
28. *Ermacora*, Der Verfassungsgerichtshof, Graz-Wien-Köln, 1956.

plainted case. Complaints have to be filed by a duly authorized Austrian attorney at law; a representation in court proceedings is only permissible through that attorney.

The Constitutional Court considers whether the appealed order has touched on the constitutional rights of the complainant; under Austrian law thereto belong in particular the Civil Rights having constitutional rank[29].

A tax notice may especially violate the taxpayer's right for *equality under law*. An infringement of that right (Art. 2 Staatsgrundgesetz of Dec. 21, 1867 RGB1. No. 142 and Art. 7 of the Federal Constitution)[30] can be ascertained only by means of comparisons with administrative actions against others. A violation of the right of equality under law by government action will in practice only be recognized if the authority is acting against an individual differently than against others without having fair and equitable reasons to do so, that is to say, if the authority is acting in an arbitrary way (the authority disregards deliberately or by negligence substantive or procedural provisions of law to the detriment of the individual); such violation would also be assumed if the authority interprets a provision of law in a sense that if such statutory provision would actually have that meaning the provision would on its part be in conflict with the rule of equality under law. The rule of equality under law is applicable only with regard to Austrian citizens and to domestic legal entities.

In that context reference should also be made to the basic right that *nobody shall be deprived of his property*[31] except in cases provided by ordinary law (art. 5 of the Staatsgrundgesetz and Art. 1 of the Protocol to the Convention for the Protection of Human Rights and Fundamental Freedoms, BGB1. No. 210/1958). The right of private ownership may therefore very well be restricted by ordinary law, provided that such limitations do not destroy this right in its very substance. (This means that private ownership has to be maintained as an institution of law.) A tax notice will always affect private ownership. If the statutory provision by virtue of which the tax notice was rendered is kept in line with the principle of private ownership as guaranteed by the Constitution, then an infringement of the basic right of private ownership could only be assumed if a decision was rendered which contained such important deficiencies that it can only be compared with an administrative action outside the legal order or be compared with actions rendered upon wrongful interpretation of law, the wrongfulness exceeding minor defaults and being already contrary to logic. Minor faults which do not go as far as lawlessness and which would not be considered an application of law contrary to the rules of logic would themselves not render the tax notice unconstitutional but only unlawful (contrary to ordinary law). This would invoke the jurisdiction of the Administrative Court.

The Constitution guarantees the right of ownership also to aliens and to legal entities incorporated abroad.

A further constitutional right, the *right to a "due" judge* (Recht auf den gesetzlichen Richter) (Art. 83 para. 2 of the Federal Constitution) is understood in Austria also as a constitutional protection of the legal competences of the administrative authorities. Actions of incompetent authorities and illegal refusals of competent authorities to pass a requested decision may therefore equally be contested before the Constitutional Court.

If the Constitutional Court discovers an infringement of rights guaranteed by the Constitution then it will quash the complainted order; by that the complainted case will be put back on the procedural stage which it had before the complainted order has been delivered by the authority. The sued authority is obliged to take immediately the necessary steps to establish a legal situation which responds to the ruling of the Constitutional Court.

The losing party may be called on to refund the cost of proceedings.

3. Judicial review of law before the Constitutional Court[32]

Under certain conditions the Constitutional Court has to verify whether provisions of law of an inferior rank correspond to higher ranking provisions (Art. 139, 140, 140a of the Federal Constitution). Ordinances conflicting with ordinary law or with the Constitution and ordinary laws conflicting with the Constitution may be annulled by the Constitutional Court; this concept is based on the theory of the hierarchic organisation of law in Austria (Stufenbaugedanke; Merkl). In the discharge of that function the Constitutional Court is not acting *ex officio* but needs an appropriate initial demand, as provided by the Constitution.

By an amendment of the Constitution in 1975, Bundesgesetzblatt No. 302/1975, individuals have been entitled to file an application before the Constitutional Court in order to obtain a review of provisions of law if immediate infringement by such provisions is alleged. But as tax law is executed solely by means of issuing administrative orders this amendment is of rare interest with regard to tax matters. The following outline will only refer briefly to the main aspects of the Court's judicial review of law.

A reviewing procedure would be opened by the Constitutional Court if it discovers during the reconsideration of a complainted case that a provision of law has been applied therein which might be in conflict with higher ranking law (this is the sole exception from the earlier mentioned rule that judicial review is opened upon demand); judicial review may further be obtained upon demand of the Administrative Court if doubts arise about the constitutionality of a provision of law which has to be applied in a case brought before that Court. The individual complainant has no formal right to invoke judicial review of law; but he is of course free (both in Administrative Court proceedings and in Constitutional Court proceedings) to draw the attention of the Court to any unconstitutionality of law and thus to suggest indirectly judicial review.

As indicated above, judicial review requires the application of the suspect provision of law in a complainted case. Judicial review will therefore only regard those parts of the law which are of relevance for the complainted case. Solely in the event of extreme deficiencies, in the case of incompetency of the law making institution, in cases of defects of promulgation or if an ordinance has been issued without legal authority the wrongful law might be annulled as a whole.

If a provision of law on which the complainted order is based had been annulled then the complainted order has lost its legal base and has to be quashed too. The fresh order which has to be rendered by the authority has to be drafted as if the annulled law had never existed (effect of the annulment *ex tunc*). However, the annulled law will enjoy further applicability with regard to all other cases on which no final decision has yet been rendered by the administration (as concerns cases already decided upon finally, the annulment of the respective provision of law would have no effect since the annulment of law does not mean that the law has been null and void but that it is annulled for the future) and which occurred before the annulment becomes effective (the Court may grant exceptions); the annulment becomes effective by its promulgation or after the expiry of a cer-

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29. *Ermacora*, Handbuch der Grundfreiheiten und Menschenrechte, Wien, 1963.
30. Cf. in particular *Kneuker*, Die Bindung des Steuergesetzgebers an den Gleicheitssatz der Bundesverfassung, ÖStZ 1966, 217 and *Gassner*, Gleichheitssatz und Steuerricht, Veröffentlichungen des Instituts für Finanzwissenschaft und Steuerrecht, Wien, 1970, Nr. 69.
31. *Adamovich*, Eigentum und Eigentumsbeschränking im Spannungsfeld von Verfassung und Rechtspolitik, Die Industrie 1973 No. 12, 20; *Stolzlechner*, Abgabengesetze und Eigentumsgarantie, ÖZW 1975, 33.
32. *Ermacora*, Verfassungslehre 345; *Walter*, Bundesverfassungsrecht 731, 743, 751; *Walter-Mayer*, Grundriss 265, 270, 274.

tain time period as prescribed by the Court (6 months with regard to ordinances and 1 year with regard to statutory law at the maximum; this concept prevents a void in the law and the competent legislative power has the opportunity to pass new provisions in due course for the sake of a continuous ruling of law). The annulment of law is therefore only of relevance for the initial case of the annulment; other cases will benefit only if they occur after the annulment has become effective.

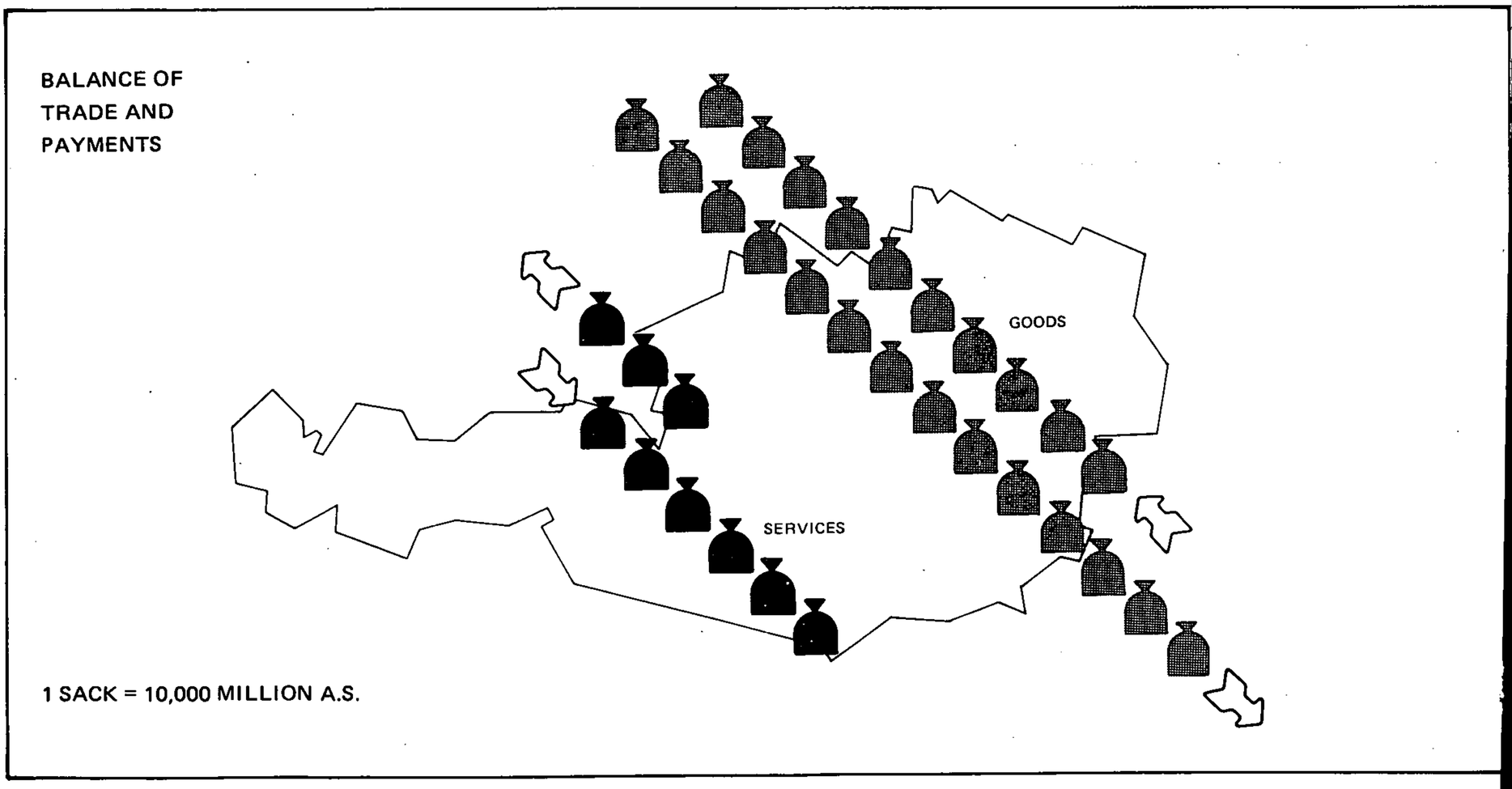
The main reasons for annulments of law are deficiencies in the law making procedure; but also infringements of the principle of equality before law are frequently observed and sanctioned by an annulment of the law. The Constitutional Court regularly refuses to review tax law with respect to the *basic right of private ownership*. As pointed out earlier, that basic right may, in accordance with the Constitution, be limited by ordinary law; therefore the Court holds that *statutory* provisions in tax matters will not interfere with that constitutional right, except in the event of abusive taxation. Deficiencies of statutory provisions in that area are therefore rather sanctioned by using a very dynamic interpretation of the principle of *equality under law*. This principle is certainly used most frequently to judge the constitutionality of tax law. This principle compels the legislative power to abstain from the adoption of regulations which provide different treatment between citizens on other than impartial grounds. Different treatment is certainly allowed if this can be explained by actual references in the regulated matter. Therefore regualtions providing differentiations, rules on borderline cases but even provisions stating equal treatment must all be based on fair and equitable experience; otherwise, if they cannot be justified on equitable grounds they would conflict with the principle of equality. The Constitutional Court does not consider whether the statutory provision responds to the equality principle in the individual case but only whether the provision is equitable *in abstractu*. Therefore not any mistake of the legislator and not any contradiction in law or other deficiency does render the provision of law unconstitutional. Only if the statutory provision is based on partial considerations of the legislative power approaching an excessive ruling would the equality principle be affected.

In contrast to the German practice, in Austria equality questions of statutory law are not decided by reference to equality principles of civil law. Pursuant to the jurisdiction of the Constitutional Court the legislator is in the area of tax law not barred to establish a separate system of law and it would not be disallowed to set out regulations which deviate from principles of that system, provided that this is done by reasons of equity. The principle of *equity in taxation* is not guaranteed by the Constitution; however, statutory provisions of tax law must reflect the efforts of the legislator to conform with the general principle of equality before law (in terms of the Constitution: equity in taxation is understood as equality in taxation).

It should be remembered here, that under Austrian law *international treaties* may rank (according to the regulated matter and to their derogative effect) with ordinances or with ordinary law (double taxation conventions[33] become effective in internal law in the same way as internal statutory provisions and they have equal juridical quality); consequently they are equally subject to judicial review before the Constitutional Court as is national law (Art. 140a of the Federal Constitution). If an international treaty ranking with the ordinances or with ordinary law does not conform with higher ranking law, then the Court would declare its illegality (strictly spoken, the treaty is not "annulled" to avoid repercussions on the international level of law). The effects of such declaration are basically the same as if internal provisions of law were annulled.

The declaration of illegality renders the international treaty inapplicable on the level of internal law; this becomes effective upon the promulgation of that declaration; a subsequent modification of the treaty on the international level will be required in order to allow a proper transformation of the international regulations into internal law in full accordance with the Austrian Constitution.

33. Regarding double taxation conventions cf. *Philipp-Pollak*, Internationales Steuerrecht, Wien 1976, *Loukota*, Über das Verhältnis zwischen Internationalem und nationalem Steuerrecht, FJ 1976, 105.



Les principes de la fiscalité autrichienne par rapport au droit fiscal international

Prof. Dr. Gerold Stoll ~ Université de Vienne

Les bonnes règles de l'hospitalité demandent de familiariser des hôtes avec leur nouvel entourage pour leur permettre de mieux s'y retrouver.

J'ai donc accepté le mandat honorable de servir en quelque sorte de guide aux très chers participants au XXXIème Congrès de l'IFA pour leur donner une idée des principes de l'ordre juridique de la fiscalité autrichienne, surtout de la Constitution fiscale autrichienne, des rapports existants entre les Conventions tendant à éviter les doubles impositions (donc du droit international) et le droit interne, du droit autrichien de la procédure et de l'organisation, de même que de la protection juridique administrative et judiciaire en matière fiscale.

Cette introduction au droit autrichien ne se limitera qu'aux grandes lignes du système en raison des limites qui me sont posées par les organisateurs pour des raisons d'ordre rédactionnel bien compréhensibles.

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Né à Vienne en 1925, l'auteur a entrepris ses études de Droit à Vienne. Après l'obtention de son diplôme (1948) il entra dans l'Administration des Contributions autrichiennes où, en 1949, il travailla ou niveau régional (Mittelinstanz). A partir de 1958 il entra au Ministère National des Finances comme chef de département (Sektionsrat) dans le secteur du Droit de la procédure fiscale responsable de l'élaboration des lois.

En 1967, il obtint l'agrégation en Droit des Finances à la Faculté de Droit et des Sciences Politiques de l'Université de Graz.

A la fin de l'année 1968, il fut nommé Professeur ordinaire à la Faculté de Droit de l'Université de Vienne avec la charge d'enseigner le Droit des Finances. Il fut également désigné Président de l'Institut De Droit Public et Administratif où il a été entre-autre à la tête de la commission d'examen de l'Etat pour les Sciences politiques.

En 1973, l'auteur fut élu membre correspondant de l'Académie des Sciences d'Autriche et, en 1974, en fut désigné membre effectif.

Il est aussi l'éditeur de la Collection "Cahiers de Droit fiscal autrichien" (Editeurs ORAC, Wien), dans laquelle jusqu' ici 13 ouvrages ont paru.

Publications majeures (mis à part les articles spécialisés):

a) Rentenbesteuerung (Le régime de l'imposition des versements périodiques) (monographie), 2º édition 1967; 3º édition en préparation.
Ermessen im Steuerrecht (Le pouvoir d'appréciation en droit fiscal), Vienne 1970.
Die Besteuerung der Genossenschaften (L'imposition des sociétés coopératives), Vienne 1972.
Das Steuerschuldverhältnis in seiner grundlegenden Bedeutung (La redevavilité de l'impôt dans sa signification fondamentale), Vienne 1972.
Leasing, Steuerrechtliche Beurteilungsgrundsätze (Le leasing, les principes d'appréciation fiscale), 2º édition 1977.
Ertragsbesteuerung der Personengesellschaften (L'imposition des profits des sociétés de personnes), 1977.

b) Publications faites en collaboration avec Min. Rat. Dr. Franz Reeger:
Kommentar zur Abgabenexecutionsordnung (Commentaire de la loi sur l'exécution des impôts), 1963.
Kommentar zur Bundesabgabenordnung (Commentaire de la loi organique des contributions), 1965.
Handbuch zur Bundesabgabenordnung (Manuel de la loi organique des contributions), 5º édition 1975.

c) Publication faite en collaboration avec Professeur Dr. Walter Korstner:
Die Gesellschaft mit beschränkter Haftung u. Co KG in Handels-, Gewerbe- und Steuerrecht (Les sociétés à responsabilité limitée & Co (société en commandite) en droit commercial, industrial et fiscal), 2º édition 1977.

I. LES CONVENTIONS TENDANT A EVITER LES DOUBLES IMPOSITIONS ET LE DROIT INTERNE DE L'AUTRICHE

Les Conventions tendant à éviter les doubles impositions constituent tout d'abord une source juridique du droit international. Toutefois, les engagements pris par les Etats contractants doivent être exécutés à l'intérieur de leurs territoires nationaux; les Conventions tendant à éviter les doubles impositions doivent donc être introduites dans l'ordre juridique national des Etats contractants. Cette intégration d'un accord international à l'ordre interne d'un Etat n'est pas particulièrement réglée par le droit international. Il s'agit là d'un problème général du droit public interne qui sera exposé par la suite en prenant pour exemple l'Autriche.

En dehors de cette question générale de l'intégration d'une Convention tendant à éviter les doubles impositions à l'ordre juridique interne d'un Etat, l'application d'une telle Convention qui vient se superposer au droit fiscal interne pose un certain nombre de problèmes réglés d'une part par le droit international fiscal et d'autre part par l'interprétation nationale.

A. L'INTEGRATION DE LA CONVENTION TENDANT A EVITER LES DOUBLES IMPOSITIONS A L'ORDRE JURIDIQUE INTERNE D'UN ETAT

Comme on l'a déjà vu, c'est au droit national de déterminer de quelle manière un accord international doit être introduit dans l'ordre juridique interne d'un Etat. Pour l'Autriche les règles juridiques s'y rapportant se trouvent dans la Constitution Fédérale, amendée en 1929; [1] l'amendement de l'année 1964 (Bundesgesetzblatt No. 59/1964) a modifié et amélioré quelques points en la matière.

L'intégration d'une Convention tendant à éviter les doubles impositions à l'ordre juridique interne d'un Etat pose plusieurs problèmes, à savoir:

1. *Quel organe d'Etat est autorisé à conclure une Convention tendant à éviter les doubles impositions?*
2. *La conclusion de la convention peut-elle être réalisée uno actu ou par une procédure de ratification?*
3. *Quelle est la méthode appliquée pour l'intégration à l'ordre juridique interne d'un Etat (méthode de transformation générale ou spéciale)?*
4. *Quel rang occupe une Convention tendant à éviter les doubles impositions dans l'ordre juridique interne d'un Etat?*
5. *Quelles sont les conséquences de la conclusion d'une Convention tendant à éviter les doubles impositions violant le droit interne d'un Etat?*
6. *Quelles sont les conséquences résultant de la structure fédérale de l'Autriche sur la conclusion d'une Convention tendant à éviter les doubles impositions?*

1. L'organe d'Etat autorisé à conclure une Convention tendant à éviter les doubles impositions

D'après la Constitution Fédérale de l'Autriche, seul le Président Fédéral a en principle le droit de conclure un traité international (Article 65 alinéa 1). Toutefois la Constitution Fédérale autorise le Président Fédéral à déléguer au Gouvernement Fédéral et aux différents Ministres Fédéraux le pouvoir de conclure de tels traités, à condition que ces traités n'entraînent ni modifications ni compléments à la législation interne et qu'ils ne soient pas de caractère politique. Le Président Fédéral a déjà utilisé cette possibilité lors de l'entrée en vigueur de la Constitution Fédérale en 1920 et a délégué le "treaty-making-power" pour les accords gouvernementaux (Regierungsübereinkommen) au Gouvernement Fédéral; pour les accords ministériels (Ressortübereinkommen) au Ministre Fédéral compétent avec le consentement du Ministre Fédéral des Affaires Etrangères; et pour les accords administratifs (Verwaltungsübereinkommen) au Ministre Fédéral compétent (voir la résolution du Président Fédéral du 31 décembre 1920, Bundesgesetzblatt No. 49/1921, fondée sur l'article 66 alinéa 2 de la Constitution Fédérale).

Conformément au droit interne, le pouvoir de conclure un traité dépend donc en premier lieu de la question de savoir s'il s'agit d'un traité portant modification de la loi (ou d'un traité complétant la loi ou de caractère politique). Pour les conventions autrichiennes tendant à éviter les doubles impositions, cette question a toujours reçu une réponse afirmative. Il est vrai, qu'il existe une disposition en droit fiscal interne (§ 48 de la Loi Fédérale portant sur la procédure fiscale), [2] autorisant le Ministre Fédéral des Finances à supprimer la double imposition; et ceci non seulement par décret pour des cas individuels, mais également sous forme générale par ordonnance. Pourtant, jusqu'à maintenant on n'a encore jamais considéré que la conclusion d'une convention tendant à éviter les doubles impositions pouvait être réalisée par le Ministre Fédéral des Finances; en application de la compétence qui lui a été déléguée et par conséquent, une convention tendant à éviter les doubles impositions, n'a jamais été conclue sous forme d'un accord ministériel (Ressortübereinkommen) ne modifiant pas la loi (la disposition citée au § 48 de la Loi Fédérale portant sur la procédure fiscale ne suffirait absolument pas pour servir de base légale à l'insertion de certaines dispositions secondaires à une convention tendant à éviter les doubles impositions, comme par exemple l'article portant sur l'échange de renseignements ou sur la non-discrimination). C'est seulement dans le cas de traités tendant à éviter les doubles impositions dans des domaines particuliers (p.e. aviation) que le § 48 de la Loi Fédérale portant sur la procédure fiscale sert de base à la conclusion d'un accord ministériel (Ressortübereinkommen).

Les conventions générales tendant à éviter les doubles impositions constituent donc des traités portant modification de la loi, qui, conformément à la Constitution, ne peuvent être conclus que par le Président Fédéral.

Dans la procédure de conclusion d'une convention tendant à éviter les doubles impositions comme pour tout autre traité portant modification de la loi, on peut distinguer trois phases principales:

1. La phase des négociations et de la signature (procédure préliminaire);
2. L'approbation par le Parlement;
3. La ratification (conclusion définitive du traité).

Selon l'opinion dominante en Autriche [3] *l'ensemble* de la procédure portant sur la conclusion d'un traité, c'est à dire également tous les actes entrepris pendant la procédure préliminaire, incomberait au Président Fédéral. Etant donné que le Président Fédéral n'est pas en mesure de mener personnellement toutes les négociations pour les traités modifiant la loi, ni de les signer personnellement, il est obligé de se servir à cette fin d'un plénipotentiaire.

En vertu de la structure des compétences gouvernementales en vigueur en Autriche, le choix d'un plénipotentiaire capable de mener les négociations pose un autre problème. Etant donné que les pourparlers portant sur la conclusion d'une Convention tendant à éviter les doubles impositions ressortent sans aucun doute du domaine des affaires étrangères, il faudrait choisir le plénipotentiaire au sein du Ministère Fédéral des Affaires Etrangères

1. Bundesgesetzblatt (Journal Officiel) No. 1/1930.
2. Bundesgesetzblatt No. 194/1961.
3. Cf. *Ohlinger*, Der völkerrechtliche Vertrag im staatlichen Recht, 24

Pourtant, en raison des rapports étroits existant entre les Conventions tendant à éviter les doubles impositions et le droit fiscal interne, les négociations dans ce domaine ont toujours été menées par un représentant du Ministre Fédéral des Finances. Ce problème interne de compétence à trouvé entretemps une solution grâce à la législation (Loi portant sur les compétences entre les Ministères Féderaux 1973, Bundesgesetzblatt No. 389/1973). Dès maintenant, conformément aux principes généraux, il relève uniquement de la compétence du Ministre des Affaires Etrangères de négocier des conventions tendant à éviter les doubles impositions; celui-ci pourra néanmoins déléguer cette compétence au Ministre des Finances. Cette délégation a effectivement eu lieu par l'ordonnance du Ministre Fédéral des Affaires Etrangères datant du 3 juillet 1974, Bundesgesetzblatt No. 388/1974, de sorte que des négociations dans le domaine de la double imposition sont menées par un représentant du Ministre Fédéral des Finances dûment autorisé par le Président Fédéral.

Lorsqu'il y a des accords qui ne portent que sur l'application d'une Convention tendant à éviter les doubles impositions déjà existante, ceux-ci ne sont pas considérés comme modifiant la loi (ou complétant la loi ou de caractère politique). Ils ont donc le caractère d'accords ministériels (Ressortübereinkommen) et peuvent être conclus par le Ministre Fédéral des Finances (ou par un de ses représentants y habilité) en accord avec le Ministre des Affaires Etrangères conformément à la résolution du Président Fédéral précitée.

Dans certains cas les modalités d'application d'une Convention tendant à éviter les doubles impositions sont négociées entre les administrations fiscales par voie de correspondance, sans que les résultats de cet échange de lettres soient repris sous forme d'un instrument formel de traité. Il est seulement prévu que l'accord sur l'application de la convention entrera en vigueur dans les deux Etats par des ordonnances appropriées. Egalement dans de tels cas il faudrait partir du principe que les autorités financières effectuant des échanges de lettres agissent en tant qu'organes de leur Etat, et ont par conséquent réalisé un accord de volonté non seulement adressé aux administrations financières mais engageant comme tel les deux Etats. Il s'agit donc — au sens large du terme — d'un traité d'Etat. De tels accords effectués par échange de lettres n'ont pas de conséquences juridiques immédiates pour le contribuable et doivent donc être regroupés, du côté autrichien, parmi les accords administratifs (Verwaltungsübereinkommen). Selon la résolution du Président Fédéral précitée seul le Ministre Fédéral des Finances est habilité à les conclure, sans être obligé de faire appel au Ministre Fédéral des Affaires Etrangères.

2. La procédure de conclusion

En ce qui concerne la conclusion d'un traité le droit international distingue entre deux procédures. Dans le premier cas la simple signature du traité par l'organe de l'Etat chargé de sa conclusion entraîne l'engagement de cet Etat à le respecter. Dans l'autre cas l'organe donnant sa signature au traité déclare que seule l'approbation ultérieure (ratification) allant de pair avec l'échange ou la déposition des instruments de ratification permettra d'établir l'engagement de l'Etat en cause.

D'après la Constitution Fédérale de l'Autriche des traités modifiant ou complétant la loi, ou de caractère politique doivent être approuvés par le Parlement (Article 50 alinéa 2 de la Constitution Fédérale); par conséquent ils ne pourraient être conclus que par la procédure liée à la ratification. Quant aux Conventions tendant à éviter les doubles impositions, elles comptent parmi les traités modifiant la loi, la signature de celles-ci ne saurait se faire également que sous réserve de ratification.

Après avoir obtenu l'approbation par le Parlement, il est nécessaire, comme pour la procédure de législation interne, que le Président Fédéral pose un acte final; par sa propre signature il confirme que l'établissement du traité est conforme à la Constitution. Par voie analogue à la procédure législative interne cet acte juridique du Président Fédéral a besoin pour être valide d'être contresigné par le Chancellier Fédéral ou le Ministre Fédéral compétent.

L'autre Etat Contractant doit être informé que le traité a reçu l'autorisation constitutionnelle. Ceci se fait par l'échange traditionnel des instruments de ratification; c'est seulement à partir de ce moment que le traité international est établi.

Le moment de la conclusion du traité se distingue du moment de son entrée en vigueur, c'est à dire de sa première application. En principe, les clauses portant sur l'entrée en vigueur des conventions autrichiennes tendant à éviter les doubles impositions prévoient à cet égard un certain délai permettant de remplir les conditions nécessaires à l'entrée en vigueur dans l'Etat (publication au Journal Officiel). Les bureaux de finances autrichiens ne doivent appliquer les dispositions de la Convention nouvelle de double imposition qu'après cette publication. En l'absence d'un tel délai d'entrée en vigueur — quelques Conventions tendant à éviter les doubles impositions prévoient l'entrée en vigueur après échange des instruments de ratification, donc avant la publication au Journal Officiel — il y a divergence entre le droit international et le droit national. Ceci pourrait avoir pour conséquence qu'une Convention tendant à éviter les doubles impositions à laquelle l'Autriche est déjà liée conformément au droit international n'est pas encore applicable par les administrations. Une telle divergence est plutôt d'importance théorique étant donné que toutes les conventions tendant à éviter les doubles impositions prévoient, en dehors du moment de l'entrée en vigueur, un autre moment; il s'agit du début de la période au cours de laquelle la convention est appliquée pour la première fois. Cette date d'efficacité de la convention qui correspond en règle générale au début d'une année fiscale supprime ce problème de divergence; car l'administration attendra pour la première application de la convention que celle-ci soit publiée au Journal Officiel.

Des traités ne nécessitant pas l'approbation par le Parlement (des traités ne modifiant ni complétant la loi, ou ceux de caractère non-politique) peuvent être conclus soit par voie simple (*uno actu*) ou par voie de ratification. Dans le cas où, en matière de droit fiscal international, de tels traités sont conclus (accords d'application des Conventions tendant à éviter les doubles impositions) ceci se fait toujours, pour des raisons d'ordre économique, par simple procédure. Dans les cas où, conformément au droit interne de l'autre Etat contractant de tels accords ne peuvent être réalisés que par la procédure de ratification, l'Autriche adoptera également cette procédure. C'est ainsi que par exemple, en tenant compte de la situation juridique du partenaire allemand, la Convention austro-allemande concernant une exonération bilatérale dans le domaine de la taxation des véhicules en matière de trafic international routier [4] a été conclue suivant la procédure de ratification; bien qu'en vertu d'une exemption déjà prévue par la loi portant sur la taxe sur les véhicules, [5] elle ne soit pas de caractère à modifier la loi du côté autrichien, et aurait pu par conséquent être conclue sous forme d'accord ministériel (Ressortübereinkommen).

3. La méthode de transformation

Des traités en tant que sources juridiques du droit international ne créent des droits et des obligations qu'entre des Etats ou entre d'autres sujets du droit international. Donc les traités s'adressent immédiatement aux Etats eux-mêmes. Pourtant, les Etats sont tenus d'exécuter les normes du droit international, créées par les traités, à l'intérieur de leurs propres territoires. Selon le droit international il revient au droit national de déterminer la méthode, par laquelle le droit international pourra être appliqué en droit interne. Généralement il y a deux méthodes d'intégration d'un traité dans l'ordre juridique interne d'un Etat. La transformation des normes du droit international au niveau du droit national sans procédure particulière (transformation générale) ou bien par des mesures législatives speciales (transformation spéciale).

4. Bundesgesetzblatt No. 128/1971.
5. Bundesgesetzblatt No. 110/1952.

Comme la plupart des ordres juridiques des pays européens, la Constitution Fédérale autrichienne a choisi la méthode de la transformation générale. Par conséquent, les Conventions tendant à éviter les doubles impositions conclues par l'Autriche et les accord relatifs à leur application sont applicables comme tels dans l'ordre juridique national sans que leur validité interne dépende de prescriptions spéciales.

La méthode de transformation générale a pour inconvénient que l'acceptation immédiate des dispositions du traité entraîne l'entrée de normes juridiques ne s'harmonisant pas avec l'ordre interne et ceci peut difficilement être évitée par l'Autriche. Vu le développement des relations internationales et la nécessité d'accepter des formules de traité généralement reconnues, il est évidemment impossible de se limiter à la conclusion de traités répondant au système juridique de tous les Etats Contractants.

L'amendement de la Constitution Fédérale de l'année 1964 a admis pour la première fois la possibilité d'une option pour la transformation spéciale. L'article 50, alinéa 2 prévoit dans sa version amendée qu'au cours de l'approbation d'un traité modifiant ou complétant la loi, ou de caractère politique, par le Parlement, le "Nationalrat" (l'Assemblée Nationale) peut prendre la décision que ce traité soit exécuté en vertu d'une loi à éditer. En cas d'un traité ne nécessitant pas l'approbation par le Parlement, la transformation spéciale peut être choisie par le Président Fédéral ou par les autres organes habilités à conclure des traité (Article 65, alinéa 1 et article 66 alinéa 2 de la Constitution Fédérale).

Dans le domaine du droit relatif à la double imposition on n'a pas encore trouvé nécessaire de garantir l'exécution des engagements émanant du droit international par des lois et ordonnances spéciales. C'est pourquoi même après la réforme constitutionnelle de l'année 1964 des Conventions tendant à éviter les doubles impositions et les accords quant à leur application sont intégrés à l'ordre juridique interne uniquement par voie de transformation générale. Le fait que l'Autriche puisse renoncer à utiliser la procédure de transformation spéciale pour les Conventions tendant à éviter les doubles impositions peut être attribué, pour une grande partie, au fait que les Conventions autrichiennes récentes en la matière se fondent sur le projet de Convention tendant à éviter les doubles impositions de l'OCDE; l'administration autrichienne avait eu l'occasion au cours des délibérations au sein du Comité des Affaires Fiscales de l'OCDE d'éviter dans la mesure du possible l'insertion de formules ne se trouvant pas en accord avec l'ordre juridique autrichien.

4. Le rang occupé par la Convention tendant à éviter les doubles impositions dans l'ordre juridique interne

L'ordre juridique interne de l'Autriche peut être comparé à une échelle dont l'échelon le plus élevé forme la loi constitutionnelle; le deuxième échelon est constitué par les loi ordinaires, le troisième échelon par les ordonnances. Les normes juridiques de l'échelon supérieur doivent garantir une couverture totale des normes de l'échelon inférieur.

L'intégration d'une Convention tendant à éviter les doubles impositions à l'ensemble de l'ordre juridique interne pose le problème de savoir de quelle manière le traité international peut s'intégrer à ce schéma.

Autrefois on considérait que des traités ne peuvent se ranger qu'au niveau du droit constitutionnel; cet interprétation est fondée sur le principe "*pacta sunt servanda*" qui est reconnu d'une manière générale par le droit international. [6] D'après l'interprétation actuelle le traité peut être attribué à chacun des trois échelons du droit autrichien. Des dispositions contenues dans le traité devant occuper un rang constitutionnel devraient être marquées expressément comme modifiant la loi constitutionnelle et devraient subir la même approbation par le Parlement que celle requise pour les dispositions du droit constitutionnel interne; tous les autres traités approuvés par le Parlement sont qualifiés de lois fédérales ordinaires; tous les autres traités occupent l'échelon d'ordonnances.

Jusqu'à maintenant les Conventions tendant à éviter les doubles impositions conclues par l'Autriche n'ont pas été considérées comme modifiant ou complétant la Constitution et occupent donc au sein de l'ordre juridique interne le rang de lois fédérales ordinaires.

Cette interprétation pose deux problèmes. D'une part l'attribution à ce niveau a pour condition que toutes les dispositions de la Convention tendant à éviter les doubles impositions sont couvertes par la situation juridique de la Constitution existante. L'absence d'une telle courverture peut avoir comme conséquence l'examen du traité par la Cour Constitutionnelle ce qui, par la suite, pourrait aboutir à la suppression de la Convention. Mais dans les cas individuels il n'est pas toujours simple de répondre à la question de savoir si un traité est conforme à la Constitution. C'est ainsi que les experts en droit constitutionnel ont par exemple déjà mis en doute "l'article sur les étudiants" (art. 20 de la Convention-modèle de l'OCDE): est-il ou non en plein accord avec l'art. 18 de la loi constitutionnelle fédérale. D'après ces dispositions constitutionnelles l'ensemble de l'administration publique doit se fonder sur les lois. Ceci signifie entre autre que les termes juridiques employés doivent être de nature à définir un acte d'une manière suffisamment précise; des lois ne répondant pas à cette nécessité sont contraires à la Constitution (voir par ex. la décision de la Cour Constitutionnelle du 14 mars 1969, G 30/68).

Dans cet ordre d'idées on a affirmé que le terme d'"étudiant" employé à "l'article sur les étudiants" est beaucoup trop vague; il est difficile de savoir si ce terme se refère uniquement aux étudiants des Universités ou comprend également les élèves des lycées.

Un deuxième problème se pose dans le domaine de l'effet de dérogation. Par la transformation d'une Convention tendant à éviter les doubles impositions dans l'ordre juridique interne, le traité abroge toutes les dispositions contraires du droit fiscal national; cet effet d'abrogation se fonde sur le principe selon lequel la loi fédérale ordinaire postérieure abroge la loi fédérale ordinaire antérieure (*lex posterior derogat legi priori*). Cet effet d'abrogation d'une Convention tendant à éviter les doubles impositions ne peut être contesté. Il existe moins d'unanimité sur la question de savoir si les dispositions d'une convention peuvent être supprimées par des modifications du droit fiscal national survenus ultérieurement. En principe des spécialistes en droit public admettent l'existence d'une telle possibilité. [7] Ceci pose le problème de savoir si par exemple la retenue de l'impôt sur le revenu nouvellement introduite en 1973 pour les non-résidents, prélevée sur les rémunérations payées en vertu des contrats relatifs à la fourniture de main-d'oeuvre, peut abroger les dispositions contraires contenues dans des Conventions antérieures tendant à éviter les doubles impositions.

L'administration financière a essayé de résoudre ce problème en se fondant sur la juridiction de la Cour d'Administration de l'Autriche qui considère les dispositions contenues dans les Conventions tendant à eviter les doubles impositions par rapport au droit fiscal interne comme "*lex specialis*" (voir décision de la Cour d'Administration du 28 juin 1963, chiffre 2312/61). Conformément à cette interprétation l'administration financière tend à adhérer à l'opinion qui conformément au principe "*lex special*

6. Voir *Kunz*, Völkerrechtliche Bemerkungen zur österreichischen Bundesverfassung, 320.
7. Voir *Ohlinger*, Der völkerrechtliche Vertrag im staatlichen Recht, 22

derogat legi generali" une loi postérieure ne peut abroger une Convention tendant à éviter les doubles impositions dans son propre champ d'application. Quant au cas précité ceci signifie que des rémunérations payées à des entreprises étrangères en vertu de contrats sur la fourniture de main-d'oeuvre peuvent continuer à être exemptes d'impôts, même après l'introduction de la nouvelle retenue à la source.

Les accords portant sur l'application des Conventions tendant à éviter les doubles impositions ont le rang d'ordonnances en tant que traités ne nécissitant pas l'autorisation par le Parlement.

5. Les conséquences juridiques de la conclusion illégale d'une Convention

En cas de conclusion d'un accord international qui ne s'avère pas conforme à l'ordre juridique interne, la question de sa validité au niveau du droit international n'est certainement pas mise en cause à l'heure actuelle. Les auteurs de la Constitution Fédérale autrichienne ont encore été partisans de cette opinion [8] mais n'ont pas su l'imposer. Conformément au droit international chaque Etat peut considérer qu'un Etat concluant un traité avec un autre Etat interprète et applique ses dispositions constitutionnelles en bonne règle. Un Etat qui conclut bona fide un traité avec un autre Etat sans avoir connaissance de la limitation du "treaty making power" de l'organe représentant cet autre Etat peut réclamer une indemnisation dans le cas où ce dernier ne reconnait pas les engagements résultant du traité. [9]

Inspiré par l'idée de la sécurité juridique l'ordre juridique autrichien connait également dans le domaine interne non pas des actes nuls mais des actes à annuler. Par conséquent, une Convention tendant à éviter les doubles impositions conclue en opposition à la loi acquiert force de loi à l'intérieur du pays, peu importe si la violation de la loi provient de la procédure (par exemple un accord modifiant la loi n'a pas été soumis au Parlement) ou provient de ses termes (par exemple une disposition de la Convention n'est pas conforme à la Constitution).

Pourtant depuis la réforme constitutionnelle de l'année 1964 la Constitution Fédérale prévoit la possibilité d'une procédure de vérification effectuée par la Cour Constitutionnelle.

Mais ce n'est pas le contribuable qui a le droit de faire appel à cette Cour pour contester une Convention tendant à éviter les doubles impositions mais une telle procédure de vérification ne pourrait être mise en route que sur la demande d'un gouvernement provincial ou d'une des trois Cours suprèmes responsables de l'application d'un Traité d'Etat.

Si la Cour Constitutionnelle donne suite à la demande d'annulation et que l'illégalité de la Convention soit constatée, la Convention devient inapplicable dans le domaine du droit interne après la publication de cette décision. La Cour Constitutionnelle peut fixer un délai à cet effet qui ne doit pas dépasser deux ans en cas de traités modifiant ou complétant la loi, ou de caractère politique; pour tous les autres cas il est de l'ordre d'un an.

Cette situation provenant de la Constitution Autrichienne est la raison pour laquelle les délégations autrichiennes s'efforcent toujours au cours des négociations sur les Conventions tendant à éviter les doubles impositions d'éviter des restrictions dans les clauses de dénonciations (p.e. "le présent traité pourra être dénoncé à l'expiration d'une période de cinq ans après son entrée en vigueur"). Car dans le cas où une Convention s'avère contraire à la loi, le Gouvernement autrichien doit avoir la possibilité de créer une situation juridique au niveau du droit international qui sera conforme au droit public interne; même au prix d'une dénonciation de la Convention.

6. Les Conventions tendant à éviter les doubles impositions et la structure fédérale de l'Autriche

L'Autriche est un Etat fédéral dans lequel l'Etat central et les Bundesländer (provinces fédérales) se partagent le pouvoir législatif et administratif. Ce partage englobe également la fiscalité. Il faut toutefois tenir compte du fait que la plus grande partie des revenus fiscaux en Autriche (environ 95%) provient des impôts fédéraux. Ceux-ci sont réglementés par la législation fédérale et sont perçus également par les autorités fédérales (administration financière fédérale). Les rendements provenant des impôts fédéraux les plus importants (en particulier la TVA et l'impôt sur le revenu) doivent néanmoins être partagés avec les autres collectivités locales (Bundesländer et Gemeinden/Communes).

Etant donné que le champ d'application de la Convention tendant à éviter les doubles impositions couvre essentiellement les impôts fédéraux, la structure fédérale de l'Autriche ne crée en général pas de problèmes particuliers.

Il y a seulement trois cas où des Conventions tendant à éviter les doubles impositons se réfèrent à des impôts locaux: ce sont le "Gewerbesteuer" (l'impôt sur les exploitations) dans la mesure où celui-ci est perçu pour le compte des Communes, le "Lohnsummensteuer" (l'impôt sur les salaires) et le "Grundsteuer" (impôt foncier).

Bien que ces trois impôts soient classés dans le groupe des impôts communaux (étant donné que les Communes en ont le seul droit de disposition) le pouvoir législatif en la matière, contrairement à la règle, n'est pas transmis aux Bundesländer mais est réservé à l'Etat fédéral, de sorte que la conclusion d'une Convention de double imposition ne pose pas de problèmes particuliers. En ce qui concerne les impôts des Bundesländer et des Communes une disposition de la Loi Constitutionnelle Financière de l'année 1948, Bundesgesetzblatt No. 45/1948, § 7 alinéa 4, attribue en outre à l'Etat fédéral la compétence de veiller à éviter des doubles impositions, à adapter de tels impôts aux dispositions du droit fiscal international et à empêcher des difficultés dans le domaine des transports internationaux et autres relations économiques.

Le seul effet pratique de la structure fédérale de l'Autriche sur la conclusion de Conventions tendant à éviter les doubles impositions résulte de l'engagement de l'Etat fédéral de partager le rendement de ses impôts fédéraux avec les Bundesländer et les Communes. Si, par conséquent, la conclusion d'une Convention tendant à éviter les doubles impositions ou toute autre mesure de l'Etat central pouvait entraîner une diminuation des parts de rendements fiscaux incombant aux Bundesländer, il faudrait alors entrer en négociations en temps utile avec les collectivités locales concernées (§ 5 du Finanzausgleichsgesetz 1973, Bundesgesetzblatt No. 445/1972).

B. LES RAPPORTS PARTICULIERS EXISTANT ENTRE LA CONVENTION TENDANT A EVITER LES DOUBLES IMPOSITIONS ET L'ORDRE JURIDIQUE FISCAL INTERNE D'UN ETAT

En dehors de la question générale traitée dans la première partie relative à l'intégration d'un traité international à l'ordre juridique interne, la Convention tendant à eviter les doubles impositions a encore d'autres points de rencontre avec l'ordre juridique fiscal interne, points qui ont besoin d'être éclaircis particulièrement. Vu sous l'angle de l'application pratique des Conventions tendant à éviter les doubles impositions en Autriche, ces questions peuvent être résumées comme suit:

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8. Voir *Kelsen-Merkl-Fröhlich*, Die Bundesverfassung vom 1. Oktober 1920, remarques à l'article 50.
9. Voir *Verdross*, Völkerrecht [4], 105.

1. *Une Convention tendant à éviter les doubles impositions peut-elle créer des droits nouveaux d'imposition non prévus par le droit fiscal interne?*
2. *La Convention tendant à éviter les doubles impositions peut-elle influencer le mode selon lequel les droits d'imposition attribués par le traité sont mis en valeur?*
3. *Le droit interne peut-il servir de base à l'interprétation de la Convention tendant à éviter les doubles impositions?*
4. *Des dispositions contenues dans les Conventions tendant à éviter les doubles impositions peuvent-elles servir de base à l'interprétation du droit fiscal interne?*

1. Absence de création de nouvelles sources d'impôt

Il peut arriver qu'une Convention tendant à éviter les doubles impositions confère à l'Autriche un droit d'imposition qui n'est pas prévu par l'ordre juridique fiscal interne. C'est ainsi que par exemple l'article 11, alinéa 2 de la Convention tendant à éviter les doubles impositions austro-helvétique, Bundesgesetzblatt No. 63/1975, attribue à l'Etat de la source le droit de prélever sur des intérêts un impôt de 5 pour cent. Donc dans le cas où un bailleur de fonds résidant en Suisse offre un crédit à une entreprise autrichienne, l'Autriche aurait le droit, conformément à la Convention de double imposition, de frapper les intérêts payés à ce sujet d'un impôt de 5 pour cent. Pourtant d'après le droit fiscal interne (voir § 98 de la Loi sur l'impôt sur le revenu du 1972, Bundesgesetzblatt No. 440/1972) des intérêts payés à des non-résidents ne pourraient être imposés que s'ils sont garantis en Autriche par hypothèque. Dans le cas contraire, la question se pose de savoir si les autorités autrichiennes sont habilitées à percevoir, en la matière, l'impôt de 5% prévu par la Convention de double imposition qui est équivalent à la loi autrichienne relative à l'impôt sur le revenu (voir supra).

Cette question a toujours reçu une réponse négative en Autriche. Ces problèmes ont déjà été portés devant la Cour Constitutionnelle autrichienne qui dans sa décision s'y rapportant (voir décision du 11 mars 1965, B 210, 211/1964) considère que la tâche primordiale d'une Convention tendant à éviter les doubles impositions consiste à répartir les droits d'imposition et que par conséquent l'effet d'une telle Convention ne saurait dépasser le cadre d'une restriction du droit fiscal national existant. La Cour Constitutionnelle en conclut que le bien fiscal attribué à un Etat contractant ne peut être imposé par celui-ci que dans la mesure où le droit fiscal interne le permet.

Cette interprétation de l'effet exercé par une Convention tendant à éviter les doubles impositions sur la fiscalité interne qui se fonde sur la jurisprudence de l'ancien Reich allemand (voir jugement de la Cour Suprême des Finances du Reich du 3 octobre 1935, III A 267/34, "Reichssteuerblatt" de 1935, page 199) a pourtant été plusieurs fois sujet à critique. [10] Sa justification serait surtout mise en cause dans le cas où elle serait à l'origine de doubles *non*-impositions.

Si, par exemple, une entreprise allemande acquiert en Autriche des biens immobiliers pour la simple raison de placement sans les utiliser à ses propres fins industrielles ou commerciales (si par conséquent ces biens immobiliers ne constitutent pas d'établissement stable de l'entreprise allemande) et que ces biens immobiliers soient aliénés après expiration d'un délai de 6 ans, l'article 3 de la Convention austro-allemande tendant à éviter les doubles impositions, Bundesgesetzblatt No. 221/1955, confère à l'Autriche le droit d'imposer le gain réalisé par cette aliénation. D'après le droit autrichien relatif à l'impôt sur le revenu les gains réalisés par une entreprise étrangère ne peuvent être imposés que dans la mesure où ils peuvent être attribués à un établissement stable de l'entreprise étrangère situé en Autriche, ou bien qu'ils proviennent de l'aliénation de biens immobiliers nationaux effectués avant l'expiration d'un délai de cinq ans (délai de spéculation). D'autres cas d'imposition de gains réalisés par des entreprises étrangères en Autriche, énumérés d'une manière limitative au § 98 de la loi sur l'impôt sur le revenu, sont sans importance en l'occurence. Dans ces conditions l'Autriche est habilitée en vertu de la Convention tendant à éviter les doubles impositions d'imposer les gains provenant de l'aliénation de biens immobiliers, mais en est empêchée par son droit interne; il est vrai que dans le cas inverse la République fédérale d'Allemagne aurait, d'après son droit interne, une possiblité d'imposition (obligation fiscale illimitée), mais est empêchée d'exercer ce droit par les dispositions de la Convention tendant à éviter les doubles impositions.

2. L'importance du droit interne pour la réalisation des droits d'imposition attribués par la Convention

Conformément au principe exposé ci-dessus, selon lequel une Convention tendant à éviter les doubles impositions est en mesure de restreindre, mais non pas de créer des droits d'imposition internes, la question de savoir *si* dans une affaire fiscale internationale l'Autriche peut faire valoir son droit à l'imposition, ne pourra être résolue qu'en application commune du droit international et du droit national. La deuxième question à savoir *de quelle manière* un droit d'imposition fixé aussi bien par le traité que par le droit interne peut être exécuté, doit être résolue seulement en application du droit interne.

Ce principe a quelque importance dans le cas suivant: Conformément à l'article VII de la Convention austro-américaine tendant à éviter les doubles impositions, Bundesgesetzblatt No. 232/1957, des intérêts provenant de sources américaines peuvent être imposés en Autriche. Un contribuable résidant en Autriche, ayant touché des intérêts provenant d'obligations publiques ou communales américaines, a contesté le droit d'imposition de l'Autriche, en faisant valoir que ces intérêts sont exempts d'impôt selon le droit américain et qu'il faudrait en tenir compte dans l'imposition en Autriche conformément à la Convention austro-américaine tendant à éviter les doubles impositions. Conformément aux expositions plus hautes l'administration financière autrichienne a considéré que la Convention tendant à éviter les doubles impositions avait conféré à l'Autriche le droit d'imposer des intérêts américains, mais qu'elle ne pourrait pas avoir d'influence sur la détermination du montant imposable des revenus étrangers par les autorités fiscales autrichiennes. Les avantages fiscaux prévus par le droit américain relatif à l'impôt sur le revenu ne peuvent donc pas avoir de conséquences sur le calcul du revenu imposable en Autriche. Pour résoudre ce litige juridique on a fait appel à la Cour Administrative autrichienne qui a pourtant confirmé l'opinion de l'administration financière autrichienne dans sa décision du 27 mai 1966, chiffre 417/1966.

Le principe exposé ci-dessus joue aussi un certain rôle dans la prise en considération des revenus étrangers en vertu de la clause de progressivité. On peut souvent observer que dans les déclarations de l'impôt sur le revenu le montant des revenus provenant de l'étranger qui entrait en ligne de compte pour l'établissement de la progressivité en Autriche est identique à celui figurant à l'avis d'imposition à l'étranger. Là aussi il faudra tenir compte du fait que cette pratique ne sera admissible que dans la mesure où les lois des deux Etats relatives au calcul du revenu ne présentent pas trop de divergences. Car, comme il a déjà été dit, le montant des revenus provenant de l'étranger doit toujours être fixé conformément au droit autrichien.

Il faut procéder de même dans des cas de double résidence. Un contribuable ayant un résidence en République fédérale d'Allemagne dispose en Autriche d'une résidence secondaire (le centre de ses intérêts vitaux se trouvant en RFA); ses seuls revenus de source autrichienne proviennent de la location d'habitations. Etant donné que le contribuable dispose en Autriche d'un domicile fiscal, le droit interne revendique de l'assujettir intégralement (obligation d'impôt illimitée); ceci a pour conséquenc

10. Voir *Kruse* au "Österreichische Steuerzeitung" de 1975, 200, remarque No. 70.

que ses revenus provenant de la RFA comme de tout autre pays sont soumis à l'impôt sur le revenu autrichien. Ce devoir fiscal illimité procure pourtant au contribuable certains avantages (par ex. déductibilité de primes d'assurances sur la vie, déductibilité de certaines charges exceptionnelles, comme frais d'hôpital, jouissance de certains montants d'imputation), qui ne sont pas accordés aux non-résidents imposés seulement pour certains de leurs revenus autrichiens (contribuables à devoir fiscal limité). Dans le cas présent, la Convention tendant à éviter les doubles impositions confère à l'Autriche le droit d'imposer des revenus locatifs réalisés en Autriche; mais elle exclut l'Autriche d'imposer également les revenus allemands ou les revenus provenant de tout autre Etat. On pourrait très bien défendre l'opinion qu'un allègement international de l'obligation d'impôt des non-résidents durait entraîner également une réduction des avantages fiscaux. L'application du principe exposé aboutit pourtant au résultat inverse, à savoir que la Convention n'intervient pas pour résoudre la question de savoir de quelle manière des revenus locatifs autrichiens sont à imposer par l'Autriche; cette question se pourrait trouver uniquement une solution par l'application du droit interne. Etant donné que le droit interne relatif à l'impôt sur le revenu accorde les avantages fiscaux résultant de l'obligation fiscale illimitée sans tenir compte du fait que cette obligation fiscale est créée par une résidence principale ou par une résidence secondaire, il n'y a pas de possibilité lègale de ne pas accorder au contribuable les avantages fiscaux cités ci-dessus.

On peut encore noter que l'Autriche a déjà fait un premier essai, par sa législation interne, pour supprimer cette situation insatisfaisante: Ce n'est que récemment que dans le domaine de l'imposition de la fortune, les montants d'exonération d'impôt liés également à l'obligation fiscale illimitée ont été supprimés pour tous les cas où un contribuable résidant en Autriche selon le droit interne, est considéré en vertu d'une Convention tendant à éviter les doubles impositions comme résidant dans un autre Etat (voir amendement à la loi sur l'impôt sur la fortune de 1976, Bundesgesetzblatt No. 665/1976, chiffre 1).

3. L'importance du droit interne pour l'interprétation des Conventions tendant à éviter les doubles impositions

L'administration fiscale autrichienne déduit ce principe de l'article 3, alinéa 2 du projet de convention tendant à éviter les doubles impositions de l'OCDE. Cette dipsosition est la suivante:

"*Pour l'application de la Convention par un Etat contractant, toute expression qui n'est pas autrement définie a le sens qui lui est attribué par la législation dudit Etat régissant les impôts faisant l'objet de la Convention, à moins que le contexte n'exige une interprétation différente.*"

Ce principe s'applique dans le cas suivant: Une entreprise suisse construit un immeuble en Autriche qui, par la suite, est donné à bail à une entreprise allemande. L'entreprise allemande donne en sous-location ces installations à des entreprises autrichiennes. Ceci n'est pas considéré comme établissement stable de l'entreprise allemande en Autriche. Il n'y a aucun doute que les sommes payées par l'entreprise allemande à l'entreprise suisse peuvent être imposées en Autriche conformément à la règle d'attribution du droit d'imposition s'appliquant à des revenus provenant de biens immobiliers. Il est pourtant plus difficile de trouver une réponse à la question de savoir si les sommes touchées par l'entreprise allemande à titre de sous-location peuvent également être prises en considération pour l'imposition en Autriche. D'après l'article 3 de la Convention austro-allemande tendant à éviter les doubles impositions l'Autriche aurait le droit d'imposer les revenus provenant de biens immobiliers situés en Autriche. Il faut donc trancher la question de savoir si un contrat de sous-location doit être considéré comme location d'un droit de bail ayant le caractère d'un bien économique mobilier ou bien s'il s'agit plutôt là, du point de vue fiscal, d'un contrat de location relatif à des biens immobiliers. La Convention austro-allemande tendant à éviter les doubles impositions ne contient pas de disposition particulière à ce sujet. L'Autriche devra trouver une réponse à cette question en se fondant sur son droit interne qui décidera pour l'interprétation citée en deuxième lieu. [11]

Il est évident que ce principe d'interprétation sera limité dans la mesure où l'accord lui-même ne prévoit pas expressément autre chose. Il serait par exemple inadmissible de ne pas appliquer en Autriche la règle relative aux dividendes pour les gains de sociétés à responsabilité limitée pour la simple raison que conformément à la terminologie juridique autrichienne seuls les gains réalisés par des sociétés par actions sont nommés "dividendes". Car dans ce cas, conformément à la définition de la Convention tendant à éviter les doubles impositions, ce terme doit s'appliquer aux gains réalisés par toutes les sociétés de capitaux.

4. L'incompétence du droit fiscal international dans l'interprétation du droit fiscal interne

Le principe qui vient d'être exposé selon lequel le droit interne pourrait servir à l'interprétation du droit fiscal international, ne pourrait pas être appliqué dans le sens inverse.

Si, par conséquent, une entreprise suisse dispose en Autriche d'un simple bureau d'information qui, selon les dispositions de la Convention austro-helvétique ne doit pas être qualifié d'établissement stable (article 5, lit. e), le droit fiscal international, en se fondant sur cette définition, retire à l'Autriche le droit de frapper les installations d'une entreprise suisse sur le territoire autrichien de l'impôt sur le revenu et sur la fortune. Il ne serait pas juste de prétendre également que ce bureau d'information n'aurait pas le caractère d'un établissement stable pour la TVA. Le § 12 de la loi sur la TVA, Bundesgesetzblatt No. 223/1972, lie le droit d'une entreprise étrangère de faire valoir son droit à déduction de la taxe qui a grevé le prix de revient, entre autre à la condition que l'entreprise étrangère ait en Autriche un établissement stable. L'interprétation de ce terme d'établissement stable employé en matière de TVA doit se fonder sur le droit interne (voir § 29 de la loi fédérale portant sur la procédure fiscale, BGBl. No. 194/1961); selon le droit interne, de tels bureaux d'information constituent sans doute un établissement stable; il serait donc inadmissible de ne pas faire profiter l'entreprise suisse du droit à déduction en se référant à la définition des dispositions de la Convention austro-helvétique tendant à éviter les doubles impositions.

La Convention tendant à éviter les doubles impositions n'a également pas d'effets sur la question de savoir si l'obligation fiscale des employés travaillant dans le bureau d'information sera accompli par voie de déclaration d'impôt ou par voie de retenue à la source. Il est vrai que la loi autrichienne relative à l'impôt sur le revenu, Bundesgesetzblatt No. 440/1972 prévoit la possibilité d'une retenue à la source sur les salaires uniquement dans les cas où l'employeur dispose en Autriche d'un établissement stable (§ 81 de la loi relative à l'impôt sur le revenu); mais ce n'est de nouveau pas la Convention tendant à éviter les doubles impositions mais exclusivement le droit interne autrichien qui décide de la question de savoir si le bureau d'information constitue un établissement stable pour que la procédure de rétention d'impôt sur les salaires devienne applicable.

C. RESUME

Sans prétendre définir les rapports existant entre le droit international et le droit interne au sens d'une théorie moniste ou dualiste, il faut constater qu'il s'agit d'une part de deux domaines de

11. Voir *Schubert-Pokorny-Schuch*, remarque 22 faite au § 98 de la loi relative à l'impôt sur le revenu et la décision de la Cour d'Administration du 16 mars 1971, chiffre 1357/1970.

droit différents qui ont d'autre part de multiples points de rencontre. Le but de cet exposé était de parler de ces points de rencontre en prenant comme exemple l'Autriche.

Les Conventions tendant à éviter les doubles impositions font en premier lieu partie intégrante du droit international public. Une des affinités à l'ordre juridique interne résulte du fait que les accords internationaux doivent être exécutés dans le domaine du droit interne; ceci mène au problème de l'intégration d'une Convention tendant à éviter les doubles impositions à l'ordre juridique interne d'un Etat. En Autriche cette intégration se fait par voie de transformation générale; il serait possible d'appliquer à titre de choix également la méthode de transformation spéciale, mais dans le domaine du droit relatif aux Conventions tendant à éviter les doubles impositions on ne s'est pas encore servi de cette méthode. Une transformation en bonne règle doit respecter plusieurs conditions en vertu de la Constitution; des Conventions tendant à éviter les doubles impositions ne doivent être conclues que par le Président fédéral; en tant que traité modifiant la loi elles nécessitent l'approbation par le Parlement et ne doivent pas être signées *uno actu*, mais uniquement sous réserve de ratification. Des Conventions tendant à éviter les doubles impositions occupent à l'échelle de l'ordre juridique autrichienne le rang de simples lois fédérales et doivent donc être conformes à la Constitution. Des illégalités se produisant à l'occasion de la conclusion ou dans le texte d'une telle Convention n'entraînent pas sa nullité; pourtant des Conventions tendant à éviter les doubles impositions peuvent être annulées par la Cour Constitutionnelle (avec l'effet *ex nunc*); l'annulation se rapporte uniquement au domaine juridique interne et ne touche en aucune manière les obligations internationales de la Convention.

Quelques autres points de rencontre qui doivent être résolus dans l'application de la Convention tendant à éviter les doubles impositions peuvent être résumés comme suit: la Convention ne peut pas établir des droits à imposition qui ne sont pas déjà prévus par le droit interne; c'est exclusivement le droit interne qui décide de la manière suivant laquelle les droits à imposition attribués sont mis en valeur; les Conventions tendant à éviter les doubles impositions doivent être interprétées en se fondant sur le droit interne; on ne peut pas faire appel à des Conventions tendant à éviter les doubles impositions pour interpréter des prescriptions internes d'imposition.

II. LA REALISATION DES DROITS FISCAUX ET LA PROTECTION JURIDIQUE DANS LA PROCEDURE FISCALE AUTRICHIENNE
(en tenant compte en particulier des possibilités de conflits résultant des règlements internationaux)

A. L'ORGANISATION DE L'ADMINISTRATION FISCALE

Un principle dominant de la Constitution autrichienne est le principe fédéral. [12] Il est réalisé de manière que l'Etat fédéral et les Länder se partagent le pouvoir législatif et le pouvoir exécutif (la juridiction par contre est uniquement réservée à l'Etat fédéral) et les Länder ont le droit de coopérer à la législation fédérale (droit de remontrance suspensif à la deuxième Chambre, la Chambre des Länder). Les devoirs de l'administration fédérale ne sont accomplis qu'en partie par des autorités appartenant à l'Etat fédéral — brevets, PTT, armée). La plupart des affaires administratives de l'Etat fédéral sont réglées sous forme d'administration fédérale indirecte, par les autorités des Länder (chef du gouvernement provincial et autorités du Land qui lui sont subordonnées, autorités administravies du Bezirk); dans ce domaine de leur activité, celles-ci ont la fonction d'autorités fédérales et sont par conséquent obligées de s'en tenir aux instructions émanant des organes de l'Etat fédéral (autorités centrales).

Le premier échelon territorial de l'organisation administrative est constitué par les communes; celles-ci sont (comme l'Etat fédéral et les Länder) des collectivités territoriales (Gebietskörperschaften) ayant le droit à l'administration autonome ainsi que les compétences administratives qui relèvent de ce droit. De même que le droit constitutionnel attribue aux Länder des devoirs qu'ils accomplissent indépendamment des organes fédéraux, les communes sont elles aussi chargées de travaux administratifs qu'elles doivent effectuer sans être liées aux instructions de l'Etat fédéral et du Land (domaine autonome, réservé). Pourtant, de même que les Länder et les autorités leur appartenant peuvent être chargés d'effectuer des activités administratives pour l'Etat fédéral (administration fédérale indirecte), des devoirs publics peuvent également être transférés aux communes qu'elles sont tenues d'accomplir non pas au titre de leur position en tant qu'organisme autonome, mais au titre de leur qualité de ressort administratif public (domaine transféré).

Il apparait donc qu'en Autriche la législation est uniquement réservée à l'Etat fédéral et aux Länder. L'administration par contre est assurée par l'Etat fédéral, les Länder et également par les communes. Les Länder et les communes peuvent toutefois exercer une partie de leur activité en tant qu'administration déléguée, c'est à dire dans un domaine transféré et par conséquent liées à des instructions (ils fonctionnent en tant qu'autorités de la collectivité territoriale supérieure).

Bien que plusieurs domaines des compétences administratifs d'une collectivité territoriale supérieure puissent faire l'objet d'un transfert à des collectivités territoriales inférieures (un transfert dans l'autre sens est possible avec l'accord de la collectivité territoriale concernée, mais c'est rarement le cas), il apparait que — en dehors de l'attribution de compétences législatives — le principe fédéral trouve aussi son application dans l'organisation de l'activité des differentes autorités. Ceci permettrait de penser qu'il incombe à l'Etat fédéral, aux Länder et aux communes, donc à toutes les collectivités territoriales, d'assurer elles-mêmes la couverture des frais résultant de leur travail en particulier par la perception d'impôts. Cette solution idéale qui correspondrait à ce système (système de séparation) est mentionnée par la Constitution, [13] mais elle n'est pourtant pas mise en pratique. La raison est d'ordre historique: c'est uniquement l'Etat fédéral qui dispose d'une organisation bien rodée et efficace dans le domaine des impôts et de l'administration, dotée d'un corps de fonctionnaires très qualifiés. C'est ainsi qu'il apparait inopportun de constituer en dehors de l'administration traditionnelle d'un bon fonctionnement, une organisation parallèle dans les Länder et les communes

12. Article 2 de la Loi constitutionnelle fédérale, pour l'explication des notions et d'autres références de doctrine voir *Ermacora*, "Österreichisches Verfassungslehre", Vienne 1970, 251; *Walter*, "Österreichisches Bundesverfassungsrecht", Vienne 1972, 107; *Walter-Mayer*, "Grundriss des österreichischen Bundesverfassungsrechts", Vienne 1976, 45.
13. § 2 de la Loi portant sur la Constitution fiscale (F-VG) de 1948 Journal (BGBl. No. 45/1948.

C'est la raison pour laquelle la perception des impôts plus importants est réservée aux autorités fiscales de l'Etat fédéral. [14] Nonobstant la souveraineté des Länder et des communes dans le domaine des impôts, ceux-ci, conformément à leurs possibilités de perception limitées, ne gèrent que des impôts moins lucratifs et moins importants. La somme totale des impôts perçus en Autriche est réalisée pour 95% par les autorités fiscales de l'Etat fédéral. En tenant compte du principe fédéral et de la garantie réservée par la Constitution à toutes les collectivités territoriales [15] de maintenir leur existence, la sureté matérielle des Länder et des communes est assurée en leur accordant la participation appropriée aux résultats réalisés par la perception fédérale (donc système intégré), de même que par des affectations financières et subventions particulières.

Quant aux impôts classiques, tels que l'impôt sur le revenu, l'impôt sur les exploitations, la taxe sur le chiffre d'affaires, l'impôt sur la fortune, de même qu'en ce qui concerne les impôts sur certaines transactions ou des impôts de consommation, des monopoles et des droits de douane, ce sont donc uniquement les autorités fiscales de l'Etat fédéral qui en effectuent la perception.

L'organisation de l'administration fiscale de l'Etat fédéral est exposée par la loi fédérale du 13 décembre 1974, Journal Officiel (Bundesgesetzblatt) No. 18/1975 (loi portant sur l'organisation de l'administration fiscale — AVOG) de même que par la loi sur les ministères fédéraux de 1973, Journal Officiel (BGBl.) No. 389/1973. Conformément à ces lois — mis à part quelques rares exceptions prévues expressément par la loi — les *bureaux de finances* (Finanzämter) qui assument toujours le travail administratif nécessaire pour recouvrer les impôts. Il s'agit là d'autorités de première instance constituées au niveau du Bezirk. Le premier échelon dans le domaine des douanes est constitué par les *bureaux de douane* (Zollämter).

Les autorités de l'instance intermédiaire (en général au niveau du Land) sont formées par les Directions Fiscales Régionales (*Finanzlandesdirektionen*); ce sont des autorités supérieures ayant le droit de donner des instructions aux bureaux de finances et de douane. Les Directions Fiscales Régionales sont également des autorités de recours. Ce n'est que dans des cas exceptionnels qu'elles tranchent des décisions de première instance (particulièrement dans le domaine des impôts de consommation et des douanes).

Les activités de l'administration fiscale suprême de l'Etat fédéral sont exercées par le *Ministère fédéral des Finances*. Dans le domaine fiscal il lui incombe en particulier de s'occuper des affaires relatives à l'organisation financière, à la péréquation fiscale, au budget et au pouvoir législatif. Il doit donc également veiller à l'établissement de projets de loi dans ce domaine. C'est uniquement dans des cas très rares (expressément prévus par la loi) que le Ministère fédéral des Finances doit accomplir des tâches demandant des décisions par avis (Bescheid); il lui revient avant tout un pouvoir d'organisation et d'instruction.

Le Ministère des Finances prend des décisions en première instance sur des questions se rapportant au droit fiscal international par ex. pour éliminer sur demande par décision (individuelle) certains objets imposables totalement ou en partie de l'obligation fiscale ou pour imputer totalement ou en partie des taxes frappant de tels objets sur des impôts internes (§ 48 de la Loi Fédérale portant sur la procédure fiscale (BAO)), à condition qu'il n'existe pas de Conventions tendant à éviter les doubles impositions ou que dans des cas individuels elles ne soient pas en mesure d'éviter de manière efficace la double imposition. Le Ministère fédéral des Finances est également compétent pour consentir l'imputation de sommes, versées à titre d'impôt sur les successions à l'Etat du lieu de situation et frappant des objets situés à l'étranger sur l'impôt sur les successions et de donation autrichiens. [16] Finalement le Ministère fédéral des Finances peut accorder par décision des "avantages fiscaux d'entrée" dans le domaine de l'impôt sur le revenu et sur la fortune [17] à des personnes transférant leur domicile en Autriche sans y exercer une activité lucrative (ces avantages reviennent à restreindre l'obligation fiscale illimitée qui est constituée par l'installation du domicile en Autriche). En tant qu'autorité suprême il incombe au Ministère fédéral des Finances d'introduire et d'exécuter des procédures amiables avec des Etats contractants (voir art. 25 du Projet de l'OCDE d'une Convention tendant à éviter les doubles impositions et les Conventions bilatérales).

Etant donné que les Directions Fiscales des "Länder" constituent la dernière instance dans les voies de recours fiscales, le Ministère fédéral des Finances n'a pas la fonction d'une autorité d'appel. Ce sont uniquement les décisions prises par les bureaux de finances et les bureaux de douane qui peuvent faire l'objet d'un recours administratif; les voies de recours s'arrêtent donc aux Directions Fiscales des "Länder". Les décisions qu'elles prennent — soit en leur qualité d'autorité de recours ou en vertu de leur propre compétence en tant que première instance — ne peuvent pas faire l'objet d'une procédure de contestation administrative ce qui vaut également pour les décisions émanant du Ministère fédéral des Finances.

Etant donné que les dispositions résultant de Conventions tendant à éviter les doubles impositions font partie du droit interne une fois qu'elles ont été approuvées par le Parlement, la question de savoir s'il faut appliquer les règles autonomes du droit fiscal ou des règles se basant sur des Traités ne relève pas de la compétence des autorités. Les règles de compétence esquissées plus haut s'appliquent donc sans tenir compte des sources du droit fiscal. Aucune autorité spéciale, ni aucune compétence particulière ne sont prévues pour des impositions dont les effets dépassent les frontières de l'Autriche, en particulier dans les cas de double imposition ou dans les affaires où s'applique le droit international (bilatéral ou multilatéral).

B. LA REALISATION DES CREANCES FISCALES DE L'ETAT PAR LES ADMINISTRATIONS FISCALES; LES PRINCIPES DOMINANT LA PROCEDURE

Conformément au droit fiscal autrichien (comme par ex. au droit allemand) la créance fiscale de l'Etat en tant que créance de droit public (correspondant à la dette fiscale du redevable) est constituée avec la réalisation d'éléments constitutifs de l'obligation fiscale énoncés par la loi. Si, par conséquent, un acte concret est posé répondant aux exigences abstraites de ces éléments, la conséquence légale prescrite dans la loi se trouve réalisée. [18] Ceci ne répond pas seulement au principe impératif, selon lequel l'imposition doit se baser exclusivement sur des éléments constitutifs de l'obligation fiscale et au principe de la légalité de l'administration, [19] mais signifie en même temps que la créance publique (dont l'effet patrimonial est la création d'une créance dans le chef du créancier fiscal et d'une dette correspondante dans le chef du débiteur d'impôt) ne naît pas par sa constatation par l'administration, mais déjà par un comportement répondant à ces élé-

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14. Conformément au § 3 de la Loi portant sur la Constitution fiscale, il revient à la législation fédérale de répartir les droits d'imposition et le rendement provenant des impôts (des lois dites de péréquation financière sont édictées, dernièrement BGBl. No. 445/1973); voir *Melichar*, "Die Österreichische Finanzverfassung" et *Wissgott*, "Der Finanzausgleich in Österreich" au "Handbuch der österreichischen Finanzwirtschaft" édité par Andreae, Innsbruck 1970, 13 et 59.
15. § 4 de la Loi sur la Constitution fiscale (F-VG) de 1948.
16. § 6, alinéa 3 de la loi portant sur l'impôt sur les successions et sur l'impôt de donation de 1955, BGBl. No. 141/1955.
17. § 103 de la loi portant sur l'impôt sur les revenus de 1972 et § 10 de la loi portant sur l'impôt sur la fortune de 1954.
18. § 4, alinéa 1 de la Loi Fédérale portant sur la procédure fiscale (BAO); *Stoll*, Steuerschuldverhältnis, Vienne 1972.
19. Article 18 de la Loi Constitutionnelle fédérale, § 5 de la Loi portant sur la Constitution fiscale.

ments constitutifs prescrites par la loi. Vu sous cet angle, les activités de l'administration fiscale ayant comme but l'établissement de l'impôt par décision, [20] aboutissent donc dans un acte administratif de nature déclarative, étant donné que ce n'est pas la décision relative à l'imposition qui constitue la dette fiscale, elle est seulement l'instrument de la réalisation d'une dette fiscale déjà existante. Conformément aux principes de la légalité elle est donc la condition préalable de la perception de l'impôt (ordre de paiement et base pour l'exécution).

La procédure fiscale [21] doit tenir compte du caractère public de la créance fiscale et du principe de la légalité en matière de perception fiscale. Dans les lignes qui suivent, nous traiterons des principles dominant la procédure.

Au premier plan se trouve le principe de *la poursuite d'office*, le principe selon lequel l'autorité fiscale détermine elle-même la marche de la procédure; ceci signifie que la procédure fiscale — mis à part des genres de procédures basées sur une demande (par ex. certaines affaires douanières) — doit être ouverte, exécutée et terminée d'office, c'est á dire qu'il est du devoir de l'autorité de constater les faits donnant lieu à l'imposition, le redevable ayant toutefois un devoir de coopération. Ce dernier est obligé sous peine de sanction, d'exposer sa situation revelatrice de l'imposition sans restrictions et conformément à la vérité. En raison des principes de la poursuite et de l'enquête d'office, principes qui sont déterminés par la loi, il incombe à l'administration fiscale de s'occuper entièrement de l'enquête des faits (constatation des faits, exposition des preuves) ce qui signifie que l'autorité fiscale ne doit pas seulement constater d'office des faits générateurs d'un droit d'impôt, mais doit également tenir compte des faits annulant ou atténuant ce droit. Etant donné que conformément aux règles générales de procédure, on ne saurait demander des choses impossibles et inutiles, l'obligation de l'autorité fiscale de faire une enquête d'office pour rechercher les faits trouve une limite au moment où le contribuable n'est pas prêt à coopérer à la recherche de la vérité. Des faits peu courants évoqués par le contribuable et des faits qui ne peuvent pas être supposés doivent être prouvés par celui-ci. En particulier s'il s'agit de faits ayant leur source à l'étranger, le devoir du redevable de coopérer va en croissant dans la mesure où l'obligation de l'administration fiscale de rechercher d'office des faits va en diminuant pour la raison que les possibilités d'enquête dont elle dispose en Autriche lui manquent à l'étranger. Du moment que le redevable n'accomplit pas son devoir de coopération, l'autorité fiscale peut se baser sur les documents et les éléments dont elle dispose sans être obligée de tenir compte de toutes les possibilités pouvant être importantes pour l'énoncé des faits et de prouver toutes les circonstances possibles pouvant être prises en considération.

C'est ainsi qu'on arrive au principe de *la libre appréciation des preuves* dont la nature, ce qui vaut pour chaque procédure moderne, consiste dans le fait qu'il revient à l'administration de juger elle-même, en tenant bien compte des résultats de la procédure d'enquête, de la question de savoir si un fait doit être considéré comme prouvé ou non. La libre appréciation ne dispense pas de l'observation des règles de la recherche des faits. Les conclusions finales basées sur des faits irréfutables et mettant hors de doute l'existence ou la non-existence des faits en question, doivent correspondre aux lois logiques de la pensée. Il faut qu'il y ait un enchaînement rationnel d'une pensée à l'autre et que les considérations et conséquences qui en sont tirées doivent être concluantes, elles doivent être exposées aux redevables pour permettre leur vérification. D'ailleurs, avant la fin de toute procédure d'enquête, les parties doivent avoir l'occasion, en vue de défendre leurs intérêts, de prendre position aux suppositions faites par les autorités, sous forme d'idées opposées, d'objections, d'indications justifiées, pour contribuer à trouver la vérité (*Principe de l'audition des parties*). *La consultation du dossier* qui est également accordée aux parties (y ayant un droit), dans la mesure où il n'est pas porté préjudice à de tiers personnes (des dossiers internes sont également exclus), doit contribuer à faire valoir et à défendre des intérêts bien fondés, de même qu'elle doit servir à faciliter la recherche des faits tels qu'ils se présentent en réalité.

Conformément au but de la procédure qui est de déterminer la dette de droit public et de la constater par décision, tous les faits ayant un rapport avec cette dette doivent être énoncés suivant leur véritable importance. Ce ne sont pas les suppositions évoquées par les parties, souvent non contestées, qui sont décisives, mais il s'agit uniquement de rechercher la vérité matérielle et de la mettre à la base de l'imposition.

La procédure fiscale connaît dans une large mesure le *principe de la forme écrite*. En principe les demandes des parties et les actes de l'administration doivent se présenter toujours sous la forme écrite; il est également prévu de déposer des demandes ou de régler l'affaire oralement, mais seulement dans des cas exceptionnels. La procédure fiscale *n'est pas accessible au public*. L'autorité est soumise à *une obligation très stricte au secret* (sous peine de sanction pénale) en ce qui concerne tous les éléments de situation énoncés ou recherchés par elle.

Dans la mesure où les lois fiscales matérielles ne prévoient pas expressément des délais particuliers dont l'expiration entraîne l'extinction des droits, l'administration fiscale est tenue d'entendre jusqu'au moment où le jugement est passé en force de chose jugée des demandes déposées par les parties (donc encore au cours de la procédure d'appel), des observations de fait et de nature juridique, même si ces demandes et observations n'ont pas encore été déposées par faute ou négligence du contribuable (pas d'interdiction de faire valoir de faits nouveaux, pas de procédure par contumace, donc pas de perte de droit en cas d'inobservation des délais de déclaration, etc.).

Les parties ont le droit, mais non l'obligation, de se faire représenter dans la procédure fiscale (pouvoir de représentation). Quant à l'exercice de ce pouvoir de manière professionnelle, seules les personnes qualifiées ont le droit d'agir au nom du contribuable devant les autorités fiscales autrichiennes. Ce sont avant tout les avocats, agents en brevets et notaires travaillant selon les règles professionnelles autrichiennes, de même que les conseillers fiscaux admis par le droit interne (ordre professionnel des conseillers fiscaux, BGBl. No. 125/1955), tels que les experts-comptables et conseillers économiques. Une licence appropriée acquise à l'étranger ne donne pas droit à la représentation de parties en Autriche, étant donné que le droit autrichien ne prévoit pas cette possibilité et qu'il n'existe pas d'accords internationaux à ce sujet.

Les impôts préscrits par avis qui ne sont pas payés au plus tard le jour de leur échéance sont recouvrables en règle générale à l'expiration d'un mois à compter de la remise en mains propres de la décision. Un recours présenté contre la décision fiscale n'a pas d'effet suspensif, le recouvrement par voie de contrainte ne peut donc pas être évité en prenant la voie d'appel. Pourtant dans le cas où l'acquittement de l'impôt à la date prévue constituerait pour le redevable une grande rigueur, l'autorité fiscale peut par décision (libre appréciation) remettre à un moment ultérieur la date fixée pour le versement de l'impôt (ajournement). Elle peut également admettre que le paiement s'effectue à tempérament, ceci à condition que le sursis de paiement accordé ne mette pas en cause la recouvrabilité des impôts.

Si les frais encourus par les autorités fiscales sont supportés d'office par celles-ci (ceci vaut également pour la procédure de recours) les parties doivent toutefois subvenir personnellement aux frais qui leur incombent par la procédure fiscale (principe de l'acceptation de la charge des frais, la loi n'accordant pas des droit mutuels du remboursement de frais). Dans des cas exceptionnels, à savoir dans la procédure douanière, la procédure en matière d'impôt de consommation, la procédure de monopoles et la procédure d'exécution, peut s'effectuer un remboursement des frais de la part du contribuable à l'administration fiscale.

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20. La plupart c'est à dire les impôts principaux sont fixés par avis d'impôt. En plus, la législation connaît encore les systèmes de la retenue d'impôt et de la calculation de l'impôt par le contribuable même, les autorités fiscales n'intervenant qu'en cas de défauts de calcul ou d'acquittement.

21. Quant à la procédure fiscale voir en particulier *Reeger-Stoll*, Commentaire à la Loi Fédérale portant sur la procédure fiscale, Vienne 1966 et "Die Bundesabgabenordnung" (manuel), Vienne 1975, de même que *Lager*, Bundesabgabenordnung, Vienne 1975.

C. LA PROTECTION JURIDIQUE EN MATIERE FISCALE

1. Voies de recours administratives

Les décisions prises par les autorités fiscales de première instance (bureaux de finances, bureaux de douane) sont susceptibles d'appel (en dehors de rares exceptions). Le délai de réclamation est d'un mois. Ce délai peut être prolongé pour des raisons dignes d'être prises en considération, si nécessaire, à plusieurs reprises. (En cas d'expédition par la poste dans le délai prévu, le délai est considéré comme respecté, même si le recours parvient plus tard à l'autorité.) Le recours peut être présenté à l'autorité fiscale ayant pris la décision contestée ou également à la Direction Fiscal du "Land" compétente de juger de l'appel.

En cas d'irrecevabilité de l'appel, il est rejeté sans que l'autorité fiscale soit obligée d'intervenir en la matière. Un rejet est prononcé si l'appel n'a pas été déposé dans les délais prévus ou s'il n'est pas possible de faire appel contre une affaire qui est expressément exclue de la voie de recours, ou en cas d'une "*res judicata*" ou bien s'il a été renoncé légalement à déposer un appel, ou encore en raison du fait que le réclamant n'est pas en droit de se prévaloir de l'appel.

Des vices de forme de l'appel (par ex. manque de signature, pas de pouvoir), de même que certains défauts de contenu (pas de déclaration, dans laquelle la décision est contestée et quels changements sont demandés, manque d'un exposé de motifs) ne justifient pas le rejet; l'autorité fiscale doit plutôt inciter le réclamant à régulariser ces vices en indiquant que dans le cas où les vices ne seraient pas régularisés dans un délai approprié, l'appel serait rejeté.

Dans le cas où l'appel est donc présenté dans le délai prévu, et s'il est admissible et sans vices, une décision en la matière doit être prise pour statuer de l'affaire. Cette décision basée sur les faits remplace la décision contestée et peut différer par rapport à la première en tout sens (pas d'interdiction d'une *reformatio in peius*). Des appels injustifiés quant au fond sont rejetés.

L'autorité qui a prononcé la décision contestée, donc l'autorité de première instance, peut tout d'abord décider elle-même du moyen de recours. Une telle *décision préalable d'appel* (Berufungsvorentscheidung) sert à la simplification administrative. Surtout dans le cas où l'autorité ayant prononcé la décision reconnaît le caractère fautif de sa propre décision, elle peut donner suite à la demande d'appel justifiée sans que l'autorité supérieure en soit saisie. Une décision préalable d'appel n'est pas obligatoire. L'autorité de première instance peut, sans prendre de décision préalable, présenter l'appel à l'autorité de recours (Directions Fiscales des "Länder") en vue d'une décision. Pourtant dans le cas où une décision préalable a été prise et que le réclamant — non satisfait — introduit dans le délai d'un mois une demande en vue d'une décision de l'autorité supérieure, la décision préalable d'appel devient sans effet. Dans le cas où le réclamant ne demande pas de décision à la Direction Fiscale du "Land", la décision préalable d'appel a l'effet d'un règlement définitif de l'appel. Cette décision seulement (et non pas la décision contestée) constitue à partir de ce moment la valeur juridique.

Si le bureau de finances n'a pas prononcé de décision préalable d'appel ou que ceci ait été fait, mais que celle-ci soit devenue sans effet en raison d'une demande respective déposée par la partie, la *Direction Fiscale du "Land"* [22] doit statuer sur l'appel. Cette décision tient également compte des faits. La Direction Fiscale du "Land" doit prononcer une décision matérielle qui remplace complètement la décision contestée. Dans la procédure d'appel l'autorité de recours dispose des mêmes droits et devoirs relatifs à la procédure dont dispose l'autorité fiscale de première instance.

Donc, au besoin, elle doit procéder de nouveau à une enquête de fait ou doit compléter la recherche faite en première instance et est tenue à chercher elle-même des preuves. Elle n'est pas liée au contenu de la décision prise en première instance. Elle peut donc modifier la décision en tout sens (donc également pour le pire). Son pouvoir de décision ne se restreint pas aux points faisant l'objet de l'appel, sa décision peut dépasser le cadre de la contestation en cause. La décision résultant du recours de la procédure fiscale autrichienne est donc une décision nouvelle qui ne peut pas être restreinte par des limites formelles ou par des décisions préliminaires, elle doit être prise, quant aux choses réelles et juridiques, comme s'il s'agissait d'une première décision en la matière.

C'est ainsi que la décision de recours remplace comlètement la décision contestée à l'origine, c'est elle seule qui est de valeur juridique.

Il faut encore signaler que, du point de vue de la procédure juridique et de la compétence, le fait qu'il s'agit d'affaires relatives au droit fiscal interne ou au droit international ne fait aucune différence. La procédure de première instance, de même que la procédure de deuxième instance (recours) ne font aucune différence que les parties de la procédure soient Autrichiennes ou étrangères, qu'elles soient des personnes résidant en Autriche ou à l'étranger.

2. Voies de recours judiciaires [23]

En ce qui concerne les voies de recours judiciaires en Autriche l'individu jouit d'une protection juridique contre les activités des autorités administratives de l'Etat non pas auprès des tribunaux ordinaires, mais en principe auprès de la *Cour administrative*. [24] Cette institution a plusieurs dimensions. La Cour administrative est appelée à contrôler l'activité des autorités administratives de l'Etat fédéral, des Länder et des communes (pas de tribunaux administratifs des Länder). Occupant une position de monopole dans l'organisation judiciaire, elle est compétente pour recevoir des plaintes contre des actes de l'administration de toute sorte (il n'y a donc pas de tribunaux administratifs spéciaux, par ex. pour les affaires sociales ou financières), finalement il faut signaler que la juridiction administrative n'a qu'un échelon, c'est à dire que la Cour administrative est la seule instance à décider.

Pour garantir l'observation de la Constitution, une autre Cour de droit public est instituée dont l'activité est parallèle à celle de la Cour administrative (pas de subordination, pas de cour supérieure); il s'agit de la *Cour constitutionnelle*. En dehors de multiples activités prévues par le droit constitutionnel, elle a la fonction d'un tribunal administratif particulier. C'est ainsi que la Cour constitutionnelle doit statuer des réclamations portées à l'encontre des décisions prises par les autorités administratives de dernière instance, elle n'y est pourtant habilitée que dans la mesure (ce qui pose des limites à sa compétence) où le réclamant affirme avoir été lésé dans un droit qui lui est garanti par la loi constitutionnelle [25] (par ex. en cas de violation des droits fondamentaux et des droits de la liberté); pourtant, dans le cas où il fait valoir la violation d'autres droits subjectifs, la plainte doit

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22. Dans certains cas, en particulier quant aux affaires relatives à l'impôt sur le revenu, sur les sociétés, sur les exploitations, sur le chiffre d'affaires et sur la fortune, la Direction Fiscale Régionale décide par des Sénats. Ces Sénats d'appel ne sont ni des autorités indépendantes (bien que leurs membres ne soient pas soumis à des directives et bien qu'ils n'appartiennent pas tous à l'administration fiscale), ni des tribunaux ou des autorités similaires, mais uniquement des organes appartenant à l'autorité fiscale de deuxième instance, donc aux Directions Fiscales Régionales.

23. *Winkler*, voies de recours judiciaires contre le pouvoir exécutif en Autriche dans: "Gerichtsschutz gegen die Exekutive II 835"; *Melichar*, "Die Überprüfung von Abgabenbescheiden durch die beiden Gerichtshöfe des öffentlichen Rechts, FJ 1976, 144.

24. Art. 129-136 de la loi portant sur la Constitution fédérale (B-VG), Loi portant sur la Cour administrative de 1965, Bundesgesetzblatt No. 2, *Ermacora*, "Verfassungslehre" 186, 392; *Walter*, Bundesverfassungsrecht 661, *Walter-Mayer*' "Grundriss des österreichischen Bundesverfassungsrechts", 236.

25. Art. 144 de la loi constitutionnelle fédérale (B-VG), Verfassungsgerichtshofgesetz 1953 BGBl. No. 85, *Ermacora*, Verfassungslehre 183, 229, 327, 388; *Walter*, Bundesverfassungsrecht 710, 736, 788; *Walter-Mayer*, Grundriss 254.

être adressée à la Cour administrative (en cas d'illégalité et d'irrégularité d'une décision). La Cour constitutionnelle occupe une position centralisée qui ressemble à celle de la Cour administrative.

La Cour constitutionnelle de même que la Cour administrative sont des tribunaux au sens technique, la juridiction est exercée par des juges (inamovibles, ne pouvant pas être mutés, non liés à des instructions). Dans la procédure de recours, le réclamant et l'autorité accusée (autorité ayant pris la décision contestée en dernière instance) sont des parties à égalité de droits.

La juridiction exposée ci-dessus ne saurait être invoquée qu'à partir du moment où les autorités administratives ont pris leur dernière décision, donc après l'épuisement des voies de recours administratives. Il s'agit donc d'une juridiction *a posteriori*. Les devoirs des deux Cours de droit public ne consistent pas à prendre des décisions définitives en la matière en tant qu'autorité superposées. Elles exercent plutôt uniquement des fonctions de contrôle par rapport aux autorités administratives. C'est à dire qu'elles jugent en cassation si la décision contestée a violé des préscriptions. D'autre part elles rejettent la demande en cas de non-violation du droit. S'il est donné suite au recours, il n'y a pas de nouvelle décision basée sur les faits de la Cour remplaçant la décision attaquée. La décision de la Cour donnant suite au recours se restraint plutôt à l'annulation de la décision contestée. Par la suite il incombe à l'autorité administrative dont la décision a été annulée, de prendre une nouvelle décision en la matière (décision de remplacement) tout en étant liée à la conception juridique de la Cour Suprême.

Il faut signaler également le fait que la compétence des Cours ainsi esquissée est valable peu importe qu'il s'agisse d'appliquer le droit fiscal autonome interne ou le droit fiscal international. Il est de même en général indifférent de savoir si les parties faisant appel aux Cours sont des nationaux, des étrangers, des personnes physiques ou morales, résidant sur le territoire national ou à l'étranger. Le recours doit être présenté dans un délai (ne pouvant pas être prolongé) de 6 semaines, compté à partir de la notification de la décision prise en dernière instance, directement à la Cour. L'appel n'a pas d'effet suspensif. Sur demande particulière la Cour peut pourtant accorder un sursis, dans le cas où l'exécution imminente causerait un dommage ne pouvant plus être réparé et qu'il n'y ait pas d'intérêts publics qui demandent l'exécution immédiate de la décision.

a) Le recours auprès de la Cour administrative [26]

Parmi les exigences requises pour adresser une demande à la Cour administrative afin que celle-ci puisse ouvrir la procédure concrète, se trouve la désignation de l'acte administratif attaqué et de l'autorité ayant pris la décision, une description des faits, une demande en annulation particulière et un exposé des motifs, de même que l'indication du droit (subjectif) dans lequel le réclamant se sent lesé (points de la demande). Tels sont les éléments constitutifs de la procédure et la Cour ne peut statuer qu'uniquement sur les questions évoquées dans la demande. Elle ne peut donc pas dépasser le cadre de la contestation ainsi délimité par la partie.

L'acte en pourvoi (la réclamation) a besoin d'être signé par un avocat (de la nationalité du pays). [27] Dans les autres stades de la procédure, l'obligation de prendre un avocat est limitée: dans la procédure, les parties peuvent défendre leur affaire elles-mêmes, mais si elles veulent se faire représenter, elles ne peuvent confier leur mandat qu'à un avocat de nationalité autrichienne (mais pas par ex. à un conseiller fiscal).

Conformément à la tâche qui lui revient en tant qu'instance de contrôle, la Cour administrative est obligée de vérifier la décision en se basant sur les faits exposés par l'autorité attaquée. Elle n'est pas liée à cette obligation dans le cas où les faits supposés par l'autorité sont contradictoires et ne correspondent pas à la vie réelle ou si les conclusions de l'autorité ayant abouti à l'énoncé des faits contredisent les lois logiques de la pensée ou que la procédure sur la constatation des faits est défectueuse. Dans ce cas également ce n'est pas la Cour qui procède elle-meme à la constatation des faits, elle supprime seulement la décision. Il incombe par la suite à l'autorité contestée de compléter la procédure sur la constatation des faits et de prendre une nouvelle décision. S'il n'y a pas de telles raisons de supprimer la décision, le fait que la Cour est obligée de s'en tenir aux faits constatés entraîne également pour les parties l'interdiction d'énoncer de nouveaux faits qui n'étaient pas exposés au cours de la procédure administrative précédente.

Dans le cas où le contenu de la décision est en contradiction avec la loi, la décision attaquée est supprimée. Il n'y a pas illégalité si la décision se base sur une disposition conférant à l'autorité un pouvoir discrétionnaire et que l'autorité ait donc pris sa décision conformément à la loi. Si par conséquent plusieurs décisions se révèlent conformes à la loi et que l'autorité à choisi une de ces solutions, pour des raisons justifiées, la Cour n'intervient pas, même si une autre solution avait été plus opportune (sa tâche consiste en un contrôle juridique, non pas en une vérification de l'opportunité).

Si une décision attaquée a été rendue par une autorité non compétente, la décision doit être annulée (même si ce défaut n'est pas invoqué); ceci pour la raison que le défaut d'incompétence constitue également une violation des droits fondamentaux (retrait du juge légal — au sens le plus large du terme). La nullité s'opère donc de toute façon, également dans le cas où le contenu de la décision ne paraît pas contraire à la loi (ce qui ne doit plus être vérifié dans ce cas).

La violation d'autres règles de procédure que celles portant sur la compétence (mis à part le défaut selon lequel la décision est contraire au contenu des actes ou le défaut de compléter les faits énoncés) entraînent la suppression de la décision uniquement dans le cas où l'observation des règles de procédure violées aurait pu aboutir à une autre décision (nécessité du caractère essentiel du défaut de procédure).

La partie gagnant la procédure a droit à indemnisation des frais par la partie perdante (un règlement forfaitaire est prévu).

b) Le recours auprès de la Cour constitutionnelle [28]

La Cour constitutionnelle est appelée à juger des mesures prises par une autorité administrative (donc également par une autorité fiscale) résultant de décisions prises en dernière instance, si le réclamant affirme être lésé par la décision dans un droit garanti par la loi constitutionnelle ou bien s'il affirme que la décision en cause a violé ses droits subjectifs par l'application d'un règlement illégal, d'une loi contraire à la Constitution ou d'un traité contraire à la loi.

Les citations doivent comprendre une constatation des faits et de la violation du droit justifiant la compétence de la Cour (quant à la Cour constitutionnelle, ces points ne se limitent pas, contrairement à la Cour administrative, à l'objet de la procédure; les conditions de la procédure une fois remplies, la Cour constitutionnelle vérifie elle-même si un droit du réclamant garanti par la loi constitutionnelle a été violé). Les réclamations doivent être présentées par un avocat autrichien y étant autorisé; la partie peut se faire représenter dans la procédure par cet avocat (et non pas par d'autres personnes, obligation absolue de prendre un avocat).

La Cour constitutionnelle vérifie donc, si l'acte administratif contesté a violé un droit garanti à l'individu par la Constitution (donc un droit subjectif attribué par la Constitution); en Autriche il s'agit particulièrement des droits fondamentaux et des libertés individuelles [29] occupant un rang constitutionnel.

Le redevable peut être lésé par une décision fiscale surtout dan

26. Der Verwaltungsgerichtshof (La Cour administrative), Graz-Vienne-Cologne 1955.
27. *Schimtschek*, "Zur Frage der Mitwirkung von Wirtschaftstreuhänder im Verwaltungsgerichtshofverfahren, FJ 1977, 33.
28. *Ermacora*, "Der Verfassungsgerichtshof", Graz-Vienne-Cologne, 195
29. *Ermacora*, "Handbuch der Grundfreiheiten und Menschenrechte" Vienne, 1963 (manuel).

son droit à *égalité devant la loi*. La violation du droit à l'égalité (art. 2 de la loi fondamentale de l'Etat du 21 décembre 1867, RGBL (Reichsgesetzblatt) No. 142 et art. 7 de la Loi Constitutionnelle fédérale [30]) ne peut être constatée qu'en se référant aux mesures prises à l'égard d'autres personnes. Une violation du droit à l'égalité devant la loi par le pouvoir exécutif ne peut se produire que si l'autorité, pour des raisons non relatives au fond mais uniquement relatives à la personne, traite la partie de manière inégale, donc si l'autorité agit de manière arbitraire (l'autorité ne tient pas compte, sciemment ou par négligence, de dispositions légales pour défavoriser la partie; ceci peut se faire par l'infraction grave à des prescriptions légales se rapportant à la matière ou à la procédure). Il y a aussi violation du droit à l'égalité devant la loi si l'autorité attribue à une disposition légale un sens qui, si la disposition l'avait effectivement, l'opposerait au principe de l'égalité. En règle générale, ce n'est qu'aux personnes de nationalité autrichienne et aux personnes morales autrichiennes que le principe de l'égalité confère un droit subjectif.

Dans cet ordre d'idées il faut attirer l'attention également au droit fondamental de *l'inviolabilité de la propriété* [31] (art 5 de la loi fondamentale de l'Etat et art 1 du protocole additionnel à la Convention des droits de l'homme, Bundesgesetzblatt No. 210, 1958). Cette garantie est donnée toutefois sous réserve de la loi. Des restrictions des droits patrimoniaux par la législation ordinaire sont donc admissibles dans la mesure où elles ne portent pas atteinte au principe essentiel du droit fondamental (ceci signifie que la propriété privée en tant qu'institution du droit objectif est de toute façon inviolable). Le recouvrement d'impôt constitue en quelque sorte toujours une atteinte à la propriété. Si, du point de vue de la protection de la propriété garantie par le droit constitutionnel, la disposition légale ne peut pas être contestée, une atteinte à la propriété contraire à la Constitution pourrait toutefois se produire, d'une part par une décision qui présente un nombre de défauts d'une importance telle qu'elle est considérée comme en sortant de la légalité ou d'autre part par une interprétation de la loi ayant déjà dépassé le cadre des défauts généralement tolérables, de sorte que l'interprétation de la loi est pour ainsi dire inconcevable. De simples inexactitudes usuelles, des incorrections qui ne manquent pas de base légale n'entraînent pas pour la décision une lésion au droit constitutionnel, mais seulement une "illégalité"; l'observation de raisons de telle sorte entre pourtant dans la compétence de la Cour administrative.

La protection de la propriété garantie par le droit constitutionnel revient également aux étrangers de même qu'aux personnes morales étrangères.

En Autriche le *droit à l'institution d'un juge légal* (art. 83, alinéa 2, Loi constitutionnelle fédérale) garanti par le droit constitutionnel s'applique également au droit à la sauvegarde et au maintien des compétences attribuées par la loi aux autorités administratives. La Cour constitutionnelle peut donc également être appelée en cas d'intervention d'autorités incompétentes, de même que si une autorité compétente refuse de prendre une décision prévue par la loi (refus illégal d'une demande justifiée).

Si la Cour constitutionnelle constate une violation de droits garantis par la Constitution, la décision administrative est annulée. L'affaire administrative est remise à l'état dans lequel elle s'est trouvée avant la prise de la décision. Les autorités administratives sont obligées de constituer sans délai la situation juridique répondant à la conception juridique de la Cour.

L'indemnisation des frais de la procédure peut être demandée à la partie perdante.

. Contrôle de constitutionnalité des lois par la Cour constitutionnelle [32]

Dans certaines conditions la Cour constitutionnelle a également le devoir de vérifier des dispositions légales pour savoir si elles sont en concordance avec des prescriptions légales se trouvant à un échelon supérieur (art. 139, 140, 140a de la Loi constitutionnelle fédérale). Donc dans le cas où des ordonnances sont en contradiction avec des lois ordinaires ou avec des dispositions constitutionnelles ou que des lois ordinaires contredisent la loi constitutionnelle, la Cour constitutionnelle doit annuler les dispositions fautives en vertu de l'ordre hiérarchique du droit autrichien (Stufenbaugedanke, Merkl). En général, la Cour constitutionnelle ne doit pas accomplir cette tâche d'office. Il faut la présentation de demandes respectives (prévues par la loi constitutionnelle).

Etant donné que la loi fiscale s'exécute par la notification de décisions, il n'est pas nécessaire de mentionner l'autorisation des individus, introduite par l'amendement à la Constitution de 1975 BGBl. No. 302/1975, de demander une vérification de la loi, s'ils affirment être lésés directement dans leurs droits par cette loi. Pour cette raison le bref aperçu qui suit traite seulement des possibilités d'application les plus importantes.

C'est ainsi que la Cour constitutionnelle introduit une procédure de contrôle de constitutionnalité des lois lorsqu'elle doit appliquer dans le cadre d'un cas contesté une disposition légale dont elle suppose qu'elle est en contradiction avec les dispositions d'une loi d'un rang supérieur (seule exception au principe mentionné ci-dessus de décider sur demande) ou que la Cour administrative pense qu'une règle qu'elle doit appliquer constitue une atteinte aux droits de la manière qui vient d'être exposée et qu'elle présente à la Cour constitutionnelle une demande de contrôler la loi en cause. En cas de conflit, la partie n'a pas de droit formel de présenter une demande visant à une vérification de la loi. Elle a toutefois la possibilité (au cours de la procédure devant la Cour administrative ou devant la Cour constitutionnelle) de signaler l'inconstitutionnalité des dispositions légales venant à application et d'inciter ainsi la Cour administrative de poser une demande adéquate, ou respectivement d'inciter la Cour constitutionnelle d'introduire d'office une procédure de vérification de la loi.

C'est ainsi que l'introduction d'une procédure de vérification suppose le caractère préjudiciel de la disposition légale pour statuer d'un cas contesté. La vérification de la loi par la Cour constitutionnelle et la suppression qui en résulte éventuellement, portent donc uniquement sur des parties de la loi qui deviendraient applicables dans l'affaire juridique en cause. Seulement en cas de constatation d'incompétence de l'organe ayant édicté la loi et en cas de défauts relatifs à sa promulgation, la loi peut être annulée dans sa totalité; ceci vaut également dans le cas où une ordonnance est privée de toute base légale (donc en cas de très graves vices dans la création du droit).

L'annulation de la loi signifie que la décision attaquée est privée dès maintenant de sa base juridique et que c'est également la décision qui est vouée à la suppression. La nouvelle décision de l'administration doit être rédigée comme si la loi annulée n'avait jamais existé (effet *ex tunc*). La loi annulée continue à être appliquée à tous les autres cas concernés n'ayant pas encore force de chose jugée (de telles annulations ne portent pas automatiquement atteinte à la force de chose jugée; il n'y a pas constatation de nullité, mais annulation), dans la mesure où il s'agit de faits qui se sont passés avant la décision de l'annulation (la Cour peut prévoir une exception à cette règle); l'efficacité de l'annulation prend son effet avec la publication de la décision de la Cour Constitu-

30. Voir à ce sujet en particulier *Kneuker*, "Die Bindung des Steuergesetzgebers an den Gleichheitssatz der Bundesverfassung" (ÖStZ, Journal fiscal autrichien, 1966, 217) et *Gassner*, "Gleichheitssatz und Steuerrecht", publications de l'Institut de sciences financières et de droit fiscal, Vienne 1970. Nr. 69.

31. *Adamovich*, "Eigentum und Eigentumsbeschränkung im Spannungsfeld von Verfassung und Rechtspolitik", "Die Industrie" 1973, No. 12, 20; *Stolzlechner*, "Abgabengesetze und Eigentumsgarantie" ÖZW 1975, 33.

32. *Ermacora*, Verfassungslehre 345; *Walter*, Bundesverfassungsrecht 731, 743, 751; *Walter-Mayer*, Grundriss 265, 270, 274.

tionnelle rendant l'annulation effective ou à l'expiration d'un délai fixé par elle (en cas d'ordonnance le délai ne doit pas dépasser six mois, en cas d'annulation d'une loi pas supérieur à un an); ceci pour éviter un vide juridique, étant donné que le législateur peut maintenir la continuité du droit en éditant de nouvelles prescriptions. Mis à part le cas ayant donné lieu à l'annulation, le fait que la loi annulée cesse d'être en vigueur produit son effet seulement aux faits survenus après l'efficacité de l'annulation.

Parmi les raisons entraînant l'annulation de la loi on trouve essentiellement des défauts dans la création du droit, mais on constate également souvent des violations du principe de l'égalité devant la loi qui sont sanctionnées de manière appropriée. La Cour constitutionnelle refuse régulièrement de vérifier des prescriptions fiscales sous l'angle des *droits fondamentaux de l'inviolabilité de la propriété*. Ce principe constitutionnel délimité par la loi ordinaire, doit être interprété au sens historique; la Cour part du principe qu'une *loi* fiscale ne saurait porter atteinte au droit fondamental, à moins qu'il s'agisse d'un abus de formes de la fiscalité. Mais par une interprétation dynamique du *principe de l'égalité* on tâche de sanctionner certaines insuffisances. Voilà ce qui est le critère le plus souvent appliqué dans la vérification des lois en matière fiscale. Conformément à ce critère la législation est obligée de tenir compte exclusivement des caractéristiques objectifs dans le traitement juridique d'un citoyen. Des traitements différentiels sont évidemment admis, mais ceux-ci doivent être en concordance avec des différences effectives de la matière à régler. Des règlements différentiels, des délimitations, mais aussi des mises au pas doivent en principe correspondre à une expérience raisonnable; dans le cas où elles manquent d'objectivité et ne peuvent pas être justifiées par la matière, le législateur viole le principe de l'égalité. A cet égard, la Cour constitutionnelle ne contrôle pas, si la disposition légale causant des traitements différentiels est justifiable dans le cas individuel, mais uniquement si elle peut être justifiée de manière abstraite. C'est ainsi que toute négligence, tout dèsaccord ou toute imperfection, toute contradiction, comme tout défaut de caractère politico-juridique de la part du législateur n'entraîne pas nécessairement l'inconstitutionnalité d'une loi; il y a uniquement contradiction au principe de l'égalité si les dispositions légales se basent sur des décisions non objectives et excessives du législateur.

En Autriche — à la différence de la République Fédérale d'Allemagne — l'objectivité d'une loi ne doit pas être mesurée au système du droit privé. La jurisprudence n'empêche pas le législateur de constituer dans le domaine du droit fiscal un système particulier et même de régler à l'intérieur de ce système certains faits d'une manière non conforme au système, si des raisons objectives le justifient. Le principe de la *justice fiscale* n'a pas de rang constitutionnel, pourtant les règlements législatifs doivent faire apparaître l'effort de la part du législateur de tenir compte du principe général de l'égalité (par rapport au droit constitutionnel positif, la justice fiscale se comprend comme régularité fiscale).

Etant donné qu'en Autriche, dans les domaines en question, *des traités* sont considérés sous l'angle du droit constitutionnel (d'après leur contenu et de leur pouvoir abrogatoire) comme se trouvant au niveau d'ordonnances et de loi (des Conventions tendant à éviter les doubles impositions [33] sont mises en vigueur à l'intérieur de l'Etat comme des lois et ont le même effet que celles-ci), la Cour constitutionnelle décide de l'illégalité de traités en règle générale selon les mêmes principes qu'elle décide du caractère fautif de la loi autonome (art. 140 a de la Loi constitutionnelle fédérale). Dans le cas où un traité intégré au droit interne en tant que ordonnance ou loi, se trouve en contradiction avec des prescriptions légales supérieures, l'illégalité du traité est constatée (pas d'annulation pour ne pas affecter la validité au niveau du droit international). Les effets d'une telle procédure de vérification et d'annulation sont en principe les mêmes du point de vue interne, que ceux qui se produisent en cas d'annulation de prescriptions autrichiennes autonomes.

La constatation de l'illégalité du traité par la Cour constitutionnelle et l'inapplicabilité qui en résulte pour le droit autrichien dès la publication de celle-ci doivent être suivies d'une modification appropriée (devant être réalisée sur la base internationale) du traité qui permettra son intégration au droit interne en conformité avec la Constitution.

33. Quant aux Conventions tendant à éviter la double imposition, voir *Philipp-Pollak*, "Internationales Steuerrecht" (2ème édition), Vienne 1976, *Loukota*, "Über das Verhältnis zwischen internationalem und nationalem Steuerrecht, 1976, 105.

Future IFA Congresses:

The *International Fiscal Association* has released its plans as to future tax conferences:

1978	XXXIInd Congress	—	Sydney	—	September 17-22 *
1979	XXXIIIrd Congress	—	Copenhagen	—	September 4-8
1980	XXXIVth Congress	—	Paris	—	September 14-19
1981	XXXVth Congress	—	Berlin or Munich	—	date not yet decided

* See for program under Conference Diary, p. 338.

The Taxation of Canadian Residents on Foreign Accrual Property Income

by T.G. Hierlihy*

Tax Reform Legislation was introduced in Canada in 1971 with effect as of January 1, 1972. Included were provisions of an anti-avoidance nature aimed at passive income, or "Foreign Accrual Property Income", sheltered outside Canada. Such provisions were originally scheduled for implementation in 1973. This article is intended to describe in general terms the provisions of the Canadian Income Tax Act designed to subject this sheltered passive income to Canadian income tax.

Terminology

The main focal point of these provisions is the accumulation by Canadian residents of such income in foreign corporations and foreign trusts, including discretionary trusts, located in tax haven jurisdictions. Passive income has been termed Foreign Accrual Property Income (FAPI) and the concept of a "foreign affiliate" and a "controlled foreign affiliate" has been introduced.

A "foreign affiliate" of a Canadian resident is a non-resident corporation in which the Canadian resident's equity percentage is at least 10 percent. This equity percentage would include an indirect interest in a non-resident corporation which might be held through share ownership in another corporation having a direct interest in that non-resident corporation. A "controlled foreign affiliate" is a foreign affiliate of a Canadian resident that is controlled directly or indirectly by:

1) that resident,
2) that resident and not more than four other Canadian residents, or
3) a related group which includes that resident.

Pre-1972 legislation

Prior to 1972 the general thrust of Canadian tax legislation was to tax resident individuals on dividends received from foreign corporations while permitting a credit against this tax in respect of any foreign taxes withheld. Dividends from foreign sources received by resident corporations were also included in income, but where more than 25 percent of the voting shares of the foreign payor corporation were held by the recipient corporation, such dividends were deductible in computing taxable income.

While this article pertains to passive income accumulated in foreign jurisdictions, it is appropriate also to note that the Tax Reform Legislation includes provisions intended to subject the active business income earned in tax haven jurisdictions by foreign affiliates of resident corporations to the equivalent of the Canadian rate of tax when such income is passed on to Canada in the form of a dividend. This result is achieved through limiting the deduction allowed in computing taxable income in respect of such a dividend to an amount calculated by reference to the underlying foreign tax, if any, paid by the foreign affiliate on such income and to any foreign tax withheld from the dividend.

The components of FAPI

Foreign Accrual Property Income, or FAPI, comprises income from property, income from businesses other than active businesses, and taxable capital gains (½ of capital gains) arising on dispositions of property to the extent that such capital gains have accrued after the foreign affiliate's 1975 taxation year. Also included in FAPI is the service income of a controlled foreign affiliate where:

1) payment therefor is deductible in computing income from a business carried on in Canada by the person in respect of whom the affiliate is a controlled foreign affiliate or by a person related to that person, or
2) the services are performed by someone described in 1) above who is an individual resident in Canada.

In this regard services include the insurance of Canadian risks but do not include transportation or services related to the purchase or sale of goods.

Specifically excluded from FAPI are:

1) dividends received by a foreign affiliate from another foreign affiliate of the Canadian resident;
2) where the Canadian resident is a corporation, dividends received by an affiliate from certain corporations resident in or carrying on business in Canada which dividends, if they had been received directly by the Canadian resident, would have been deductible by it in computing its taxable income;
3) taxable capital gains from property used in an active business;
4) income from foreign sources, otherwise includable, that pertains to or is incidental to an active business carried on in a foreign jurisdiction by the affiliate or another non-resident corporation not at arm's length with the Canadian resident; and
5) amounts received from another foreign affiliate of, or non-resident corporation not at arm's length with, the Canadian resident to the extent

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that such amounts represent expenses of carrying on an active business in a foreign jurisdiction by that other affiliate or non-resident corporation.

It will be noted that the exclusions referred to in (4) and (5) above would not extend to income derived from, for example, a related foreign partnership.

Application of FAPI provisions

While originally scheduled for implementation in 1973, the effective date was subsequently twice deferred to the current situation where the FAPI provisions apply in respect of taxation years of foreign affiliates commencing after 1975. These time delays were intended to provide sufficient planning time to taxpayers but were also necessitated by problems encountered in designing a workable set of regulations to govern the application of these provisions.

Inasmuch as the FAPI provisions are of an anti-avoidance nature it has been stated that, if they achieve their objective, they will generate no income tax revenue. In other words, Canadian resident taxpayers would no longer attempt to shelter passive income in foreign corporations or trusts as the FAPI provisions would operate to subject such income to full Canadian rates of tax. There seems little doubt that such provisions will in fact generate tax revenue.

How applied

Under the provisions, a Canadian resident is required to include in computing his income an amount determined to be his share of the FAPI of his controlled foreign affiliates. That portion is determined by reference to his direct shareholdings in controlled foreign affiliates and to the "participating percentage" of each such share. The determination of this participating percentage is straightforward where only one class of shares is involved but is subject to fairly extensive regulations where there is more than one class. The intention is that it should represent a reasonable proportionate entitlement of the share upon a hypothetical distribution. An important qualification to the determination of the participating percentage is a stipulation that where the FAPI of the controlled foreign affiliate is not greater than $5,000, the participating percentage in respect of that affiliate is considered to be nil. Accordingly, it is only the FAPI of controlled foreign affiliates with in excess of $5,000 of such income that is subjected to immediate taxation in Canada.

While the participating percentage relates to each share of a controlled foreign affiliate held by a Canadian resident, it extends through that controlled foreign affiliate and through a chain of non-resident corporations to each controlled foreign affiliate of that resident.

A deduction is allowed in determining income for Canadian tax purposes which is computed by reference to the "foreign accrual tax" paid by the controlled foreign affiliates in respect of their FAPI. The computation of this deduction reflects the fact that it is intended that the combined Canadian and foreign taxes on the FAPI should equal the effective Canadian tax rate exigible if that income were received directly by the Canadian taxpayer. For example, the general rule is that an individual is allowed a deduction equal to twice the underlying foreign taxes and this presupposes a 50 percent marginal tax bracket whether or not that is an accurate reflection of the individual's actual marginal rate. As the federal corporate tax rate is presently 46 percent, corporations are allowed a deduction of 2.1739 times the foreign taxes. This deduction cannot exceed the related income amount.

A further deduction in the form of a reserve may also be allowed where it can be established that, because of exchange restrictions in a foreign jurisdiction, it would impose undue hardship on a taxpayer if he were taxed on all his FAPI.

Adjustments to cost base of shares

As FAPI may be taxed in Canada prior to its having been received by the Canadian resident taxpayer, provisions are included whereby the "adjusted cost base" of the shares in respect of which FAPI has been imputed are correspondingly increased. A subsequent dividend from that foreign affiliate would be excluded, or deducted, from income to the extent that it is paid from surplus which has already been effectively taxed in Canada and, of course, there is a provision for a corresponding reduction in the adjusted cost base of the shares. Should the shares have been sold in the interim and prior to the receipt of such a dividend, the fact that the adjusted cost base of those shares had been increased would service to eliminate the double taxation effect reflected in the capital gain which would otherwise be computed with respect to such a disposition.

Segregation of surplus

For the FAPI provisions to be operative, it is necessary to segregate the surplus of foreign affiliates into separate pools which are described in the legislation as "pre-acquisition surplus", "exempt surplus", and "taxable surplus". This segregation is pertinent only for foreign affiliates of corporations resident in Canada. Dividends paid by foreign affiliates of Canadian resident individuals are deemed to have been paid from taxable surplus. This distinction between corporate and individual shareholders is required as corporate shareholders are entitled to deductions in computing taxable income in respect of dividends received from exempt surplus and pre-acquisition surplus.

Pre-acquisition surplus is a notional amount from which any dividend or portion thereof is deemed to have been paid where it is not otherwise stipulated under the legislation to have been paid from exempt surplus or taxable surplus. In effect it represents income and net capital gains accumulated by a non-resident corporation prior to its becoming a foreign affiliate of a Canadian resident.

FAPI earned in the 1976 and subsequent years of a foreign affiliate is included in the taxable surplus of that affiliate which is in turn reduced by any income taxes paid by the affiliate in respect of such income. As was

previously noted, the FAPI of a controlled foreign affiliate for its 1972 to 1975 taxation years inclusive was not required to be immediately included in the income of a Canadian resident. Such income is included in exempt surplus and any dividends therefrom are deductible in computing the taxable income of a corporation resident in Canada.

As the legislation establishes separate surplus pools, this further necessitates the ordering of distributions from the surplus of a foreign affiliate. Essentially, dividends are deemed first to have been paid from exempt surplus, then from taxable surplus and then, notionally, from pre-acquisition surplus.

A summary

At this stage it would be appropriate to summarize, for purposes of emphasis, certain of the more salient points:

1) It is the FAPI of a foreign affiliate which also qualifies as a controlled foreign affiliate that may be subjected to immediate tax in Canada.
2) If the FAPI of a controlled foreign affiliate does not exceed $5,000 in a year, it will not be subjected to tax in Canada in the corresponding taxation year of the Canadian resident.
3) Adjustments to the cost base of the shares held by Canadian residents of foreign affiliates which are or have been controlled foreign affiliates are provided for as a means of avoiding double taxation.
4) The segregation of the surplus of foreign affiliates is of particular significance only for corporations resident in Canada and not for individuals. The Tax Reform Legislation includes provisions similar to the pre-1972 legislation allowing corporations a deduction in computing taxable income in respect of dividends received from affiliates in foreign jurisdictions. These provisions are necessarily more complex than previously and vary in accordance with the nature of the income and the jurisdiction in which earned.

Treatment of dividends

When individuals or corporations resident in Canada receive dividends from their foreign affiliates they are required to be included in income. A deduction is allowed in computing income for tax purposes, or net income, to the extent that a dividend represents previously taxed FAPI. Where the recipient is an individual, the dividend is deemed paid from the taxable surplus of his foreign affiliate and any foreign tax withheld is eligible to be claimed as a credit against tax otherwise payable to the extent that the foreign tax does not exceed 15 percent of the dividend. Any excess over 15 percent may be claimed as a deduction in computing income.

Where the recipient is a corporation, it is first necessary to ascertain from which surplus pool of the foreign affiliate the dividend was paid. If from pre-acquisition or exempt surplus, the dividend may be deducted from income in computing taxable income. If from taxable surplus, a deduction is allowed in computing taxable income which is calculated by reference to the underlying foreign taxes paid by the affiliate and to any foreign tax withheld from the dividend. To the extent that the dividend is from taxable surplus and exceeds these deductions, then the deduction in computing income is available to the extent that the dividend represents previously taxed FAPI. A credit against tax otherwise payable is not available to corporations in respect of foreign taxes attributable to dividends received from their foreign affiliates.

Trusts

It was mentioned at the outset that the FAPI provisions equally apply with respect to income realized by certain foreign trusts. Specifically, such provisions may extend to trusts which are not resident in Canada where a person beneficially interested in the trust is:

1) a person resident in Canada;
2) a corporation or trust with which a person resident in Canada is not dealing at arm's length; or
3) a controlled foreign affiliate of a person resident in Canada.

Essentially, the FAPI provisions will extend to the income of such a trust where it, or a corporation that would be its controlled foreign affiliate if the trust were resident in Canada, has acquired property from a person who is a beneficiary thereof, from specified relatives of such person, or from another trust or corporation not dealing at arm's length with that person or the specified relatives of that person. Where the person from whom the property was acquired is the beneficiary or one of his specified relatives, that person must have been resident in Canada in the 18 month period before the end of the year to which the FAPI provisions are to be applied. If that person has died, the 18 month period is that prior to the date of death. In addition, where that person is an individual he must have been, before the end of that year, resident in Canada for more than 5 years.

It is stipulated that these provisions will not apply to an inter vivos trust created before 1960 by a person who at that time was not resident in Canada or to a testamentary trust arising on the death of an individual where death occurred before 1976.

Non-discretionary trusts

Where the beneficial interest in a trust subject to the FAPI provisions is not subject to any discretionary power, the trust is, with respect to any beneficiary whose interest is valued at not less than 10 percent of the value of all beneficial interests, considered a non-resident corporation controlled by that beneficiary. Accordingly, such a trust would be considered a controlled foreign affiliate of that beneficiary. It is further provided that the trust is considered to have a single class of capital stock divided into 100 issued shares and each beneficiary of the trust is deemed to own shares equal in proportion to the fair value of his beneficial interest in the trust.

In computing the FAPI of such a trust, a deduction is permitted for an amount that would otherwise be in-

cluded but that has been established as having been payable in the year to a beneficiary.

Discretionary trusts

Where a non-resident discretionary trust is involved an equitable basis for the taxation of Canadian beneficiaries is obviously more difficult to establish. The approach adopted under the FAPI provisions has been referred to facetiously, but not necessarily inaccurately, by at least one tax practitioner as the "steam-shovel" approach. Where a discretionary trust is otherwise established, within the criteria noted above, as being subject to the FAPI provisions, it is deemed to be a person resident in Canada whose taxable income for any year includes:

1) the amount that would be its taxable income earned in Canada if it were not a resident of this country;
2) the amount that would be its FAPI for the year if it were not a discretionary trust; and
3) the FAPI of any of its controlled foreign affiliates.

A deduction in computing taxable income is allowed to the extent of amounts otherwise includable in 2) or 3) above that are established as having been payable in the year to a beneficiary.

As not all beneficiaries of such a trust may be resident in Canada, it is provided that only certain persons in addition to the trust will be subject to those provisions of the Act which stipulate the requirements for the filing of tax returns and the payment of income taxes. Generally, it is those persons from whom the trust might have acquired property under such circumstances that the trust would become subject to the FAPI rules. It is further provided, however, that any such person is responsible for the payment of taxes, related penalties and costs only to the extent of amounts paid to him by the trust, amounts which he is entitled to enforce payment of from the trust, or amounts received on the disposition of an interest in the trust.

It is noteworthy that a beneficiary of a non-resident discretionary trust could conceivable find himself in a situation where he pays Canadian tax equal to the full amount he has received from the trust even though he may be the only beneficiary resident in Canada and where one might reasonably expect that the income subject to tax in Canada should be substantially less than the full income of the trust. Again, one is reminded only too clearly of the anti-avoidance nature of the FAPI provisions.

The foregoing summarizes the general trust of the Canadian income tax legislation pertaining to Foreign Accrual Property Income. Not commented on specifically but of obvious importance to Canadian taxpayers are various alleviating provisions related to such as the winding up of foreign affiliates of corporations, inter-affiliate transfers of shares of other foreign affiliates, the election available to a corporation on the disposition of shares of a foreign affiliate to treat a portion of the proceeds as a dividend, and the application of losses of foreign affiliates from active businesses against their otherwise taxable FAPI. Also not specifically commented on are the anti-avoidance provisions included, not surprisingly, with the FAPI provisions which are themselves stated to be of an anti-avoidance nature. Included is a provision that would ignore the issue of additional shares where one of the main reasons therefor can reasonably be considered the reduction or postponement of taxes.

As the FAPI provisions are of recent application, it will be a considerable period before contested assessments are taken before the Courts. One area that seems destined for litigation is that involving the fine-line distinction between an active and inactive business.

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Convention between the United States of America and the Netherlands Antilles with respect to taxes on income

When on April 29, 1948 the United States and the Netherlands concluded a treaty for the avoidance of double taxation they included an article (Art. XXVII) authorizing the two countries to enter into negotiations for the extension of the treaty to their overseas parts or territories. It took, however, a long time before this provision was implemented since in 1952 only the U.S. and Dutch authorities started exchanging notes with a view to the extension of the treaty to the Netherlands Antilles. These notes and the resulting Protocol of June 15, 1955 deleted and modified a number of the treaty provisions in their application to the Netherlands Antilles. Further deviations between the treaty provisions as they are applicable to the Netherlands proper (i.e. in Europe) and the Netherlands Antilles were introduced by the Protocol of October 23, 1963 (which contains special provisions applicable to Netherlands Antilles holding companies) and the Supplementary Treaty of December 30, 1963 which significantly changed the treaty provisions but only with respect to the Netherlands proper. The result of these numerous amendments and deletions is that the treaty provisions which apply between the U.S. and the Netherlands Antilles are scattered over a number of protocols and treaties and since no official consolidation exists the consideration of the treaty provisions between these two countries requires careful and time consuming research. In order to facilitate the consideration of these provisions the International Bureau of Fiscal Documentation has prepared a consolidation of the text which is reproduced below.

An unofficial consolidated text of the Convention between the United States of America and the Kingdom of the Netherlands for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income signed at Washington on April 29, 1948, as supplemented and modified by Protocol signed at Washington on June 15, 1955, and extended to the Netherlands Antilles by Exchanges of Notes dated at Washington on June 24 and August 7, 1952, September 15 and November 4 and 10, 1955 and again modified and supplemented by the Protocol signed at The Hague on October 23, 1963.

Article I

(1) The taxes which are the subject of the present Convention are:

(a) In the case of the United States: the Federal income taxes.

(b) In the case of the Netherlands Antilles: income taxes and profits taxes.

(2) The present Convention shall apply also to any other taxes of a substantially similar character imposed by either Contracting State subsequently to the date of signature of the present Convention.

(3) In the event of appreciable changes in the fiscal laws of either of the Contracting States the competent authorities of the Contracting States will consult together.

Article II

(1) In the present Convention, unless the context otherwise requires:

(a) The term "United States" means the United States of America, and when used in a geographical sense means the States, the Territories of Alaska and of Hawaii, and the District of Columbia.

(b) The term "Netherlands Antilles" means the group of islands off the coast of Venezuela, including Aruba, Bonaire, Curaçao, Saba, St. Eustatius and St. Martin (Netherlands part).

(c) The term "United States corporation" means a corporation, association or other organization or juridical entity created in the United States or under the laws of the United States or of any State or territory of the United States.

(d) The term "Netherlands Antilles corporation" means a corporation, association or other organization or juridical entity created in the Netherlands Antilles or under the laws of the Netherlands Antilles.

(e) The terms "corporation of one Contracting State" and "corporation of the other Contracting State" mean a United States corporation or a Netherlands Antilles corporation, as the context requires.

(f) The term "United States enterprise" means an industrial or commercial enterprise or undertaking carried on in the United States by a citizen or resident of the United States or by a United States corporation.

(g) The term "Netherlands Antilles enterprise" means an industrial or commercial enterprise or undertaking carried on in the Netherlands Antilles by a citizen or resident of the Netherlands Antilles or by a Netherlands Antilles corporation.

(h) The terms "enterprise of one of the Contracting States" and "enterprise of the other Contracting State" mean a United States enterprise or a Netherlands Antilles enterprise, as the context requires.

(i) The term "permanent establishment", when used with respect to an enterprise of one of the Contracting States, means a branch, factory, or other fixed place of business, but does not include an agency unless the agent has, and habitually exercises, a general authority to negotiate and conclude contracts on behalf of such enterprise or has a stock of merchandise from which he regularly fills orders on behalf of such enterprise. An enterprise of one of the Contracting States shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business dealings in such other Contracting State through a *bona fide* commission agent, broker or custodian acting in the ordinary course of his business as such. The fact that an enterprise of one of the Contracting States maintains in the other Contracting State a fixed place of business exclusively

for the purchase of goods or merchandise shall not of itself constitute such fixed place of business a permanent establishment of such enterprise. When a corporation of one Contracting State has a subsidiary corporation which is a corporation of the other Contracting State or which is engaged in trade or business in such other Contracting State, such subsidiary corporation shall not, merely because of that fact, be deemed to be a permanent establishment of its parent corporation.

(j) The term "competent authority" or "competent authorities" means, in the case of the United States, the Commissioner of Internal Revenue or his duly authorized representative; in the case of the Netherlands Antilles the Administrateur van Financiën or his duly authorized representative; and, in the case of any part or territory to which provisions of the present Convention are extended under Article XXVII, the competent authority for the administration in such part or territory of the taxes to which such provisions apply.

(2) In the application of the provisions of the present Convention by either of the Contracting States, any term which is not defined in the present Convention shall, unless the context otherwise requires, have the meaning which that term has under the laws of such Contracting State relating to the taxes which are the subject of the present Convention.

Article III

(1) An enterprise of one of the Contracting States shall not be subject to taxation by the other Contracting State in respect of its industrial or commercial profits unless it is engaged in trade or business in the other Contracting State through a permanent establishment situated therein. If it is so engaged the other Contracting State may impose the tax only upon the income of such enterprise from sources within such other State.

(2) Where an enterprise of one of the Contracting States is engaged in trade or business in the other Contracting State through a permanent establishment situated therein, there shall be attributed to such permanent establishment the industrial or commercial profits which it might be expected to derive if it were an independent enterprise engaged in the same or similar activities under the same or similar conditions and dealing at arm's length with the enterprise of which it is a permanent establishment, and the profits so attributed shall, subject to the law of such other Contracting State, be deemed to be income from sources within such other Contracting State.

(3) In determining the industrial or commercial profits from sources within one of the Contracting States of an enterprise of the other Contracting State, no profits shall be deemed to arise from the mere purchasing of goods or merchandise within the former Contracting State by such enterprise.

(4) The competent authorities of the Contracting States may lay down rules by agreement for the apportionment of industrial or commercial profits.

Article IV

Where an enterprise of one of the Contracting States, by reason of its participation in the management, control or capital of an enterprise of the other Contracting State, makes with or imposes on the latter enterprise, in their commercial or financial relations, conditions different from those which would be made with an independent enterprise, any profits which would, but for those conditions, have accrued to one of the enterprises, may be included in the taxable profits of that enterprise.

Article V

Income of whatever nature derived from real property and interest from mortgages secured by real property shall be taxable only in the Contracting State in which the real property is situated.

Article VI

Income which an enterprise of one of the Contracting States derives from the operation of ships or aircraft registered in that State shall be taxable only in the State in which such ships or aircraft are registered. Income derived by such an enterprise from the operation of ships or aircraft not so registered shall be subject to the provisions of Article III.

Article VII *

(1) The rate of United States tax on dividends derived from a United States corporation by a resident or corporation of the Netherlands Antilles not engaged in trade or business in the United States through a permanent establishment shall not exceed 15 percent: Provided that such rates of tax shall not exceed 5 percent if such Netherlands Antilles corporation controls, directly or indirectly, at least 95 percent of the entire voting power in the corporation paying the dividend, and not more than 25 percent of the gross income of such paying corporation is derived from interest and dividends, other than interest and dividends from its own subsidiary corporation. Such reduction of the rate to 5 percent shall not apply if the relationship of the two corporations has been arranged or is maintained primarily with the intention of securing such reduced rate.

(2) Dividends derived from sources within the Netherlands Antilles by a resident or corporation of the United States not engaged in trade or business in the Netherlands Antilles through a permanent establishment shall be exempt from Netherlands Antilles tax.

(3) Either of the Contracting States may terminate this Article, by giving written notice of termination to the other Contracting State through diplomatic channels, on or before the thirtieth day of June in any year after the first year for which the present Convention becomes effective. In such event this Article shall cease to be effective on and after the first day of January in the year next following that in which such notice is given.

Article VIII *

(1) Interest (on bonds, securities, notes, debentures, or on any other form of indebtedness), other than interest referred to in Article V of the present Convention, derived from sources within the United States by a resident or corporation of the Netherlands Antilles not engaged in trade or business in the United States through a permanent establishment, shall be exempt from United States tax; but such exemption shall not apply to such interest paid by a United States corporation to a Netherlands Antilles corporation controlling, directly or indirectly, more than 50 percent of the entire voting power in the paying corporation.

(2) Interest (on bonds, securities, notes, debentures, or on any other form of indebtedness), other than interest referred to in Article V of the present Convention, derived from sources within the Netherlands Antilles by a resident or corporation of the United States not engaged in trade or business in the Netherlands Antilles through a permanent establishment, shall be exempt from Netherlands Antilles tax; but such exemption shall not apply to such interest paid by a Netherlands Antilles corporation

* See restrictions to Articles VII, VIII, IX in Protocol of October 23, 1963.

to a United States corporation controlling, directly or indirectly, more than 50 percent of the entire voting power in the paying corporation.

Article IX *

Royalties for the right to use copyrights, patents, designs, secret processes and formulae, trade marks, and other analogous property, and royalties, including rentals, in respect of motion picture films or for the use of industrial, commercial or scientific equipment, derived from sources within one of the Contracting States by a resident or corporation of the other Contracting State not engaged in trade or business in the former State through a permanent establishment, shall be exempt from tax imposed by the former State.

Article X

A resident or corporation of one of the Contracting States, deriving from sources within the other Contracting State royalties in respect of the operation of mines, quarries, or natural resources, or rentals from real property, may elect for any taxable year to be subject to the tax of such other Contracting State on such income on a net income basis.

Article XI.

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Article XII

Dividends and interest paid by a Netherlands Antilles corporation shall be exempt from United States tax except where the recipient is a citizen, resident, or corporation of the United States.

Article XIII

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Article XIV

(1) The United States income tax liability for any taxable year beginning prior to January 1, 1936, of any individual (other than a citizen of the United States) resident in the Netherlands Antilles, or of any Netherlands Antilles corporation, remaining unpaid on the effective date of the present Convention, may be adjusted on a basis satisfactory to the United States Commissioner of Internal Revenue: Provided that the amount to be paid in settlement of such liability shall not exceed the amount of the liability which would have been determined if

(a) the United States Revenue Act of 1936 (except in the case of the Netherlands Antilles corporation in which more than 50 percent of the entire voting power was controlled, directly or indirectly, throughout the latter half of the taxable year, by citizens or residents of the United States), and

(b) Article XII of the present Convention, had been in effect for such year. If the taxpayer was not, within the meaning of such Revenue Act, engaged in trade or business in the United States and had no office or place of business therein during the taxable year, the amount of interest and penalties shall not exceed 50 percent of the amount of the tax with respect to which such interest and penalties have been computed.

(2) The United States income tax unpaid on the effective date of the present Convention for any taxable year beginning after December 31, 1935, and prior to the effective date of the present Convention in the case of an individual (other than a citizen of the United States) resident of the Netherlands Antilles, or in the case of any Netherlands Antilles corporation, shall be determined as if the provisions of Article XII of the present Convention had been in effect for such taxable year.

(3) The provisions of paragraph (1) of this Article shall not apply

(a) unless the taxpayer files with the Commissioner of Internal Revenue within a period of two years following the effective date of the present Convention a request that such tax liability be so adjusted and furnishes such information as the Commissioner may require; or

(b) in any case in which the Commissioner is satisfied that any deficiency in tax is due to fraud with intent to evade the tax.

Article XV

(1) Wages, salaries and similar compensation, and pensions and life annuities, paid either directly by, or from funds created by, one of the Contracting States or the political subdivisions or territories thereof to individuals in the other Contracting State shall be exempt from taxation in the latter State.

(2) Private pensions and life annuities derived from within one of the Contracting States and paid to individuals in the other Contracting State shall be exempt from taxation in the former State.

(3) The term "pensions" as used in this Article means periodic payments made in consideration for services rendered or by way of compensation for injuries received.

(4) The term "life annuities" as used in this Article means a stated sum payable periodically at stated times during life, or during a specified number of years, under an obligation to make the payments in return for adequate and full consideration in money or money's worth.

Article XVI

(1) A resident of the Netherlands Antilles shall be exempt from United States tax upon compensation for labor or personal services performed within the United States if he is temporarily present within the United States for a period or periods not exceeding a total of one hundred eighty-three days during the taxable year and his compensation is received for labor or personal services performed as a worker or employee of, or under contract with, a resident of the Netherlands Antilles, or a Netherlands Antilles corporation, carrying the actual burden of the remuneration.

(2) The provisions of paragraph (1) of this Article shall apply, *mutatis mutandis*, to a resident of the United States deriving compensation for labor or personal services performed within the Netherlands Antilles.

Article XVII

(1) Professors or teachers, residents of one of the Contracting States, who, in accordance with the agreements between the Contracting States or between teaching establishments in the Contracting States for the exchange of professors and teachers, visit the other Contracting State to teach, for a maximum period of two years, in a university, college or other teaching establishment in such other Contracting State, shall not be taxed by such other State with respect to the remuneration which they receive for such teaching.

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* See restrictions to Articles VII, VIII, IX in Protocol of October 23, 1963.

Article XVIII

Students or business apprentices of one Contracting State residing in the other Contracting State exclusively for the purposes of study or for acquiring business experience shall not be taxable by the latter State in respect of remittances received by them from abroad for the purpose of their maintenance or studies.

Article XIX

(1) Notwithstanding any provisions of the present Convention (other than paragraph (1) of Article XV when applicable in the case of an individual who is deemed by each Contracting State to be a citizen thereof), each of the two Contracting States, in determining the taxes, including all surtaxes, of its citizens or residents or corporations, may include in the basis upon which such taxes are imposed all items of income taxable under its own revenue laws as though this Convention had not come into effect.

(2) As far as may be in accordance with the provisions of the United States Internal Revenue Code, the United States agrees to allow as a deduction from the income taxes imposed by the United States the appropriate amount of taxes paid to the Netherlands, whether paid directly by the taxpayer or by withholding at the tax source.

(3) The Netherlands Antilles shall allow a deduction (or the equivalent thereof) from its tax of the Federal income tax paid to the United States by citizens of the United States resident in the Netherlands Antilles with respect to income of such citizens from sources within the United States, but in an amount not in excess of that proportion of the entire Netherlands Antilles tax which such income tax bears to the entire income subject to such Netherlands Antilles tax.

Article XX

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Article XXI

The competent authorities of the Contracting States shall exchange such information (being information which such authorities have in proper order at their disposal) as is necessary for carrying out the provisions of the present Convention or for the prevention of fraud or the administration of statutory provisions against legal avoidance in relation to the taxes which are the subject of the present Convention. Any information so exchanged shall be treated as secret and shall not be disclosed to any person other than those concerned with the assessment and collection of the taxes which are the subject of the present Convention. No information as aforesaid shall be exchanged which would disclose any trade, business, industrial or professional secret or trade process.

Article XXII

(1) The Contracting States undertake to lend assistance and support to each other in the collection of the taxes which are the subject of the present Convention, together with interest, costs, and additions to the taxes and fines not being of a penal character.

(2) In the case of applications for enforcement of taxes, revenue claims of each of the Contracting States which have been finally determined may be accepted for enforcement by the other Contracting State and collected in that State in accordance with the laws applicable to the enforcement and collection of its own taxes. The State to which application is made shall not be required to enforce executory measures for which there is no provision in the law of the State making the application.

(3) Any application shall be accompanied by documents establishing that under the laws of the State making the application the taxes have been finally determined.

(4) The assistance provided for in this Article shall not be accorded with respect to the citizens, corporations, or other entities of the State to which application is made, except as is necessary to insure that the exemption or reduced rate of tax granted under the convention to such citizens, corporations or other entities shall not be enjoyed by persons not entitled to such benefits.

Article XXIII

(1) In no case shall the provisions of Articles XXI and XXII be construed so as to impose upon either of the Contracting States the obligation

(a) to carry out administrative measures at variance with the regulations and practice of either Contracting State, or

(b) to supply particulars which are not procurable under its own legislation or that of the State making application.

(2) The State to which application is made for information or assistance shall comply as soon as possible with the request addressed to it. Nevertheless, such State may refuse to comply with the request for reasons of public policy or if compliance would involve violation of a trade, business, industrial or professional secret or trade process. In such case it shall inform, as soon as possible, the State making the application.

Article XXIV

Where the action of the revenue authorities of the Contracting States has resulted or will result in double taxation contrary to the provisions of the present Convention, the taxpayer shall be entitled to lodge a claim with the State of which he is a citizen or subject or, if he is not a citizen or subject of either of the Contracting States, with the State of which he is a resident, or, if the taxpayer is a corporation, with the State in which it is created or organized. Should the claim be upheld, the competent authority of such State shall undertake to come to an agreement with the competent authority of the other State with a view to equitable avoidance of the double taxation in question.

Article XXV

(1) The provisions of the present Convention shall not be construed to restrict in any manner any exemption, deduction, credit or other allowance accorded by the laws of one of the Contracting States in the determination of the tax imposed by such State.

(2) Should any difficulty or doubt arise as to the interpretation or application of the present Convention, the competent authorities of the Contracting States shall undertake to settle the question by mutual agreement.

(3) The citizens or subjects of one of the Contracting States shall not, while resident in the other Contracting State, be subjected therein to other or more burdensome taxes than are the citizens or subjects of such other Contracting State residing in its territory. The term "citizens" or "subjects" as used in this Article includes all legal persons, partnerships and associations deriving their status from, or created or organized under the laws in force in, the respective Contracting States. In this Article the word "taxes" means taxes of every kind or description whether national, federal, state, provincial or municipal.

Article XXVI

(1) The authorities of each of the Contracting States, in accordance with the practices of that State, may prescribe regulations necessary to carry out the provisions of the present Convention.

(2) With respect to the provisions of the present Convention relating to exchange of information and mutual assistance in the collection of taxes, the competent authorities may, by common agreement, prescribe rules concerning matters of procedure, forms of application and replies thereto, conversion of currency, disposition of amounts collected, minimum amounts subject to collection, and related matters.

Article XXVII

(1) Either of the Contracting States may, at the time of exchange of instruments of ratification or thereafter while the present Convention continues in force, by a written notification of extension given to the other Contracting State through diplomatic channels, declare the desire of the government of any overseas part of the Kingdom (in the case of the Netherlands) or overseas territory (in the case of the United States), which imposes taxes substantially similar in character to those which are the subject of the present Convention, that the operation of the present Convention, either in whole or as to such provisions thereof as may be deemed to have special application, shall extend to such part or territory.

(2) In the event that a notification is given by one of the Contracting States in accordance with paragraph (1) of this Article, the present Convention, or such provisions thereof as may be specified in the notification, shall apply to any part or territory named in such notification on and after the first day of January immediately preceding the date of a written communication through diplomatic channels addressed to such Contracting State by the other Contracting State, after such action by the latter State as may be necessary in accordance with its own procedures stating that such notification is accepted in respect of such part or territory. In the absence of such acceptance, none of the provisions of the present Convention shall apply to such part or territory.

(3) At any time after the expiration of one year from the effective date of an extension made by virtue of paragraphs (1) and (2) of this Article, either of the Contracting States may, by a written notice of termination given to the other Contracting State through diplomatic channels, terminate the application of the present Convention to any part or territory to which the Convention, or any of its provisions, has been extended. In that case, the present Convention, or the provisions thereof specified in the notice of termination, shall cease to be applicable to the part or territory named in such notice of termination on and after the first day of January following the expiration of a period of six months after the date of such notice; provided, however, that this shall not affect the continued application of the Convention, or any of the provisions thereof, to the United States, to the Netherlands, or to any part or territory (not named in the notice of termination) to which the Convention, or such provision thereof, applies.

(4) For the application of the present Convention in relation to any part or territory to which it is extended by notification given by the United States or the Netherlands, references to the "United States" or to "the Netherlands" or to one or the other Contracting State, as the case may be, shall be construed to refer to such part or territory.

Article XXVIII

(1) The present Convention shall be ratified and the instruments of ratification shall be exchanged at Washington as soon as possible.

(2) The present Convention shall become effective on the first day of January in the year last preceding the year in which the exchange of instruments of ratification takes place. It shall continue effective for a period of five years beginning with that date and indefinitely after that period, but may be terminated by either of the Contracting States at the end of the five-year period or at any time thereafter, provided that at least six months' prior notice of termination has been given, the termination to become effective on the first day of January following the expiration of the six-month period.

DONE at Washington, in duplicate, in the English and Dutch languages, the two texts having equal authenticity, this 29th day of April, 1948.

For the Government of the United States of America:

G.C. MARSHALL (seal)

For the Government of the Kingdom of the Netherlands:

E.N. van KLEFFENS (seal)

PROTOCOL

The Government of the United States of America and the Government of the Kingdom of the Netherlands,

Desiring to conclude a further Protocol modifying and supplementing the Extension to the Netherlands Antilles of the Convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and certain other taxes signed at Washington on April 29, 1948, as supplemented by the Protocol signed at Washington on June 15, 1955, and as extended to the Netherlands Antilles by Exchanges of Notes dated at Washington on June 24 and August 7, 1952, September 15 and November 4 and 10, 1955,

Have accordingly appointed their respective representatives for this purpose, who have agreed as follows:

Article I

(1) Articles VII, VIII, and IX of the Convention shall not apply to income derived from sources within the United States by any investment or holding company, corporation, limited partnership or other entity entitled to any of the special tax benefits provided under Article 13, Article 14, or Article 14A of the Netherlands Antilles' National Ordinance on Profit Tax of 1940, as in effect on September 1, 1963, or to substantially similar tax benefits granted under any law of the Netherlands Antilles enacted after such date.

(2) Notwithstanding the provisions of paragraph (1) of the present Article, Articles VII, VIII and IX of the Convention shall

continue to apply to dividends, interest, and royalties derived by any entity, to which the provisions of paragraph (1) of this Article would otherwise apply, if either

(a) the payer of such income is a United States corporation (other than a United States corporation, 60 percent or more of the gross income of which is derived from interest except to the extent derived by a corporation the principal business of which is the making of loans, dividends, royalties, rents from real property, or gain from the sale or other disposition of stock, securities, or real property), 25 percent or more of the stock of which is owned by such entity; or,

(b) all of the stock of such entity is owned
   (i) solely by one or more individual residents of the Netherlands Antilles in their individual capacities,
   (ii) solely by one or more individual residents of the Netherlands in their individual capacities, or
   (iii) solely by one or more corporations of the Netherlands.

Article II

This Article has been incorporated in the main Treaty as Article X.

Article III

(1) The present Protocol shall be ratified and the instruments of ratification shall be exchanged at Washington as soon as possible.

(2) The present Protocol shall come into force on the date of exchange of instruments of ratification.

(3) Article I of the present Protocol shall be applicable with respect to payments made on or after the first day of January of the year immediately following the year in which the exchange of instruments of ratification takes place. Article II of the present Protocol shall be applicable with respect to elections made for taxable years beginning on or after the first day of January of the year immediately following the year in which the exchange of instruments of ratification takes place.

(4) Notwithstanding the provisions of paragraph (3) of this Article, the following provisions shall apply with respect to dividends and interest paid to a corporation or other entity which is organized in the Netherlands Antilles under a notarial deed of incorporation dated on or before May 14, 1963, if Articles VII and VIII of the Convention would not be applicable to such dividends and interest by reason of Article I of the Present Protocol:

(a) In the case of a dividend
   (i) paid during the period of two years beginning on the first day of January, 1964, the provisions of Article VII of the Convention shall continue to apply as though the present Protocol had not yet come into force;
   (ii) paid during the year beginning on the first day of January, 1966, United States tax with respect to such dividend shall be imposed at a rate not exceeding 20 percent; and

(b) In the case of interest paid during the period of three years beginning on the first day of January, 1964, the provisions of Articles VIII shall continue to apply as though the present Protocol had not yet come into force.

IN WITNESS WHEREOF the undersigned representatives, duly authorised for that purpose, have signed the present Protocol.

DONE in duplicate, in the English and Dutch languages, the two texts having equal authenticity, at The Hague, this 23rd day of October, 1963.

For the Government of the United States of America:
JOHN S. RICE

For the Government of the Kingdom of the Netherlands:
L. de BLOCK

UNITED STATES-NETHERLANDS INCOME TAX CONVENTION

Rev. Rul. 65–16

Article I(1) of the protocol of October 23, 1963, to the tax convention between the United States and the Kingdom of the Netherlands, T.D. 5778, C.B. 1950–1, 92, as extended to the Netherlands Antilles, C.B. 1956–2, 1116, provides that Articles VII, VIII, and IX of the convention shall not apply to income derived from sources within the United States by any investment or holding company, corporation, limited partnership, or other entity entitled to any of the special tax benefits provided under Article 13, Article 14, or Article 14A of the Netherlands Antilles National Ordinance on Profit Tax of 1940, as in effect on September 1, 1963, or to substantially similar tax benefits granted under any law of the Netherlands Antilles enacted after such date.

Held, a Netherlands Antilles corporation electing to be taxed, with respect to all of its income from United States sources, under Article 8A of the National Ordinance on Profit Tax of 1940, as added by the National Ordinance of December 30, 1963, will not be entitled to tax benefits which are substantially similar (within the meaning of Article I(1) of the protocol) to those provided under Articles 13, 14, or 14A, and therefore may be entitled to benefits accorded by Articles VII, VIII, and IX of the tax convention between the United States and the Kingdom of the Netherlands, as extended to the Netherlands Antilles.

Tax aspects of east-west business relations — A STATUS REPORT

by W.G. Kuiper *

I. INTRODUCTION

During the last few years, East-West trade relations have intensified and public attention has focused upon the rapidly increasing number of Western commercial contacts throughout Eastern Europe. These contacts have been facilitated by the introduction of a joint-venture legislation in several Eastern European countries and by the conclusion of many tax treaties between the countries of Eastern and Western Europe.

II. JOINT VENTURES

As regards Eastern European countries, the joint venture is a business association of comparatively long duration set up by two or more parties in order to run an enterprise subject to sharing of control, risk and profit. This concept of joint venture is not new: for many years joint ventures with Eastern European countries have been operating outside the territory of these countries. A number of factors, inter alia, the need for technology and hard currency, compelled the Eastern European countries to attract Western investment. As a consequence of this, four Eastern European countries have allowed joint business operations with Western firms on their territory, i.e. Yugoslavia, Romania, Hungary and Poland.

A. YUGOSLAVIA

In 1967, Yugoslavia became the first Eastern European country to allow foreign investment on its territory in the form of a joint venture. In 1973, part of the 1967 Law was replaced by the "Law on Foreign Investments in Domestic Organizations of Associated Labour" which may be considered the most important legal basis for foreign investment in Yugoslavia.

The basis of a joint venture between a Yugoslav and a foreign firm is a contract which, to become effective, must be registered with the Federal Secretariat of the Economy. The contract, inter alia, states the total amount invested, the value of the foreign investment (which may not be less than 1,500,000 dinars and not more than 49 percent) and the foreign partner's share in the profits.

Joint venture income is determined with reference to net income after ordinary and necessary expenses including depreciation have been deducted. Depreciation rates are normally spelled out in the joint venture contract. Profits derived from joint ventures are subject to a federal profits tax which is levied at a flat rate of 35 percent. This tax is not really on the entity itself but is imposed on the share of the profits allocated to the foreign investor. The Yugoslav investor is separately taxed on his share of the profits. The tax on the profits of the foreign partner is actually imposed by the individual republics. [1] The latter may, in fact, levy tax at a lower rate than that envisaged by the Federal Law.

In the case of reinvestment of the profits realized, the tax may be considerably reduced, depending on the amount of the reinvestment. In this case as well, the reduction of tax may differ according to the law of the individual republic which imposes the tax.

Chart I may clarify the impact of the tax reductions and reinvestment incentives in the various republics.

It should be noted that, once the profits tax has been levied, the foreign investor is free to repatriate the profits realized (as far as not reinvested). In that case, no withholding tax on dividends becomes due.

B. ROMANIA

The second Eastern European country which gave permission to foreign business operations on its territory in the form of a joint venture was Romania (under Decrees No. 424 and 425 of November 2, 1972). [2] Joint ventures in Romania must be constituted as joint stock companies or limited liability companies. The organization and operation of these joint ventures must be set up in the "Company's Contract" and in the "Statutes". A foreign ownership of the equity in joint ventures with Romanian enterprises up to 49 percent is allowed.

CHART I — YUGOSLAVIA

Republic	*Reinvested profits (%)*	*Tax on reinvested profits (%)*	*Tax on total profits (%)*
Croatia, Slovenia, Serbia and Voivodina	—	—	35
	25	29.75	34.20
	50	27.30	34
	100	22.30	22.30
Bosnia and Hercegovina	—	—	20
	25	17	19.25
	50	15.50	17.75
	100	12.75	12.75
Macedonia	—	—	14
	25	11.20	13.30
	50	9.80	11.90
	100	7.70	7.70
Montenegro	—	—	14
	25	11.90	13.50
	50	7.70	11.70
	100	5.60	5.60
Kosovo	—	—	35
	25	28.70	33.40
	50	16.10	25.50
	100	9.80	9.80

* Staff Member of the International Bureau of Fiscal Documentation.

1. See Ksente Bogoev, *Yugoslavia, Trends in fiscal federalism*, Bulletin for International Fiscal Documentation, Vol. 31, No. 5 at 201 (May 1977).

2. See W.G. Kuiper, *Socialist Republic of Romania, Organization, operation and taxation of joint companies - Taxation of income obtained by non-resident individuals and corporations*, European Taxation, Vol. 16, No. 6 at 190 (June 1976).

The contributions to the capital may consist of a contribution in cash, a contribution in goods required for carrying out the investment activities in which the company is engaged, and a contribution of industrial property rights or other rights.

In general, profits of joint ventures with Romanian and foreign participation are subject to an annual tax of 30 percent.

The taxable base is net profits, i.e. gross income less business expenses, depreciation allowances and legally required reserves. As regards the latter, the creation of a reserve of five percent of the annual taxable profits is mandatory, until the total reserve fund reaches 25 percent of the invested capital.

The Council of Ministers of Romania may grant a full tax exemption for the first year in which taxable profits are made and, additionally, a 50 percent reduction (rate 15 percent) for the following two years. In this respect it should be noted that, in the event the joint venture begins to make profits during the second half of the year, the tax exemption may also be granted for the profits made in the first half of the following year.

A reinvestment allowance is offered in the form of a reduction of 20 percent from the normal tax rate (effective rate 24 percent) for profits reinvested for a period of time of at least five years.

Profits remaining for distribution to the shareholders after payment of taxes shall be taxed at a rate of 10 percent *if such profits are transferred abroad.*

C. HUNGARY

Under Law No. 18/1970 and Decree 28/1972 (as amended by Decree No. 7/1977) Hungary became the third Eastern European country to permit joint ventures on its territory.

The share of the foreign partner in a Hungarian joint venture may not exceed 49 percent. The ownership ratio is fundamental for purposes of profit sharing and financial risks but not necessarily for voting rights. The methods of management of the joint venture are laid down in the "Memorandum of Association".

It is mandatory to set up a risk fund until it reaches ten percent of the capital invested. It must be formed out of the annual profits in accordance with the method laid down in the Memorandum of Association. In addition, the joint venture may set aside an amount in the employee profit sharing fund up to fifteen percent of the annual wages. Both are deductible in computing taxable income.

After deduction of the amounts set aside for the risk fund and the profit sharing fund — both of which reduce the profits — the remainder is the taxable base for purposes of the profits tax, which is levied — after the amendments set forth by Decree 7/1977 — at a uniform rate of 40 percent.

If the joint venture untilizes its taxed profits for increasing its investment capital, part of the profits tax paid may be refunded upon application submitted to the Ministry of Finance.

In addition, joint ventures are subject to a flat 35 percent payroll tax on annual wages.

Capital invested (e.g. in the case of winding-up) and after tax profits can be repatriated tax-free.

D. POLAND

By virtue of Decrees 109 and 110 of May 25, 1976 joint ventures in Poland can be undertaken by individuals or legal entities domiciled abroad, as well as by foreigners living in Poland with a permanent residence permit with entities of the socialist sector. [3] The company's contract should be approved by the competent Minister of the Polish People's Republic.

The contributions to the share capital of a joint venture can consist of a contribution in cash or a contribution in kind. The foreign contribution *in cash* must amount to at least 50 percent of the entire foreign participation. Any contribution made in cash must be paid in convertible currency. The extent of the Western participation is *not* restricted. Thus, in principle, the split could presumably be 80 percent foreign and 20 percent Polish, or any other combination.

The creation of a reserve fund of 20 percent of the after tax profits is mandatory.

Since joint ventures are considered residents of Poland, they are subject to income tax on their world-wide income. Polish tax law does not contain special provisions concerning the taxation of joint ventures.

The Polish income tax system is a schedular one. There are three different schedules aggregating the income from specified sources of income. Consequently, there are three potentially applicable tax tables, the rates of which range from 20 to 85 percent. For corporate entities, however, the highest overall rate is 65 percent.

If the Polish partner holds more than 50 percent of the share capital the 65 percent tax rate is always applicable to the foreign partner, unless it is reduced by the Minister of Finance upon application.
The company's after tax profits, determined on the basis of the existing income tax regulations, can be repatriated in convertible currency. The repatriated profits, however, cannot exceed nine percent of the total foreign investment per year, unless more than one half of the company's products are exported. Repatriated profits are subject to a final withholding tax of 30 percent.

III. OTHER TAX ASPECTS OF DOING BUSINESS WITH EASTERN EUROPE

A. REPRESENTATION OFFICES

Where only four countries have enacted joint venture legislation, representation offices of Western firms are allowed in all Eastern European countries. Such representation offices are, in principle, subject to tax in those countries. However, the Soviet Union, the German Democratic Republic and Bulgaria do not actually tax such representation offices, provided that they do not act in their own name.

In *Czechoslovakia*, on the other hand, representation offices are subject to income tax which is levied at a rate of 65 percent.

In *Poland*, representation offices are subject to income tax which is levied at progressive rates (up to 50 percent), unless the income is derived from transactions concluded through the intermediary of Polish representative offices acting as agents. In the latter case, the representation office is exempt from tax.

In *Yugoslavia*, income earned by representation offices is subject to income tax as levied under the tax laws of the independent Republics. Therefore, the rates may differ considerably.

In *Hungary*, representation offices are subject to the "agency tax". The rates of this tax are either three, five or eight percent (depending on the kind of activity) of the office's turnover less ten percent of the taxable base for expenses incurred in Hungary.

In *Romania*, taxable income of representation offices is established in a lump-sum amount, according to the following scale:

Type of office	*Annual taxable income in le*
A (employing 1-2 people)	100,000
B (employing 3-5 people)	250,000
C (employing 6-8 people)	400,000
D (employing more than 8 people)	800,000

The regular income tax table for enterprises in the private sector applies. The rate is 42 percent for income up to 80,000 le increased by 2 percent for every 15,000 le up to a maximum of 60 percent.

B. WITHHOLDING TAXES

Another interesting question is at what rates taxes are withheld by Eastern European countries with respect to interest and patent royalties paid to Western countries

3. See M. Weralski, *Polish People's Republic: New joint venture legislation*, European Taxation, Vol. 17, No. 4 at 114 (April 1977).

In this respect, it should be noted that, due to the economic and social system of the Eastern European countries, *dividends* can normally be transferred to the West, only if they come from profits derived by a joint venture. The taxes on repatriation of such profits, if any, are discussed above.

Chart II indicates the rates of taxes on interest and patent royalties withheld by Eastern European countries (as far as the information is available).

It should be noted that the rates in chart II may be reduced pursuant to tax treaties concluded between East and West.

IV. TAX TREATIES

As indicated by Chart III, to date 29 treaties for the avoidance of double taxation have been concluded between East and West, while several other treaties are being negotiated.

A study on the provisions of these treaties reveals that they are mainly based on the OECD-Model Convention (except for the pre-war treaties concluded by Hungary and the treaty between the United States and the USSR).

Some interesting exceptions, however, include the following:

— Where Art. 5(2)(g) of the OECD-Model Convention provides that a building site or construction project is considered a permanent establishment if it exists for more than 12 months most (however, not all) East-West tax treaties provide that such building sites or construction projects are deemed permanent establishment after 18 or 24 months or not at all.

— Art. 11 of the OECD-Model Convention provides that interest may be taxed in the State in which it arises; however, the rate may not exceed 10 percent. Most East-West tax treaties (except the ones concluded by Romania) provide for a tax exemption in the State in which the interest arises.

— Some of the tax treaties concluded by Romania contain a provision for commission fees (including a withholding tax of five to twelve and a half percent).

— Under Art. 12 of the OECD-Model Convention royalties are taxable in the State of residence; there is no provision for a tax in the State in which the royalties arise. Most East-West tax treaties however, contain a provision under which royalties may also be taxed in the State in which they arise, in general however, the tax may not exceed five or ten procent. In the light of the predominant flow of technology from the West to the East, the provision for a withholding tax on royalties must be considered to be favourable to the Eastern European countries.

CHART II – WITHHOLDING TAXES

Country	*Interest*	*Patent royalties*
Bulgaria	exempt	uncertain, probably 40%
Czechoslovakia	20%	40%
German Democratic Republic	15%	25%
Hungary	uncertain, probably 30%	20% *
Poland	30%	30%
Romania	15% *	20% *
USSR	exempt	exempt
Yugoslavia	exempt	various rates

* If a non-treaty country taxes one of the above-mentioned types of income paid to residents of the Eastern European country at a higher rate, the above rates may be increased up to the same level, e.g. under the conditions existing prior to the Romania-U.K. tax treaty, the United Kingdom taxes royalties paid abroad at a rate of 35 percent. In that case, Romania could also tax royalties paid to a resident of the United Kingdom at a rate of 35 percent.

CHART III – EAST-WEST TAX TREATIES

	Treaties	*Date of conclusion*
	Czechoslovakia—France	June 1, 1973
	Czechoslovakia—the Netherlands	March 14, 1974
	Czechoslovakia—Finland	January 31, 1975
*	Czechoslovakia—Belgium	June 19, 1975
	Hungary—Italy	November 25, 1925 2)
	Hungary—Sweden	June 17, 1936 1)
	Hungary—the Netherlands	November 15, 1938 1)
	Hungary—Switzerland	October 5, 1942 1)
	Hungary—Austria	February 25, 1975
*	Hungary—Federal Republic of Germany	July 18, 1977
	Poland—Federal Republic of Germany	December 18, 1972
	Poland—Austria	October 2, 1974
	Poland—United States	October 8, 1974
	Poland—Pakistan	October 25, 1974
	Poland—Sweden	June 5, 1975
	Poland—France	June 20, 1975
	Poland—Denmark	April 6, 1976
*	Poland—United Kingdom	December 16, 1976
	Romania—Federal Republic of Germany	June 29, 1973
	Romania—United States	December 4, 1973
	Romania—France	September 27, 1974
	Romania—United Kingdom	September 18, 1975
*	Romania—Japan	February 12, 1976
*	Romania—Austria	September 30, 1976
*	Romania—Belgium	October 14, 1976
*	Romania—Italy	January 14, 1977
	USSR—United States	June 20, 1973
	Yugoslavia—France	March 28, 1974
*	Yugoslavia—Austria	May 7, 1975

All treaties (except the treaties concluded by Hungary with Italy, Sweden and the Federal Republic of Germany and by Romania with Austria, Belgium and Italy), are published by the International Bureau of Fiscal Documentation in the English language in SUPPLEMENTARY SERVICE TO EUROPEAN TAXATION, Sec. C., thus including 4 treaties which were not yet effective at the date of publication of this survey.

* = not yet in force.

1) = published in the English language in: United Nations, Department of Economic and Social Affairs. International Tax Agreements. World Guide.

2) = published in the English language in: League of Nations. Double Taxation and Fiscal Evasion. Collection of International Agreements and Internal Legal Provisions for the Prevention of Double Taxation and Fiscal Evasion.

THE EUROPEAN COMMUNITY'S SCHEME OF GENERALIZED TARIFF PREFERENCES 1978[1]

Source: Information Memo, P-71, July 1977

The 1978 scheme of generalized tariff preferences for the developing countries has just been approved by the Commission. If the Council adopts the Commission's proposals, the volume of imports eligible for preferential treatment will be equivalent to 6,400 million European units of account, [2] of which 5,100 million EUA for industrial semi-manufactures and manufactures and 1,300 million EUA for processed agricultural products.

The main features of the 1978 scheme are a limited increase in the volume of imports eligible for preferential treatment, the maintenance of the present ceilings for certain industries in difficulties, such as steel and textiles, and the emphasis on practical improvements in the operation of the system, particularly as it affects the least developed countries.

The Commission proposals remain within the scope of the offer on generalized tariff preferences made to UNCTAD by the Community in 1969, which the Community was the first industrial power to bring into operation — starting on 1 July 1971. [3] The Commission notes in its communication to the Council that in the present economic climate it is hard for the Community to introduce substantial new improvements to the GSP, particularly since the Community's industrialized partners have not made comparable efforts. For that reason, efforts will be concentrated on making practical improvements and the fullest possible use of existing concessions.

The following are the main outlines of the Commission's proposals:

Agricultural products

Eleven new products are to be added to the list, among them horses for slaughter, certain kinds of crustaceans and molluscs, dried garlic, limes, tropical fruit cocktails and certain kinds of fruit and vegetables during the winter season. The new list would thus cover 307 products, representing a total import volume worth 1,300 million EUA. It will be recalled that in 1977 the Community has substantially improved the GSP as regards agricultural products, in accordance with the Community offer on tropical products made in the GATT multilateral trade negotiations.

The 1977 GSP for agricultural products adds 46 new products and 70 margin of preference improvements to the 1976 scheme, raising the volume of imports from 1,000 million to 1,240 million EUA.

Industrial products

The GSP arrangements for industrial products involve duty-free entry for all industrial manufactures and semi-manufactures without exception, up to a ceiling which is equal to the volume of imports from beneficiary countries in a given reference year, plus an additional amount normally equal to 5% of imports from non-beneficiary, i.e. industrialized countries. The 1978 scheme will use the same basic reference year (1974), but the figures for 1975 have been taken into account in calculating the additional amounts, which means that the general level of the ceilings is raised. [4]

For iron and steel, petroleum and textile products, footwear and plywood, the ceilings will be held at their present level in view of the difficult situation in the industries in question. In proposing that the status quo be maintained for textile products the Commission is also taking account of the current negotiations for the renewal of the MFA.

The Commission is, however, proposing two substantial improvements in the operation of the system:

For "sensitive" products subject to tariff quotas, which until now have been subdivided into national shares, the Commission is continuing its policy of introducing a reserve share aimed at simplifying the operation of the quotas. [5] In the industrial sector, the number of quotas including a 20% reserve share is increased from six to twelve, excluding the quotas for plywood, textile products and ECSC products. It is proposed to introduce reserve shares for all agricultural products subject to quotas.

For semi-sensitive and non-sensitive products subject to ceilings it is proposed that the least developed countries [6] be exempted from reintroduction of the duty in cases where ceilings are exceeded.

In 1977 these countries already enjoy such exemption in connection with the maximum country amounts ("butoirs") — i.e. the maximum amounts that can be exported by a single beneficiary country, which are normally equal to 50%, though sometimes to 20 or 30%, of the ceiling. Special arrangements have also been introduced for these countries in 1977 reserving them 70% of the ceilings for a large number of textile products, in contrast to more competitive countries.

Lastly, two special measures:

As regards coir and jute products, the tariff suspension accorded by the Community as a quid pro quo for the voluntary restraint agreements negotiated with India (jute and coir) and Bangladesh (jute) will be raised from 80% to 100% on 1 January 1978, although in the case of jute total suspension was not due to enter into force until 1 July 1978.

The Commission proposes to extend to Romania the benefit of preferences for a number of additional products as an indication of the Community's readiness to take account of the difficult period that country is going through.

Fuller use of the GSP

The Commission intends to continue its efforts to improve understanding of the operation of the Community's GSP among business operators in the beneficiary countries. Seminars will be organized for them in Brussels, Asia and Latin America, and publication of the Practical Guide to the Use of the GSP, the first edition of which came out in May 1977, will be continued.

The figures below show the growth in the volume of imports eligible for preferential treatment since 1974, together with utilization rates.

	Volume	Utilization (%)
1974	3,250 million u.a.	65
1975	3,680 million u.a.	50
1976	5,600 million u.a.	62
1977	6,230 million u.a.	----
1978	6,400 million u.a.	----

1. COM(77)330.
2. Following the Council's decision to adopt the European unit of account (EUA) from 1978 particularly for the purposes of the Common Customs Tariff, the 1978 GSP is expressed in EUA and not u.a.as was previously the case
3. Japan introduced a generalized preference system in August 1971 and the United States in January 1976. Other developed countries now using such a system are Austria, Finland, Norway, Sweden, Switzerland, Australia, Canada and New Zealand.
4. However, if the application for this rule were to result in a lowering of the ceiling, the ceiling would be maintained at the present level. As regards products for which the calculations result in escessively high growth rates, on the other hand, the ceiling increases will be limited to 50%
5. The current industrial GSP covers 46 sensitive products, 131 semi-sensitive products and about 1,700 non-sensitive products.
6. Countries appearing on the list established by the United Nations Resolution 3487 (XXX) of 12 December 1975.

TAX CHANGES IN Singapore

by Lee Fook Hong, FCIS, FAIA

A — THE INCOME TAX (AMENDMENT) ACT, 1977

Introduction

The Income Tax (Amendment) Bill was published in the Government Gazette Bill Supplement No. 8 dated 2nd June 1977. It was introduced into Parliament and read the first time on 27th May 1977. It was passed by Parliament on 29th June 1977 and assented to by the President of the Republic of Singapore on 5th July 1977. The Amendment Act was published in the Government Gazette Act Supplement No. 4 dated 7th July 1977.

The major tax changes introduced by the Amendment Act are summarised below:

1. The Amendment Act, inter alia, provides for concessional rates of tax for offshore income derived by the Asian Currency Units of financial institutions from advising or confirming offshore letters of credit.

2. The Amendment Act also contains provisions dealing with the concessionary tax treatment of pensions and with the source of certain types of income. Examples of such income are:—

a. Income in connection with any loan or indebtedness;

b. Royalties and other payments for the use of movable property;

c. Payments for the right to use scientific, technical, industrial or commercial knowledge or information;

d. Management fees; and

e. Rents or other payments under any agreement or arrangement for the use of movable property.

3. Under the Act now amended, taxpayers having accounting periods ending on or before 30th September are required to furnish the Comptroller of Income Tax with an estimate of their chargeable income within three months after the end of the accounting period.

4. Provisions are also introduced to impose a late payment penalty on employers for not paying promptly to the Comptroller the tax that has been deducted from employees' emoluments.

The references below are to the Sections of the Singapore Income Tax Act as amended by the Amendment Act.

I. Definition of Permanent Establishment

(Section 2, effective from Y/A 1978)

The definition of "permanent establishment" has now been inserted in Section 2 of The Income Tax Act. Previously the term "permanent establishment" was defined only for the purposes of any Avoidance of Double Taxation Agreements with other countries. The definition now states the meaning of "permanent establishment" for purposes of the Income Tax Act. It stipulates the instances where a person shall be deemed to have "permanent establishment" in Singapore.

"Permanent establishment" means a fixed place where a business is wholly or partly carried on including:

(a) a place or management;
(b) a branch;
(c) an office;
(d) a factory;
(e) a warehouse;
(f) a workshop;
(g) a farm or plantation;
(h) a mine, oil well, quarry or other place of extraction of natural resources;
(i) a building or work site or a construction, installation or assembly project; and,

without prejudice to the generality of the foregoing, a person shall be deemed to have a permanent establishment in Singapore if that person:

(j) carries on supervisory activities in connection with a building or work or a construction, installation or assembly project; or
(k) has another person acting on that person's behalf in Singapore who —
  (i) has and habitually exercises an authority to conclude contracts;
  (ii) maintains a stock of goods or merchandise for the purpose of delivery on behalf of that person; or
  (iii) habitually secures orders wholly or almost wholly for that person or for such other enterprises as are controlled by that person.

Where an avoidance of double taxation agreement exists, the provisions of the Double Taxation Agreement will override the definition in Section 2 of the Income Tax Act.

II. Pensions

(Section 10(6A), effective from Y/A 1977)

Pensions derived by a Singapore resident will now be taxed only on 50 percent of such pension. This concessionary treatment is applicable to all pensions granted under any written law relating to pensions in Singapore and also to private pension schemes approved by the Minister for Finance.

III.(1) Income from a Loan or Indebtedness

(Section 12(6), effective from Y/A 1978)

Subsection (6) of Section 12 of the Income Tax Act which deals with a source of the income in connection with any loan or indebtedness has been amended and a new subsection (7) has been inserted.

These two new subsections 12(6) and 12(7) introduce provisions to deem the following payments to be derived from Singapore.

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B — OTHER TAX CHANGES

Taxation of Leave Passages

Senior Partner of Lee Fook Hong & Co., Chartered Secretaries and Management Consultants, Singapore.

(a) (i) When a payment is made by a person resident in Singapore or by a permanent establishment in Singapore; or
(ii) when a payment is deductible against any income accruing in or derived from Singapore; or
(b) Any income derived from loans where the funds provided by such loans are brought into or used in Singapore.

The effect of the new subsection 12(6) is that the term 'loan' has been extended to cover all forms of indebtedness. Therefore not only interest on loans but also any commission, fees or any other payments in connection with any loan or indebtedness or with any arrangement, management, guarantee, or service relating to any loan or indebtedness will be deemed to be derived from Singapore. However all these payments must be borne directly or indirectly by a person resident in Singapore or a permanent establishment in Singapore before they can fall within the 'deeming' provisions.

Another effect of Section 12(6) which is far reaching is that when a loan is brought into the Republic or used in the Republic, any interest or income from such a loan will be deemed to be a Singapore source and liable to Singapore income tax accordingly.

III.(2) Royalties, Management Fees, Rents and Other Payments

(Section 12(7), effective from Y/A 1978)

The new subsection (7) added to Section 12 defines the source of royalties and other payments for the use of movable property etc. It provides that the items mentioned hereunder will be deemed to be derived from Singapore where they —
(i) are borne directly or indirectly by a Singapore resident or a permanent establishment in Singapore; or
(ii) are deductible against any income accruing in or derived from Singapore.

The items under (i) and (ii) above which are deemed to be Singapore source cover the following payments:—
(a) royalty or other payments in one lump sum or otherwise for the use of or the right to use any movable property;
(b) any payment for the use of or the right to use scientific, technical, industrial or commercial knowledge or information or for the rendering of assistance or service in connection with the application or use of such knowledge or information;
(c) any payment for the management or assistance in the management of any trade, business or profession; or
(d) rent or other payments under any agreement or arrangement for the use of any movable property;

For withholding tax from payments to non-residents see VII and VIII, infra.

IV. Asian Dollar Bonds

(Sections 13(1)(v) & 13(2), effective from the date specified by the Ministers' notification in the Gazettes in respect of each case)

Paragraph (v) of subsection (1) of Section 13 of the Income Tax Act is amended so that the exemption in respect of interest received from Asian Dollar Bonds need not be restricted to Asian Dollar Bonds issued in Singapore. Previously only interest from Asian Dollar Bonds issued in Singapore was exempted. Henceforth all approved Asian Dollar Bonds are tax exempt irrespective of the places where they are issued, i.e. whether inside or outside Singapore.

The amendment also extends the power of the Minister to exempt from tax wholly or in part any loan interest, falling under Section 13(2) to any interest, commissions, fees or other payments falling under the new subsection (6) or (7) of Section 12. The exemption may be subject to such conditions as may be imposed by the Minister. In granting the full or partial exemption, the Minister will have regard to whether or not the payments are made for a purpose which will promote or enhance the economic or technical development of Singapore.

V. Relief for Dependents who are Living with the Taxpayer

(Section 39(2)(f), effective from Y/A 1977)

Section 39(2)(f) has been amended to restrict relief to be granted in respect of parents, grandparents or great grandparents. With effect from the Year of Assessment 1977, a taxpayer will only be entitled to such relief if he maintains any such dependents in the same household *in Singapore.* Consequent upon the amendment it is no longer possible to claim relief for maintaining dependents who reside *outside Singapore.*

VI. Concessional Rates of Tax for Off-Shore Income Derived by the Asian Currency Unit

(Section 43A(2), effective from Y/A 1977)

The definition of "off-shore income" in Section 43A has been extended to include "fees, commission or interest received from advising or confirming off-shore letters of credit from transactions in bills drawn on such letters of credit". Such income is now taxed at the reduced rate of 10 percent instead of the normal 40 percent. To qualify as an off-shore letter of credit various conditions have to be fulfilled e.g.
(a) the letter of credit is opened in currencies other than Singapore dollars;
(b) neither the buyer nor the seller who is a party to the letter of credit is a resident of Singapore or a permanent establishment in Singapore; and
(c) the goods covered in the letter of credit are not exported from or imported into Singapore.

VII. Withholding Tax from Payments of Income to Non-Residents

(Section 45A, effective from Y/A 1978)

A new Section 45A is inserted in the Income Tax Act to extend the application of Section 45 (Deduction of tax at source) to the payment of income referred to in subsection (7) of Section 12 (see paragraph III(2) above).

Section 45A imposes an obligation to deduct tax at 40 percent when making payments to non-residents of royalties, management fees, rents or others falling under Section 12(7).

Where an avoidance of double taxation agreement exists the tax to be deducted will be at the rate specified in the Double Taxation Agreement. This tax deducted and withheld must be remitted to the Comptroller within seven days after the payment is made, failing which a penalty of 5 percent of the tax will be imposed. An additional penalty of 1 percent of the tax per month will be charged until the withheld tax and penalty are paid to the Comptroller.

To prevent anyone attempting to circumvent the intention of the provisions of Section 45, it is provided that cases where a payment is re-invested, accumulated, capitalised or carried to any reserve or credited to any reserve or credited to any account is also considered as a payment having been made for the purpose of Section 45. The Minister has once said that anyone who fails to comply with this withholding tax Section may be guilty of a criminal breach of trust. An offence under this Section is regarded as a serious one punishable with penalties similar to those applicable to tax fraud.

In view of the new Section 45A it is important to note that payments falling within the Section 12(7) when made to a non-resident are now subject to deduction of tax.

Persons making payments to non-residents are advised to review their position if they have been paying without deduction of tax, any of the following items:—
(a) interest on indebtedness other than a loan;
(b) management fees or technical assistance fees to parent or associated companies for services rendered in Malaysia or other countries outside Singapore;

(c) rentals or payments for leasing machinery and equipment or other movable property;
(d) charter fees for ships.

VIII. Tax Deducted from Dividends, Interest, Royalties & Other Payments

(Section 46, effective from Y/A 1978)

As a result of the insertion of the new Section 45A, Section 46 has to be amended to include the tax deducted from royalties and other payments for set off for purposes of collection against the tax chargeable on the relevant chargeable income. This is but a consequential amendment arising from the new Section 45A.

IX. For Purposes of Double Taxation Arrangements

(Section 49, effective from Y/A 1978)

The amendment to Section 49 of the Act is to enable Singapore, when entering into any double taxation arrangement to provide for "exemption with progression", i.e., the use of any income, though exempted under the double taxation agreement to be taken into account in determining the effective rate of tax to be charged on other income. The effect of the so-called "exemption with progression" is that the effective tax rate is increased and consequently the tax relief.

The formula to be used in arriving at the "effective rate of tax" is:—

$$\frac{A}{B + C}$$

where
A is the tax payable before allowance of credit under any arrangements having effect under this Section on B + C computed in accordance with the provisions of the Income Tax Act.
B is the exempt income, and
C is the other income.

X. Tax Credit allowed on Income which is subject to Double Taxation Agreements

(Section 50, effective from Y/A 1977)

A new subsection (11) to Section 50 of the Act has been introduced to make it clear that any tax credit allowed on income subject to any double taxation agreement must not have the effect of reducing the tax payable on income accruing in or derived from Singapore.

XI. Accounting Period of Any Trade, Business, Profession or Vocation

(Section 63A, effective from Y/A 1978)

Section 63A is a new Section. It provides that where the accounting period ends on or before the 30th day of September in any year the taxpayer has to furnish to the Comptroller an estimate of his chargeable income within three months after the end of the accounting period. Failure to furnish an estimate will be an offence. The objective of imposing this obligation on the taxpayer is to empower the Comptroller to raise advance assessments so that the tax may be collected on a date closer to the date the profits are earned. Taxpayers who have benefitted from the lapse of time between the end of a financial year and the date of payment of tax will now have to pay tax on their income from trade or business much earlier.

For example, a taxpayer who prepares his annual accounts to 31st July each year may make up his accounts for the accounting year to 31st July 1977. In such a case he must furnish to the Comptroller before 31st October 1977 an estimate of his chargeable income for the financial year to 31st July 1977. Failure to furnish an estimate within 3 months after the end of the financial year will constitute an offence.

The Comptroller has indicated that he will continue to accept proposals for monthly instalment payments. The number of such instalments will not exceed ten. However, the Comptroller may exercise his descretion to allow deserving cases such extension of time to furnish estimates and pay monthly instalments as he thinks fit.

XII. Proceedings before Board of Review and High Court

(Section 83, effective from Y/A 1978)

Section 83 of the Act has been amended to enable Comptroller to apply to the Board of Review or the High Court for a public hearing of an appeal. Before this amendment only the taxpayer had the right to make such an application.

XIII. Employer's obligation in respect of Tax Deducted from Employee's Emoluments

(Section 91(2A), effective from Y/A 1978)

The insertion of a new subsection (2A) to Section 91 of the Act makes it obligatory for the employer to pay over to the Comptroller the tax which has been deducted from the employee's emoluments within 10 days after the date of deduction. Penalties are now payable where the employer does not pay promptly such tax deducted from employee's emoluments. If the amount deducted is not paid to the Comptroller:—

(a) within the said period of ten days, a penalty equal to 5 percent of that amount shall be payable by the employer to the Comptroller.
(b) within one month after the date of deduction, an additional penalty equal to 1 percent of that amount shall be payable by the employer to the Comptroller for each completed month that the amount remains unpaid, but the total additional penalty shall not exceed 12 percent of the amount outstanding.

However, the Comptroller has the discretion to remit wholly or in part the penalties for any good cause shown to him.

B – OTHER TAX CHANGES

Taxation of Leave Passages

Following the negotiations between the Singapore International Chamber of Commerce and the Comptroller, it has been agreed that only 20 percent of the cost of the employees' leave passages paid by the employers in 1977 and subsequent years will be treated as income of the employees for income tax purposes. However, this concession is restricted to one return passage for the employee and his wife and to two passages for each child annually.

The Comptroller has clarified that the concession applies only to those employees whose home country is not Singapore.

COUNTRY BY COUNTRY SURVEY OF LOOSE-LEAF PUBLICATIONS . . .

ERRATUM

INTERNATIONAL

INTERNATIONAL TAX STRATEGY

Edited by Michael Edwardes-Ker.
In-Depth Publishing, Ltd., Alton House, Herbert Street, Dublin-2.
Supplemented: 12 times a year (not as stated on page 265 of the number 6 issue of 1977).

LIECHTENSTEIN

STEUERN IN LIECHTENSTEIN

By Eduard L. Hilti and René H. Melliger. Grafos Verlag AG., Schwefelstrasse 33, Postfach 231, Vaduz.
Supplemented: twice or more times a year.

Loose-leaf publication dealing with all taxes levied in Liechtenstein, the social contribution system, the appeal procedures, fines, the obligation to keep accounts, and tax planning. Texts of the tax statutes and double taxation treaties are appended.

NETHERLANDS ANTILLES

BELASTINGWETGEVING IN DE NEDERLANDSE ANTILLEN

Een samenstelling van belastingteksten voor praktijk en studie. By F. Metry.
De Curaçaosche Courant, N.V., Theaterstraat 11, Willemstad, Curaçao.
Supplemented: annually.

Loose-leaf publication containing compilation of texts of major tax laws in the Netherlands Antilles. The material does not cover import and excise duties, but does cover individual income tax, corporate income tax, tax incentive measures, death duties, stamp duties, and the double taxation treaty between the U.S.A. and the Netherlands Antilles, as well as the Double Taxation Regulation concluded between the Netherlands and the Netherlands Antilles.

NEW ZEALAND

TAX REPORTS

Previously entitled New Zealand Taxation Board of Review Decisions. By J.D. Pope.
Butterworths, 62-28 Waring Tailor St., P.O. Box 472, Wellington.
Supplemented: regularly.

Text of reports of tax cases decided by Judicial Committee of the Privy Council, Court of Appeal, Supreme Court and the Official Reports of the Taxation Review Authorities. The issues are to be filed in loose-leaf binders.

NORWAY

SKATTELOVSAMLING

Jacob Jarφy, Torgeir Vraasgt. 18, 3700 Skien.
Supplemented: once or twice a year.

Loose-leaf publication in three volumes of a compendium of Norwegian tax laws on income and capital. The value added tax is also included. Texts of related circulars and other legislation are appended. A detailed index is also provided. The material is supplemented by the issuance of supplementary pages.

SKATTE-NYTT

A + B
Norsk Skattebetalerforening, Kongensgate 6, Oslo 1.
Supplemented: monthly.

This periodical entitled Tax News appears monthly and is to be filed in a loose-leaf binder. Part A (white paper) contains text of tax amendments and new tax law with respect to Norwegian taxation. Part B (blue paper) is a supplement to Part A and provides information on tax developments and detailed references to other tax provisions.

PERU

IMPUESTO A LOS BIENES Y SERVICIOS

Impuesto y contribuciones sobre remuneraciones por servicios personales; impuestos específicos al consumo.
Editorial Economia y Finanzas, Av. 2 de Mayo 810, San Isidro, Lima.
Supplemented: three times a year.

Loose-leaf publication of a handbook dealing with the value added tax, the turnover tax on services and consumption taxes. Texts of the relevant legislation are appended.

MANUAL DE IMPUESTO A LA RENTA

By Teodoro Nichtawitz and Hernán Valdez Arróspide.
Editorial Economia y Finanzas, Av. 2 de Mayo 810, San Isidro, Lima.
Supplemented: about four times a year.

Loose-leaf publication of a handbook on the taxation of income in Peru. The work explains the taxation of income derived by individuals and corporations. Texts of the income tax law, regulations and related legislations are appended.

MANUAL DE IMPUESTOS INTERNOS

By Teodoro Nichtawitz and César Talledo.
Editorial Economia y Finanzas, Av. 2 de Mayo 810, San Isidro, Lima.
Supplemented: about four times a year.

Loose-leaf publication of a handbook dealing with the taxation of immovable property, registration duty, succession duty, business license fees and some other internal taxes. In addition, ministerial regulations and case law in connection with the taxes are appended.

REGIMENES ESPECIALES DE TRIBUTACION

By Teodoro Nichtawitz and César Talledo with the assistance of Beatrice Merino.
Editorial Economia y Finanzas, Av. 2 de Mayo 810, San Isidro, Lima.
Supplemented: twice a year.

Loose-leaf publication of a handbook on special tax reliefs for industry, fishing, farming, mining, etc.
Summary of the tax reliefs is follow

ed by the text of the relevant legislation. We have been informed by the publisher that the supplementation of this publication has been discontinued as of the middle of 1977.

RHODESIA

JUTA'S RHODESIAN INCOME TAX SERVICE

Legislation Section.
Editor A.S. Silke, assistant editors C. Divaris and M.L. Stein.
Juta & Co., Ltd., 816 Grand Parade Center, P.O. Box 30, Cape Town-8000.
Supplemented: once a year.

Loose-leaf publication containing consolidated text of the income tax act and extracts from the annual amendment acts thereto. Texts of double taxation agreements concluded by Rhodesia and the texts of ancillary legislation are appended. A detailed index is included.

SOUTH AFRICA

BUTTERWORTHS SOUTH AFRICAN INCOME TAX

Legislation Service. Previously entitled Law and Practice of South African Income Tax, Statutes Section.
Butterworths, P.O. Box 792, Durham.
Supplemented: annually.

Loose-leaf publication explaining the South African income tax law with reference to case law. The text of the income tax act and subsidiary legislation is appended. In addition, the texts of double taxation agreements concluded by South Africa as well as extracts from provincial financial relations legislations are appended. A detailed index is included.

JUTA'S TAX SERVICE

Legislation Section.
Editor A.S. Silke, assistant editors C. Divaris and M.L. Stein.
Juta & Co., Ltd., 816 Grand Parade Center, P.O. Box 30, Cape Town-8000.
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Loose-leaf publication containing annotated consolidated text of the income tax act, regulations and annual amendment acts in connection with income taxation. The annotated text of the estate duty act and the South West African income tax ordinance and regulations thereto are also included. In addition, the text of double taxation agreements concluded by South Africa, South West Africa respectively are appended.

PERMANENT VOLUME ON INCOME TAX IN SOUTH AFRICA

By David Meyerowitz and Erwin Spiro.
The Taxpayer Publishing Company (Pty), Ltd., P.O. Box 3191, Cape Town-8000. Second edition, 1975.
Supplemented: annually.

Loose-leaf publication explaining the Income Tax Act of South Africa. Text of the Income Tax Legislation, general double taxation agreements and double taxation agreements in respect of sea and air transport concluded by South Africa are appended. Consolidated text of the income tax law is included.

SPAIN

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India:
THE FINANCE BILL, 1977

Summary of proposed changes in direct and indirect taxation with extracts of the text of the Finance Minister's 2nd Budget Speech for 1977-78 on June 17, 1977 *

by Kailash C. Khanna**

DIRECT TAXATION

The Finance Bill, 1977, proposes the following changes in regard to corporate and personal taxation.

1. Corporate Taxation

(a) *Corporate tax rate*
It is proposed to withdraw the option at present available to companies to deposit with the Industrial Development Bank of India, an amount equivalent to the surcharge in lieu of the surcharge on corporate tax. Consequently, companies will have to pay the surcharge at the rate of 5 per cent. of corporate tax. As a result, the rates of corporate taxation on total income will be restored to the increased levels prevailing before the 1977/78 assessment year, namely

(i)	domestic widely held company [1]	— 57.75%
(ii)	domestic closely held industrial company [2]	— 63 %
(iii)	foreign company	— 68.25%

Concessional rates of tax will, of course, be available to foreign companies in respect of income from dividends, royalties and technical know-how fees, the respective rates being 25 per cent., 40 per cent., and 40 per cent. of the gross amount.

I shall now address myself to the task of formulating proposals for covering the deficit to the extent feasible.
The proposals, in so far as direct taxes are concerned, which I am presenting before you, are designed to increase corporate savings, channel more funds into productive investment, accelerate the pace of industrial growth and, at the same time, strengthen the redistributive role that direct taxes, to my mind, must be made to play.
In so far as indirect taxes are concerned, I have endeavoured to ensure that may proposals do not impinge on the necessities of life. There, I have sought to raise resources, in the main, from the less essential or luxury items, while giving relief to some deserving sectors, and simplifying and rationalising the central excise tariff structure generally.
Under a provision made last year, companies were given the option, instead of paying 5 per cent. surcharge on income-tax, to deposit an equivalent amount with the Industrial Development Bank of India for a period of five years. I propose to withdraw this option. The Budget accordingly takes credit for an additional tax receipt of Rs. 56 crores [3] on this account.

(b) *Investment Allowance*
It is proposed to extend the existing investment allowance to all industries excepting specified low priority industries, such as cigarettes, cosmetics, alcoholic beverages, refrigerating machinery, watches, electric fans, domestic electric appliances. An enhanced allowance of 35 per cent. will be granted on new plant and machinery installed after 30th June 1977 but before 1st April 1982 by using technology or know-how developed in a public sector company, university or government aided laboratory.

With a view to stimulating industrial development and economic growth, I consider it desirable to widen the scope of the scheme of investment allowance introduced last year. That scheme has unfortunately not laid down any well-defined and clear criteria for selecting industries to which the benefit of the concession was to be extended. This made it difficult to explain to those claiming eligibility why some industries had been given the benefit, while it was denied to others. Since there is a need for encouraging generation of internal resources for financing investment, I consider it best to extend the scope of investment allowance to all industries except those which are engaged in the manufacture of specified low priority items such as cigarettes, cosmetics and alcoholic beverages. This measures will be of great benefit to the economy.
In order to promote scientific and technological self-reliance, I propose to provide an incentive to the users of technical know-how developed in our country. It is accordingly proposed to grant investment allowance at the higher rate of 35 per cent. on machinery and plant installed for the manufacture of any article made in accordance with know-how developed in Government laboratories, public sector companies and universities.

(c) *Rural Development*
Expenditure incurred by a company on approved rural development programme is proposed to be allowed as business expenditure. Rural development programme is intended to include programmes for promoting social and economic welfare of the public in rural areas.

With a view to encouraging companies to involve themselves in the work of rural welfare and uplift, I propose to provide that expenditure incurred by them on approved programmes of rural development will be allowed to be deducted in computing their taxable profits.

(d) *Compulsory distribution of dividends*
At present, closely held domestic companies are required to make a minimum distribution of dividends. It is intended to exempt closely held industrial companies from this statutory requirement.

From the point of view of maximising expansion of industry, I can see litte merit in compelling closely-held industrial companies to distribute a high percentage of their net profits as dividends. I propose, therefore, to exempt such companies from the requirement of compulsory distribution of dividends. I do not propose to extend this relief to all other kinds of closely-held companies.

(e) *Small-scale Industries*
It is intended to grant small-scale industrial undertakings set up in rural areas a deduction from their taxable income of an amount equal to 20 per cent. of the profits and gains for a period of 10 years from commencement of manufacture.

In order to give a direct stimulus for the setting up of small-scale industrial undertakings in rural areas, I intend to accord preferential tax treatment to industries which are set up in such areas, and which begin their manufacturing activity after 30th June, 1977. Such industrial undertakings will be entitled to a deduction in the computation of their taxable profits of an amount equal to 20 per cent. of the profits. The concession will be available for each of the ten years commencing from the year in which the undertaking begins its manufacturing activities.

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* Extracts of the Budget Speech were inserted by the Editors and printed in italics.

** Kailash C. Khanna & Co., Chartered Accountants, Calcutta, India.

1. Total income exceeds Rs. 1,00,000.
2. Total income exceeds Rs. 2,00,000.
3. One crore is 10 million.

(f) *Revival of sick industries*
With a view to encourage the amalgamation of sick industrial units with healthy ones, it is proposed to allow the carry forward and set off of the accumulated loss and unabsorbed depreciation of the sick undertakings as if the said loss and depreciation were the loss and depreciation of the healthy concern, provided the amalgamation is approved by the Government as being in public interest and prescribed conditions are fulfilled.

Sickness among industrial undertakings is a matter of grave national concern. Closure of any sizeable manufacturing unit in any industry entails social costs in terms of loss of production and employment, and also waste of valuable capital assets. Experience has shown that taking over of such units by Government is not always the most satisfactory or the most economical solution. A more effective course would be to facilitate the voluntary amalgamation of sick industrial units with sound ones by providing certain incentives and by removing impediments in the way of such amalgamation. It is accordingly proposed to provide that where an amalgamation is accepted by the Central Government to be in public interest, the accumulated losses and unabsorbed depreciation of the amalgamating company will be allowed to be carried forward and set off in the hands of the amalgamated company.

2. Personal Taxation

(a) *Rates of Income-tax*
It is proposed to raise the limit of minimum income not liable to income-tax from the existing Rs. 8,000/— to Rs. 10,000. Simultaneously, it is intended to increase the rate of surcharge on personal income-tax from 10 per cent. to 15 per cent., thereby raising the maximum marginal rate of personal income-tax, inclusive of surcharge to 69 per cent. as against the existing 66 per cent.

In fulfilment of an assurance in the Janata Party manifesto, I propose to provide that no income-tax shall be payable by individuals and Hindu undivided families whose taxable income does not exceed Rs. 10,000. In order, however, to keep the sacrifice of revenue to the minimum, the nil *rate slab of income is being retained at Rs. 8,000. Hence, where the taxable income exceeds Rs. 10,000, the excess over Rs. 8,000 will be charged to tax as at present subject to the grant of marginal relief in cases where the taxable income exceeds Rs. 10,000 by a small margin.*
I do not propose to make any change in the basic rates of income-tax. However, in view of the imperative need to raise additional resources, I propose to increase the rate of surcharge on income-tax in the case of all categories of taxpayers, except companies, from 10 per cent. to 15 per cent. With the increase in the rate of surcharge, the maximum marginal rate of personal income-tax will now be 69 per cent., as against 66 per cent. at present.

(b) *Compulsory Deposit Scheme*
The scheme of compulsory deposits in respect of income-tax payers is proposed to be extended for another two years at the existing rates.

As hon'ble Members are aware, Government have already dispensed with the Compulsory Deposit Scheme in its application to additional dearness allowance as from 6th May, 1977. Having regard, however, to the state of the economy and the inflationary pressures that exist, I propose to continue the Compulsory Deposit Scheme for Income-tax Payers for another two years.

(c) *Taxation of capital gains*
(i) Capital assets which are held by a taxpayer for a period exceeding 36 months are proposed to be termed "long-term capital assets"; at present the holding period must exceed 60 months.
(ii) At present, the taxpayer may, in respect of old assets, at his option, substitute the market value of the capital asset as at January 1, 1954 in place of the actual cost of acquisition. It is proposed to replace the market value as at January 1, 1964 in place of January 1, 1954.
(iii) Where sale proceeds, or a part thereof, realised from the transfer of a capital asset are invested in specified assets within a period of six months of the transfer and are so held for a period of three years, the capital gain, or a part thereof, as the case may be, is intended to be exempted from tax. The specified assets include government securities, Units, shares in Indian companies and deposits in banks.

It is my belief that the present structure of capital gains taxation stands in the way of adequate mobility of investible resources, and perpetuates investment in low priority assets. In this view, I am proposing certain changes in our existing scheme of capital gains taxation.
(a) At present capital gains arising from the transfer of a capital asset held by a taxpayer for a period exceeding 60 months alone are entitled to concessional tax treatment. With a view to improving mobility, I propose to reduce the holding period to 36 months.
(b) In respect of capital assets acquired prior to the 1st of January, 1954, a taxpayer has the option of adopting the fair market value of the asset on 1st January, 1954, in place of the actual cost of acquisition. Determination of the fair market value of a capital asset with reference to a date more than 23 years ago presents practical difficulties. Moreover, capital gain arising from the transfer of assets held over a length of time is, in a world of rapid and continuing inflation, to a great extent illusory in nature. On the whole, therefore, it seems to me desirable to advance the notional date by 10 years, namely, to 1st of January, 1964.
(c) Capital gains tax is payable on the sale of a residential house. The existing law provides that if another residental house is either purchased or constructed within a specified time, then the capital gains can be wholly or partially exempted depending upon the amount of capital gains utilised on the new residential house. Similar concessions are not available in respect of capital gains arising from sale of assets, such as jewellery or shares. I see no reason for drawing such a distinction. Accordingly, I propose to exempt the capital gains from tax, if the sale proceeds of any asset are reinvested within six months in shares, bank deposits, units of the Unit Trust or other preferred assets. In order to prevent abuse of this concession, it is required that the assets in which the sale proceeds have been reinvested are held for a period of not less than three years.

(d) *Passage Moneys*
It is proposed to grant tax exemption for passage moneys received by a foreign employee from his employer in respect of his children studying in a foreign institution and proceeding to India during vacation.

(e) *Remuneration received in foreign currency*
50 per cent. of the remuneration received in foreign currency by an employee for approved services rendered outside India is proposed to be exempted from Indian income-tax, whether the remuneration received is from an Indian or a foreign employer.

Fifty per cent. of the remuneration received by Indian technicians from a foreign Government or a foreign enterprise for services rendered outside India is exempt from income-tax. We cannot justifiably deny this concession when the employer happens to be an Indian concern. I propose accordingly to enlarge the scope of this concession to cover Indian technicians employed by Indian concerns in any branch or office outside India.

(f) *Deduction of tax at source*
Non-company shareholders, who do not have taxable income, may receive dividends from a company not exceeding Rs. 250/— without deduction of tax at source, provided they file a declaration in the prescribed form and verified in the prescribed manner with the dividend paying company

Deduction of tax from small dividends has been a source of considerable hardship to a large number of small investors in joint stock companies. With a view to avoiding inconvenience to such investors, and in particular to investors from rural areas, the requirement of deduction of tax at source

from dividends will be waived in cases where the dividend paid does not exceed Rs. 250.

(g) *Rates of wealth-tax*

It is proposed to raise the rates of wealth-tax by ½ per cent. on net wealth exceeding Rs. 2,50,000; however, on net wealth exceeding Rs. 15,00,000, the proposed increase is 1 per cent.

It is my feeling that wealth-tax rates were reduced in the Budget of 1976 to an unjustifiable extent. If the essential objective of a wealth-tax is to be achieved, it must be so devised that while it does not become oppressive and counter-productive, it does have an effect on excessive accumulation of wealth in individual hands. In this view of the matter, I propose to raise the rates of wealth-tax. The existing rate of half per cent. will continue unchanged on the first Rs. 2.5 lakhs [4] of net wealth, but for the higher slabs there will be an increase of half a per cent. over the existing rates, while in the highest slab of over Rs. 15 lakhs, the new rate will be three and a half per cent., that is, an increase of one per cent. over the existing rate. There will be corresponding changes in the rates applicable to Hindu undivided families having one or more members with net wealth exceeding Rs. 1 lakh. The new rate schedule will come into force from the current assessment year and will thus supersede the changes made last year in the rate schedule. These changes will result in an additional revenue of about Rs. 10 crores in 1977-78.

INDIRECT TAXES

1. One per cent. general excise duty levied on commodities not attracting excise duties under any specific head, is proposed to be raised to two per cent.

2. Present system of taxing cinematograph films is intended to be changed to ad-valorem duty. Specific rates of duty on pigments, paints, varnishes, etc. are proposed to be replaced by ad-valorem rates.

3. Excise duties are proposed to be raised/readjusted on

(a) Hand/small tools, weighing machines, watches/clocks, electric light fittings, polish for footwear and acetylene gas etc.

(b) Cigarettes and biris (hand-made Indian cigarettes).

(c) Cars and scooters.

4. Excise duties on products of handloom and power loom are proposed to be reduced or abolished.

5. Relief from excise duty is suggested to small paper mills, match box industry, mini-steel plant, confectionery and electronic industry.

6. Reduction in import duty on newsprint is proposed.

4. One lakh is 100,000.

TACHSHIV IN ISRAEL – An Addendum

In Professor Arye Lapidoth's article on The Israeli experience of using the Tachshiv for estimating the taxable income, *published in this Bulletin's 1977/3 issue at page 99, footnote 12 at page 106 refers to the Income Tax Amendment* Law *(No. 25). This reference is due to a printing error. As clearly appears from the accompanying text the Bill had not yet been enacted at the time the article was written and published.*

*Now the enactment has taken place and the new amendments are embodied — with an essential change as compared to the provisions of the Bill — in the Income Tax Amendment Law No. 25 of 16 March 1977, published in the Book of Laws (*Sefer Ha-Chukkim*) No. 860 of 31 March 1977.*

The essential change concerns the exclusion of the proposed Sections 145A and 153(c). This means that neither the word "tachshiv" nor the "highest obtainable income" assessment have become part of the Law. In this respect, the author's assumption expressed in the last two paragraphs of his article (p. 106) has not materialised.

An up-to-date version of the author's article is contained in Chapter 14 of a comprehensive and comparative study which just appeared as Volume 4 in the series Selected Monographs on Taxation, *a joint publication of Harvard Law School International Tax Program and the International Bureau of Fiscal Documentation:* Arye Lapidoth, *The Use of Estimation for the Assessment of Taxable Business Income (with special emphasis on the problems of taxing small business), Amsterdam 1977, 166 pages. As stated by Professors Oliver Oldman and J. van Hoorn Jr. in their Foreword to Professor Lapidoth's study, "foreign tax experts. . . in lending assistance to developing countries. . . have more than once adverted to the problem of taxing small business effectively". And: "The present monograph. . . examines the full range of literature available in English and organizes it for understanding and adaptation. It gives those who must design practical systems a number of measures to choose from and warns of the difficulties that would undoubtedly be encountered during implementation".*

TAX REFORM IN EGYPT*

Discussion of a reform of the present tax system has been going on since 1974, after the introduction of the new open-door economic policy which aims at encouraging Arab and foreign investment to the country. The proposed tax reform aims at coordinating the present tax system with this new investment policy while at the same time providing more stability and security for the taxpayer and a system which deals more equitably with the poorer elements of the community. A commission including members of parliament, businessmen, academics and members of the profession was set up to examine the possibilities and at the beginning of 1977 a number of amendments was drafted for consideration by parliament — the discussion which had dragged on over several years finally having been speeded up by violent popular demonstrations against massive price increases and the government's need to meet the Budget deficit. The draft amendment can be summarised as follows:

I. TAXATION OF INCOME

1. Consolidation of the tax rate of the schedular taxes; a basic tax is at present levied together with a number of smaller taxes such as defence tax, national security tax and local government tax. Thus, the present tax on industrial and commercial profits is levied as follows: a basic 17 percent + 10.5 percent defence tax + 8 percent national security tax + 1.7 percent local government tax making a total of 37.2 percent. In future one single rate will be levied made up of a basic tax plus the various supplementary taxes.

2. Changes in the rates of the majority of the schedular taxes and of the general income tax. The present and proposed rates are shown below:

A. Schedular Taxes

i) Tax on income from movable capital:
a) present rate (17 percent basic rate + 10.5 percent defence tax + 8 percent national defence tax + 2.55 percent local government tax) = 38.05 percent
b) proposed rates (progressive):

L.E. Up to	*Rate (%)*	*L.E. Up to*	*Rate (%)*
500	29.5	4000	36.5
1000	31.5	Over	
2000	33.5	4000	38.5

A supplementary local government tax of 2.55 percent of the tax base is levied in addition.

ii) Tax on industrial and commercial profits:
a) present rate (17 percent basic rate + 10.5 percent defence tax + 8 percent national security tax + 1.7 percent local government tax) = 37.2 percent
b) proposed rate = 37.2 percent

iii) Tax on salaries, wages etc.:
a) present basic rates:

L.E. Up to	*Rate (%)*	*L.E. Up to*	*Rate (%)*
100	2	1350	11
250	3	1850	13
400	4	2850	15
550	5	4850	18
750	7	Over	
1050	9	4850	22

Plus (1) a defence tax levied as follows:

L.E. Up to	*Rate (%)*	*L.E. Up to*	*Rate (%)*
400	1.5	800 to 1200	5
400 to 800	2.5	Over 1200	6

and (2) a national security tax which is levied as follows:

L.E. Up to	*Rate (%)*	*L.E. Up to*	*Rate (%)*
400	1	800 to 1200	3
400 to 800	1.5	Over 1200	4

b) proposed rates:

L.E. Up to	*Rate (%)*	*L.E. Up to*	*Rate (%)*
60	2	1200	16
120	3	2400	18
180	5	4850	20
240	7	Over 4850	22

The above rates of defence and national security tax will be added to these taxes.

iv) Tax on income from non-commercial professions:
a) present rates:

L.E.	(basic rate	+ defense tax	+ national security tax)	= *total rate*
Up to	%	%	%	%
1500	11	+ 10.5	+ 8	= 29.5
2000	13	+ 10.5	+ 8	= 31.5
3000	15	+ 10.5	+ 8	= 33.5
5000	18	+ 10.5	+ 8	= 36.5
Over 5000	22	+ 10.5	+ 8	= 40.5

b) proposed rates:

L.E. Up to	*Rate (%)*	*L.E. Up to*	*Rate (%)*
1500	29.5	5000	36.6
2000	31.5	Over	
3000	33.5	5000	38.5

B. General Income Tax

a) present rates:

L.E. Up to	*Rate (%)*	*L.E. Up to*	*Rate (%)*
1000	exempted	6000	40
1500	8	7000	50
2000	9	8000	60
3000	10	9000	70
4000	15	10000	80
5000	25	Over 10000	95

b) proposed rates:

L.E. Up to	*Rate (%)*	*L.E. Up to*	*Rate (%)*
1200	exempted	15000	25
2000	8	20000	30
3000	9	30000	35
4000	10	40000	40
5000	11	50000	45
6000	12	60000	50
8000	15	70000	60
10000	20	Over 70000	70

3. Raising of the family allowance from 360 L.E. to 500 L.E. with no ceiling on the maximum income which may benefit from this allowance. This proposal was enacted in February 1977.

4. In order to encourage saving, interest on resident and non-resident bank and post office accounts will be exempt from tax.

5. Introduction of accelerated depreciation rates to encourage capital investment and the renewal of fixed assets. Exemption from tax on interest from bonds and securities in order to activate the stock market.

6. Extension of the tax on industrial and commercial profits to income derived by individuals from cattle breeding and poultry raising, bee-keeping and rental of agricultural machinery and also to income from single transactions such as commission.

7. Application of the general income tax to farming income in excess of 1200 L.E. per annum.

8. Increase in the use of deduction of tax at source; for instance wholesalers will be required to add a certain percentage for tax purposes to their bills to retailers and similar arrangements will apply between contractors and sub-contractors.

II. TAXATION OF WEALTH

1. All taxpayers whose income exceeds 500 L.E. must file a wealth return. Spouses may opt to file a joint return although in the case of sales or gifts between them a joint return is compulsory. The provision regarding the filing of a wealth return was enacted by Law No. 2 of 1977.

2. Introduction of a tax on capital transactions relating to land, buildings and motor vehicles.

It is generally believed that the remaining proposals will be enacted with only minor changes although there is understandably

* Based on information supplied by Dr. Ahmed H. El-Gowainy, Director General of Research, Ministry of Finance, Egypt, U.N. Expert on Finance, Somalia.

strong opposition to the idea of taxing farming income in a predominantly agricultural country like Egypt and the introduction of the wealth tax return has resulted in the shifting of wealth from immovable property to movable and less obvious sources such as gold and foreign currency. Taxpayers' hopes that the supplementary taxes to the basic schedular taxes would eventually be abolished have also finally vanished with their inclusion in the basic rates. It seems unlikely that these tax changes will result in a reduction of the budget deficit since any extensions or increases in taxation or more steeply progressive rates of tax are offset by decreases in taxation or a less steep progression and increases in relief and allowances.

Besides this, the timing of the tax changes is generally felt to be unfortunate since the discussion concerning the amendment has been so prolonged that it has allowed certain taxpayers to alter their present tax position in order to obtain the most favourable results once the new amendments are enacted or to lessen the impact of these amendments on themselves.

XVIII INTER-AMERICAN CENTER OF TAX ADMINISTRATORS TECHNICAL CONFERENCE*

This Conference took place at Montevideo from March 14 to 19, 1977, and was organized by CIAT, a governmental organization formed by countries of North, South and Central America. In addition to the participants from the member countries observers attended from the Federal Republic of Germany, Spain, Italy, Korea, Ghana, Swaziland, Thailand, and ten important international organizations such as the European Economic Community, the International Monetary Fund and the IFA, which I represented.

The only topic considered was "Tax aspects of the activities of multinational companies" and many papers were presented. The conclusions of the Final Report are undoubtedly of international importance, as they represent the official pronouncement of the administrations of an important group of countries including some like Argentina and the members of the Andean Pact, which had adopted a radical position in front of the multinational companies in defense of their fiscal interests. In the scientific area there had been no agreement with this radical position, not even with the Latin American position, as shown in the Seminar of the XXVIII IFA Congress which was held at Mexico in 1974 (this Bulletin, Vol. XXIX, pp. 51, 59, 91, 99 and 179, and *Fiscal Harmonization in the Andean Countries*, International Bureau of Fiscal Documentation, Amsterdam, 1975); at the XXIX Congress at London in 1975 (this Bulletin, Vol. XXX, p. 31); and in the VII Latin American Meeting on Tax Law which took place at Caracas in 1975 (this Bulletin, Vol. XXX, p. 16).

The recommendations approved by this CIAT Conference are distinguished by their moderation and rationality and may be considered similar to the opinions expressed in the seminar mentioned above and in IFA and CLADT resolutions. These characteristics are of particular interest with respect to the tax treatment of contractual relations between a head office and its branches and subsidiaries. In contrast with the solutions of the Andean Pact Model and the Argentine legislation and jurisprudence of the 1971/76 period, the recommendations tacitly accept debits and credits related to royalties, technical assistance and interest when proposing procedures for discouraging tax evasion, first with respect to the arm's length price (Rec. III, b1) and then, more specifically, for combating the remittance of profits abroad under the most favourable tax system, which generally applied to payments of those intangible goods (see last part of the Recommendation, III).

This tacit acceptance did not result in observations or reserves from the Andean Pact members or from Argentina which is no surprise since Argentina as well as Chile has reacted against the position of denying the existence of those contractual relations for tax purposes. The recent law of December 1976 has revoked the prior legislation on multinational companies and at present accepts the effectiveness of those contracts, considering them as being signed by independent enterprises when they fit usual practices of the market, with some limits tending to prevent evasion.

The recommendations of the Conference, Chile's desire to separate from the Andean Pact, and the reform of the Argentine legislation disclose an evolution that leads one to expect a normalization of the criticized prior position in a policy which contemplates both the economic reality, and therefore the rights of the taxpayers, and the legitimate fiscal interests of the countries where they act.

The other recommendations should not cause any problems, as they follow generally admitted solutions. For example, there was not very much advance with respect to the exchange of information by the fiscal administrations (Rec. V). In the fight against tax evasion by the use of tax havens, the solution adopted is the base of assumptions as in the recent French legislation (Rec. IV). Also the final Report contains definitions of some acts and situations connected with the topic discussed that may arise. For example, one observation referred to tax avoidance which is, in my opinion, erroneously identified with violations of the law.

* This summary was supplied by Prof. Ramón Valdés Costa, Montevideo.

TAX GLOSSARY

by H.W.T. PEPPER *

BACHELOR TAX – Most income tax systems contain, in effect, a tax on bachelors (and spinsters) because the reliefs granted to married persons are greater than those to single persons. In addition social security payments are commonly levied at the same level both for single and married persons although the latter stand to gain greater benefits where benefits are payable for wives and children as well as for the contributor. Although a specific bachelor tax is encountered from time to time, in general fiscal systems are sufficiently "loaded" against the single person for a specific additional tax to be unnecessary.

BACK DUTY – The term normally used in Britain to apply to tax for previous years which has been computed in the course of an investigation into cases of tax-evasion.

BACK TO BACK – The term "back to back" is used for the situation where a person or organization obtains financial credit in one country on the strength of his resources in another country. The credit will usually be granted by an international bank or financial organization which does business through branches, subsidiaries or affiliates in both the countries concerned.
Back to back facilities may often be employed legitimately for circumventing difficulties in international trade or investment created by exchange control restrictions.

BAD DEBTS – An allowance for bad debts, or for doubtful debts where the probable loss is precisely estimated, is usually authorized in income tax and sales tax law where the income or sales are calculated on the EARNINGS or ACCRUALS basis (q.v.) to include sales, or the potential profit from sales in advance of such sales being actually paid for. No such allowance is possible where cash income or cash sales are taxed since the unpaid debts never rank in the tax calculation in the first place.

BADGES OF FRAUD – Penalties for tax offences are usually steeper where there has been wilful evasion, as distinct from inadvertent omission. Professor Oldman has listed a number of "Badges of Fraud" to identify situations where there is an inference of fraudulent evasion leading to possible prosecution, or the imposition of heavier penalties, as follows:—

1. Repeated claiming of improper deductions over several years especially where the taxpayer might be presumed to know better.
2. Where omissions made are of such a character and magnitude that a taxpayer cannot reasonably claim to have overlooked them or to have been unaware that liability existed.
3. False statements, especially if made under oaths about material facts.
4. Keeping a double set of books.
5. False entries or alterations in books and records, false invoices or other documents.
6. Destruction of records or books, especially if done in anticipation of investigation and for non-statute-barred periods.
7. Failure to keep records after having been advised or required to keep them.
8. Concealment of assets by use of aliases or nominees.
9. Consistent concealment, without adequate explanations, of large sums of cash, or the unexplained use of cash in business transactions.
10. Concealment of income in secret bank accounts, or by conducting a brokerage or commission account under a false name, or by use of safety deposit boxes.
11. Claiming non-existent dependents.
12. Use of multiple addresses or frequent address changes without apparent business reason.

BADGES OF TRADE – In the case of isolated transactions not forming part of a regular trade or business it is necessary to consider the circumstances surrounding transactions in order to decide whether any profit or loss arising may be regarded as arising from trade. Various factors have been identified in case law as forming the "Badges of Trade", an expression used by Lord Radcliffe in his judgement in Edwards v Bairstow and Harrison (36, T.C. at page 230). If one of the badges of trade is present there is an inference that the transactions were in the nature of trade.
The items identified as badges of trade are:—

(a) the existence of an organization, or a degree of organization, with regard to the transactions;
(b) activities which lead to the materialising of the assets to be sold;
(c) the existence of a special skill or of special opportunities in connection with the article to be dealt with; or
(d) the fact that the *nature* of the asset lends itself to commercial transactions.

BALANCING ALLOWANCES AND CHARGES – Adjustments made on the sale of assets which have been the subject of depreciation or capital allowances for tax purposes. When the assets are sold, destroyed, or scrapped the sum received from the sale, insurance policy, or scrap proceeds is compared with the depreciated or written-down value and any deficit or shortfall below that value is allowed as a deduction to the taxpayer. Where the depreciation deductions already given for tax purposes exceed the actual deficiency between cost price and disposal proceeds the surplus may be made the subject of a charge in the taxpayer's tax computation.

BAREMA/BAREME – Tax table (Belgium).

BAREME – Tax table (France).

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* *With the assistance of the staff of the International Bureau of Fiscal Documentation.*

BARTER – Barter transactions have significance, e.g., for income tax, in that one trader may supply goods or services to another and obtain reciprocation in kind in the course of friendly and legitimate arrangements which may, however, not be properly recorded for income tax computation purposes. Where goods are supplied without payment it is necessary in order for the value of what is supplied to be credited that there have been a corresponding debit in the trader's accounts when he purchased the relevant goods (see also CONTRA ACCOUNTS and CAPTIVE USE).

BASE STOCK – This term denotes the stock of materials necessary in certain industries as an irreducible minimum because of the need to "clothe" the machinery in continuous processes, particularly in textiles. Briefly, no production can be obtained until a certain quantity has been fed in and the usable product is what is obtained after the initial "clothing" process. The base stock cannot be extracted and disposed of in practive because it would then be necessary to re-clothe the machinery (an expensive operation) before new production could be commenced. The term applies equally to oil or other substances in a pipeline, or semi-manufactured or processed materials in plant. One theory is that the stock "in process" should not be revalued each year but treated, in effect, as part of the cost of the plant or machinery since the latter cannot function without the former. Some countries have allowed the use of the L.I.F.O. method of valuation of stock (q.v.) which effectively incorporates a static value for base stock. A somewhat analogous situation arose in connection with a stock of parts (knives and lasts) which had to be fitted to machinery in a leather factory to adapt it successively to manufacturing different products. In that case, however (Hinton v Maden and Ireland, 38 T.C. 39), the "parts" were held to be "plant and machinery".
exempt if his income fell below a certain figure, or he might be entitled to various allowances or deductions in computing taxable income or his "tax base". (See also CASH BASIS, EARNINGS BASIS, TAX-INCLUSIVE and TAX-EXCLUSIVE BASIS.)

ASIS OF ASSESSMENT – See ASSESSMENT and BASE, TAX.

EARER LEVY – "Bearer" securities are often preferred to registered stock by investors because of greater ease in transferring ownership. Some, however, use the anonymity of a bearer holding to evade income tax. Accordingly, some countries impose a withholding tax on the income from bearer securities. The holder can only obtain credit for the tax withheld if he declares the investment income on his tax returns.

BEDRIJF – Enterprise (Holland).

BEDRIJFSINKOMSTEN – Earned income (Belgium) (Note: in Holland – income from a business).

BEDRIJFSMIDDELEN – Fixed assets (Holland).

BEDRIJFSVOORHEFFING – Wage tax (Belgium).

BELASTING – Tax (Holland).

BELASTING DER NIETVERBLIJFHOUDERS – Income tax on non-resident individuals and entities (Belgium).

BELASTINGKREDIET – Tax credit, see also AVOIR FISCAL (Belgium).

BELASTING OP DE TOEGEVOEGDE WAARDE – Value added tax: "BTW" (Holland).

BELASTINGPLICHTIGE – Taxpayer (Holland).

BELASTINGVERDRAG – Tax treaty (Holland).

BELEGGINGSINSTELLING – Tax exempt investment fund.

BENEFICE – Gain or profit.

BENEFICE CONSOLIDE – Aggregation of the income of a French domestic company and of its foreign subsidiaries for tax purposes.

BENEFICE MONDIAL – Aggregation of the income of a French company and its foreign permanent establishments.

BENEFICIAL OCCUPATION – The occupation of land or real property either rent-free or at a rent less than the rent which could be obtained in an arms' length letting. The value of the beneficial occupation, i.e., what the property is worth on annual letting, less what, if anything, is paid for occupation, may represent taxable income to the occupier. Where beneficial occupation is a perquisite attached to an appointment the benefit obtained may be statutorily regarded as part of the remuneration of the employment. The occupation or use of real property is usually dealt with slightly differently from, say, the free use of a motor-car or yacht and other types of fringe benefits the value of which, however, may also be subject to taxation upon the beneficiary.

BENEFITS IN KIND – Also sometimes included in "fringe benefits", the term refers to earnings, usually from an employment, other than those received in cash. Examples are free or subsidised housing, free use of a car, free or subsidised meals. In the case of income tax some or all of the benefits may be valued and added to the cash income in assessing the income charge. For sales tax the entrepreneur may benefit from taking goods etc. from stock for his own use and most sales tax codes provide for the value of such benefits to be included in the tax charge. Some benefits in kind (e.g., free coal to miners) are traditionally exempt from tax on recipients in certain countries, notably the U.K., which, however, has legislated to make certain benefits specifically taxable on directors and higher salaried employees to prevent abuse. (See also FRINGE BENEFITS.)

BEQUEST TAX – Also sometimes known as "legacy duty", "transmission tax", or "succession duty", the tax is levied on assets of a decreased person bequeathed to an heir. The tax may be accompanied by a tax on the estate as a whole, often at graduated rates on the aggregated assets.

BETRIEB (also GEWERBEBETRIEB) – Enterprise.

BETRIEBSAUSGABEN – Business expenses.

BETRIEBSEINNAHMEN – Business income.

BETRIEBSTÄTTE (also BETRIEBSSTÄTTE) – Permanent establishment.

BETRIEBSVERMÖGEN – Capital invested in a business.

BETRIEBSVERMÖGEN, GEWILLKÜRTES – That part of the taxpayer's capital which he may elect to consider either to belong to his business capital or to his private capital.

BETRIEBSVERMÖGEN, NOTWENDIGES – That part of the taxpayer's capital investment which belongs necessarily to his business capital.

BETTERMENT TAX – The term is used in three different senses, (a) to refer to taxes based on rent or annual or capital value of lands and property bene-

fitting from drainage, irrigation, or other improvement schemes. The pre-improvement tax base is usually increased by a percentage varying with the amount of improvement the land has received. The next type of tax (b) is that on the increase in value of a piece of land when permission has been given by the Planning Authority to change its use, e.g., from agricultural to residential to office-block development. Another instance (c) is where there has been improvement of the kind referred to in (a) or where a wilderness has been given a value because of governmental expenditure on roads and on making public utilities available.

In the case of (b) the charge to tax may be made when permission to develop or "convert" to another use is given or else when the development or conversion takes place. The increase in value within (c) may be taxed by making periodical valuations of the land affected by the state's development schemes and charging tax on the increase in value over the period.

BETTING TAX – This tax is usually a "sales" or turnover tax on bets made, either through a totalisator, in which case it is a simple matter to compute a percentage of the gross amounts wagered, or on the bets waged with bookmakers on race-courses or in betting-shops off the course. In addition the tax may be levied on the amounts staked on football pools, and on the "house" percentage in the case of a casino (where it would usually be impracticable to tax the gross amounts staked). It is usual to charge a slightly lower tax rate on bets made on the course than on off-course bets, e.g., in the U.K. course betting is taxed at 5 percent, while 6 percent is charged on the betting shops.

BEWERTUNG – Valuation.

BEWERTUNGSFREIHEIT – Term used to indicate that certain business assets (usually those whose purchase price is relatively low) may be written off in the year in which they were acquired. (See also FREE DEPRECIATION.)

BEWIRTUNG (AUFWENDUNGEN FÜR DIE) – Entertainment (expenses).

BICYCLE TAX – A tax levied in some countries on the use of bicycles, usually as a small annual licence fee. The subject has been discussed from time to time in Britain but as a means of raising revenue is marred by the comparatively high cost of collection even if it were socially acceptable. Such a tax would be unlikely to be initiated in countries where there is concern over the pollution and road and environmental hazards, caused by the sedentary habit of car-driving where there was already a move towards greater use of bicycles for healthy recreation. In some small countries the bicycle tax, involving registration and identification number for each machine, has been a factor limiting to some extent the scope for bicycle thieves. The island of Guernsey which raises annual revenue of £90 from a £0.125 bicycle tax is currently considering abolition.

BIENS D'INVESTISSEMENT – Fixed assets (capital goods) (term in particular used in Belgian VAT law. In France, usually, "immobilisations").

BIJHUIS – Branch office (Belgium).

BILLS OF EXCHANGE TAX – A tax on bills of exchange and other commercial documents is an example of a tax on transactions which is often resorted to to raise revenue, usually on the basis of a low rate of tax applied to a fairly wide tax base. A disadvantage is that particular forms of transactions are penalised and the tax may be avoided by completing the transaction in some other form so that equity is lost and there is distortion of the form that commercial transactions take. There is also a serious lack of equity where some goods pass through more distribution stages than others and so attract more applications of tax.

BINGO DUTY – A tax at 2½ percent levied in Britain, effectively on amounts staked in Bingo games. Duty is also charged at 1/39th of any amount by which the value of the prizes exceeds the duty-exclusive value of the stakes. (Other names for Bingo include "Housey-Housey", "Lotto" and "Tombola".)

BLIND SPOT – Term originally used by Professor John Due to refer to gaps in price ranges of goods under British Purchase Tax at time when tax was not levied on "utility" goods made to certain specifications and price, but on goods of the same type when produced to higher quality and price. Goods at a slightly higher (taxed) price could not be produced or sold so that there developed an unusual gap in the price range. The phenomenon may also occur where goods which for some reason are tax-free (e.g., clothing specially designed for industrial use) compete with other goods (e.g., fashion clothes) where substitution has become possible because of fad or fashion changes.

BLUE RETURN SYSTEM – A feature of Japanese income tax administration is that where an individual or corporation can satisfy the tax department that his book-keeping standards are reasonably good, he may be permitted to make his tax declarations on blue return forms. In that case he will not be subjected to arbitrary estimated assessments and will be entitled to certain tax privileges. The most important privileges are the right to carry a net tax loss back one year and forward for five years, and the right to claim the special increased depreciation on fixed assets and other extra depreciation allowances. In addition, the blue return (individual) taxpayer may deduct from taxable income an allowance based on the volume of export sales and a corporation may claim a special incentive credit where it can show an increase in research and experimental expenditure.

BODY OF PERSONS – Income Tax is usually levied at graduated rates on individuals and at a flat rate on companies and corporations. The term "body of persons" is a collective one usually referring to impersonal entities such as companies (corporations), statutory undertakings, associations, societies, unions, and trusts. Partnerships of individuals are not, however, regarded as bodies of persons for tax purposes since tax will be calculated by reference to the respective circumstances of the individual partners. Some bodies of persons may be entitled to exemption or special tax treatment because of the charitable nature of their activities or for other reasons, but apart from that consideration tax will usually be charged upon them at a flat rate without reliefs or abatements.

BONDED WAREHOUSE – A warehouse where dutiable or taxable goods may be stored without payment of tax, the latter being payable when goods are withdrawn from the warehouse for sale or delivery to a buyer. The warehouse is often kept under two locks the key of one of which is retained by the tax department who supervise the taxing of the goods withdrawn when the trader wishes to remove some of the goods stored. In addition the trader or owner of the warehouse is normally required to put up a bond to cover the amount of tax that might be at risk if there were irregular withdrawals with the connivance of the trader or theft or burglary by others. The system is particularly used for highly taxed goods such as spirits and tobacco.

BONDS — The word has more than one meaning — the most widely used meaning is that of an interest-bearing loan to a government or entrepreneur. A "bond" is also the security given by a taxpayer for the payment of taxes and may consist of a deposit of cash in advance of payment becoming due, or merely an arrangement with a bank or other guarantor that a certain sum will be paid on the taxpayer's behalf in the case of his tax default. In some countries the putting up of bonds on a taxpayer's behalf for a consideration has been developed by professional bondsmen, the best example being the U.S. "Bonds" in the first-mentioned sense also are sometimes sold to those who are able to pay their tax in advance. The bonds* in question can usually be proffered directly in payment, and bear interest, for the period held, which may be tax-free. (*See TAX RESERVE CERTIFICATES.)

BOND-WASHING — The method, usually adopted by individuals in HIGH INCOME TAX BRACKETS (q.v.), to avoid receiving (taxable) income from bonds and other investments they hold. The bonds are sold cum-dividend and later re-purchased ex-dividend so that the taxpayer does not receive income but makes a profit on the higher capital value attached to cum-dividend, as compared with ex-dividend, bonds.

BONI DE LIQUIDATION — Liquidation distribution.

BONUS SHARE TAX — Bonus shares, also known as "stock dividends" are a recurring subject for suggestions that they should be taxable, usually from a misconception that they represent income to the recipient. An ordinary issue of shares, however, merely increases the nominal value of a taxpayer's holding of shares in a particular company without increasing his total share in the equity capital. Where, however, a company distributes redeemable loan capital, or shares in other companies, there is a real distribution of money's worth and tax liability will arise.

BOOKS, STATUTORY — In most countries certain standards of book-keeping, involving compulsory keeping of certain types of records, are enjoined by law, either in the general commercial code or in laws specifically relating to corporate bodies or other forms of commercial entities. It is fairly common for Customs and Excise laws to stipulate that certain types of records should be kept and in some countries such stipulations are also contained in sales tax and income tax legislation.

BORDER ADJUSTMENTS — The term used to refer to (a) adjustments, normally refunds, of sales tax on the export of goods from one country to another, particularly the European Common Market countries where VAT (and previously cascade taxes) are embodied in goods up to the time they reach the frontier for export; and (b) the imposition on imports of taxes corresponding to the internal taxes of the importing country. (See also AUSGLEICHSTEUER, AUXILIARY, CATALYST.)

BOYCOTT, INTERNATIONAL — If a (USA) person or company takes part in an international boycott in the course of his business, foreign tax relating to the income attributable to the boycott factor would not be allowed in computing his foreign tax credit. (Lesser) Relief may, however, be allowed by deducting the disallowed tax in computing profits for tax purposes.

BRACKETS — The term used to refer to the range of taxable income subjected to a particular rate of income tax, and to other taxable items, e.g., wealth or capital, which are charged to tax at graduated rates. For example the first $1,000 of income might be taxed at 10 percent, the next $1,000 at 20 percent and so on. A person with an income of $1,500 would be regarded as falling within the $1,001 to $2,000 "brackets". The concept is also used for other taxes whereby a scale of specific tax charges is constructed to avoid the fractions that would arise by using a strict ad valorem calculation. For example, a car tax might be charged at $30 for up to 1,000 c.c.s. cylinder capacity, $60 for those between 1,000 and 2,000 c.c.s.

BRAIN TAX — See ACADEMIC TAX.

BRANCH OF FOREIGN COMPANY — See FILIALE DI SOCIETA ESTERA (Italy).
See BIJHUIS (Belgium).

BRANCH TAX — Treatment of branches for French corporate tax is subject to certain options — see BENEFICE CONSOLIDE and BENEFICE MONDIAL.

BRIBES, FOREIGN — The USA now has specific provisions taxing illegal foreign bribes, kickbacks, or similar payments as if they were distributions to U.S. shareholders under Subpart F.

BRITISH PREFERENTIAL TARIFF — To qualify for the British Preferential Tariff, goods imported into *Canada* must have 50 percent British (or Commonwealth) content and be shipped direct from a British (or Commonwealth) port. The tariff applies favourable duty rates to goods from British Commonwealth countries.

BROUGHT-IN ASSETS — A term used in connection with British PETROLEUM REVENUE TAX (q.v.), applying to plant used in exploiting North Sea oil. Allowances up to 175 percent of value may be given on plant (including ships) brought into the area of the mineral deposit working, provided allowances have not already been given in the same field for the same plant.

BRUSSELS DEFINITION OF VALUE — The "Brussels definition" of value for customs purposes has been widely adopted not only by countries using the Brussels nomenclature but by others using different systems, largely because it is important to have internationally-accepted methods of valuation of goods entering into international commerce. The basic definition (Article I (1)) is "For the purpose of levying duties or customs, the value of any goods imported for home consumption shall be taken to be the normal price, that is to say, the price which they would fetch at the time when the duty becomes payable on a sale in the open market between buyer and seller independent of each other". The various terms used in this definition are defined at length in the remainder of Article I and in Articles II and III and in the interpretative notes and addenda to those Articles.

BRUSSELS TARIFF NOMENCLATURE (BTN) — The Brussels Tariff Nomenclature (BTN) is the internationally recognised standard classification of goods for *customs* purposes. The BTN is intended to provide a systematic classification covering all goods in world trade thus providing a "common customs language" to simplify international tariff negotiations. Over 100 countries, providing about 80 percent of the world's export and import trade, have adopted BTN and others are in the course of adopting it.
For *statistical* purposes the S.I.T.C. (Standard International Trade Classification) established by the United Nations Statistical office is usually adopted and current editions of the BTN provide correlated S.I.T.C. reference numbers.

BUFFER RULE — The rule, in the French V.A.T. system, whereby when credits

for the V.A.T. content in purchases cannot be wholly offset against the tax due on deliveries, the unrelieved excess could be carried forward for offset against the tax due in subsequent tax periods. Formerly the excess credits could not, however, be repaid as France had no refund provisions, except in respect of goods exported. Currently the Decree of February 4, 1972 provides for the refund of excess credit. Special provisions exist for excess credits which have been accumulated in the past.

BUILDING SOCIETY ARRANGEMENT — The interest due to depositors is paid at a percentage rate which is "tax-compounded", i.e., tax is paid at a composite rate by the society. The calculation of tax payable by the society is made by sampling the depositors and obtaining details of the average rate at which they each pay tax.

BUILDINGS TAX - See IMPOSTA SUL REDDITO DEI FABRICATI.

BUITENGEWONE LASTEN — Extraordinary financial burdens, personal expenses not connected with the acquisition of income, which are deductible under Dutch individual income tax law, if they are deemed to be more burdensome than they would have been for the average individual taxpayer.

"BUNCHED GAINS" — The term sometimes used to refer to accumulated gains in the value of assets which have been held for a number of years in a period of rising values, the gains being subject to capital gains tax wholly in the year the assets are disposed of.

BUOYANCY — The buoyancy of tax revenue is the expression used to describe the position where the yield keeps pace with or exceeds the rate of growth of a country's G.N.P. or rise in the retail price index. With income tax, buoyancy or increased yield is normally automatic where the tax rates are graduated because income increases put the taxpayer into higher tax brackets. In the case of sales taxes the same result is obtained where luxuries and semi-luxuries are taxed at higher rates than necessities because with greater affluence taxpayers spend a higher proportion of their incomes on the higher-taxed goods. In each case the tax revenue is arithmetically certain to rise at a more rapid rate than G.N.P. or retail sales provided evasion and avoidance are kept within bounds.

BURDEN, TAX — The "tax burden" is usually computed as the percentage which the tax yield bears to the national income (G.N.P. or G.D.P.). There is some degree of shading possible as to whether taxation should include all kinds of social security contributions, retirement provisions etc. as well as the more normal direct or indirect taxes. Where social security "taxes" are included there will be disparities in comparing one country with another, where one country has a state-run welfare scheme and the other leaves social security provision and insurances to the private sector.

BURIAL TAX — A tax sometimes levied to produce local government revenue, sometimes payable as a relic of manorial dues from the Middle Ages, but sometimes justified as an administration levy where the local government has responsibilities to ensure that burials are carried out with due regard to the relevant laws regarding certification of death, and with regard to sanitation etc.

BUSINESS ACTIVITIES TAX — The name sometimes given to taxes levied on the gross receipts of the business (see also, BUSINESS TAX, GROSS RECEIPTS TAX, TRANSACTIONS TAX). The term has also been applied by the state of Michigan to its tax introduced in 1953, in the form of an embryonic V.A.T., charged at low rates varying from 0.2 to 0.75 percent on sales and levied with the object, inter alia, of producing unhypothecated revenue for the State.

BUSINESS CYCLE EQUALISATION RESERVES — A system used in Sweden allows companies to make tax-free income tax reserves from business or agricultural income up to 40 percent (10 percent in the case of forestry).
46 percent of such reserves must be deposited by the company in a blocked account with the Swedish National Bank but the remainder may be invested elsewhere. The government may authorise expenditure of the reserves in particular ways or issue instructions as to their use in either of which instance a deduction from taxable profits would be allowed of 10 percent of the amount of reserves withdrawn. Where no special withdrawal permission is given, the company may commence withdrawal after 5 years, initially up to 30 percent of the reserves.
The purpose of the income tax allowances, which enable companies to defer payment of tax and profits, and in some cases to obtain a 10 percent deduction for reserves employed in business investments, is to spread investment more evenly over the business cycle, i.e., to try to even out fluctuations in the rate of investment which ordinarily is sensitive to upturns and downswings in the economy. In some instances the instructions by the government on the use of the reserves are to direct investment to particular regions where there is underinvestment.

BUSINESS TAX — The name given to certain taxes on businesses, often at a low percentage rate on sales, e.g., as a TRANSACTIONS TAX (q.v.) or GROSS RECEIPTS TAX (q.v.), rather than a tax on income. In effect such taxes are a form of sales tax.

BUTLERAGE — The name given to the tax on wine introducted in the reign of Edward I in the 13th century in Britain.

[to be continued]

U.S. TAXATION and the ARAB BOYCOTT

The U.S. Tax Reform Act of 1976 contained, inter alia, provisions denying certain tax benefits for U.S. taxpayers who participate in international boycotts. These provisions were general in many respects, delegating power to the Secretary of the Treasury to establish regulations which would implement the application of these provisions. One of the areas left to be established was a procedure whereby a taxpayer could get a determination by the Internal Revenue Service of whether an existing or contemplated activity would constitute participation in an illegal boycott. The Internal Revenue Service has now issued Revenue Procedure 77-9, which sets forth the procedure for obtaining such a determination. The Revenue Procedure is reprinted in full here.

A Brief Description of the New Rules

In setting forth the procedures for requesting a determination of participation in an illegal boycott, the Internal Revenue Service has separated the cases into two categories: where the person making the request is not under active examination or audit concerning the activity forming the basis of his request and where the person making the request is under active examination or audit. The information required of taxpayers in either category is essentially the same, however.

The taxpayer must provide a complete statement of all relevant facts. This includes the names of all interested parties. Copies of contracts and other documents must be provided, though this does not relieve the taxpayer of the duty to describe their contents in his statement. The taxpayer must express his opinion as to whether the activity in question is a participation in an international boycott and must cite authority for his view.

Where the taxpayer is not under active audit, a determination issued then will not be revoked or modified retroactively if there was no misstatement of facts, the actual developments did not vary materially from what was anticipated, the applicable law has not changed, the determination applied to a proposed transaction and the taxpayer relied in good faith on the determination.

When the taxpayer is under active audit, the conclusions of the National Office on boycott participation will be transmitted to the District Director of the district in which the audit is taking place. The District Director will proceed to process the taxpayer's case based on these conclusions or will ask for a reconsideration. A determination by the National Office will have retroactive effect where favourable for the taxpayer. It will have retroactive effect where unfavourable unless the Secretary of the Treasury exercises his discretionary power to limit the retroactive effect.

IRS REVENUE PROCEDURE 77-9 ON OBTAINING DETERMINATIONS AS TO WHETHER A PARTICULAR OPERATION CONSTITUTES PARTICIPATION IN ARAB BOYCOTT

SECTION 1.
Purpose.

This Revenue Procedure sets forth the procedures of the Internal Revenue Service pertaining to the issuance of determinations under section 999(d) of the Internal Revenue Code of 1954, relating to whether a particular operation of a person, or of a member of a controlled group (within the meaning of section 993(a)(3)) that includes that person, constitutes participation in or cooperation with an international boycott as defined in section 999(b)(3).

SEC. 2.
Background and General Information.

.01 Sections 1061 through 1064, and 1066(a) of the Tax Reform Act of 1976 (Pub. L. No. 94-445, 94th Cong., 2d Sess. (October 4, 1976)) (the Act) deny certain benefits of the foreign tax credit, deferral of earnings of foreign subsidiaries, and domestic international sales corporation (DISC) to a person, if that person, or a member of a controlled group (within the meaning of section 993(a)(3) of the Code) that includes that person, or a foreign corporation of which a member of the controlled group is a United States shareholder, agrees to participate in or cooperate with an international boycott.

.02 Generally, the provisions of the Act relating to the denial of such benefits are effective with respect to participation in or cooperation with an international boycott after November 3, 1976.

.03 In the case of operations that constitute participation in or cooperation with an international boycott and that are carried out in accordance with the terms of a binding contract entered into before September 2, 1976, the provisions of the Act apply to such participation or cooperation after December 31, 1977.

.04 Section 999(d) of the Code, added by the Act, provides, in part, that upon a request made by the taxpayer, the Secretary of the Treasury or the Secretary's delegate shall issue a determination with respect to whether a particular operation of a person, or a member of a controlled group that includes such person, constitutes participation in or cooperation with an international boycott.

.05 In Treasury News Release WS-1156, dated November 4, 1976, the Treasury issued guidelines relating to the anti-boycott provisions of the Act. The guidelines were also published in 41 FR 49923 on November 11, 1976. In those guidelines and in IR-1697, dated November 16, 1976, procedures for obtaining a determination under section 999(d) of the Code were announced. Pending the issuance of final regulations, determinations under section 999(d) will be made by the National Office of the Service concerning issues specifically addressed in published Treasury guidelines. If an issue arises that is not specifically addressed in published guidelines, the National Office will not make a determination until it has brought the issue to the attention of the Assistant Secretaries of the Treasury for International Affairs and for Tax Policy and a new or modified guideline that specifically addresses the issue is published by the Secretary.

.06 The National Office will issue taxpayer requested determinations with respect to whether a particular operation of a person or of a member of a controlled group that includes that person constitutes participation in or cooperation with an international boycott. However, the National Office will issue determinations only with respect to operations that occurred after, or are contemplated to occur after:

(1) December 31, 1977, or

(2) November 3, 1976, but before December 31, 1977, provided that the operations are not carried out in accordance with the terms of a binding contract entered into before September 2, 1976.

Determinations in advance of an operation will be issued only in those circumstances that are of such a nature that an advance determination is possible and

appropriate. The National Office may defer issuing determinations until after the close of the taxable year, even though the determination requests are made either before the particular operation is commenced or before the end of the taxable year.

.07 Section 3 of this Revenue Procedure sets forth the procedures for requesting determinations under section 999(d) of the Code of issues not present in the return of a person (or a member of a controlled group that includes a person) that is under active examination or audit by a district office or is being considered by a regional appellate division. The effects of determinations issued pursuant to a request made under section 3 are set forth in section 9. Section 4 of this Revenue Procedure sets forth the procedures for requesting determinations under section 999(d) of issues present in the return of a person (or a member of a controlled group that includes that person) that is under active examination or audit by a district office. The effects of determinations issued pursuant to a request made under section 4 are set forth in section 10. Section 5 of this Revenue Procedure sets forth the procedures for requesting determinations under section 999(d) of issues present in a return of a person (or a member of a controlled group that includes that person) that is being considered by a regional appellate division. The procedures set forth in sections 6, 7, 8 and 11 are applicable to determinations requested under both sections 3 and 4 of this Revenue Procedure.

.08 Nothing in this Revenue Procedure will preclude a District Director from requesting technical advice, in accordance with the procedures set forth in Rev. Proc. 73-8, 1973-1 C.B. 754, on the District Director's own initiative on any issue under the anti-boycott provisions of the Act.

.09 For purposes of section 3.08 and 6.02 of this Revenue Procedure, a determination is a ruling. Thus, the amendments to the Statement of Procedural Rules, 26 CFR 601, published in the Federal Register on November 5, 1976, 41 FR 48740, and Rev. Proc. 76-29, 1976-29 I.R.B. 17, are applicable. A determination is also a ruling for purposes of section 7805(b) of the Code.

.10 For purposes of this Revenue Procedure, any reference to District Director or district office also includes, where appropriate, the Office of the Director, Office of International Operations.

SEC. 3.

Requests for Determinations under Section 999(d) of Issues not present in a Return under Active Examination or Audit or under Consideration by a Regional Appellate Division.

.01 Section 3.02 through 3.15 of this Revenue Procedure set forth the procedures under which a request should be made of the National Office for determinations under section 999(d) of the Code with respect to issues not present in the return of a person (or a member of a controlled group that includes that person) that is under active examination or audit by a district office or is being considered by a regional appellate division.

.02 A request for a determination is to be submitted in duplicate if (1) more than one issue is presented in the request or (2) a closing agreement is requested with respect to the issue presented.

.03 Each request for a determination must contain a complete statement of all relevant facts relating to the operation. Such facts include names, addresses, and taxpayer identifying numbers of all interested parties; the location of the district office that has or will have audit jurisdiction over the return or report of each party; a full and precise statement of the business reasons for the operation; and a carefully detailed description of the operation. In addition, copies of all contracts, wills, deeds, agreements, instruments, and other documents involved in the transaction must be submitted with the request. Original documents should not be submitted because documents and exhibits become a part of the Service file that cannot be returned.

Relevant facts reflected in documents submitted must be included in the taxpayer's statement and not merely incorporated by reference, and must be accompanied by an analysis of their bearing on the issue or issues, specifying the pertinent provisions. The request must contain a statement whether, to the best of the knowledge of the taxpayer or the taxpayer's representative, the identical issue is being considered by any field office of the Service in connection with an active examination or audit of a tax return of the taxpayer (or a member of the controlled group that includes the taxpayer) already filed or is being considered by a regional appellate division.

Where the request pertains to only one step of a larger integrated operation, the facts, circumstances, etc., must be submitted with respect to the entire operation.

.04 As an alternative procedure for requesting determinations on prospective operations, the taxpayer may submit a summary statement of the facts it considers controlling the issue, in addition to the complete statement required for a determination by section 3.03 above. Assuming agreement with the taxpayer's summary statement, the Service will use it as the basis for the determination. Any taxpayer wishing to adopt this procedure should submit with the request for determination:

(1) A complete statement of facts relating to the operation, together with related documents, as required by section 3.03 above; and

(2) A summary statement of the facts that the taxpayer believes should be controlling in reaching the requested conclusion. Where the taxpayer's statement of controlling facts is accepted, the determination will be based on these facts and only this statement will ordinarily be incorporated in the determination. It is emphasized, however, that:

(a) This procedure for a "two-part" determination request is elective with the taxpayer and is not to be considered a required substitute for the regular procedures contained in this Revenue Procedure;

(b) Taxpayers' rights and responsibilities are the same under the "two-part" determination request procedure as those provided in this Revenue Procedure; and

(c) The Service reserves the right to make the determination on the basis of a more complete statement of facts it considers controlling and to seek further information in developing facts and restating them for determination purposes.

.05 The taxpayer must state its views as to whether the proposed or prospective operation constitutes participation in or cooperation with an international boycott and must furnish a statement of relevant authorities to support such views.

.06 A request by or for a taxpayer must be signed by the taxpayer or the taxpayer's authorized representative. If the request is signed by a representative of the taxpayer, or if the representative is to appear before the Service in connection with the request, the representative must be:

(1) an attorney who is a member in good standing of the bar of the highest court of any State, possession, territory, Commonwealth, or the District of Columbia, and who files with the Service a written declaration that such attorney is currently qualified as an attorney and is authorized to represent the principal;

(2) a certified public accountant who is duly qualified to practice in any State, possession, territory, Commonwealth, or the District of Columbia, and who files with the Service a written declaration that such accountant is currently qualified as a certified public accountant and is authorized to represent the principal; or

(3) a person, other than an attorney or certified public accountant, enrolled to practice before the Service, and who files with the Service a written declaration that such person is currently enrolled (including in the declaration either such person's enrollment number or the expiration date of such person's enrollment card) and that such person is authorized to represent the principal. (See Treasury Department Circular No. 230. Revised, 1966-2 C.B. 1171, as amended, 1967-1 C.B. 433, and 1970-2 C.B. 644, for the rules on who may practice

before the Service.) The above requirements do not apply to an individual representing such individual's full-time employer, or to a bona fide officer, administrator, trustee, etc., representing a corporation, trust, estate, association, or organized group.

An unenrolled preparer of a return (other than an attorney or certified public accountant referred to in clauses (1) and (2) above) who is not a full-time employee or a bona fide officer, administrator, trustee etc., may not represent a taxpayer with respect to a determination. Any authorized representative, whether or not enrolled to practice, must also comply with the conference and practice requirements of the Statement of Procedural Rules. Forms 2848, Power of Attorney, and 2848-D, Authorization and Declaration, may be used with regard to determinations requested under this Revenue Procedure.

.07 A request for a determination under section 999(d) of the Code should be addressed to the Commissioner of Internal Revenue, Attention: T:C:C:3, Washington, D.C. 20224.

.08 Determinations issued to taxpayers under section 999(d) of the Code will be made open to public inspection under the procedures in section 6110, the regulations thereunder, and the Statement of Procedural Rules.

Amendments to the Statement of Procedural Rules, 26 CFR Part 601, published in the Federal Register on November 5, 1976, 41 FR 48740, require a taxpayer requesting a ruling to make proposals concerning the deletions to be made, pursuant to section 6110(c), in the documents open to public inspection and to sign, under penalties of perjury, a declaration that the facts in the request are true, correct and complete.

.09 Any request for a determination that does not comply with all the provisions of this Revenue Procedure will be acknowledged by the National Office, and the requirements that have not been met will be pointed out. If a request for a determination lacks essential information, the taxpayer or the taxpayer's representative will be advised that if the information is not forthcoming within 30 days, the request will be closed.

If the information is received after the request is closed, the request will be reopened and treated as a new request as of the date of the receipt of the essential information. Priority treatment of such request will be granted only in rare cases upon the approval of the Director, Corporation Tax Division.

.10 A taxpayer or a taxpayer's representative that desires an oral discussion of the issue or issues involved should indicate such desire in writing when filing the request or soon thereafter in order that the conference may be arranged at the stage of the consideration when it will be most helpful.

.11 It is the practice of the Service to process requests for determinations in regular order and as expeditiously as possible. Compliance with a request for consideration of a particular matter ahead of its regular order, or by a specified time, tends to delay the disposition of other matters. Requests for processing ahead of the regular order, made in writing in a separate request submitted with the request or subsequent thereto and showing clear need for such treatment, will be given consideration as the particular circumstances warrant.

However, no assurance can be given that any letter will be processed by the time requested. For example, the scheduling of a closing date for a transaction or a meeting of the Board of Directors or shareholders of a corporation without due regard to the time it may take to obtain a determination will not be deemed sufficient reason for handling a request ahead of its regular order. Requests by telegram will be treated in the same manner as requests by letter. Determinations ordinarily will not be issued by telegram.

.12 The Assistant Commissioner (Technical) has primary responsibility for issuing determinations under section 999(d) of the Code.

.13 A taxpayer or its representative desiring to obtain information as to the status of its case may do so by contacting:
Group Chief, T:C:C:3:2 (202) 566-3261

.14 Determinations issued by the National Office will be furnished to the taxpayer and to the District Director having audit jurisdiction over the return or report of the taxpayer.

.15 When a taxpayer receives a determination prior to the filing of its return with respect to any operation that has been consummated and that is relevant to the return being filed, a copy of the determination should be attached to the return.

SEC. 4.
Requests for Determinations under Section 999(d) of Issues present in a Return under Active Examination or Audit.

.01 Section 4.02 through 4.06 of this Revenue Procedure set forth the procedures under which a request should be made of the National Office for determinations under section 999(d) of the Code with respect to issues present in the return of a person (or a member of the controlled group that includes that person) that is under active examination or audit by a district office.

.02 A request for a determination made pursuant to this section must be made in accordance with the procedures set forth in sections 3.03, 3.05 through 3.13 and 4.02 through 4.06 of this Revenue Procedure.

.03 The request for a determination under section 999(d) of the Code made pursuant to this section should be addressed to the Commissioner of Internal Revenue, Attention: T:C:C:3, Washington, D.C. 20224, but must be submitted to the examining officer or district conferee along with copies of all relevant materials.

The taxpayer should submit to the examining officer or district conferee the number of copies of the relevant documents specified in section 3.02 of this Revenue Procedure, plus one additional copy for the use of the examining officer or district conferee.

A determination request submitted to the examining officer or district conferee that does not comply with the provisions of this Revenue Procedure (other than the provisions of section 3.08) will be returned by the examining officer or district conferee for completion prior to sending it to the National Office for a determination.

If a request for a determination lacks essential information, the taxpayer or the taxpayer's representative will be advised by the examining officer or the district conferee that if the information is not forthcoming within 30 days, the request will be returned to the taxpayer. If the request is returned to the taxpayer, it will be treated as a new request as of the date of the receipt of the essential information.

.04 After receipt of the determination request and relevant documents that meet the requirements of this Revenue Procedure, the examining officer or district conferee must indicate in writing to the taxpayer the extent, if any, to which such examining officer or district conferee may not be in complete agreement as to the facts and the specific points at issue.

Every effort should be made to reach agreement as to the facts and the specific points at issue. If agreement cannot be reached, the examining officer or district conferee may submit to the National Office a statement of such examining officer's or district conferee's understanding as to the specific point or points at issue and a statement of position on the issues, citing precedents believed relevant to the case.

If such a statement is submitted to the National Office, a copy of the statement must be submitted to the taxpayer at the time the statement is submitted to the National Office. The examining officer or district conferee must forward such determination request, statements, and all relevant documents to the National Office for determination within 30 days of receipt of the determination request and relevant documents that contain all essential information.

.05 The National Office may submit a proposed determination to the District Director for comment before issuing the determination to the taxpayer.

.06 Determinations issued pursuant to a request made under section 4 will be sent to both the taxpayer and the District Director.

SEC. 5.

Requests for Determinations under Section 999(d) of Issues present in a Case under Consideration by a Regional Appellate Division.

If a request is made for a determination under section 999(d) of the Code with respect to issues present in a case of a person (or a member of the controlled group that includes that person) under consideration by a regional appellate division, such division will immediately relinquish jurisdiction and return the entire case to the district office having audit jurisdiction over the return, for processing the taxpayer's request for a determination.

All the procedures set forth in section 4, and all other procedures set forth in this Revenue Procedure that are applicable to determinations requested under section 4, shall apply. The case will remain with that district office until a determination has been made by the National Office.

SEC. 6.

Conferences in the National Office.

.01 Except as otherwise provided herein, this section applies to determinations requested under both sections 3 and 4 of this Revenue Procedure.

.02 In accordance with Rev. Proc. 76-29, the taxpayer or the taxpayer's authorized representative will be contacted by a Service representative to informally discuss the procedural and substantive issues involved within 15 working days after receipt of the determination request by the National Office.

.03 If a conference has been requested, the taxpayer will be notified of the time and place of the conference. A conference is normally scheduled only when the Service deems it will be helpful in deciding the case or an adverse decision is indicated. If conferences are being arranged with respect to more than one request for a determination involving the same taxpayer, they will be so scheduled as to cause the least inconvenience to the taxpayer.

The conference will be arranged by telephone, if possible, and must be held within 21 calendar days after contact has been made. Extensions of time will be granted only if justified in writing by the taxpayer and approved by the Chief, Corporation Tax Branch.

.04 A taxpayer is entitled, as a matter of right, to only one conference in the National Office unless one of the circumstances discussed in section 6.05 develops. This conference will be held by the office of the Assistant Commissioner (Technical). In appropriate cases involving a determination requested pursuant to section 4 of this Revenue Procedure, the examining officer or district conferee may also attend the conference to clarify the facts in the case.

If more than one operation is to be discussed at the conference, the discussion will constitute a conference with respect to each operation. In order to promote a free and open discussion of the issues, the conference will usually be held after the National Office has had an opportunity to study the case.

However, at the request of the taxpayer or its representative, the conference may be held at an earlier stage in the consideration of the case than the Service would ordinarily designate. No taxpayer has a "right" to appeal the action of the Assistant Commissioner (Technical) to the Commissioner or to any other office of the Service, nor is a taxpayer entitled as a matter of right, to a separate conference in the Chief Counsel's office or the Treasury on a request for a determination.

.05 In the process of considering a determination proposed at a conference, it may appear that the final answer will involve a reversal of the determination proposed at the conference with a result less favorable to the taxpayer. Or it may appear that an adverse determination proposed at the conference will be approved, but on different grounds than those mentioned at the conference.

Under either of these circumstances, the taxpayer or its representative will be invited to another conference. The provisions of this Revenue Procedure limiting the number of conferences to which a taxpayer is entitled will not foreclose the invitation of a taxpayer to attend further conferences when, in the opinion of National Office personnel, such need arises. All additional conferences of the type discussed in this paragraph are held only at the invitation of the Service.

.06 It is the responsibility of the taxpayer to furnish to the National Office, within 21 calendar days after the conference, a written record of any additional data, line of reasoning, precedents, etc., that were proposed by the taxpayer and discussed at the conference but were not previously or adequately presented in writing. Extensions of time will be granted only if justified in writing by the taxpayer and approved by the Chief, Corporation Tax Branch.

The additional material should be addressed to and sent to the National Office. In the case of a determination requested under section 4, a duplicate copy of the additional material must also be submitted to the National Office for forwarding to the appropriate examining officer or district conferee.

.07 In the case of a determination requested pursuant to section 4 of this Revenue Procedure, the examining officer or district conferee will be requested to give the additional material prompt attention. The examining officer or conferee may verify the additional facts and data and comment on it to the extent deemed appropriate.

SEC. 7.

Withdrawal of Requests.

The taxpayer's request for a determination may be withdrawn at any time prior to the signing of the determination. However, in such a case, the National Office may furnish its views to the District Director whose office has or will have audit jurisdiction of the taxpayer's return or to the examining officer or district conferee.

The District Director, the examining officer or district conferee will consider the information submitted in any current or subsequent audit or examination of the taxpayer's return. Even though a request is withdrawn, all correspondence and exhibits will be retained in the Service and will not be returned to the taxpayer.

SEC. 8.

Oral Advice to Taxpayers.

.01 The Service will not issue determinations upon oral requests. Furthermore, National Office officials and employees ordinarily will not discuss a substantive tax issue with a taxpayer or a taxpayer's representative prior to the receipt of a written request for a determination since oral determinations are not binding on the Service.

This should not be construed as preventing a taxpayer or a taxpayer's respresentative from inquiring whether the Service will rule on a particular question. In such cases, however, the name and identifying number must be disclosed. The Service will also discuss questions relating to procedural matters with regard to submitting a request for a determination, including the application of the provisions of sections 3 and 4 above to the particular case.

.02 A taxpayer may, of course, seek oral advice from a district office in the preparation of the taxpayer's return or report, pursuant to other established procedures. Such oral advice is advisory only and the Service is not bound to recognize it in the examination of the taxpayer's return.

SEC. 9.

Effect of Determinations of Issues not present in a Return under Active Examination or Audit or under Consideration by a Regional Appellate Division.

.01 The procedures set forth in sections 9.02 through 9.09 of this Revenue Procedure apply to determinations issued pursuant to a request made under section 3.

.02 A taxpayer may not rely on a determination issued to another taxpayer. A determination, except to the extent incorporated in a closing agreement, may be revoked or modified at any time in the wise administration of the taxing statutes. See section 2.07 of Rev. Proc. 72-3, 1972-1 C.B. 698, for the effect of a closing agreement.

If a determination is revoked or modified, the revocation or modification applies to all open years under the statutes, unless the Secretary or the Secretary's delegate exercises the discretionary authority under section 7805(b) of the Code to limit the retroactive effect of the revocation or modification. The manner in which the Secretary or the Secretary's delegate generally will exercise this authority is set forth in this section.

.03 As part of the determination of a taxpayer's liability, it is the responsibility of the District Director to ascertain whether any determination previously issued to the taxpayer has been properly applied. It should be determined whether the representations upon which the determination was based reflected an accurate statement of the material facts and whether the operation actually was carried out substantially as proposed.

If, in the course of the determination of the tax liability, it is the view of the District Director that a determination previously issued to the taxpayer should be modified or revoked, the findings and recommendations of that office will be forwarded to the National Office for consideration prior to further action.

Such reference to the National Office will be treated as a request for technical advice and the procedures of Rev. Proc. 73-8 will be followed. Otherwise, the determination is to be applied by the district office in its determination of the taxpayer's liability.

.04 Appropriate coordination with the National Office will be undertaken in the event that any field official having jurisdiction of a return or other matter proposes to reach a conclusion contrary to a determination previously issued or contemplated to be issued to the taxpayer.

.05 A determination found to be in error or not in accord with the current views of the Treasury may be modified or revoked by the National Office. Modification or revocation may be effected by a notice to the taxpayer to whom the determination originally was issued, or by a guideline or other statement published in the Internal Revenue Bulletin.

.06 Except in rare or unusual circumstances, the revocation or modification of a determination will not be applied retroactively with respect to the taxpayer to whom the determination was originally issued or to a taxpayer whose tax liability was directly involved in such determination if (1) there has been no misstatement or omission of material facts, (2) the facts subsequently developed are not materially different from the facts on which the determination is based, (3) there has been no change in the applicable law, (4) the determination was originally issued with respect to a prospective or proposed transaction, and (5) the taxpayer directly involved in the determination acted in good faith in reliance upon the determination and the retroactive revocation would be to its detriment.

Where a determination issued to a taxpayer is revoked with retroactive effect, the notice to such taxpayer will, except in fraud cases, set forth the grounds upon which the revocation is being made and the reasons why the revocation is being applied retroactively.

.07 A determination issued to a taxpayer with respect to a particular operation represents a holding of the Service on that operation only. However, the application of that determination to the operation will not be affected by the subsequent issuance of guidelines or regulations (either temporary or final) if the conditions specified in section 9.06 above are met.

If the determination is later found to be in error or no longer in accord with the holding of the Treasury, it will afford the taxpayer no protection with respect to a like operation in the same or subsequent year, except to the extent provided in section 9.08.

.08 If a determination is issued covering a continuing operation or a series of operations and it is determined that the determination was in error or no longer in accord with the holding of the Treasury, the Secretary or the Secretary's delegate ordinarily will limit the retroactivity of the revocation or modification to a date not earlier than that on which the original determination is modified or revoked.

If a determination relates to a continuing operation or a series of operations, the determination will be applied until the date of issuance of applicable guidelines or regulations holding otherwise, or until specifically withdrawn. Publication of a notice of porposed rulemaking will not affect the application of any determination issued under the procedures set forth herein.

.09 In the case of determinations involving completed operations, other than those described in section 9.08 above, taxpayers will not be afforded the protection against retroactive revocation provided in section 9.06 above in the case of proposed operations since they will not have entered into the operations in reliance of the determination.

SEC. 10.

Effect on Determinations of Issues present in a Return under Active Examination or Audit.

.01 The procedures set forth in sections 10.02 and 10.03 of this Revenue Procedure apply to determinations pursuant to a request made under section 4.

.02 Unless the District Director believes that the conclusions reached by the National Office in a determination should be reconsidered and promptly requests such reconsideration, the District Director's office will proceed to process the taxpayer's case on the basis of the conclusions expressed in the determination. If the District Director believes that the conclusions reached by the National Office in a determination should be reconsidered, the procedure set forth in section 9.03 of this Revenue Procedure shall be applicable.

.03 Except in rare or unusual circumstances, a determination that is favorable to the taxpayer is applied retroactively. Moreover, a determination that is adverse to the taxpayer is also applied retroactively unless the Secretary or the Secretary's delegate exercises the discretionary authority under section 7805(b) of the Code to limit the retroactive effect of the determination.

Likewise, a determination that modifies or revokes a prior determination will also be applied retroactively, with one exception. If the new determination is less favorable to the taxpayer, it will generally not be applied to the period in which the taxpayer relied on the prior determination in situations involving continuing operations of the type described in section 9.08 of this Revenue Procedure.

SEC. 11.

Effective Date.

This Revenue Procedure is effective February 3, 1977.

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By Oliver Oldman** and Richard Bird***

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I. INTRODUCTION

Only a few years ago it was customary in considering the design of income taxes to contrast the schedular and the global approaches to taxing income. Today the latter approach has triumphed, at least in principle, throughout the world. The income tax in virtually every high-income developed country is now global in concept, although there are still important gaps in most countries and the move is very recent in others (e.g., 1974 in Italy). Among the developing countries, those influenced by British colonial administrations have long had global-type income taxes, and almost no country in the world now has a pure schedular system, with completely separate taxes on income derived from different sources. The prevalent form of income tax in much of Latin America, as in Francophone Africa, is probably still the "mixed" system (schedular taxes capped by a complementary global tax), but present indications are that any changes in this situation will likely be in the direction of increased globalization. As Plasschaert notes, ". . . to our knowledge no reverse sequence, from a global to a schedular or mixed frame, can be mentioned." [1]

This worldwide move towards a "global" income tax has both an economic and a equity rationale. Although equity rationales are of course always matters of social judgment (and hence disputable), it is widely accepted in principle that income, broadly defined to include all accretions to economic power (potential spending power), provides a particularly suitable measure of ability to pay and hence the best basis for personal taxation. From an equity point of view, then, the tax implications of an additional dollar of net income (thus defined) should be the same, regardless of the source of that income.

Exactly the same rule is advisable from an economic point of view to avoid distorting unduly the pattern of economic activity by diverting resources into relatively lightly-taxed activities. This assumes, of course, that such neutrality is an appropriate characteristic of the tax system, which may not always be the case, especially in developing countries where a main aim of policy is often precisely to change the prevalent pattern of resource allocation.

No country, even the most highly developed, has currently gone all the way to a truly global income tax.

Arguments such as this are one reason why no country, even the most highly-developed, has actually gone all the way to a truly comprehensive or global income tax — although detailed proposals along these lines have been made both in Canada (by the Royal Commission on Taxation in 1967) and, more recently and more tentatively, in the United States (in a report entitled *Blueprints for Tax Reform* issued by the U.S. Treasury Department early in 1977).

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1. S.R.F. Plasschaert, "First Principles About Schedular and Global Frames of Taxation," *Bulletin for International Fiscal Documentation*, 30 (March 1976), 99-111.

Three reasons for the common retention of (often significant) schedular elements even in the most globalized income tax systems may be distinguished: principle, policy, and administration. Perhaps the major question of principle concerns the appropriate tax treatment of "earned" and "unearned" income: it is discussed in Section II of this paper. A secondary issue that may perhaps also be decided on grounds of principle concerns the treatment of gifts and bequests. In practice, such receipts are rarely (a partial exception exists in Colombia) taxed as income to the recipient, although both Henry Simons, one of the intellectual parents of global income taxes, and the Canadian Royal Commission argued that they should be so taxed.

In addition to the possible "incentive" motivation for desiring differential tax treatment of, say, income from certain sectors (or, more usually, of certain uses of income, e.g., investment), other "policy" issues also arise with respect to the treatment of international income (income going to foreigners and foreign income going to residents) and such matters as personal deductions, the treatment of pension income, and so on. A few of these issues are discussed briefly later in this paper.

Finally, and in practice perhaps most importantly, administrative realities have forced considerable modification of the ideal of a truly global income tax even in the most highly-developed countries. As a rule, the easiest income to tax effectively is wage and salary income: everything else gives rise to problems of varying difficulty. In the past, many countries apparently concluded that the resulting lower probability of catching a dollar of capital (or self-employment) income in the tax net should be recognized by imposing a higher tax rate on such dollars than on wage income. The trouble with this approach is twofold: (1) it leads to neglect of the need to improve the administration of the tax on non-wage income (precisely because of the belief that the differential rates take care of the problem); and (2) the belief that the differential rates take care of the problem is almost certainly wrong (precisely because the neglect of administration means that evasion will tend to escalate to offset the differential).

Abolishing schedular taxes resolves no problems

The argument in the preceding paragraph is, of course, by now widely accepted. What seems to be less widely understood, however, is that simply abolishing the various schedular taxes resolves no problems. [2] Indeed, unless the move to globalization is accompanied by significant administrative tightening on non-wage income, its immediate effect may perhaps even be to increase the taxes on wage and salary earners relative to those receiving other forms of income (as appears to have happened in Bolivia in early 1976). Much of the present paper is concerned with pointing out the sorts of steps which are needed to reach income from property effectively under an income tax.

The focus of this paper is thus on certain problems of principle, policy, and administration likely to be encountered in the course of transition from a schedular or mixed system to a more global income tax. Globalization in this sense is essentially a question of the *base* of the income tax. Sometimes the requisite base-broadening has been made more politically palatable by reducing tax *rates* (as in Canada) or raising personal *exemptions* (as also in Canada, and as proposed in the recent report of the Fiscal Reform Mission in Bolivia), but the determination of the appropriate structure of rates and exemptions for personal income tax is really a quite different matter that cannot be discussed here. Similarly, the present paper does not discuss such important related, but separate, issues in the design of a personal income tax as the appropriate tax unit (individual or family) and personal deductions (e.g., the merits of credits vs. deductions), let alone the even more complex issue of the tax treatment of juridical entities (and its relation to the personal income tax).

In short, the discussion in this paper is limited to certain questions concerning the base of the personal income tax, with particular attention to those issues which experience in other countries suggests may give rise to differentiation even within the framework of a global income tax. Most of the issues mentioned here have been treated quite differently in different countries. For reasons of time and prior knowledge, this discussion draws mainly on the experience of a few countries, particularly the United States, Canada, France, Venezuela, Colombia, and Bolivia. The text discussion blends experience from these different countries in a brief analytical fashion, often without specific country attribution.

II. THE TREATMENT OF EARNED INCOME

There appear to be two principal rationales for differentiating in favor of earned income (apart from the administration argument noted in Section I). The first is the argument that a dollar of income received from investment carries with it a greater inherent "capacity to pay" than a dollar recieved from work — for example, because he who receives the former dollar (the "man of property") receives two substantial additional benefits: the income flows without taking much, if any, of his time or effort, and his source of income, his wealth, provides a sense of security and power over and above that of the job of the man who works.

Without developing this line of thought further, it may simply be noted here (a) that it flatly contradicts the underlying rationale of a global income tax ("a dollar is a dollar is a dollar"), and (b) that, if true, it points more to the desirability of an additional tax on wealth as such rather than lighter income taxes on earned income. Nevertheless, arguments such as this help explain such income tax differentiations as the important earned income credit in Britain, the former surtax on investment income in Canada, and perhaps also the large exclusions from earned income found in such countries as Bolivia.

2. For a rare exception, see the interesting paper by Fernando Rezende, "Income Taxation and Fiscal Equity," *Brazilian Economic Studies*, No. 2, 1976, pp. 105-45.

Sometimes such arguments for special treatment of one *source* of income are confused with arguments for favoritism to lower *levels* of income, e.g., when the earnings of those receiving the minimum wage are exempted. It should be clear, however, that these two questions are quite distinct in principle: if there is a case for exempting low-income earners — and there is — that case does not depend on the *source* of their low earnings.

Income from labor is less "pure" than income from capital

More consistent with the general framework of a global income tax is the view that income from labor is, so to speak, less "pure" (or net) than income from capital (e.g., because of the lack of explicit tax provision for the costs of acquiring and maintaining "human capital"). What this argument seems to reduce to is the view that inadequate allowance is made for expenses of earning labor income compared to capital income. Presumably the income of the self-employed — usually "mixed" income — would come in between on this scale.

Within the framework of the personal income tax, two broad approaches to differentiating earned and unearned income may be distinguished in different countries, with the dividing line to some extent perhaps reflecting the two rationales noted above (as witness the treatment of the self-employed).

In the United States, for example, earned income from personal services is entitled to a credit of 10% up to $4,000 of earned income, with the credit being reduced for higher incomes until it vanishes completely at $8,000 of earned income. Until the 1940's, the U.S. followed a different appreach, giving a 10% credit without limit for earned income. At the other end of the income scale, the maximum tax *rate* now applicable to earned income in the U.S. is 50%, even though 70% is the general top marginal rate otherwise applicable. (A quite different approach towards rate differentials was employed at one time in Canada, where before 1961 all investment income was subject to a *surtax* of 4%.) In contrast, Bolivian recipients of labor income are entitled to a *deduction* from gross income of 25% of such income up to a maximum of $b. 70,000 (which is quite high in Bolivian terms), not to mention exemptions for vacation and severance pay. All of these provisions apply whether the income is earned through employment or self-employment.

There are also in most countries, even in those which do not have special tax treatment for all labor income, special provisions for employees only. These provisions are of two types: exclusion of various fringe benefits paid by the employer (such as in the Bolivian case mentioned above), and, more closely related to the basic issue of differentiation by source of income, some allowance for employment expenses.

There is indeed a case in most tax systems for providing some recognition of the "costs" of earning labor income. Different countries have done this in various ways. In principle, optional deduction of itemized employment expenses (excluding such basic costs of living as food, shelter, and commuting expense) is probably the best system. In practice, some countries provide a small "standard" deduction of a certain percentage of employment income (often up to some maximum, e.g., 3% up to $250 in Canada), for administrative convenience. The United States and Canada also recognize, within limits, moving expenses incurred by employees who change their place of residence and work. To some extent, a case can also be made along these lines for tax recognition of certain educational expenditures. [3]

Since self-employed taxpayers can usually deduct all costs of earning income anyway, they are not usually extended any special deduction for "employment" expenses: indeed in their case the problem is often the opposite, to limit the deduction of what are really "personal" expenses (e.g., for the use of an automobile). Many countries have therefore imposed arbitrary limits on the deductibility of expenses by the self-employed; for example, Canada has complex rules on personal use of automobiles and the U.S. has severely restricted deductions for offices located at home. [4] Furthermore, since withholding is, by definition, not readily applicable to the incomes of this group, they should in principle be required to pay on a "current payment" basis, as is now required in Colombia, for example. In addition, the self-employed are often subject to special review and "estimated income" procedures. Small business, professionals, and farmers (especially the latter) are subject to such procedures in many countries: The recent report of the Fiscal Reform Mission in Bolivia provides a particularly detailed account of such special rules (which are perhaps most developed in practice in Israel).

III. THE TREATMENT OF INCOME FROM CAPITAL

The rationale for special treatment of income from capital rests not on principle but on considerations of policy and administration. Perhaps the most important policy rationale for taxing income from capital lightly arises from the desire to increase savings and investment. In addition to exempting (or otherwise favoring) income that is saved or invested, many countries provide favorable tax treatment for some or all income from capital (e.g., interest or capital gains) either in order to raise the rate of return on such activity and hence make it more attractive or else on the presumption that such income is more likely to be "used" in a socially useful way (i.e., saved). The fact that the efficiency of such incentive measures has been severely questioned in most empirical studies has not, apparently, weakened their attractiveness to policy-makers. A closely related set of issues concerns the appropriate treatment of investment income accruing to foreigners.

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3. For a careful discussion of this question, see Richard Goode, *The Individual Income Tax* (Rev'd ed.; Washington: The Brookings Institution, 1976), pp. 80-92. Canada in fact permits the deduction of tuition expenses by students (not their parents), as Goode recommends.

4. The complex issues involved in devising such rules are discussed in W.D. Popkin, *The Deduction for Business Expenses and Losses* (International Tax Program, Harvard Law School, 1973).

Many varieties of exclusions, exemptions, deductions, and credits for income that is saved or invested (or for income *from* savings or investment) may be found in different countries (e.g., Canada, Venezuela). It is not possible to summarize these measures here: instead, we shall simply note that this area of income tax design is particularly difficult to generalize about because what is best for any country depends so heavily on factors specific to that country, such as its degree of openness (linkages to the international capital market), its preference for financial vs. fiscal means of mobilizing and channelling savings, the efficiency of tax-induced changes in the rate of return, and other difficult (and often largely unknown) matters.

One might well think that the *administrative* problem in taxing income from capital would be much less severe than in the case of the self-employed, at least to the extent that such income is received from such organized modern-sector institutions as corporations and banks. One complication in this regard occurs when bearer securities are important, as they are in Canada and most Latin American countries. Even in this case, however, it would appear in principle easy to avoid income tax collection problems by requiring the paying institution to withhold tax at a high rate: ideally, at the highest rate in the income tax rate scale (which, it should be noted, would therefore probably have to be lower than that which is often levied, in effect, only on high-salaried groups). The withheld tax would then be fully creditable against income tax otherwise due. This system would be equally suitable for bearer and nominative securities were it not for the fact that the former also provide a means of avoiding capital gains and wealth taxes (whether levied annually or at the time of gift or death): for this reason, a higher rate on bearer shares may be advisable, as in Bolivia and Mexico. Another possible approach would be to levy a higher tax on the retained earnings of corporations whose shares are not registered, in order to obtain at least some compensation for the revenue thus foregone on capital gains, gifts and inheritances.

Interest, dividends and royalties are easy to tax

Despite these problems, interest, dividends, and royalties should all be fairly easy to tax. The fact that they are not in most countries very effectively taxed thus in a sense reflects as much policy as administrative factors.

The administrative problem is much more severe with regard to property incomes paid by other than large enterprises, e.g., most rents, interest to moneylenders, etc. Administrative problems are particularly severe with regard to the imputed income on owner-occupied houses: the partial attempt to tax such income in the United Kingdom was abandoned some years ago and even the ambitious Royal Commission Report did not recommend that such income be taxed in Canada. Indeed, it may well be that the most effective, albeit crude, way to reach such income is through a simple annual tax on real property.

There seems no easy way to collect tax on such generally unorganized sources of capital income except by techniques similar to those alluded to in Section II for self-employed taxpayers. As in the case of the self-employed, there is no short-cut to an alert and well-informed tax administration.

Problems exist with respect to capital gains

Even such an administration will have a great many problems in taxing one particular type of capital income, namely, capital gains. Where such a tax exists, it cannot be enforced effectively even on shares (usually the easiest case) if bearer shares exist. Nor can it be enforced effectively on real property in the absence of an up-to-date and accurate cadaster. Furthermore, gains on closely-held businesses, objets d'art and similar items tax the taxman in the most advanced countries — witness the cases of France and Canada — so severely that it seems hopeless to expect less developed fiscal administrations to be able to deal with them very effectively.

Finally, even where large corporations are concerned, there is always a serious problem in controlling the conversion of ordinary income of corporations into non-taxable (or partly taxable) capital gains. *Any* differential between the rate of personal income tax levied on, say, dividends and interest and that imposed on capital gains gives rise to many avoidance possibilities which have to be anticipated and blocked in one way or another if the "global" character of the income tax is not to remain in large part a mere illusion.

The only way to avoid serious administrative problems in this respect is by approximating as closely as possible to a position in which *all* payments from corporations to shareholders are taxed similarly, no matter how they are labeled. This aim can, of course, be achieved by lowering all taxes on income from capital to the rate levied on capital gains (which is more or less what Canada did in 1977, only 5 years after introducing a tax on gains in the first place). In effect, of course, this policy then introduces a substantial degree of discrimination against labor income.

A more desirable approach, and one more consistent with the concept of a global income tax, would be to treat all such payments (including those arising through liquidation, "thin capitalization," full and partial redemptions, and so on) as ordinary income of shareholders. Obviously, a fairly harsh and arbitrary set of administrative rules would be needed to achieve this aim, but there is no other way even to approach the goal of an equitable global income tax. Some further thoughts bearing on this point are sketched in Section V below.

IV. SOME SPECIAL PROBLEMS

Many other particular problems have been encountered in different countries in the process of "globalizing" the base of the personal income tax. As in the case of the more basic issue of the relative treatment of income from labor and income from capital, the solutions found to these problems in different systems illustrate a chang

ing and varied mixture of rationales derived from principle, policy, and administrative need.

In the case of *pensions*, for example, the U.S. treatment (non-deduction of individual social security contributions and exemption of benefits) may be contrasted to the Canadian (and Bolivian) treatment (deductibility of contributions, taxation of benefits). An additional important question on the treatment of pensions in general is the extent to which analogous treatment is extended to private pension schemes — from which the more highly-paid generally receive most benefit. In Canada, for example, pressure from the self-employed has led to the allowance of considerable deductions from income for contributions to such private schemes.

In the case of *international income*, the U.S. (and to a lesser extent Canadian) treatment (taxation of foreign income of residents — citizens in the U.S. — and flat-rate taxation of most payments to non-residents) may be contrasted to the Bolivian (and Venezuelan) application of the territorial principle (exempting foreign income of residents, though still taxing payments to non-residents). This whole area, of course, poses some of the most difficult questions in income tax design.

All countries make considerable use of a wide variety of *tax incentives*, the usual effect of which is to lighten the weight of taxes on income from capital. Most countries also have significant *sectoral differentiation*, with special regimes (at least with respect to the determination of net income) for industries such as agriculture, mining, and the financial sector (banking and insurance).

A problem of special interest in many countries in recent years has been the impact of inflation on the tax system

Some countries such as Canada and the Netherlands have introduced automatic indexation schemes for personal exemptions and rates; others, such as the U.S., have preferred to rely on discretionary adjustments in personal tax structure to offset undesired tax increases as a result of inflation. Still others — including perhaps many of the developing countries — may even welcome such inflationary increases as a relatively painless way of increasing tax revenues. Still more difficult questions are posed with regard to adjusting the *base* of the income tax for the effects of inflation. The principal areas of difficulty here are depreciation, inventory valuation and — an often-neglected but important offset to the other two — financial items on the balance sheet. (The important point here is that those who owe money in fixed nominal currency amounts, as do many business firms, gain in inflation.) While some countries (e.g., Brazil and Argentina) have gone much further than others in dealing with these problems, it seems fair to say that there is as yet no real consensus in either theory or practice as to how best to recognize inflation in income tax structure. A partial solution, such as commonly advocated by business, may be worse from a social point of view then no action, while a comprehensive solution seems beyond the reach of even the most advanced country at this time.

In all these (and other) cases, there are no simple answers to the question of the appropriate tax treatment of many items, whether one is operating within the framework of a global system or not. Perhaps the major contribution of the notion of globality in this context is to serve as a standard (or principle) requiring all deviations in treatment from the treatment applied to the "standard case" of wage income to be specially justified in terms of the social benefits to be achieved from such deviation (policy) or the social costs of not so deviating (administration). This is no small contribution, but it does bring out again the important point that the adoption of a global framework alone does little to resolve the hard problems of designing an effective personal income tax in an evolving society.

V. CONCLUSION

Much of this brief paper has been concerned with sketching some of the many problems countries have encountered in moving towards a more global personal income tax base.

Although in principle globalization means the treatment of all income alike, regardless of source, in practice different degrees of "netness," "policy" rationales, and the various administrative problems alluded to above mean that no tax system anywhere really treats all forms of income alike. Nor does it seem reasonable to posit this as a short-run goal in any developing country. [5] Instead, attention should be focused on (1) strengthening administration in those areas in which it is inherently weakest — the self-employed, rental incomes, etc. — and (2) considering carefully the extent to which policy objectives (or simply politics?) require more favorable treatment of certain types of income than seems warranted in the name of the principle of globalization. To the extent that such schedular elements remain, it must also be carefully considered whether it is best to mark them out explicitly (e.g., by special tax rates on interest income) or to allow them to exist in practice but not in form (as with agricultural income in many countries). [6] The former would seem better in principle, but the latter is clearly the more common practice.

These qualifications do not, however, mean that one ought to give up on globalization as an appropriate goal

One important function of law in any country is to state or announce social ideals or goals, even if they cannot, for the moment, be fully or adequately implemented. In this sense, the imposition of a global framework for the income tax may serve an important role as a statement of goals which may provide administrators and judges

5. Indeed, Rezende (in the paper cited earlier) has gone so far as to argue that a revised form of schedular taxation would be more suitable for most developing countries than further moves toward ineffective globalization.

6. For a careful discussion of agricultural income taxes, see G.E. Lent, "Taxation of Agricultural Income in Developing Countries," *Bulletin for International Fiscal Documentation*, 27 (August 1973), 324-343.

alike with some basis for deciding difficult cases of interpretation.

One way to achieve this purpose is by providing, for example in a preamble to the taxing statute, that any tax avoidance scheme intended to circumvent the statute will fail to do so if it is determined to violate the broad intent of the statute (i.e., to tax equally all forms of income received by persons). The Canadian income tax law, for instance, contains more or less just such a provision (Sec. 246) permitting the Treasury Board (a committee of cabinet ministers and hence a political body) to so rule. The fact that this provision has seldom been used, and not at all for several decades, is in the present context perhaps less important than the mere fact of its existence — as it were, as a kind of ultimate deterrent. An even stronger provision in Australia, giving considerable powers to the Commissioner of Taxes (an official), appears similarly to have been so effective that it has had to be used only once (in 1960). [7]

In addition to the general "anti-avoidance" provision, the administrative structure of the Canadian income tax contains several related provisions of more specialized scope but operating below cabinet level. There is, first, a general provision (Sec. 247) that, at the discretion of the Revenue Minister, transactions involving the "stripping" of dividends from a corporation (and their conversion into capital gains) can be disregarded and the proceeds taxed as ordinary income. Secondly, there are general (not discretionary) anti-avoidance provisions, e.g., that transactions that "artificially or unduly" reduce capital gains or increase losses will be ignored for tax purposes (Sec. 55) and a similarly-worded provision on certain pension payments to company executives (Sec. 245). Such broadly-worded statements in effect confer substantial power on the tax administration. The very vagueness of the language employed, while it invariably annoys and disturbs taxpayers — and especially their lawyers — increases the effectiveness of the law (and hence presumably its compliance with the goal of globalization) at the expense of reducing its certainty and perhaps increasing its arbitrariness.

In turn, these broad provisions in the Canadian law are supported by dozens of detailed provisions intended to prevent and block off particular modes of tax avoidance. To use a military metaphor, these detailed provisions are like snipers aiming at well-identified targets, supported by the machine guns of the broader provisions against avoidance in such contentious fields as capital gains, dividend-stripping, associated corporations, and pensions, and backed up ultimately by the "big gun" of a general anti-avoidance provision. (In addition, in recent years Canadian courts, as had U.S. courts long before, have begun to disregard certain legal maneuvers on the grounds that they are simply "shams" intended to achieve no purpose except to reduce taxes. [8])

Obviously, the legal (and political) situation varies in every country. The point of including this brief account here is not to put forth Canada as a model but simply to bring out clearly the need, even in developed countries with a very "global" tax structure and generally high levels of administrative competence and taxpayer compliance, to support the legal transition of the personal income tax to a more global concept with an effective legal structure for tax administration (and, of course, an effective administration). Global income taxes make sense in both equity and economic terms, as noted in Section I; they also may make sense, as at least an aspiration, even when they cannot be effectively enforced, as noted earlier in the present section; but there is no getting around the fact that the key to moving towards an effectively global income tax lies in improved tax administration at many levels. For this reason, the present brief account of some of the issues encountered in different countries in the course of making such a transition has heavily stressed the administrative aspect.

Questions of principle and policy are of course important and even decisive in many instances — and much more could be said about them than has been done here. But what can be said without fear of contradiction is that in the end the administrative constraint will very likely be a decisive consideration on what can actually be done in any country about globalizing its income tax. Moreover, for this and other reasons, a strong case can, we believe, be made for avoiding large, sudden changes, especially in the taxation of income from capital: too often such changes lead to over-reaction, especially in periods of economic distress. "Nature", said Alfred Marshall, the well-known English economist, "does not proceed by jumps" — and neither should tax reforms in such delicate economic and administrative areas as this. Small, regular changes (e.g., gradual increases in withholding rates) may be absorbed more easily, and hence seem in general a better way to go, both providing less occasion for adverse extreme reaction and more time for the necessary accompanying administrative improvement.

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7. "Every contract, agreement or arrangement . . . . shall so far as it has or purports to have the purpose or effect of in any way, directly or indirectly . . . . defeating, evading or avoiding any duty or liability imposed on any person by this Act . . . . shall be absolutely void, as against the Commissioner." (Sec. 260, *Income Tax Act*, Australia.)

8. The anti-avoidance provisions in the U.S. Internal Revenue Code include such broad provisions as Section 482, which gives the Commissioner of Internal Revenue and his staff the power to reallocate income and expenses between related persons and entities in order more properly to reflect each taxpayer's taxable income. Other provisions deal with acquisitions made for the purpose of avoiding tax (Section 269), transfers to avoid income tax (Sections 1491-1494), and specifically blocked actions or transactions (e.g., Sections 531-565). Also, the courts have developed anti-avoidance doctrines such as the "business purpose test" in *Gregory v. Helvering*, 293 U.S. 465 (1935).

APPENDIX

UNITED STATES

Background

While the United States Federal Government had short-lived income taxes during the last century for a decade in the 1860's and for a few months in 1894, when the tax was held unconstitutional, the modern income tax dates from 1913, after a constitutional amendment was adopted. That act imposed taxes on individuals at rates from 1% on the first $20,000 to 6% on amounts above $500,000. The tax was annually reenacted until a permanent code was adopted in 1939 and revised in 1954. The 1954 Internal Revenue Code, as amended from time to time, is the current law. While generally regarded as a global income tax applying to all types of income and all income wherever located geographically, numerous exceptions exist to the broadest concepts of globalization.

These notes will not go into the wide variety of special rules applicable to different types of business income in reaching the figure of net income, which is then subject to tax like other income. Such special rules for calculating net income exist for banking, insurance, so called public utilities, mining, oil, farming, ship building, and a number of other particular types of manufacturing.

Personal Services

Earned income from personal services is entitled to a credit of 10% up to $4,000 of earned income, but the credit is reduced as income increases beyond $4,000, so that at the $8,000 level the credit vanishes completely. At the other end of the income scale, the maximum rate of tax applicable to earned income is 50%, even though 70% is the top marginal rate otherwise applicable to individuals.

Accident and health plan benefits provided by employers to employees are exempt.

Employer contributions to pensions, profit sharing benefits, stock bonuses, and stock options, are either exempt to the employee or given special treatment in the form of reduced taxes. (At the same time employers generally get to deduct from their income the costs of these contributions.)

Social Security taxes are based upon the employee's wages and are paid in part by the employee through deduction from his wages and in part by the employer. The employer part is deductible from the employer's income but is not included in the taxable income of the employee either at that time or later as benefits. The employee's part is not deductible by him from the wage income taxed to him, but the payments made to the employee after retirement from the social security scheme are exempt income at that time.

Meals and lodging furnished by the employer for his convenience are deductible by the employer, but not taxable as income to the employee.

Various other fringe benefits paid for by the employer are generally deductible for the employer and not taxable to the employee, with exceptions.

Prizes and awards are generally exempt, subject to special rules.

Scholarships and fellowships are also generally exempt from income tax to the recipient, but are subject to ceilings and to special rules.

Military personnel also have a variety of exemptions for combat pay and exclusions of subsistence and uniform allowances and other payments.

Personal Deductions

Interest paid by individuals on borrowed funds is deductible even though the funds are used for such personal purposes as buying homes, TV sets, and automobiles.

Taxes paid to state and local governments if levied on sales, property, income, and gasoline are deductible by the individual even though none of these taxes has been incurred for business reasons.

Medical expenses are deductible by individuals if they exceed 3% of income.

Contributions made by individuals to charitable, educational, and religious organizations are deductible up to 15% or 30% of income depending on the type of organization.

Losses suffered by individuals through casualties (for example, storms) or thefts are deductible to the extent they exceed $100 for each loss incurred.

Exclusions from Income

Gifts and inheritances are excluded from taxable income.

Life insurance proceeds are excluded, as are portions of annuities.

A portion of pay received while injured or sick has been excluded under the Internal Revenue Code for a number of years, but the sick pay exclusion has been repealed beginning in 1977.

Interest received on bonds and other forms of indebtedness issued by state and local governments is exempt from the Federal income tax (similarly, federal bond interest is exempt from state and local income taxes).

Capital Gains

Long term capital gains, that is, realized gains on property held for more than a year, are subject to a maximum tax of 35%, but may be taxed even less. Extremely complicated rules exist for the definition and taxation of capital gains and losses.

Minimum Tax on Preference Income

A tax of 15% (10% before 1977) is levied on items of

tax preference, which now include itemized deductions in excess of 60% of adjusted gross income, accelerated depreciation in excess of straight line depreciation on all personal property subject to a lease, long term capital gains, percentage depletion, intangible drilling costs, and certain other items. This minimum tax represents an attempt to reduce the benefits received by high income taxpayers from a variety of what are widely regarded as tax preferences.

Miscellaneous

The Tax Reform Act of 1976 made a number of changes, including limiting an individual's ability to deduct expenses attributable to the use of a portion of his home for business purposes. Similarly, deductions for expenses of attending conventions, educational seminars, and other meetings outside the United States have been considerably curtailed. Benefits of employee stock options have been reduced. Moving expense deductions when changing jobs have been increased to $1500, plus certain other benefits. Gain on the sale of a residence by elderly persons is excluded from income to the extent of $35,000. Employer contributions to group legal service plans for the benefit of employees are excluded. This new provision is applicable for 5 years on an experimental basis.

State and Local Taxes

While a number of the states of the United States have personal income taxes, many of them "piggy-back" on the federal tax. But not all of them do. Many have fewer personal expense deductions or broader tax bases. The State of Massachusetts, for example, allows deductions only for medical expenses. In addition, the State of Massachusetts not only taxes 100% of long term capital gains, but applies a rate twice as high to them as to earned income. This high rate also applies to interest and dividend income. Most other states use graduated rates applicable to all income, but these rates exceed 10% in only a few states.

CANADA

A. General

Canada has a fully developed global income tax. Nevertheless, there are various structural and administrative differences in the treatment of different types of income (and uses of income). These notes are intended simply as a brief sketch of certain features of this complex system and must not be construed as being either complete or fully accurate.

B. Earned Income

Traditionally no special treatment of earned income has existed in Canada. At one time, however, income from investments (e.g., interest and dividends) was subject to a surtax of 4 percent. In 1961, the base of this surtax was reduced to investment income from sources outside Canada, and a few years later it was dropped completely.

All wage and salary income (except for certain limited occupations) was long considered to be net income and consequently fully subject to taxation with no allowance for any expenses incurred in earning the income. The 1966 Royal Commission on Taxation criticized this treatment as discriminatory (compared with the ability of the self-employed to deduct such expenses) and recommended that employees be able to deduct certain employment expenses or else claim an optional deduction of 3 percent of earned income up to a maximum of $500. The new tax law introduced in 1972 instead granted an automatic deduction of 3 percent of wage and salary income, with a maximum of $150. This amount was increased to $250 in 1977 (but has not been indexed, although both the rate structure and personal exemptions were indexed in 1973).

C. Capital Income

1. *Interest.* Traditionally, there has been no withholding at source. Instead, payèrs must issue information slips (T5), at least for amounts over $50. When interest is paid on a bearer bond, the payer similarly issues an information slip (T600): it appears, however, that there has been no real control over such interest payments since not only can anyone ("straw men") collect them but also the identification number of recipient need not be on the form. In March 1977, this omission was fully rectified when Revenue Canada required that residents of Canada cashing bond interest coupons either provide a "correct" social insurance number or pay a 25 percent withholding tax.

Since 1974 the first $1000 of interest income received has been exempt from tax. Originally, this exemption was to be extended only to net interest receipts, that is, after deducting interest paid and claimed as a tax deduction (in Canada, only interest paid on money borrowed to aquire income-producing assets), but the actual legislation extended the exemption to gross interest. In 1977, the exemption was again restricted to net interest. Dividends and capital gains from the sale of Canadian stock may also be included in this $1000 exemption. In 1975, any unused portion of this exemption was made transferable between spouses, a not insignificant concession given the individual tax unit in Canada. The stated rationale for the interest exemption was to offset the effects of inflation.

2. *Dividends.* The administrative system is the same as for interest payments except that *all* dividend payments give rise to information slips (T5), regardless of their amount. The reason for this difference is that dividends (of Canadian companies) carry with them a federal tax credit owing to the partial integration system described below. Bearer shares appear to be legally possible but are seldom if ever issued: many shares are, however, held in "street names" which means, in effect, that much of the task of the tax administration is handled by the brokerage houses.

Since 1949 Canada has granted special tax treatment to dividends: from 1952 to 1971, for example, dividend recipients were entitled to deduct from their taxable income an amount equal to 20 percent of dividends received. This system was severely criticized by the Royal

Commission on Taxation as inequitable (in that it provided larger tax savings to high-income than to low-income taxpayers) and inefficient (in that it did not accurately "offset" the corporate tax). The Commission's own proposal was for a system of full integration of the corporate and personal taxes, in effect including all corporate profits (including undistributed profits) in shareholders' income and allowing the corporate tax as a credit against personal tax due on such "grossed-up" income. The system actually introduced in 1972 does not go nearly so far but does amount to full integration for small businesses (which are subject to a lower corporate rate) which fully distribute their profits.

In general, the present system amounts to a partial "gross-up-and-credit" system, with recipients adding about one-third of actual cash dividends, as well as the dividends themselves, to their income, calculating the tax due on income including this grossed-up amount and then subtracting a federal tax credit amount to about 50 percent of the dividend from this tax. Until 1977, the credit was about 33-1/3 percent: one apparent reason for the increase was to reduce the pressure to avoid dividend taxes by "converting" dividends into capital gains, which were taxed at a lower rate. The increase means that dividends are also taxed at almost as low a rate, relative to wage and salary income. All the relevant amounts needed for this calculation are shown on the T5 information slip. (Owing to the complex relations between federal and provincial income taxes in Canada, all statements on percentages are approximate and vary from province to province.)

D. Capital Gains

For many years capital gains as such were not taxed in Canada (although about 25 percent of receipts treated as gains in the U.S. were taxed as income in Canada). The Royal Commission on Taxation recommended full taxation of realized gains at regular income tax rates, together with deemed realization of accrued gains on property transferred by gift or bequest as well as when an individual ceased to be a resident of Canada. As actually introduced in 1972, however, only one-half of gains realized on assets held over one year are subject to income tax, with accrued gains being subject to the same tax on death, gift, or change of residence. The main exemption was for "principal residences", sales of which are completely exempt from income tax (regardless of whether the vendor acquires another house). Recent concessions include a doubling of the amount of capital losses that can be offset against ordinary income (to $2000) and, more importantly, exemption of certain stock options and stock dividends that had previously been subject to tax and also of gains on the sales of businesses and farms, provided the money is reinvested in a similar activity.

The major administrative problems encountered in introducing this system have arisen in connection with the valuation of closely-held business. Simplifying slightly, only gains arising after the end of 1971 are subject to tax (on the difference between sales price and cost or value as of end-1971). Official "Valuation Day" prices for all quoted shares have been issued. No account is taken of inflationary price increases, although the subject is under discussion.

The only special concession made to the "lumpiness" problem is in the case of deemed realizations at death where a six-year payment option is available (see also section G). Gains income is also taken into account in an automatic "general averaging" system and, more importantly, qualifies for a special scheme under which tax on certain types of income (*not* including wage and salary income) may be postponed for up to 15 years by purchasing an income-averaging annuity contract (IAAC). The proceeds of the contract are then taxed as received. (A somewhat similar system had been suggested by the Royal Commission on Taxation, with the important difference that under the Commission's proposal interest would have been charged on the postponed tax.)

E. Pensions

The present treatment of pensions was basically introduced in 1946. The essential idea is that inflows into registered pension plans are untaxed (whether from employee or employer), as is any interest earned by the fund, while all withdrawals are subject to tax. Prior to 1972 (and still, for amounts then accrued) special reduced rates were applied to lump-sum withdrawals: currently, the averaging provisions discussed in section D apply.

With the introduction of the Canada Pension Plan (CPP) in 1966, similar treatment was extended to public pensions, with contributions being deductible and benefits taxable. The basis Old Age Security payment had long been taxed (although contributions were not deductible since it was financed from general revenues). Following the recommendation of the Royal Commission on Taxation, unemployment insurance contributions and benefits have been treated like the CPP since 1972 and family allowance payments have been taxable since 1974. Other public transfer payments, however — war disability pensions, workmen's compensation benefits, the Guaranteed Income Supplement (paid to old age pensioners below certain income levels), and various provincial welfare payments — are still exempt.

Following arguments in the 1950's from the self-employed of discriminatory treatment, the registered pension plan system described above was extended to encompass what are called Registered Retirement Savings Plans (RRSPs). In recent years these plans have become much more important: they are outlined further in section F.

Recently a special exemption of $1000 was granted to pension income (other than that from the indexed public pension plans) purportedly as an offset for inflation. This exemption is transferable between spouses (see section C1).

F. Savings

The major exemption for savings in Canada is for income paid into RRSPs (see section E). The original limits for this exemption were $1500 if the taxpayer was

also a participant in a registered pension plan (section E) or $2500 if he was not a participant in such a plan. In 1972, these limits were raised to $2500 and $4000 respectively. Effective in 1977, the limits are now $3500 and $5000. A self-employed Canadian taxpayer can exempt up to $5000 a year from income taxes by investing it in one of the wide variety of RRSPs offered by financial institutions or by setting up his own RRSP. RRSPs may consist of holdings of a wide range of shares, mortgages, bonds, and similar financial assets. In addition to the initial exemption, the taxpayer also benefits from a similar exemption of all returns accruing to the funds invested in an RRSP. He is subject to tax on all withdrawals from an RRSP, however, and must, in the end, convert his RRSP funds to an IAAC (see section D) when he is 70. In 1974 contributions to "spousal RRSPs" were permitted, thus opening a way to splitting income for many taxpayers.

In 1974 a new savings exemption was created in the form of the Registered Home Ownership Savings Plan (RHOSP), allegedly intended to foster home ownership in Canada. The mechanics of this plan are rather like that of the RRSP except that each taxpayer is entitled to only one RHOSP in his life (there is no limit on the number of RRSPs anyone can have) and that only those who do not own any interest in real property can open a RHOSP. Subject to these limitations, taxpayers can exempt from tax up to $1000 a year for up to 10 years by investing in an RHOSP. As with the RRSP, returns accruing to the funds so invested are also exempted. In addition, however, the funds placed in an RHOSP may escape tax *completely* if on withdrawal they are used to purchase a house. In 1977, the RHOSP rules were substantially tightened to reduce flagrant abuses that had been taking place.

G. Gifts and Bequests

Death taxes were first introduced by some provinces in the 1890's. In 1941 the federal government introduced its own tax, first on an inheritance and then on an estate basis. (A federal gift tax had been introduced in 1935.) The Royal Commission on Taxation recommended that all special taxes on gifts and bequests should be abolished and that such transfers should be subject to the regular income tax. Federal taxes on gifts and bequests were in fact abolished in 1971, allegedly because of the simultaneous introduction of the capital gains tax on gains deemed to be realized on property transferred by death or gift (section D). These transfers were not, however, otherwise made subject to income tax and this gains tax is now the only federal tax on gifts or bequests. Since 1972, 7 of the 10 provinces have also abolished transfer taxes on gifts and bequests, and two other provinces have substantially lightened the impact of such taxes by repeatedly reducing rates (Quebec) or raising exemptions (Ontario).

H. Hard-to-Tax Groups

No special techniques are emplayed (other than administratively) to deal with such groups.

I. Other Topics

1. *Agricultural Income.* At least three special features exist with respect to agricultural income: (a) Farmers (and fishermen) have since 1949 been able to utilize an optional five-year block averaging system. Despite the introduction of general averaging in 1972, they still have this option. (b) The amount of farm losses that can be claimed by taxpayers ("hobby farmers") whose principal income is from nonfarming sources is severely restricted; (c) Farmers are given more option to treat certain income and expenses on a cash rather than accrual basis than are other taxpayers.

2. *International Income.* Since 1933 all payments to non-residents not engaged in business in Canada have been subject to withholding tax. Originally at 5 percent, this rate was raised to 15 percent on gross payments of interest, royalties, etc. for many years, with a lower rate of 10 percent being granted by treaty. The Royal Commission recommended that the rate be raised to 30 percent; in fact, it was raised to 25 percent in 1976, with a lower rate of 15 percent being granted by treaty. (The treatment of dividends is different and more complex owing to the partial integration system discussed in C2; it is not discussed here.) Interest paid to non-resident holders of government and long-term bonds is, however, exempted from withholding tax.

All foreign income received by Canadian residents is subject to income tax, with a tax credit being granted (in a somewhat unusual manner) for taxes paid abroad on such income.

3. *Mining.* The importance of the extractive sector in Canada is reflected in the importance and complexity of the federal and provincial taxes imposed on the mining and oil industries. Following the report of the Royal Commission on Taxation, the previous three-year exemption of income from new mines was abolished in 1974, as was the previous system of percentage depletion. The latter was replaced by a new concept of "earned depletion" which in essence amounts to more than 100 percent immediate write-off of exploration expenditures. Further discussion of this subject would be so complex that it cannot be undertaken here.

4. *Incentives.* Other than those already mentioned, the major incentives in Canada are probably those to fixed investment in manufacturing and processing industries. In addition to a two-year write-off of machinery and equipment, such firms (and firms in the resource industry) have since 1975 benefitted from a 5 percent investment credit on both buildings and machinery, as does all expenditure on scientific research and development. As noted in Section C2, small business corporations are also subjected to a lower tax rate (approximately half the usual corporate rate), and some provinces have special incentives for investment in such businesses. In the past extensive use was also made of regional development incentives, but these are now all grants except for investment credits of 7.5 and 10 percent (rather than the usual 5 percent) extended in 1977 to certain investments in certain regions. There are also various minor tax incentives (e.g., two-year write-off of pollution control equipment).

FRANCE

The most useful way to get a handle on France is to read pages 79-93 of the well known volume, produced by the Harvard Law School International Tax Program, *World Tax Series: Taxation in France* (by Martin Norr and Pierre Kerlan, and published in 1966 by Commerce Clearing House in Chicago). In these few pages one observes the sweep of history over the centuries to modern times. France was an early user of forms of income taxes, but not until the 1959 reform did France get a modern global income tax. France's progress through various stages of schedular taxation illustrates the impact of changes in economic structure and tax techniques and administrative capability through the 19th century and the first half of the 20th century. Since the second world war France has, of course, been under the pressure of the European Economic Community (Common Market) to conform its income tax structure to those of its major competitors. Italy has been under the same pressure.

The detailed examination of the French changes over time would be appropriate as a part of implementation studies for changes in Mexican law. For present purposes it hardly seems necessary to do more than note the availability of the information in the World Tax Series volume, excerpts from which begin below.

One exception to the foregoing, however, is the recent French experience with broadening its taxation of capital gains. This past year a modest capital gains tax was adopted by the French Government to apply to individuals with gains on transferable securities. The opposition of the business community following enactment has led to a substantial pull-back in the implementation of the new provisions. Recent action by the French Government postpones the effective date of the new capital gains provisions to January 1, 1979. All this activity has taken place in context of a law which already taxes the capital gains of business firms and certain gains of individuals on real estate transactions and on securities where the shareholder and his family have ownership of more than 25 percent of the total shares at any time within 5 years before the transaction.

Excerpt from WTS: France, pp. 90-93 (original footnote numbers retained)

THE TAX REFORMS OF THE FIFTH REPUBLIC

1. *Income tax.* Reform of the French tax structure paralleled the economic transformation of France that occurred following World War II (1/2.1). Reform began under the Fourth Republic with the adoption of a separate corporate income tax in 1948 (2/1.2e) and of the value-added tax in 1954-1955 (2/1.2f). The Fifth Republic carried tax reform forward with new vigor after it came to power in 1958. [108]

The first major tax measure was the reform law of 28 December 1959. [109] Probably the most important aspect of that law was the reform of the individual income tax. Schedular taxation was abolished; both the proportional tax (schedular in nature) and the progressive surtax were repealed. In their place, there was established a new individual income tax (*impôt sur le revenu des personnes physiques* or IRPP), global in nature and modern in design, resembling in its essentials the individual income taxes of the United Kingdom, Germany, and the United States. Indeed, the desire to conform the French income tax structure to those of its major competitors in the Common Market was an important factor in the reform: [110]

Finally, the European economic community requires that the tax structure of our country be comparable to that of competing nations. A tax reform should be the occasion for a harmonization of the principal aspects of the legislation and not the pretext for the establishment of a "tax moat."

Thus, the 1959 reform has been hailed as "the first stage in the process of aligning the tax systems of the Common Market." [111]

Because of revenue requirements, however, the abolition of the proportional tax was not immediately made effective in all respects. As a temporary supplement to the new individual income tax, a flat-rate complementary tax (*taxe complémentaire*) was enacted. The tax applied only to certain special categories of income. The scope and rate of the complementary tax have been steadily reduced, and the tax is scheduled for abolition by 1968 (16/1).

The 1959 tax reform also marked the beginning of a process of reducing the weight of the individual income tax, which had become increasingly heavy as inflation pushed taxpayers into higher tax brackets without fully commensurate increases in real income. Almost every finance act since the 1959 reform has made some reduction in income tax rates (12/1.5a).

Fewer changes were required in the corporation income tax, a modern tax that had been adopted during the reform of 1948 (2/1.2e).

One of the earliest achievements of the de Gaulle regime was to put a stop to rampant inflation and monetary depreciation. The 1959 reform abolished the complicated tax provisions permitting the revaluation of depreciable assets (6/6.2) and the setting aside of special deductible reserves for the maintenance of essential inventory (6/5.2). In addition, the reform provided for the abolition over a five-year period of the straight-line depreciation system and for the adoption, in its place, of a modern declining-balance system like the systems then used in Germany and the United States (7/3.4). Indeed, the new depreciation rules, like new inventory valuation rules adopted at the same time (6/5.2), were modeled after Germany's rules and marked another step in the process of aligning the income tax structures of the Common Market countries.

2. *Succession tax.* Another accomplishment of the 1959 tax reform law was the reform of succession and gift taxes (3/2, 3/3). Before 1959, France had two death taxes: a succession tax and an estate tax. The reform abolished the two-tax system, leaving France with only the succession tax. Moreover, for transfers between spouses or in the direct line, the reform made sharp reductions in the burden of the succession tax.

3. *Registration and stamp taxes and the taxation of real property transactions.* In addition to reforms of the income tax and of succession and gift taxes, the 1959 reform made certain changes in the registration tax system, but these changes were not extensive. In 1961, the Ministry of Finance proposed a major reform of registration taxes, which, after certain changes, became law in 1963. [112] The new law simplified and modernized registration taxes (3/4.1d) and stamp taxes (4/10.1), but its major effects were in the taxation of housing construction and the taxation of capital gains realized by individuals.

To encourage the construction of housing and to eliminate inequalities in tax burden resulting from the different forms taken by construction operations, the 1963 reform extended the value-added tax to all operations involved in the construction and delivery of housing and eliminated the registration taxes previously imposed on certain of those operations (3/4.2, 14/2.3a5).

108. Tax reform was, of course, only one aspect of the reform aims of the de Gaulle government, a government that "had efficiency and the modernization of the country for its objective, taking up the task of national renewal where Mendès-France had been forced to halt a half-decade earlier." Hughes, *Contemporary Europe: A History* 474.
109. L. 59-1472, 28 December 1959. Because the reform went into effect on 1 January 1960, it is sometimes known as the "1960 reform."
110. "La réforme fiscale," *Stat. et Etudes Fin.*, no. 136, 349 (1960).
111. Nortcliffe, *Common Market Fiscal Systems* v.
112. L. 63-254, 15 March 1963.

Another accomplishment of the 1963 reform was to subject to income tax capital gains realized by individuals in a variety of real property transactions (9/8.3, 9/8.4, 9/8.5). [113]

4. *Tax procedures.* The government of the Fifth Republic has accomplished procedural as well as substantive reforms. One feature of the French tax system is its reliance on a variety of taxes (2/1.1c). Over the years, different procedures for the assessment and collection of these different taxes, as well as different penalties and different rules governing protests, refunds, and statutes of limitation, had developed. In 1963, Parliament enacted a far-reaching procedural reform proposed by the Ministry of Finance; the new law provided for the harmonization and unification of the rules governing audit, refund, and litigation procedures, as well as the rules governing penalties, interest, and statutes of limitation (13/1.2). [114]

Legislation enacted in 1963, moreover, provided for reform of customs procedures, many of which had remained unchanged since the days of sailing ships and horse-drawn wagons (4/6.1). [115]

5. *Proposed reform of the sales tax system.* The de Gaulle government has also propsed extensive reforms of other aspects of the system. One of these is a proposal for reform of the sales or turnover tax system (*taxes sur le chiffre d'affaires*). This reform would abolish the local tax on retail sales (14/4) and expand the scope of the value-added tax, already the most important single tax in the French tax structure. The proposal was first introduced as part of the 1959 tax proposal, [116] but was vigorously opposed in Parliament by representatives of local government units, who objected to the abolition of the local sales tax. Parliament directed the government to come forward with a new proposal for reform of the sales tax system by 1 May 1960; if the new proposal were to provide for abolition of the local tax, the government was to provide, for local government units, another source of revenue capable of expanding with local economic development. [117]

The Ministry of Finance submitted its second reform proposal in the spring of 1960, but Parliament took no action (14/1.3). A third proposal, again calling for abolition of the local tax and for expansion of the value-added tax, was submitted by the Ministry of Finance in 1965. [118]

6. *Proposed reform of the local tax system.* The proposal to abolish the local tax is discussed at 2/1.2g5. The other major elements of the local tax structure are direct descendants of the "old four" taxes of the Revolution. The Ministry of Finance has also proposed modernization of these taxes (15/1.3).

7. *Proposed reform of the taxation of corporations and shareholders.* At present, corporations are subject to the corporation income tax at a flat rate of 50 percent; no distinction is made between distributed and undistributed profits. Distributed profits, in turn, are subject to income tax in the hands of shareholders, and no credit is available for any part of the corporation income tax paid by the distributing entity. [119] As an incentive to French capital markets, however, a reform of the taxation of corporations and shareholders was proposed by the Ministry of Finance in 1965. [120] The corporation income tax rate would remain 50 percent on all profits, distributed and undistributed, but the shareholder would, in effect, receive a credit for one half of the corporation income tax borne by the corporation with respect to distributed profits. [121] This reform also provides for abolition of withholding of preliminary tax from dividends.

The 1965 proposal called for other changes in business taxation, including simplification of the taxation of capital gains realized by business enterprises (9/8.8) and the experimental or voluntary abandonment of the territorial rule of the corporation income tax (11/1.3).

With the enactment of the proposed reforms, in addition to those already adopted, the Fifth Republic will have modernized and reformed every major element of the French tax structure: the individual income tax, the succession and gift taxes, the value-added and other sales taxes, registration and stamp taxes, the local tax system, the taxation of real property transactions and capital gains, the taxation of corporations and shareholders, and tax and customs procedures.

VENEZUELA

A. General

Venezuela has had an income tax since 1942. In 1959 a thorough review of the system (Shoup Report by Carl S. Shoup and others, *The Fiscal System of Venezuela*, Johns Hopkins University Press) recommended that the existing system, which consisted of 9 flat-rate schedular taxes plus a complementary progressive tax, be converted into a more modern unitary global tax (plus separate corporate tax). In 1967 this change was made. The system still retains significant schedular elements, however, some of which are noted below. Note that the present account is not based on fully-up-to-date or complete information.

B. Earned Income

Until 1967 salaries and wages were taxed at a 1% flat rate (in addition to the complementary tax), which was significantly lower than the rates applied to other types of income. The Shoup report recommended that if differentiation in favour of earned income were considered desirable, it should be achieved by some device such as a credit of 2% of earned income up to some (low) maximum figure. The 1967 reform, which subjected wages and salaries along with other forms of income to a lower progressive rate schedule than "commercial and business income", followed this recommendation in part by giving wage and salary earners a special credit of Bs.234 provided they had no other income and their income did not exceed Bs.19,800. In 1974, however, those with incomes of less than Bs.24,000 were completely exempted from tax, in effect removing this credit.

C. Income from Capital

1. *Interest.* Most interest paid in Venezuela is probably exempt from tax. All interest from savings and loan accounts is exempt, as is interest on certain public bonds and interest up to 8% on mortgage bonds issued by authorized financial institutions. Interest received on the first Bs.100,000 — a figure raised from Bs.10,000 to Bs.50,000 in 1967 and subsequently to Bs.100,000 in 1974 — of savings bonds and deposits appears also to be exempt. There appear to be no special withholding provisions on interest paid to resident individuals.

113. Part of this reform of the taxation of capital gains from real property transactions was carried out by the Finance Act of 1964, L. 63-1241, 19 December 1963.
114. L. 63-1316, 27 December 1963.
115. L. 63-1351, 31 December 1963.
The reform of customs procedures parallels the sharp reduction in French customs duties carried out under the terms of the Treaty of Rome establishing the European Common Market (4/6.1).
116. *Projet de loi*, no. 227, 23 July 1959, arts. 46-55.
117. L. 59-1472, 28 December 1959, art. 57.
118. *Projet de loi*, no. 663, 1 June 1960; *Projet de loi*, no. 1420, 4 June 1965.
119. Rules to prevent double taxation of intercorporate dividends are discussed at 9/2.13.
120. *Projet de loi*, no. 1309, 7 April 1965.
121. The reform would also advance the harmonization of tax systems within the Common Market; in effect, the new French system would resemble the differential taxation of distributed profits already in force in Germany and Belgium. *Projet de loi*, no. 1309, 7 April 1965, p. 10.

2. *Dividends.* Until 1967 dividends were not taxed as personal income. In that year they were made subject to personal income tax (as had been recommended in the Shoup Report). At the same time, however, resident recipients were allowed to claim a credit equal to the amount of the dividend times 40% of the effective rate applied to the paying company in the previous year. This credit reportedly eliminates the tax for most recipients. Note that there is no "gross-up", as had been recommended in the Shoup report, so that the main effect of the credit is simply to lower taxes on dividends rather than to effectuate any real "integration" between the personal and corporate taxes.

Venezuela imposed a 30% withholding tax on bearer shares (in lieu of any other tax: see also section G). Although all such shares were supposed to be converted to nominative shares after the 1974 ratification of the Andean Pact's Decision 24 this has not apparently been done. In addition, a 1% tax is withheld on dividends on nominative shares and identified bearer shares paid to resident individuals.

3. *Rents.* Deduction of maintenance and administrative expenses are limited to 15% and 5%, respectively, of gross rental income. (See also section D on some exemptions.) Taxpayers can deduct up to Bs.1000 a month for rent if they do not own any real estate (and the same amount for mortgage or loan interest connected with a house if they do).

D. Capital Gains

Capital gains have, at least in principle, always been taxed as ordinary income in Venezuela, with no apparent special provisions for inflation or averaging (the latter had been recommended by the Shoup Report). Capital gains derived from sales of real property are subject to the (higher) rate schedule applied to commercial and business income, although a law presently before Congress would significantly reduce the progressivity of this higher rate scale. In 1974, however, gains (and rentals) from real estate used for housing, commercial and industrial construction, schools, tourism, hotels and recreational facilities were all exonerated from tax (see also Section F).

Fortuitous gains such as lottery prizes and pari-mutuel winnings are subject to a flat-rate withholding tax (30% and 15%, respectively).

E. Pensions

Retirement and disability pensions are exempt. In addition, taxpayers can deduct 100% of social security contributions if they earn less than Bs.80,000 and 50% if they earn between Bs.80,000 and Bs.100,000.

F. Savings

As noted in section C1 most interest on savings is probably exempted by one provision or another. In addition, the government may authorize exemptions to investors in the SAICAs (Sociedad Anonima Inscrita de Capital Abierto) established in the 1973 Capital Markets Law, of both dividend and interest income and of profits on the sale of shares, provided the proceeds are reinvested. Apparently no such exemptions have yet been authorized. Finally, life insurance premiums (which may incorporate some saving element) paid in Venezuela are allowed as a deduction in the same fashion as social security contributions (see Section E).

G. Gifts and Bequests

There has apparently never been any consideration of the possibility of taxing gifts and bequests under the income tax. The inheritance and gift tax introduced in 1936 was substantially modified in 1967 (along lines suggested in the Shoup Report). An interesting provision of this law (first introduced in 1961) is the imposition of a tax of 50% of the total capital of any company seeking to convert its stock into bearer shares: thereafter, however, such shares are excluded from the base of the inheritance and gift tax.

H. Hard-to-Tax Groups

No information available.

I. Other Topics

1. *Agricultural Income.* Income from agriculture has always received specially favorable treatment in Venezuela. Under the schedular system agricultural profits were taxed at a flat rate of 2%, but a special exemption of Bs.30,000 was allowed provided agricultural income did not exceed Bs.30,000. The new tax law in 1967 continued this exemption for income not exceeding Bs.60,000, provided receipts from agricultural sources form at least 75% of total gross income; this limit was later changed to Bs.120,000. Most recently, a 1974 decree simply exonerated income from agricultural pursuits from all income tax. Income from capital invested in the agricultural sector is also exonerated from tax for 10 years.

2. *International Income.* The Venezuelan income tax has always been, and remains, on a territorial basis, excluding all income earned by Venezuelan residents from non-Venezuelan sources. Remuneration paid to non-residents is subject to a withholding tax of 12% (18% for professional fees). A similar flat-rate tax of 15% is levied on dividends paid abroad, while royalties and interest paid abroad (as well as fees paid to "professional societies" not domiciled in Venezuela) are to be withheld in accordance with the progressive rate scale (calculated on the cumulative total of payments made in the taxable year).

3. *Mining.* Oil and mining income, insofar as it still accrues to private hands, is subject to a special tax regime in Venezuela which is too complicated to report here.

4. *Incentives.* In addition to the exemptions noted above in section I1, Ci, and F, the government has wide powers to grant incentives to almost any activity. Such exemptions are apparently especially important with regard to income from construction and tourism. In ad-

dition, taxpayers may claim a tax credit equal to 15% of the amount of investment in fixed assets destined for the production of income. There is also a tax credit system for exporters based on the percentage of value added in Venezuela.

COLOMBIA

In 1927 Colombia abandoned the schedular system upon the recommendations of the first Kemmerer mission to Colombia in 1923. A progressive income tax with rates from 1 to 8% was levied on all income. The World Tax Series volume on Colombia (prepared for the Harvard Law School International Tax Program by G. Eder, J. Chommie and H. Becerra; published by Commerce Clearing House, Chicago, in 1964) goes on to describe major changes in that law thereafter and sets forth in considerable detail the laws that existed in 1964. As the excerpts below from the 1968-69 Musgrave mission to Colombia indicate, the Colombian law was far from truly global as of 1968. For the most part these recommendations were designed to make the base of the individual income tax more comprehensive.

R.A. Musgrave and M. Gillis (Eds.), Fiscal Reform for Colombia (Harvard Law School International Tax Program, 1971)

Summary of Recommendations

INDIVIDUAL INCOME TAXATION

Exempt Income

11.45 In order to limit the erosion of the tax base through the exemption of various income items, the Commission recommends the following:

1. Employer contributions to social security should continue to be exempted from the individual income tax, but benefit payments should be taxable when received, subject of course to the deduction of the personal exemption.

2. Certain disability payments (compensation for medical payments and personal injury) should continue to be exempted, but payments in lieu of salary should be taxed. Payments at death which were financed by the decedent's employer should similarly be taxable, but those financed by the decedent himself should not.

3. The present exemption of severance pay, service bonuses, and vacation pay should be discontinued.

4. The limited dividend exclusion now provided should be raised to P 20,000.

5. The present exemption of interest from the first P 150,000 of deposit accounts should be replaced by an exemption of the first P 20,000 of interest received, such exemption being subject to the vanishing formula. Other forms of interest exemption now provided should be terminated as promptly as feasible.

Special Exemptions and Deductions

11.46 With regard to special exemptions and deductions, the following recommendations have been made:

1. The present tax treatment of housing should be changed to provide for either (a) continuing the taxation of imputed rent and deductibility of mortgage interest and disallowing the special rent exemption, or (b) dropping the taxation of imputed rent, disallowing mortgage interest, and retaining the rental exemption.

2. Taxes now disallowed as deductions should so continue. Property tax deductions should be disallowed if the taxation of imputed rent is to be discontinued.

3. The exemption of nonmedical payments to professionals should be discontinued.

4. Payments for doctors and dentists should be included in the exemption for medical and dental expenses; the exemption should be raised to P 2,000 and should be included in the vanishing provisions.

* * *

6. The allowance for charitable contributions should be limited to contributions in excess of 3% of net income, with an upper limit of 30% of taxable income before subtracting the deduction.

7. Instead of itemizing special exemptions, the taxpayer should be permitted a standard special exemption of 5% of taxable income or P 2,000, whichever is less. Taxpayers making use of the standard exemption would file a simplified return.

Capital Gains

11.47 The following proposals have been made regarding the tax treatment of capital gains:

1. The tax should be extended to include gains on the sale or exchange of all assets in addition to real estate, except assets held in the ordinary course of trade.

2. The value of taxable gains should be based on the 1960 asset value.

3. Gains should be taxed at the time of realization, subject to a prorating factor of five or, alternatively, a factor equal to the number of years the asset was held, with a maximum of five years.

4. Unrealized gains should be taxed at the time of death or gift.

5. The present provision by which the realized gain is reduced by 10% for each year that it is held should be discontinued.

6. Two approaches to the taxation of gains at the time of realization have been suggested; the Commission has made no choice between them.

Plan A: No inflation adjustment would be applied, but gains would be taxed at a rate five percentage points below that otherwise applicable under the prorating procedure.

Plan B: An inflation adjustment would be applied to the cost base, and gains thus adjusted would be taxed at the full rate applicable under the averaging procedure. The inflation adjustment would be established by the Ministry of Finance and could be equal to approximately one half of the increase in the cost-of-living index or, alternatively, to the full increase in this same index.

7. Capital losses should be set off against capital gains. If a net capital loss resulted, this amount could be applied against ordinary income up to P 5,000. Any excess would be carried forward to the five subsequent years, applicable first against capital gains, then against up to P 5,000 of ordinary income in each year.

8. Capital gains incurred on the sale of assets related to the taxpayer's business activity should not receive the preferential treatment described in (6) above, but should receive the benefit of the prorating device.

9. Short-term gains derived from assets held less than two years should not receive either the special treatment described in (6) or the benefit of prorating but should be taxed as ordinary income.

Vanishing Provision

11.49 The benefit from personal exemptions, as well as from special exemptions and from whatever exempt income remains, should be concentrated at the lower end of the income scale and reduced at the upper end. For this purpose, the Commission recommends that the amount eligible for exemption be reduced as income increases. The vanishing provision should begin to apply

at a taxable income of P 40,000 and should proceed at a rate of 1:4. Certain items, such as charitable contributions, should be excluded from the vanishing rule.

11.50 As an alternative to the vanishing formula, the respective exemptions and allowances might be translated into a deduction from (credit against) tax so that the tax saving per peso of exemption would not rise with the taxpayer's bracket rate.

A number of reforms were adopted in Colombia subsequent to the report of the Musgrave Mission. The most extensive of these were enacted during the last 4 months of 1974 under emergency powers. Under these reforms a number of income tax deductions and special exemptions were converted to credits, a number of exemptions were eliminated, a presumption that income is at least 8% of the taxpayer's net wealth was added, and the taxation of capital gains was broadened.

A number of personal and other allowances were converted under the 1974 law from deductions or vanishing deductions where these had been adopted before 1974 pursuant to the recommendations of the Musgrave Mission. Individuals now receive (1) a personal credit of Col.$ 1,000 for the taxpayer, 1,000 for the spouse and 500 per each additional dependent, (2) a "special" credit for the greater of 1,000 or the sum of 10% of medical expenses and expenses for primary and secondary education plus 20% of the first 10,000 of rent and 5% of the excess, (3) a credit of 20% of charitable contributions, subject to a ceiling of 20% of the income tax liability, and (4) a credit of 20% of the first 40,000 of income from savings deposits, dividends, and mutual funds for taxpayers whose net wealth does not exceed 2,000,000.

Previously existing exemptions for interest on mortgages and government securities, monetary corrections on constant purchasing power bank deposits, and (under the net wealth tax) for jewelry, works of art, government securities, and other items were all eliminated. Also eliminated were some business income exemptions, such as for amounts placed in extraordinary reserves or as investments in private electric companies.

Because many wealthy Colombians in agriculture or other activities for which income was low, not taxable, or not easily discoverable were paying little or no income taxes, the 1974 law added an amount of income equal to 8% of net wealth. It was expected that substantial additional amounts would become newly subject to personal income taxation through this presumption.

Capital gains taxation coverage was broadened under the 1974 law beyond the real estate transactions previously covered. The new category of irregular or occasional income applies to property held for more than 2 years, gambling receipts, and 80% of net inheritances and gifts received. Of the total amount of net irregular income, 20% is added to ordinary income in a tentative calculation. The marginal rate that turns out to be applicable to that additional 20% is then reduced by 10 percentage points and applied to the total amount of irregular income. No constructive realization of capital gains at death is provided.

One remaining aspect of the 1974 Colombia reforms must be noted. The initially proposed reforms contained a number of changes in the administrative provisions of the tax law which were designed to strengthen the tax administration's ability to frustrate taxpayer attempts to delay assessment and collection of taxes through the appeals process. Important among these provisions was one extending the statute of limitations for re-assessment of taxes to four years instead of two years. All the administrative (or procedural) changes in the emergency legislation were successfully challenged in court by taxpayers. The courts held that such changes could not be made by emergency decree, but required the approval of Congress. So far, the Congress has not yet approved these changes, with the result that the substantive changes in the law may be some time in becoming fully effective.

BOLIVIA

A. General

These notes are based primarily on material collected in the course of the Musgrave - Bolivia Fiscal Reform Study in 1976. (The Report of the Study Group is planned for publication in Spanish by the Bolivian Government and in English in early 1978 by the Harvard Law School International Tax Program.) Bolivia seems worth considering in the context of this study largely because it affords perhaps the most recent example of the process of converting a schedular into a global system — as well as an instance of a detailed appraisal of this process by a high-level advisory group.

B. Earned Income

Until 1976, Bolivia levied both a separate progressive income tax on labor income and a complementary progressive tax on "total" income. The new system which came into force in that year carried over significant features of this earlier system, including especially a 25% (previously 20%) deduction from gross income (up to a maximum of $b.70,000) for recipients of labor income. This concession is available to both employees and self-employed persons. In addition, the former receive an extra personal exemption of $b.600 (or $b.3,600 compared to the usual $b.3,000), and, more importantly, are entitled to exclude from income received one month's salary each year (the "patriotic bonus") plus $b.655 (or more) a month received in compensation "bonus" for inflation. Finally, various family allowances received by employees under the social security law are also exempted from tax. The result of all these exclusions and deductions is to exempt from income tax about 30% of the average wage received by employees in the modern sector.

The Musgrave mission recommended that *all* income received by employees be subject to tax, that personal exemptions be raised to keep taxes on employees more or less constant, and that a small credit be introduced to allow for expenses of employment. The result of these recommendations would of course be to reduce substantially the present overt degree of discrimination in favour of earned income in Bolivia.

C. Income from Capital

1. *Interest.* Until 1976, interest income was subject to a flat rate levy of 25%. In that year, the new income tax supposedly subjected interest income to the new progressive rate scale (enforced by a 25% withholding creditable against final tax liability). In fact, however, because taxpayers were permitted to exclude from income for tax purposes interest received on deposits in financial institutions most of the effect of the new law was vitiated. The Musgrave mission recommended that this exclusion be replaced by a limited deduction of up to $b.5,000 in interest income.

2. *Dividends.* Bolivia has no public stock market. Dividends paid on bearer shares are supposed to be withheld at a rate of 30% in addition to being, in principle, subject to personal income tax. There is no provision for withholding on other dividends although a system similar to that for interest (section C1) was proposed by the Musgrave mission. There is no integration between the corporate and personal taxes, nor was any proposed by the mission.

3. *Rents.* Prior to 1976, rental income from urban real property was subjected to a schedular tax of 12% on monthly rents up to $b.600 and 15% on higher rents. The new law subjects rental income to the regular income tax with the only special provision being the limitation of (deductible) maintenance expenses to 5% of the cadastral value of the property. The Musgrave Mission recommended that this deduction be limited to 5% of the value of structures.

4. *Royalties.* The new law permits recipients of royalty income to treat up to 20% of gross income as a deduction to cover costs but otherwise subjects such income to the regular income tax.

D. Capital Gains

Gains became subject to tax with the advent of the new income tax law at full rates with no provision for averaging and only crude provision for inflation. For both shares and real property, relatively simple administrative systems are applied. At present, only share gains are taxable at death or gift, with other gains being apparently exempt. There has as yet really been no experience in managing the new capital gains tax. Gains on sales of principal residences with cadastral value of less than $b.400,000 are exempt.

E. Pensions

Prior to 1976 all pension income was tax exempt, although social security contributions were also tax deductible. The deductibility of such contributions was carried forth to the new system while at the same time pension income was made taxable. This treatment was supported by the Musgrave mission.

F. Savings

See section C1.

G. Gifts and Bequests

Apart from the provision to tax accrued share gains at death or gift, gifts and bequests in Bolivia are subject not to the income tax but to a separate transfer tax.

H. Hard-to-Tax Groups

One of the most interesting features of the Bolivian income tax concerns its attempt to reach such hard-to-tax groups as small tradesmen and professionals. The recent tax reform included several special regimes intended for this purpose. Not all of these have yet been put into force, however, and the Musgrave mission has proposed some significant changes in this system. Basically, the Musgrave proposal is for a three-stage approach to the problem of "hard-to-tax" groups: (1) exempt very small taxpayers; (2) subject small taxpayers to a *presumptive* tax in lieu of income and sales taxes, with this tax being determined by a categorization of taxpayers; (3) all other taxpayers will file tax returns, but the hard-to-tax group will have to pay a minimum tax based on income as *estimated* by the tax administration. The difference between the estimated and presumptive systems is that the former allows to some extent for the individual characteristics of the taxpayers while the latter levies the same tax on all taxpayers placed in the same category (determined by type of activity and estimated gross sales). To make the estimated system work, it is proposed to establish specific sets of guidelines for estimated income for each major activity. The same system should be applied to professionals.

I. Other Topics

1. *Agricultural Income.* At present agricultural income is supposedly subject to the income tax but in fact no effort has been made to apply the tax even in the modern sector of agriculture. The Musgrave mission proposed that a new land tax (presumed income tax) be applied to agricultural income, without attempting to integrate it into the regular income tax for the time being.

2. *International Income.* Only income from Bolivian sources is subject to income tax. In general a 30% withholding rate is applied to payments abroad.

3. *Mining.* As Bolivia's major modern sector activity, mining is, not surprisingly, subject to a completely separate tax regime. This regime was recently the subject of a detailed study by a Harvard mission (the Gillis Report).

4. *Incentives.* Incentives to investment are granted both under the income tax law and under the Investment Law, with the latter being subject to specific approval. At present the income tax law provides for an investment credit, but this provision is not yet in force, and the Musgrave mission recommended that it be replaced by a 50% expense allowance.

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Recent Developments in Excise and Sales Taxation

by Sijbren Cnossen*

This article updates the information on the structure and coverage of taxes on goods and services in over a hundred countries that was presented in a 1975 study based on data collected in 1973. [1] *General taxes on goods and services, referred to as sales taxes, were classified according to the level(s) of production and distribution at which they were imposed; selective taxes, called excises, were classified on the basis of their coverage. Both taxes were further characterized in the light of certain widely accepted equity and efficiency criteria relating to the treatment of basic necessities, luxury items, and producer goods; the coverage of services was also dealt with.*

Since the earlier publication, a number of changes have taken place that are worth reviewing. Several countries have adopted a different form of sales tax or introduced such a tax for the first time and modified the coverage of their excise system. Rates have also been increased in the quest for more revenue, or to make up for the revenue foregone owing to an increase in the number of exempted items. Also, more information has become available that makes it possible to improve the earlier presentation.

The first section of the article briefly reviews certain definitional issues that are essential in understanding the basic classification that has been followed. The second section then summarizes the available information on sales tax and excise systems in 128 countries. The revenue importance of these taxes is also shown in summary form. [2] *A concluding section broadly evaluates the changes that have taken place since 1973.*

I. DEFINITIONAL ISSUES

Sales taxes and excises are defined to include all taxes other than import duties levied on the production, sale, transfer, leasing or delivery of goods and services, irrespective of whether they are domestically produced or imported. Sales taxes and excises thus emerge as twin branches of the same tree, although there are important differences between the two that are worth noting.

First, sales taxes are general in intent, the tax base being typically defined to include all commodities for sale other than those specifically exempted. Excises, on the other hand, apply to particular commodities or a limited range of commodites that are individually enumerated in the law. The scope of a sales tax is also broader than that of an excise system, because in almost all countries it includes imports, whereas, at least historically, excises have been associated with domestically produced commodities, with any countervailing duty on goods coming from abroad being incorporated in the import duty. [3] In practice, the tax base may be similar, particularly between a sales tax with a large number of exemptions and an excise system with an extended coverage.

A second difference is that sales taxes have mostly been introduced to meet general revenue needs, but excises, though often producing much revenue, are frequently rationalized as serving a special purpose. Among the reasons that have been advanced to justify the imposition of excise type levies are the control of the consumption of items that are considered immoral or unhealthy, the discriminatory taxation of luxury commodities considered proxies for taxpaying capacity, the benefit-received taxation of road services rendered by government, the control of the discharge of pollutants, the curtailment of the use of energy, or yet the provision of incentives to promote the use of idle productive capacity or changes in factor proportions and product mix in favor of labor-intensive production processes.

Third, the discriminatory intent of excises, whether sumptuary or regulatory, generally involves some quantitative measurement of taxable output and the imposi-

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* Professor of Taxation, Erasmus University, Rotterdam. This article was originally prepared for the International Monetary Fund. Permission for publication is gratefully acknowledged. Any views expressed represent the opinion of the author and should not be attributed to the Fund.

1. Sijbren Cnossen, "Sales Tax and Excise Systems of the World," *Finanzarchiv*, Vol. 33, 1975, pp. 177-236.
2. The first and the second sections draw on chapter 2 of the author's treatise, *Excise Systems: A Global Study of the Selective Taxation of Goods and Services* (Baltimore and London: The Johns Hopkins University Press, 1977).
3. Ethiopia, Egypt, the Sudan, Turkey, and most francophone African countries designate countervailing import duties as excises. In the literature of the Organization of Economic Cooperation and Development, duties on tobacco products, alcoholic beverages, and petroleum products levied at the import stage are regarded as excises. That treatment is also followed in this paper.

tion of physical controls to ensure compliance with the law — a manner of assessing and enforcing the liability to tax, though, that is usually also applied to excises levied solely for revenue. Historically, excise taxation on the basis of physical characteristics has involved the application of specific rates, that is fixed amounts per unit of production or number of services rendered. In contrast, sales taxes are almost always assessed on the basis of the value of goods and services sold, following the submission of returns by taxpayers who apply ad valorem rates to compute the tax liability. In turn, the latter is verified through checks upon written records. Therefore, excise procedures are similar to customs operations, whereas methods to establish the sales tax liability are more akin to audit techniques for business income taxes.

1. FORM AND STRUCTURE OF SALES TAXES

Sales taxes may apply to all or nearly all stages of production and distribution. They are then called turnover taxes that are imposed on gross receipts of a business or trade, or value-added taxes that are levied on turnover after subtracting payments for purchases (technically achieved by allowing a tax credit for purchases against the tax payable on sales). Other sales taxes are intended to apply to only one stage of production or distribution and are called production, manufacturers', wholesale, or retail sales taxes. The retail/wholesale tax is a hybrid form that aims at the retail stage, but for administrative reasons excludes small outlets and instead levies the tax at the preceding wholesale stage.

All sales taxes other than turnover taxes attempt to ensure that the actual tax borne by various products does not vary capriciously depending upon the number of times that any particular product changes hands before it reaches the consumer and the percentage of total value added at earlier rather than later stages in the process of production and distribution. Effective rates expressing the tax as a percentage of the final consumer price that are not uniform in relation to the nominal or statutory rates distort competition and stimulate uneconomic vertical integration, inhibiting in particular the development of wholesale activities and the subcontracting of specialized industrial processes. The techniques employed to prevent such changes in forms or methods of doing business include the exemption of raw materials, intermediate products, and capital goods (collectively referred to as producer goods); the subtraction of taxable purchases from taxable sales; the suspension of the liability to tax on transactions between registered firms; or the provision of a credit for tax paid at a previous stage. [4]

Unintended distortions are likely to be smallest under the value-added and retail forms of sales taxation. They remain to some extent under manufacturers' and wholesale taxes owing to differences in trading margins among various commodities and the location of distribution functions. By definition few attempts to mitigate cumulative effects are made under turnover taxes, although many producer goods are often exempted. Distortions should also occur under production taxes that can be described as turnover taxes with anticascading features that are not as systematic and comprehensive in design as those of manufacturers' taxes.

The various forms of sales taxation that are in use and the manner in which cumulative effects are mitigated, are shown in Table 1.

2. COVERAGE AND FORMS OF EXCISE SYSTEMS

Historical precedence and usage in many countries support a broad application of the excise label to include selective taxes on goods, on services, and on motoring; these three groupings may be said to comprise an excise system. Selective taxes on goods consist of taxes on traditional excise goods: tobacco products, alcoholic beverages, petroleum products; foods and nonalcoholic beverages: sugar, soft drinks, and various "breakfast table" items; and other nontraditional excise goods: textiles, footwear, matches, soap, luxury items, and producer goods. Selective taxes on services include levies on transportation, travel, banking, insurance, hotel and restaurant services, and betting, gaming, and entertainment activities. Selective taxes on motoring cover all duties, charges, and license fees levied on road use except excises on gasoline and diesel fuel.

Depending on the range of goods and services covered, excise systems may be of the limited, intermediate, or extended type. While all types of excise systems include selective taxes on traditional excise goods, road use, entertainment services, and items such as sugar, soft drinks, and cement, the coverage of intermediate systems usually extends to a number of other nontraditional excise goods such as textiles, paints, cosmetics, perfumery, and specified services such as insurance and travel. Extended excise systems include, in addition, a large number of taxes on luxury items and producer goods. A more precise classification is given in Table 2.

II. OVERVIEW OF SALES TAX AND EXCISE SYSTEMS

On the basis of the definitions presented in the preceding section, The Appendix gives an overview of the sales tax and excise systems in 128 countries grouped into 11 regions. The most common or standard sales tax rate, computed exclusive of the tax itself, is shown for each country, as are the lower or higher rates of tax imposed to lessen the regressivity or further the progressivity of the tax. The treatment of services under various sales taxes is denoted separately. Excise systems are classified according to their coverage; products for which fiscal monopolies are operated are listed separately. The data on the revenue importance of each tax, although of older date, should also be of interest.

4. The tax credit principle is in use under value-added taxes as well as some manufacturers' taxes. However, the tax credit is a *conditio sine qua non* in design under the former whereas under the latter it is merely one of the techniques to eliminate cumulative effects. Furthermore, manufacturers' taxes are not levied on trading activities per se, while value-added taxes extend through the wholesale stage if not always the retail stage. Also value-added taxes are not concerned with defining manufacturing.

Table 1. Forms of Sales Taxation

1. Turnover taxes: collected on sales at all or nearly all production and distribution stages; because of their cumulative effects these taxes are also referred to as cascade taxes.

2. Production taxes: collected on sales by producers to wholesalers, retailers, or other producers; transactions prior to the sale by the last producer are often partially exempted or taxed at reduced rates:

a. *French-type production taxes:* exempt domestically produced raw materials and intermediate goods as well as imported goods that have not been further processed.

b. *Other production taxes:* exempt producer goods or apply reduced rates, while trading activities per se are excluded from the tax.

3. Manufacturers' taxes: collected on sales by manufacturers to wholesalers or retailers, including occasional direct sales to consumers. While capital goods are usually exempted outright, various techniques have been designed to counter the cumulative effects of the taxation of raw materials and intermediate goods:

a. *The suspension method:* permits the tax-free purchase of inputs by traders and manufacturers registered for that purpose, the tax being levied when products leave the "ring" and are sold to unregistered persons.

b. *The subtraction technique:* allows for a deduction of taxable purchases from taxable sales; this can be done for:
(1) physically incorporated inputs only or
(2) on some other basis such as a deduction for inputs taxed at the same rate as the finished product.

c. *The tax credit principle:* provides for a credit for tax paid on purchases against tax payable on sales.

4. Wholesale taxes: collected on sales by the last wholesaler or manufacturer to retailers, including occasional direct sales to consumers. Capital goods are usually exempted outright, while the suspension method applies to raw materials and intermediate goods.

5. Retail/wholesale taxes (hybrid systems): collected on the sales of retailers to final consumers and of wholesalers or manufacturers to retailers whose operations are considered too small for separate taxation. Producer goods are treated similarly as under wholesale taxes.

6. Retail taxes: collected on sales by retailers to final consumers, including wholesalers or manufacturers selling occasionally to consumers; producer goods are generally excluded by definition.

7. Value-added taxes: collected on sales at all or nearly all production and distribution stages, with each stage receiving a credit for tax paid on purchases from the preceding stage.

a. *The EEC model:* extends through the retail stage and provides for a credit for tax paid on all producer goods.

b. *Other types:* may not cover the retail stage and sometimes do not give credit for tax paid on certain fixed assets.

1. SALES TAXES

a. Sales tax coverage

The most favored form of sales tax is the variant imposed at the manufacturing stage. Thirty-two countries, or 37 per cent of all those with sales taxes, collect the tax at this level. The manufacturers' sales tax is particularly popular in Africa where two out of every three countries with sales taxes use it. For developing countries this tax is probably the easiest to administer as it is collected at a level where the number of taxpayers is smallest and record keeping the best. The close relationship with previously imposed production excises, and the corresponding duties collectible at the import stage are other administrative advantages.

The various techniques applied to eliminate cumulative effects are approximately evenly divided among countries that impose manufacturers' sales taxes. The subtraction technique, limiting deductions to inputs which are physically incorporated in produced goods, is exclusively a francophone African phenomenon. The suspension method and the tax credit principle are widely employed in other parts of Africa, but also in Asia and South America. These three techniques are probably equally feasible from an administrative view and given the same base and rate revenue yields should not differ. The subtraction technique and the tax credit principle have the advantage that collections are spread over more taxpayers, but the suspension method ties up less business working capital. Cumulative effects of sales taxes are partially eliminated under production taxes through the exemption or lower taxation of producer goods. This form is found in 15 countries, 6 of which were formerly associated with France.

Twenty-three countries, or 26 per cent of all those with sales taxes, now have a value-added tax, all but one of the pure consumption type. [5] Although initially confined to the European Economic Community (EEC) and associated countries, the value-added tax is increasingly being used in Latin America. The EEC type of value-added tax is the most broadly based tax; elsewhere services and retail establishments are only partially taxed and producer goods are often exempted outright.

Eleven countries collect a sales tax at one of the distribution stages, or operate the hybrid form of retail/wholesale tax. The retail tax is particularly suitable for countries, such as Canada and the United States, with large local tax jurisdictions. In developing countries this tax would face severe compliance and administrative problems. The wholesale tax is often difficult to distinguish from the manufacturers' tax operating under the suspension method. The major distinction between these two forms of sales taxation concerns the treatment of imports, which is more in line with the domestic base under the wholesale tax. The retail/wholesale tax is mainly a device to ease collection problems for small retailers; this form is being used less than before. Finally, six countries still levy multistage turnover taxes, coveted by governments in earlier times because of their

5. Under the consumption type of value-added tax, the tax base for any one firm equals sales minus purchases of producer goods; the sum of all individual tax bases equals consumption. Under the income type of value-added tax, the base for each firm equals sales minus purchases of raw materials and intermediate goods, and depreciation for capital goods; the sum of these bases in turn equals national income. This form is partially in use in Argentina. Finally, under the product form, not used anywhere, no deduction at all would be allowed for the tax paid on capital goods; the aggregated base of this variant would be gross domestic product.

revenue potential owing to the imposition of a low rate on a large base, but condemned by economists because of their cumulative effects.

The treatment of services under various sales taxes strongly follows legal traditions. Services are generally included under sales taxes in countries that follow French and Spanish taxing customs, but not in countries that have adopted features of the British tax system, reflecting a reluctance to tax transportation, banking, insurance, communications, or public utility services. Even when taxed, services are usually not fully covered under single-stage taxes, but generally enumerated individually in the law because many are personal, socially important, or simply hard to reach. The broadest coverage is under the EEC type of value-added tax that excludes only financial services, education, health, and cultural activities.

Out of 128 countries surveyed, 44 countries, or 1 out of 3, do not impose a sales tax at all. These countries are found mostly in the Caribbean, the Middle East and Africa. Many Caribbean countries operate extended excise systems instead of a sales tax, and in the Middle East broad-based sales taxes are not needed as most revenue is collected from petroleum. In some African countries the economic base may be too small to justify the introduction of a sales tax, and import duties together with selective excises still fulfill the revenue function adequately.

b. Sales tax rates and exemptions

The level of the standard sales tax rate depends on such factors as revenue requirements, the tax base (which is larger under a multistage tax than under a single-stage tax), the availability of alternative sources of revenue, and society's views on the role of sales taxes versus income taxes. Rate comparisions on the basis of The Appendix are most meaningful between countries at a similar stage of economic development that have the same kind of sales tax and follow the same taxing tradition. As expected, rates are generally higher under production and manufacturers' taxes than under turnover taxes. Rates are often also higher in high-income countries as shown by the value-added taxes in the EEC and associated countries. Twenty-two countries out of 84 with sales taxes use tax-inclusive rates that are primarily a French tradition.

To lessen the regressivity of their sales taxes, most countries have adopted a differentiated rate structure with lower rates or exemptions applying to necessities generally defined to include foods, medicines, fuel, books, newspapers, footwear, soap, and certain clothing items. In a few countries with value-added taxes, some necessities (and exports) are zero-rated, which involves a net refund for tax paid at the previous stage. In addition, to improve the progressivity higher rates of tax are often levied on cosmetics, perfumery, jewelry, various appliances, television sets, musical instruments, phonographic and photographic equipment, sporting goods, automobiles, pleasure boats, and hotel and restaurant services. Higher rates of sales tax are easiest to administer under manufacturers' taxes owing to the greater degree of business specialization at this stage.

2. EXCISE SYSTEMS

a. Excise coverage

One half of all countries listed in The Appendix have limited excise systems that comprise traditional excise goods, motor vehicles, entertainment services, and a few other commodities. Geographically, this form of excise system is heavily concentrated in North and West Africa, and in South America. One out of every four countries operates an intermediate excise system; they are predominantly a European and Central, East, and Southern African phenomenon. In Europe various food products are widely taxed, as well as some other items of widespread consumption. In Central Africa the intermediate systems comprise the *taxe unique* that is imposed on goods produced and traded in the Central African Customs and Economic Union, replacing the import duties and sales taxes collected previously.

Extended excise systems that comprise virtually all industrial activities in a country are found in 20 countries, mainly in Asia, the Caribbean and Central America. In Asia, the excise systems of the Indian subcontinent and the commodity taxes in the Republic of China, Japan, and Korea are of the extended type. In the Caribbean, the excise system comprises the consumption and purchase taxes of the countries belonging to the Caribbean Community (Caricom) that impose selective taxes on products for which trade restrictions and import duties were lifted by agreement. Most of the 9 countries that do not levy excises at all are located in the Middle East, where alternative sources of revenue are available from petroleum and transit dues.

Sugar, salt, soft drinks, and their substitutes are the most widely excised food products. Thus, of 110 countries known to impose non-traditonal excises, 65 collect an excise on sugar, 29 on salt, and 71 on soft drinks. Matches, another favored product, are subject to an excise in as many as 65 countries. Like salt, its inelastic demand features and implicit revenue properties made it commonly subject to tax in early times; at present mechanical lighters are often taxed concurrently. At least 17 governments collect an excise on playing cards, which yield only a little revenue. Among luxury items, cosmetics, perfumery, and toilet articles are subject to excises in at least 27 countries, and jewelry in 20. Producer goods that are taxed frequently — by at least 27 countries — include cement and building materials. Among services, a separate levy on insurance is imposed in 40 countries; travel in one form or another is taxed in 50 countries; hotel and restaurant services are taxed in 31 countries. Some excises are peculiarly regional, including the taxation of biscuits in East Africa, wheat flour in Central American countries, and dairy products and pharmaceuticals in Scandinavian countries.

b. Fiscal monopolies

In a large number of countries, the production or distribution of products such as tobacco, matches, alcohol, sugar, salt, and occasionally some other goods or services is reserved by law to government. The manufacturing or selling enterprises are usually referred to as fiscal monopolies; the surpluses that they generate are

economically similar to excises. Although fiscal monopolies can produce much revenue, there is no evidence that they contribute more to the fisc than countries that rely solely on excises. [6] In addition to their revenue objective, fiscal monopolies often fulfill important regulatory functions, including the control of the quality and consumption of certain goods, and the stabilization of the production and prices of the primary producers.

The most common fiscal monopolies are operated for tobacco products (26 countries), alcoholic beverages (22 countries), and matches (15 countries). Tobacco monopolies are heavily concentrated in the Mediterranean and Middle Eastern area, indicating their historic association with French and Spanish taxing traditions and mercantilistic economic policies. Tobacco monopolies are also found in the Far East and Eastern Africa. Match monopolies, mostly established at the turn of the century, are generally administered by tobacco monopolies. Geographically, alcoholic monopolies are found mainly in northern Europe, North America, and some Latin American countries where social traditions favor the control of alcohol consumption. Fiscal monopolies for sugar (6 countries) and salt (9 countries) appear to have been formed mainly for revenue purposes. Other products for which fiscal monopolies exist are listed in the footnotes to The Appendix.

3. REVENUE ASPECTS

An analysis of the revenue data shown in The Appendix indicates that sales taxes and excise systems together contribute on average about 38 per cent of total tax revenue in industrial as well as developing countries. In high-income countries the share of sales taxes is 14 per cent, while excise systems contribute 23 per cent; in low-income countries, these figures are 11 per cent and 27 per cent respectively. [7] Thus excise systems emerge as an important source of revenue: limited systems contribute 22 per cent of total tax revenue, intermediate systems 25 per cent, and extended systems 34 per cent.

The traditional excise goods are the most widely and heavily taxed, contributing on average 70 per cent of excise receipts or 18 per cent of total tax revenue. When taxes on motor fuel, vehicles, and other road user charges are considered jointly, the automotive field is the single most important source of excise revenue. In several countries its contribution to total tax revenue ranges from 10 per cent to 16 per cent, compared with 8 per cent to 14 per cent for tobacco products and for alcoholic beverages. Other goods and services that are heavily taxed include sugar, soft drinks, cement, textiles, and lotteries.

Further examination of the revenue data reveals that in several low-income countries the sales tax in fact is little more than a supplementary import duty. This is because there is no local production of the taxed items, such production is exempted, or because sales tax rates levied on imports are higher than on domestically produced goods. When the excise yield is compared with that of the sales tax relating to the domestic base, the revenue from the sales tax is often not nearly as great as receipts from a single traditional excise good. In most low-income countries, sales tax collections derive almost exclusively from typical excise goods — an indication of how small the domestic base of their sales tax really is. There is also evidence that the buoyancy and elasticity of excises in low-income countries is sufficiently high to ensure a growing source of revenue that exceeds relative increments in income. Moreover, in times of inflation, the system of physical controls that is maintained for most excises appears to be more helpful in enforcing timely payment of tax liabilities than the voluntary compliance producers of sales taxes.

Table 2. Forms of Excise Systems

1. Limited excise systems comprise at least the traditional excise goods: tobacco products, alcoholic beverages, and petroleum products — as well as motor vehicles and various forms of entertainment. In addition, some food products such as sugar, salt, soft drinks and, for instance, matches, cement, or insurance may be included. However, all in all, the coverage of limited systems would not exceed 10 to 15 commodity groups with closely related products (various petroleum products, or sugar and saccharine, for instance) being treated as one excisable item.

2. Intermediate excise systems consist of between 15 and 30 commodity groups. In addition to the items covered under limited systems, they include more food products such as various dairy and grain products. Other items of widespread consumption, such as textiles, footwear, and pharmaceuticals, may also be covered, as well as a few luxury items, for instance, cosmetics and perfumes. The producer goods that may be part of intermediate systems are cement, building materials, paints, and varnishes. As a rule, a number of services such as insurance, banking, transportation, and public utilities are taxed.

3. Extended excise systems comprise more than 30 commodity groups spanning almost the whole range of production activities in a particular country. In addition to the items taxed under intermediate systems, many luxury and producer goods are excisable. Invariably, high excises are imposed on electrical and gas-operated appliances, radios, television sets, and musical and photographic equipment. Extended systems are the only excise systems that cover a wide range of producer goods: steel and aluminum products, plastics and resins, rubber products, wood products, and sometimes machinery.

III. DEVELOPMENTS SINCE 1973

The most notable development since 1973, when the information for the previous study was compiled, is the further spread of value-added taxation. This trend is reviewed below. An attempt is also made to assess some of the experience with this relatively new form of sales taxation; more dispassion may be needed than displayed by its early proponents. In addition, there have been changes in other sales taxes and in some of the excise systems.

6. Most countries with fiscal monopolies also levy excises, particularly on tobacco products and alcoholic beverages.

7. Based on simple arithmetic averages of a representative sample of 33 low-income countries and 30 high-income countries taking US $600 as the dividing line between the two groups.

1. COUNTRIES THAT ADOPTED THE VALUE-ADDED TAX

The value-added tax has been adopted by several Latin American countries during the period under review. In 1975, Argentina and Chile introduced a value-added tax, replacing previously applicable manufacturers' taxes. In addition to broadening the base, both countries took the opportunity to raise effective sales tax rates substantially. In a further move, in 1977 Chile eliminated most of the exemptions for foods, newspapers, and books, and took steps to integrate the tax on services more closely with the basic levy. The Argentine variant resembles an income type of value-added tax that permits a credit for the tax paid on capital goods in three annual consecutive installments.

Costa Rica and Honduras followed the example of their southern neighbors in 1976, but instead of drafting new legislation a tax credit provision was grafted onto the existing retail/wholesale taxes operating under the suspension method. Costa Rica increased the standard rate of tax by 60 per cent, but Honduras reduced its rate. Panama, which has not had experience with a sales tax so far, introduced the value-added tax in 1977 at the rate of 5 per cent, permitting the usual exemptions for foods, medicines, pharmaceuticals, and fuel. In view of the narrow industrial base of the country, it may be surmised that much of the tax will be collected at the import stage. Mexico is also considering the feasibility of a value-added tax; if adopted the tax would replace a 4 per cent multistage turnover tax.

Outside Latin America, Israel introduced a value-added tax at the end of 1976, but retained much of the purchase tax that is noteworthy for its highly differentiated rate structure; the latter can now be more appropriately classified as an extended excise system. In Korea, a value-added tax of the EEC type levied at a uniform rate of 10 per cent was introduced on July 1, 1977. The tax will be supplemented by an excise system, similar in coverage to the Japanese commodity tax, with 29 categories of luxury goods and services and rates ranging from 10 per cent to 160 per cent. In the Republic of China, the changeover to a value-added tax from a highly complex system of commodity taxes, similar to that in Korea, is also in an advanced stage of preparation, but still awaits parliamentary approval.

A government proposal for a value-added tax has been shelved in Japan in the face of strong opposition that the tax would increase prices and the overall tax burden as well as the regressivity of the tax system. In Switzerland, a government-appointed commission reporting in 1974 advocated a value-added tax of the EEC type that would eliminate some of the distortions of the present retail/wholesale tax (exacerbated by recent rate increases), such as backward integration by retailers and the taxation of capital goods, as well as provide for a potentially more productive source of revenue. [8] But the proposal was rejected by a referendum in June 1977.

2. EVALUATION OF VALUE-ADDED TAX EXPERIENCE

Value-added taxation was strongly advocated in the late sixties and early seventies because of its so-called neutrality: the credit approach would not give rise to distortions in the location of production and distribution functions, would permit an accurate refund of the tax at the export stage, and would ensure equivalency between statutory rates and effective rates of tax. Recently there has been a growing recognition, however, that the value-added tax is not nearly the ideal tax that it was once made out to be. Efficiency need not always be improved by a tax that is ostensibly more neutral in design because it ignores the adjustment process that has taken place under the previous tax. Moreover, the value-added tax is not a fully general consumption tax; even in its broadest forms in the EEC and Chile, for instance, it covers little more than one half of all personal consumption expenditures. Thus, consumer as well as producer excess burdens remain to some extent.

In developing countries the base of a potential value-added tax may have to be narrowed further for practical reasons. For instance, it would be difficult to incorporate the numerous small retailers that do not keep adequate accounts in a value-added tax. Similar problems arise with the handicraft and small-scale manufacturing sectors that may account for as much as one half of total industrial output. Agricultural activities would also have to be exempted, as would most services because of the small size of many firms and the nature of their activities. These exclusions would in effect mean that the tax would extend only through the wholesale or manufacturing stage, thus entailing the same basic economic distortions as the equivalent single-stage sales tax variants. Moreover, politically, a value-added tax is, of course, subject to the same pressures to differentiate the rate structure and widen the exemptions as was the sales tax that it replaced. Yet refinements in a value-added tax can add up to an administrative burden for business firms and the tax office that is substantially more complex than that of any other sales tax.

A much overrated advantage of the value-added tax is the built-in self enforcement aspect of collection that permits the matching of tax credits against tax payable at the previous stage. Even when there are no significant limitations on administrative capacity, such a check is of little value at the retail stage because consumers are not accountable for the tax paid on their purchases. This flaw can be serious because retail margins are generally higher than the margins of wholesalers and manufacturers, who may be in a position to push some of their value-added forward to the retail stage where the tax is easier to escape. In developing countries, the conditions that would make cross-checking possible, i.e., the keeping of adequate accounts and the provision of audit facilities, may not exist. In such a situation, the scope for tax evasion should be as great or even greater than, say, under a manufacturers' tax because of the larger number of taxpayers from whom the tax has to be collected.

Furthermore, a value-added tax does not solve the basic problem of any tax based on voluntary compliance, that

8. For a brief review, see John F. Due, "Swiss Experience and the Canadian Wholesale Sales Tax Proposal," *Canadian Tax Journal*, Vol. 24 (March-April 1976), pp. 103-10.

is, obtaining reliable returns for the tax payable on sales, the tax credited for purchases, and the net tax due. Instructive in this respect is the Irish experience with value-added taxation. Even after four years of operation, the delinquency rate for filing returns is 50 per cent at the time a first reminder notice is sent out to taxpayers (two weeks after the due date for the return), 40 per cent at the time of the final reminder (two weeks after the first notice), and 30 per cent at the time that the tax office prepares an estimate of the tax due for collection. Of the 600 largest firms, 30 per cent do not pay on time. Also despite the use of a suspension rule for the tax payable at the import stage, the administration has difficulties handling the large number of refunds for exports, firms that accumulate inventory, and building contractors whose activities are subject to a lower rate of tax than applies to building materials. [9]

The Irish experience, not necessarily unique among industrial and developing countries, shows that the time that should be spent on auditing accounts is fully preempted by ensuring that returns are filed, by properly estimating tax liabilities where returns are not forthcoming, and by refunding overpaid taxes. More generally, as under other sales taxes, no shortcuts appear to be available under a value-added tax that would enable the tax administration to avoid the problems, first, of ensuring the submission of proper returns and, second, of adequate verification.

In conclusion, the basic conditions for the successful application of value-added taxation are probably met in countries where manufacturing activities are mostly on a fairly large scale and where the distribution sector is relatively well organized, thereby permitting the inclusion of retailers. A value-added tax may also be an improvement in a country that has a highly complex system of turnover and commodity taxes. In this situation, conflicting interests on tax reform may be best resolved by starting with a clean slate. This would appear to be the case, for instance, in the Republic of China and Korea, both of which have efficient tax administrations capable of handling a broad-based value-added tax.[10] Even then taxpayers' fears that their tax burden will increase, now or later, cannot be fully discounted, because the government acquires a potentially powerful tax instrument capable of yielding large amounts of revenue, as is evident from the European experience. In countries where industrial development is still at the initial stage, where distribution activities are fragmented, and where there is a high dependence on foreign trade, a value-added tax should probably not be adopted; a manufacturers' sales tax with imports included in the tax base would be more appropriate.

3. OTHER CHANGES IN SALES TAXATION

Actual changes in the structure of other sales taxes have been few, although additional information has made it possible to improve the classification with respect to a number of countries. Mention should be made of Colombia's manufacturers' tax, which was completely revamped in the latter part of 1974. While the tax credit principle of the old tax was maintained, the tax base was expanded to include raw materials and specified services. Capital goods, previously exempted, are now taxed at 6 per cent (with a few at 15 per cent) and luxury goods at 35 per cent, against 25 per cent under the previous law. The Colombian sales tax reform, which aimed at enlarging the base and enhancing the progressivity of the tax, stands out as an example of what can be done within the framework of an existing tax. If income tax administration is weak, as it is in Colombia, progressivity is likely to be achieved most effectively under a sales tax levied at the manufacturing stage where the number of taxpayers is relatively small, specialization greater, and records better.

In Barbados a 5 per cent retail sales tax was introduced from December 1, 1974. Unlike almost all other sales taxes, the levy was confined to domestic sales; imports were not covered. However, the government, in keeping with its election promise, has announced that the tax will be abolished from October 7, 1977. The abolition of this tax may not affect revenues seriously, as Barbados will retain its extended excise system that includes a broadly itemized consumption tax. Finally, Nepal moved its retail/wholesale tax to the production stages, but continues to use appraised retail values for the computation of the tax liability.

Another noteworthy point is the large number of countries that have increased their sales tax rates. Out of 84 countries with sales taxes, 26 increased the standard rate of tax to augment general government revenues. Inclusive of the countries that introduced a sales tax for the first time or changed the existing form, rate increases of two percentage points or more were enacted in Argentina, Austria, Barbados, Benin, Chile, Colombia, the Congo, Costa Rica, Iceland, Ireland, Israel, Ivory Coast, Kenya, Malawi, the Netherlands, Panama, Peru, Portugal, Senegal, Switzerland, Thailand, Upper Volta, Uruguay, and Zaire. In contrast, France and the United Kingdom reduced their value-added taxes from 20 per cent to 17.6 per cent and from 10 per cent to 8 per cent, respectively. Denmark lowered the rate temporarily from 15 per cent to 9.25 per cent in 1975, but rescinded the measure in 1976. These countries believed that a reduction in sales tax rates would moderate price increases which in turn might dampen wage demands. It is also possible that the resulting increase in the budget deficit was rationalized by some as a stimulus to the economy.

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9. For an account, see John F. Due, "Value Added Tax in Ireland," *The Tax Executive*, Vol. 29 (April 1977), pp. 200-23. See also his, "The Universality and Neutrality of the Value Added Tax Reexamined," *Taxes — The Tax Magazine*, Vol. 55 (July 1977), pp. 469-75.

10. Japan, on the other hand, does not have a business turnover tax nor is its commodity tax as broad-based and complex as the Chinese and Korean commodity taxes. For a proposal to reconcile business and intergovernmental interests by replacing a manufacturers' tax with a value-added tax, see Sijbren Cnossen, "What Kind of Sales Tax? — Critique of a Government Discussion Paper," *Canadian Tax Journal*, Vol. 23 (November-December 1975), pp. 505-19.

4. DEVELOPMENTS IN EXCISE TAXATION

Changes in the excise field have been less numerous, perhaps owing to their more traditional character. Afghanistan introduced an intermediate excise system, called consumption tax, covering soft drinks, vegetable oils, macaroni, textiles, shoes, soap, cement, batteries, plastics and steel products — all typically goods manufactured by first-stage import substituting industries. The excise system of the People's Democratic Republic of Yemen was similarly extended with the imposition of duties on domestically produced cottonseed oil, emulsions and paints, tomato paste, textiles, aluminium utensils, rubber foam, and perfumes. El Salvador also expanded its excise system with a consumption tax on several processed foods, luxury items, and automobiles. Uruguay consolidated various excises on traditional excise goods, soft drinks, and toilet articles. In Italy, many goods previously taxed under an extended excise system are now included under the value-added tax; the remaining excises are therefore more appropriately classified as intermediate in coverage. The change in the Israeli excise system has already been mentioned.

Most specific excise rates were adjusted following recent increases in price. The erosion of excise revenues in OECD countries that took place in the late sixties and early seventies owing to lags in rate adjustments appears to have been corrected. Industrial and developing countries increased taxes on gasoline by 8 per cent and 37 per cent, respectively, following the big upsurge in the price of crude oil during the second half of 1973 and early 1974.[11] No country changed its specific excise rates to ad valorem ones, often favored by economists. Specific excise rates tend to distort consumer choices regarding low-priced items, but ad valorem rates discriminate against forward integrated producers. On the whole, few moves were made to eliminate some of the very regressive or small excises such as those on salt, flour, bread, matches, lighters, and playing cards. However, more attention is being paid to the use of excises to combat pollution and to conserve energy. Finally, the EEC issued further directives to harmonize excises on traditional excise goods and road user charges.

11. See Katrine W. Saito, "Petroleum taxes: how high and why?", *Finance and Development*, Vol. 12 (December 1975), p. 19, Table 1.

APPENDIX: Sales Taxes, Excise Systems and Fiscal Monopolies of the World [1]

	Sales Tax Structure				*Excise Systems*		*Revenue Importance (In Per Cent of Total Tax Revenues)* [2]		
								Excise System	
Country	*Nature of Sales Tax* [3]	*Treatment of Services* [4]	*Sales Tax Rates (Tax-Exclusive) Standard* [5]	*Other*	*Excise Coverage*	*Fiscal Monopolies* [6]	*Sales Tax*	*Total*	*Traditional Excise Goods*
North and West Africa									
Algeria	Manufacturers [7]	T(L)	25*	6.4,7.5, 8.1,11.1, 42.8,66.7	Limited	Tobacco, matches	. . .	. . .	(. . .)
Benin	Manufacturers [8]	T	15.6*	— —	Limited	—	4	10	(9)††
Gambia, The	No sales tax	— —	— —	— —	Limited	— —	— —	. . .	(. . .)
Ghana	Manufacturers [9]	NT	11.5	5	Extended	— —	8	21	(13)
Guinea	Manufacturers [8]	T	7.5 *	5.3	Limited	— —	. . .	. . .	(. . .)
Guinea-Bissau	No sales tax	— —	— —	— —	Limited	— —	. . .	. . .	(. . .)
Ivory Goast	Manufacturers [7]	T	20.5*	3.1,6.4, 9.3,33.3	Limited	— —	26	10	(9)†
Liberia	No sales tax	— —	— —	— —	Limited	— —	— —	7	(5)†
Libyan Arab Rep.	No sales tax	— —	— —	— —	Limited	Tobacco, sugar, salt	— —	. . .	(. . .)
Mali	Manufacturers [8]	T	25* [10]	6.4,14.9, 17.6,40	Limited	— —	24	11	(7)†
Mauritania	Manufacturers [8]	T	9.9*	4.2,13.6, 33.3	Limited	— —	25	10	(9)†
Morocco	Manufacturers [7]	T	17.6*	4.2,6.8,9.9, 25	Limited	Tobacco	26	23	(17)
Niger	Manufacturers [8]	T	22*	2.6,6.4,15, 42.9	Limited	— —	28	9	(8)†
Nigeria	No sales tax	— —	— —	— —	Extended	— —	— —	14	(6)
Senegal	Manufacturers [7]	T	12.4*	4.2,9.3,33.3	Limited	— —	34	18	(16)†
Sierra Leone	No sales tax	— —	— —	— —	Intermed.	— —	— —	26	(24)
Togo	Manufacturers [8]	T	11.1*	8.7	Limited	— —	. . .	. . .	(. . .)
Tunisia	Manufacturers [8,11]	T	16.8*	2.4,6.2,28.9 43.7,59.7	Limited	Tobacco matches	25	17	(15)
Upper Volta	Manufacturers [8]	T	21.9*	3.1	Limited	Tobacco	21	12	(11)†

Source:
Sijbren Cnossen, *Excise Systems: A Global Study of the Selective Taxation of Goods and Services* (Baltimore and London: The Johns Hopkins University Press, 1977), Appendices A, B, and C.

Country	Sales Tax Structure: Nature of Sales Tax [3]	Treatment of Services [4]	Sales Tax Rates (Tax-Exclusive): Standard [5]	Other	Excise Systems: Excise Coverage	Fiscal Monopolies [6]	Revenue Importance (In Per Cent of Total Tax Revenues) [2]: Sales Tax	Excise System: Total	Traditional Excise Goods
Central Africa									
Burundi	Turnover	T	2	5	Limited	— —	...	...	(...)
Cameroon	Production [12,13]	T	9.6*	4.6,12.4	Intermed. [14]	— —	...	...	(...)
Central Afr. Empire	Production [12,15]	T	11.7*	2.4,6.2, 16.2	Intermed. [14]	— —	...	...	(...)
Chad	Production [12]	T	15.6*	4.7,5.7,6.4, 11.7,12.4,15.6	Intermed. [14]	— —	14	18	(9)†
Congo, P.R. of the	Production [12,16]	T	15.2*	3.1,4.7,7.5, 12.8	Intermed. [14]	— —	...	...	(...)
Equatorial Guinea	Turnover	T	3	10	No excises	— —	...	— —	(— —)
Gabon	Production [12,17]	T	7.5*	3.6,16.3	Intermed. [14]	— —	...	...	(...)
Rwanda	No sales tax	— —	— —	— —	Limited	— —	— —	...	(...)
Zaire	Production	T	10	4	Limited	— — —	8	6	(5)†
East and Southern Africa									
Botswana	Manufacturers [7,18]	NT	10	5,7.5,15,20	Limited	— —	...	...	(...)
Comoros	No sales tax	— —	— —	— —	No excises	— —	— —	— —	(— —)
Ethiopia	Production	NT	5	— —	Intermed.	Tobacco, matches	16	26	(17)
	Turnover	T	2	— —					
Kenya	Manufacturers [9]	NT	15	20	Intermed.	— —	— — [19]	34	(26)
Lesotho	Manufacturers [7,18]	NT	10	5,7.5,15,20	Limited	— —	...	...	(...)
Madagascar	Manufacturers [7]	T	13.6*	6.4	Limited	Tobacco, alc. bev.	20	18	(18)†
Malawi	Production	NT	15	— —	Limited	— —	...	...	(...)
Mauritius	No sales tax	— —	— —	— —	Limited	— —	— —	37	(31)
Somalia	No sales tax	— —	— —	— —	Intermed. [14]	Tobacco, matches	— —	31	(13)††
Sudan	No sales tax	— —	— —	— —	Extended [14]	Sugar	— —	...	(...)
Swaziland	Manufacturers [7,18]	NT	10	5,7.5,15,20	Limited	— —	...	...	(...)
Tanzania	Manufacturers [9]		12	15,18,24, 40,50	Intermed.	— —	11	31	(22)
Uganda	Manufacturers [9]	NT [20]	10	5,15,20	Intermed.	— —	16	29	(18)
Zambia	No sales tax	— —	— —	— —	Extended	— —	— —	10	(10)††

Footnotes

1. Information on structural aspects relates to the situation in the summer of 1977; however, some source material was of older date and sometimes incomplete. Sales taxes and excise systems in socialist economies are not included, first because data are not sufficient and second because the role of taxation in centrally planned economies differs fundamentally from that in market-oriented or mixed economic systems.
2. Revenue data are averages covering fiscal years 1969-71; generally all levels of government are included. A dash (— —) indicates that revenue is nil; dots (...) indicate that data are not available. Sales tax revenues include receipts collected at the import stage; in Barbados, Ghana, and Upper Volta imported goods are not subject to sales tax. Revenues from traditional excise goods include receipts collected under a sales tax or at the import stage. One dagger (†) indicates that revenue data are incomplete or cannot be fully disaggregated; a double dagger (††) indicates that revenues do not include receipts from tobacco products (Benin, Liberia, Trinidad and Tobago), or petroleum products (Nepal, Somalia, Zambia).
3. (L), (P), or (S) indicate that the sales tax is levied by local, provincial, or state governments.
4. NT indicates that services are not included in the sales tax base, T that they are included, and ST that some services are subject to sales tax.
5. An asterisk (*) indicates that sales tax rates, standard and other, are legally defined on a tax-inclusive basis. The relationship between tax-exclusive rates (t_e) and tax-inclusive rates (t_i) can be expressed by the formula: $t_e = \frac{1}{1 - t_i}$
6. The table shows the most common products for which fiscal monopolies are operated — tobacco, matches, alcoholic beverages, sugar, and salt. In addition, there are fiscal monopolies for cigarette paper (Ethiopia, Greece, Venezuela), saccharine (Greece), caviar (Iran), tea (Iran, Turkey), coffee (Turkey), ginseng (Korea), camphor (Japan), cement (Syrian Arab Republic), playing cards (Greece, Tunisia), gunpowder (France, Tunisia), and emery (Colombia, Greece). Historically, the production and trade in petroleum products can be considered fiscal monopolies in Afghanistan, Brazil, Greece, Haiti, Iran, Mexico, Spain, and Uruguay. A case can also be made for classifying government lotteries as fiscal monopolies.
7. Cumulative effects mitigated through tax credit principle.
8. Cumulative effects mitigated through subtraction technique.
9. Cumulative effects mitigated through suspension method.
10. The tax-inclusive rate applies only to imports.
11. Includes consumption tax levied on the same base at various rates.
12. French-type production tax.
13. East Cameroon levies a manufacturers' sales tax at a rate of 6.4 per cent; services are not taxed, except construction.
14. Excise system includes wide range of selective taxes known as *taxe unique* (Cameroon, Central African Empire, Chad, Congo, Gabon; in all countries, except Chad, an excise on goods produced in one member country of the Central African Customs and Economic Union, but marketed also in other member countries), consumption tax (Afghanistan, Barbados, Central African Empire, Costa Rica, Egypt, El Salvador, Grenada, Jamaica, Nicaragua, Somalia, Sudan, Trinidad and Tobago, Uruguay), purchase tax (Israel), additional tax (Jordan), commodity tax (Republic of China, Japan, Korea), or luxury tax (Spain, Uruguay).
15. The Central African Empire also levies a transaction tax at 1.01 per cent* on goods and services not subject to the production tax or excises.
16. Includes additional sales tax applied at 5.3 per cent* to the first sale of a good and at 3.1 per cent* to the first rendering of a service. The bases of the production tax and the additional sales tax are not completely identical.
17. In addition, Gabon administers a 1 per cent turnover tax on commercial and industrial activities not covered by the production tax.
18. The manufacturers' sales taxes of Botswana, Lesotho, and Swaziland are identical to the South African sales tax. At the import stage South Africa collects the sales tax together with import duties and excises in the form of a customs union pool, after which they are distributed to the partners according to agreed formulas.
19. Sales tax introduced subsequent to the fiscal years for which revenue data were collected.
20. The Uganda Sales Tax Act provides for the taxation of services by statutory order, but so far this provision has not been applied.
21. The sales tax picture in India is extremely complicated. There are not only single-point and multipoint taxes, but two states also operated mixed single-point and double-point systems. In addition, states with multipoint systems impose various special single-point taxes particularly on luxuries and semiluxuries. Also, a sales tax is collected by the central government on the interstate sale of goods which are chargeable at 3 per cent in the state of origin.
22. In addition, Nicaragua imposes a gross receipts tax at 0.2 per cent.
23. Also, each of the 24 departments in Argentina imposes a 1.1 per cent gross receipts tax with surcharges ranging from 20 per cent to 600 per cent.
24. Services are taxed under a separate statute at rates ranging from 2 per cent to 10 per cent.
25. In addition, Brazil levies a gross receipts tax at 0.75 per cent.
26. Generally, services are covered under separate municipal sales taxes.
27. Local governments in Venezuela impose gross receipts taxes, generally at a rate of 0.5 per cent.
28. Value-added tax based on EEC model.
29. Also known as production and expenditure tax. In addition, Turkey imposes a retail sales tax on certain goods and services, called an operation tax.

Country	Sales Tax Structure: Nature of Sales Tax [3]	Treatment of Services [4]	Sales Tax Rates (Tax-Exclusive): Standard [5]	Other	Excise Systems: Excise Coverage	Fiscal Monopolies [6]	Revenue Importance (In Per Cent of Total Tax Revenues) [2]: Sales Tax	Excise System: Total	Excise System: Traditional Excise Goods
Middle East									
Afghanistan	No sales tax	— —	— —	— —	Intermed. [14]	Tobacco, sugar	— —	. . .	(. . .)
Bahrain	No sales tax	— —	— —	— —	No excises	— —	— —	— —	(— —)
Egypt	No sales tax	— —	— —	— —	Extended [14]	— —	— —	. . .	(. . .)
Iran	No sales tax	— —	— —	— —	Intermed.	Tobacco, sugar	— —	10	(8)
Iraq	No sales tax	— —	— —	— —	Intermed.	— —	— —	. . .	(. . .)
Israel	Value-added	T	8	6	Extended [14]	— —	12	12	(8)†
Jordan	No sales tax	— —	— —	— —	Intermed. [14]	— —	— —	. . .	(. . .)
Kuwait	No sales tax	— —	— —	— —	No excises	— —	— —	— —	(— —)
Lebanon	No sales tax	— —	— —	— —	Limited	Tobacco	— —	23	(19)
Oman	No sales tax	— —	— —	— —	No excises	— —	— —	— —	(— —)
Qatar	No sales tax	— —	— —	— —	No excises	— —	— —	— —	(— —)
Saudi Arabia	No sales tax	— —	— —	— —	No excises	— —	— —	— —	(— —)
Syrian Arab Rep.	No sales tax	— —	— —	— —	Intermed.	Tobacco, sugar, salt	— —	18	(10)
United Arab. Emirates	No sales tax	— —	— —	— —	No excises	— —	— —	— —	(— —)
Yemen Arab. Rep.	No sales tax	— —	— —	— —	Limited	— —	— —	. . .	(. . .)
Yemen, P.D.R.	No sales tax	— —	— —	— —	Intermed.	— —	— —	. . .	(. . .)
South Asia and Far East									
Bangladesh	Manufacturers [9]	NT	20	7.5,25,30	Extended	— —	. . .	. . .	(. . .)
Burma	Production	NT	10	5,15	Limited	— —	. . .	. . .	(. . .)
China, Rep. of	Turnover	T	2	0.6-4	Extended [14]	Tobacco, alc. bev.	6	42	(21)
India	Turnover(S) [21]	NT	0.5-3	— —	Extended	— —	15	51	(24)
	Manufacturers(S) [9]	NT	5-7	1,2,10,15					
Japan	No sales tax	— —	— —	— —	Extended [14]	Tobacco, salt	— —	26	(17)
Korea	Value-added	T	10	— —	Extended [14]	Tobacco	7	37	(18)
Nepal	Production	NT	8	7,12	Extended	— —	15	16	(11)††
Pakistan	Manufacturers [9]	NT	20	7.5,10,25,30	Extended	— —	6	38	(24)
Sri Lanka	Production	T	5	1,15-35	Limited	Alc. bev., salt.	11	27	(24)
South-East Asia									
Indonesia	Production	T	10	5,20	Limited	— —	12	19	(17)
Laos, P.D.R.	Production [12]	T	7.2*	17.6	Limited	— —	. . .	. . .	(. . .)
Malaysia	Manufacturers [9]	NT	5	10	Intermed.	— —	— —[19]	35	(22)
Papua New Guinea	No sales tax	— —	— —	— —	Limited	— —	— —	. . .	(. . .)
Philippines	Production	T	7	2,5,40,70, 200	Limited	— —	21	16	(14)
Singapore	No sales tax	— —	— —	— —	Limited	— —	— —	40	(24)
Thailand	Production	T	7	1.5; up to 40	Limited	Tobacco	21	28	(22)
Caribbean and Central America									
Bahamas	No sales tax	— —	— —	— —	Limited	— —	— —	. . .	(. . .)
Barbados	Retail	NT	5	— —	Extended [14]	— —	— —[19]	19	(14)
Costa Rica	Value-added	NT	8	— —	Extended [14]	Alc. bev.	15	23	(17)
Dominican Republic	No sales tax	— —	— —	— —	Intermed.	— —	— —	29	(20)†
El Salvador	No sales tax	— —	— —	— —	Intermed. [14]	— —	— —	28	(21)
Grenada	No sales tax	— —	— —	— —	Extended [14]	— —	— —	. . .	(. . .)
Guatemala	No sales tax	— —	— —	— —	Limited	— —	— —	28	(23)
Haiti	No sales tax	— —	— —	— —	Extended	Tobacco, matches, alc. bev., sugar	— —	. . .	(. . .)
Honduras	Value-added	NT	3	— —	Limited	— —	7	28	(23)
Jamaica	No sales tax	— —	— —	— —	Extended [14]	— —	— —	28	(19)
Nicaragua	Ret./Wholesale [22]	T	6	— —	Extended [14]	Matches, alc. bev.	8	41	(27)
Panama	Value-added	NT	5	— —	Limited	— —	— —[19]	28	(16)
Trinidad and Tobago	No sales tax	— —	— —	— —	Extended [14]	— —	— —	22	(9)††
South America									
Argentina	Value-added [23]	T	16	— —	Intermed.	— —	17	32	(25)
Bolivia	Value-added	NT [24]	5	10,20	Limited	Tobacco, matches, alc. bev.	6	13	(11)†
Brazil	Manufacturers [7,25]	NT [26]	8	4,5,10, 15,30	Limited	— —	50	17	(15)
	Value-added(S)	NT	12.3-17.6*						
Chile	Value-added	T	20	28,40	Limited	— —	32	9	(8)†

Country	Sales Tax Structure: Nature of Sales Tax [3]	Treatment of Services [4]	Sales Tax Rates (Tax-Exclusive): Standard [5]	Other	Excise Systems: Excise Coverage	Fiscal Monopolies [6]	Revenue Importance (In Per Cent of Total Tax Revenues) [2]: Sales tax	Excise System: Total	Excise System: Traditional Excise Goods
Colombia	Manufacturers [7]	T	15	6,35	Limited	Alc. bev., salt	8	15	(14)
Ecuador	Value-added	T	4	10	Limited	——	10	16	(11)
Guyana	Manufacturers [9]	NT	10-20	3,25,30,45	Limited	——	. . .	. . .	(. . .)
Paraguay	Ret./Wholesale [9]	NT	3	10	Limited	Alc. bev.	5	20	(17)
Peru	Manufacturers [7]	T	20	1-3,11,40	Limited	——	. . .	15	(10)†
Surinam	No sales tax	——	——	——	Limited	——	——	. . .	(. . .)
Uruguay	Value-added	T	20	7	Intermed. [14]	Alc. bev.	19	27	(17)
Venezuela	No sales tax [27]	——	——	——	Limited	Matches	——	8	(7)
North America and Australasia									
Australia	Wholesale [9]	NT	15	2.5,40,50	Limited	——	7	19	(13)
Canada	Manufacturers [9]	NT	12	5	Limited	Alc. bev.	16	12	(7)
	Retail(P)	ST	5-8	——					
Fiji	No sales tax	——	——	——	Limited	——	——	. . .	(. . .)
Mexico	Turnover	T	4	5,10,15,30	Intermed.	——	11	17	(7)†
New Zealand	Wholesale [9]	NT	20	40,50	Limited	——	8	14	(13)
South Africa	Manufacturers [7,18]	NT	10	5,7.5,15,20	Limited	——	7	19	(16)
United States	Retail(S)	ST	2.5-7	——	Limited	Alc. bev.	,6	15	(8)
Western Samoa	No sales tax	——	——	——	No excises	——	——	——	(——)
European Economic Community (EEC)									
Belgium	Value-added	T	18	6,14,25	Limited	——	31	15	(12)
Denmark	Value-added	T	15	——	Intermed.	——	18	25	(16)
France	Value-added	T	17.6	7,33.3	Intermed.	Tobacco, matches, alc. bev.	38	21	(16)
	Retail(L)	ST	2.8*	9.3					
Germany, Fed. Rep. of	Value-added	T	11	5.5	Intermed.	Matches, alc. bev.	22	21	(16)
Ireland	Value-added	T	20	10,35,40	Limited	——	11	41	(36)
Italy	Value-added	T	12	6,18,30,35	Intermed.	Tobacco, matches	22	36	(25)
Luxembourg	Value-added	T	10	2,5	Limited	——	. . .	. . .	(. . .)
Netherlands	Value-added	T	18	4	Limited	——	22	15	(11)
United Kingdom	Value-added	T	8	12.5	Limited	——	8	25	(21)
Europe (non-EEC)									
Austria	Value-added [28]	T	18	8	Intermed.	Tobacco, alc. bev., salt	25	19	(13)
Cyprus	No sales tax	——	——	——	Limited	Alc. bev., salt	——	37	(24)
Finland	Wholesale [9]	NT	12.4 *	——	Intermed.	Alc. bev.	20	25	(18)
Greece	Manufacturers [8]	NT	8	——	Extended	Matches, salt	12	31	(23)
Iceland	Retail	ST	20	——	Intermed.	Tobacco, matches, alc. bev.	. . .	. . .	(. . .)
Malta	No sales tax	——	——	——	Limited	——	——	. . .	(. . .)
Norway	Value-added [28]	T	20	11.1	Intermed.	Alc. bev.	31	21	(12)
Portugal	Wholesale [9]	NT	10	20,30,40	Intermed.	Tobacco, matches	12	29	(13)
Spain	Turnover	T	2	2.7	Intermed. [14]	Tobacco, matches	. . .	. . .	(. . .)
Sweden	Value-added [28]	T	17.6*	3.1,9.9	Intermed.	Tobacco, alc. bev.	13	21	(14)
Switzerland	Ret./Wholesale [9]	NT	5.6-8.4	3.3,4.4	Limited	Alc. bev.	9	20	(13)
Turkey	Manufacturers [8,29]	NT	Various	Various	Intermed.	Tobacco, alc. bev., salt	20	30	(19)

COUNTRY BY COUNTRY SURVEY OF LOOSE-LEAF PUBLICATIONS . . .

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DOPPELBESTEUERUNGSABKOMMEN DEUTSCHLAND-SCHWEIZ

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Handelskammer Deutschland-Schweiz, Talacker 41, CH-8001 Zürich.
Supplemented: once or twice a year.

Loose-leaf publication designed to provide an updated work in four volumes, in which text, implementing provisions, relevant statutes, case law, rulings, comments and literature from both Switzerland and the German Federal Republic pertaining to the 1971 double taxation treaty in respect of income and capital are systematically arranged by treaty article.

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Steuern vom Einkommen und Vermögen. Textausgabe und Praxis.
By K. Locher, W. Meier and R. von Riebenthal.
Verlag für Recht und Gesellschaft AG., Bundesstrasse 15, 4054 Basel.
Supplemented: annually.

Loose-leaf publication in two volumes entitled "Double Taxation Treaty Switzerland-Germany 1971: Taxes on Income and Capital, Text and Practice". This work contains the text of the 1971 tax treaty and relevant texts in connection thereto from Swiss and German official sources.

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Supplemented: regularly.

Loose-leaf publication in the German language consisting of three volumes containing: texts of comprehensive double taxation treaties on income and capital concluded by Switzerland, agreements with respect to profits from aircraft and shipping enterprises, the OECD draft conventions for the avoidance of double taxation on income and capital, and on estates and inheritances, and, other agreements such as those regarding taxation of international road transports and tax privileges for diplomatic missions and international organizations and their staff personnel. Relevant Swiss enforcement regulations with respect to double taxation treaties are included. A French version of the same publication is available entitled "Droit fiscal international de la Suisse".

DIE PRAXIS DER BUNDESSTEUERN

By J. and E. Henggeler, E. Wyss and K. Locher.
Verlag für Recht und Gesellschaft AG., Bundesstrasse 15, 4054 Basel.
Supplemented: regularly.

Loose-leaf publication entitled "The Practice of Federal Taxes" in three parts containing the texts of statutes, case law and literature with respect to the Swiss federal defence tax (in three volumes), the stamp duty and federal anticipatory tax (in three volumes) and the Swiss intercantonal double taxation law (in three volumes). Part One, contains text and comment on the federal defence tax which governs the corporate income tax, net worth tax and individual income tax. Part Two, contains text and comment on stamp duties and anticipatory tax (federal withholding tax) on dividends and interest.

PRAXIS DES UMSATZSTEUERRECHTS

By Hans Herold.
Verlag für Recht und Gesellschaft AG., Bundesstrasse 15, 4054 Basel.
Supplemented: as necessitated.

Loose-leaf publication providing text, comment and literature on the Swiss sales tax law. A register is appended.

RECHTSBUCH DER SCHWEIZERISCHEN BUNDESSTEUERN

By Anton Pestalozzi.
Verlag für Recht und Gesellschaft AG., Bundesstrasse 15, 4054 Basel.
Supplemented: two or three times a year.

Loose-leaf publication in seven volumes which is a compendium of texts of federal tax laws (defence tax, anticipatory tax, sales tax, stamp tax, death and gift duties), including international double taxation treaties and other international agreements. Not dealt with are customs duties and excise duties on tobacco and beer. A detailed register is appended.

DIE STEUERN DER SCHWEIZ/LES IMPOTS DE LA SUISSE

Prepared by the Federal Tax Administration in co-operation with the Cantonal Tax Administrations.
Verlag für Recht und Gesellschaft AG., Bundesstrasse 15, 4054 Basel.
Supplemented: twice a year.

Loose-leaf publication in four parts, each consisting of several volumes, containing texts of the Swiss federal tax laws as well as tax laws in the cantons and municipalities of Switzerland. Part One deals with income tax and net wealth tax of individuals. Part Two: income tax and net worth tax of corporations. Part Three: death duties and gift taxes, taxes on the transfer of capital and consumption taxes. Part Four: (seven volumes) contains text of federal, cantonal and municipal direct taxes including church taxes, systematically arranged per canton.

ON THE UTILITY OF TAX PERFORMANCE INDICES:
Notes with Reference to Venezuela's Tax System

by Arthur J. Mann*

In a recent article Richard Bird [1] directed serious criticism at the comparative quantitative approach to tax performance assessment in developing nations. He called attention to the fact that the tax ratio and average regression approaches to the measurement of taxable capacity and tax effort are essentially without significance, for there is "no meaningful sense in which the average can be considered a standard, *nor is it conceptually useful .... to take the average as showing what is feasible in any particular country." [2] It thus follows that use of such international comparisons may serve merely to cloud the tax structure and tax performance problems in a given developing country, and that further tax capacity and tax effort analyses would be more rewarding if focused on "particular problems in particular countries."[3]*

Using as background material data recently gathered in Venezuela, I fully concur with the Bird critiques. What follows, then, is a brief discussion based upon Venezuelan tax (and national income) data designed to support the validity of the points set forth by Bird. [4]

As the point of departure, *Table 1* presents a cursory glance at the Venezuelan central government revenue structure for selected years over the 1960-1976 time period. [5] The preponderant role of taxes levied on the petroleum industry is immediately obvious. With reference to the last line of the table, it is noted that the petroleum sector d*irectly* [6] accounted for 58.2 percent of total recurrent [7] central government income in 1960; in 1976 the corresponding figure was 73.6 percent. The January, 1976 nationalization of the petroleum industry had no effect on the central government's tax structure, nor did it affect the form in which the entities comprising the industry are taxed.

Given the predominant role of taxes levied on the petroleum industry in the overall fiscal structure, and given the fact that until 1976 non-Venezuelan companies comprised over 90 percent (by output) of this essentially export industry, the proportional amount of taxes paid directly and indirectly by Venezuelan taxpayers was relatively low. In other words, the domestic aggregate tax burden (ex-petroleum levies), as measured by the proportion between non-exported taxes and GNP, was relatively light, for most — if not all — petroleum associated taxes can be assumed exported to foreigners. One can argue that nationalization did not really alter this situation, even though petroleum related taxes are now imposed on a wholly domestically-owned industry, for they remain shiftable and exportable.

The most encompassing published studies of national tax ratios, their determinants, and tax effort indices have been carried out by the International Monetary Fund (IMF). From the tax ratio determinant equation(s) the IMF has proceeded to rank the included countries according to the derived tax effort index for each country. In the most recent published analysis [8] the Venezuelan tax ratios (taxes as a percent of GNP) for the 1966-68 and 1969-71 time periods were calculated as 20.7 and 20.4 respectively. [9] Comparing these ratios with the averages for the 47-country sample of

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1. Richard M. Bird, "Assessing Tax Performance in Developing Countries: A Critical Review of the Literature," *Finanzarchiv*, V. 34, No. 2 (1976), pp. 244-265.
2. Ibid., p. 258.
3. Ibid., p. 258.
4. The choice of Venezuela to support the Bird critiques might be objected to on the grounds that Venezuela, with its mineral wealth, is not a "typical" or "average" developing country. However, petroleum plays an important part in the fiscal structures of numerous developing countries, and, moreover, it is not at all clear exactly which elements of economic and fiscal structures are associated with a "typical" developing country; i.e., is there really such an entity?
5. In Venezuela's politico-administrative and fiscal organization there do exist regional and municipal governments with very limited fiscal capacities. On the expenditure side these subordinate levels do make substantial expenditures financed principally by inter-governmental transfers, while on the income side their tax-levying abilities are severely restricted. In the years 1971-1975, of total *net* (of transfers) recurrent income (tax and non-tax) received by all three governmental levels, the central government never accounted for less than 95.3 percent; this percentage 98.1 in 1974. See Banco Central de Venezuela, Informe Economico, 1975 (Caracas: 1976).
6. The petroleum sector is also indirectly responsible for part of tax and non-tax revenues under varied income sources; e.g., customs duties, stamp taxes, exchange operations (eliminated as of 1977).
7. The recurrent income concept excludes incomes from public borrowings. These latter flows amounted to (in millions of bolívares) 1,179.5, 56.2, 351.0, and 5,010.3 in 1960, 1967, 1972, and 1976 respectively.
8. See R.J. Chelliah, H.J. Baas, and M.R. Kelly, "Tax Ratios and Tax Effort in Developing Countries, 1969-71," IMF *Staff Papers*, V. 22 (March, 1975), pp. 187-205.
9. An earlier study convering the periods 1953-55 and 1966-68 was R.J. Chelliah, "Trends in Taxation in Developing Countries", IMF *Staff Papers*, V.18 (July, 1971), pp. 254-331.

TABLE 1

THE NET RECURRENT INCOME STRUCTURE [a] OF THE CENTRAL GOVERNMENT OF VENEZUELA, SELECTED YEARS, 1960-1976
(millions of bolívares)

Income Source	1960 Amount	1960 % of Total	1967 Amount	1967 % of Total	1972 Amount	1972 % of Total	1976 Amount	1976 % of Total
Tax income	*2720.7*	*54.8*	*5369.4*	*62.9*	*8811.8*	*72.3*	*29,242.7*	*76.7*
Petroleum Firms	1260.3	25.4	2929.2	34.3	5090.9	41.8	21,282.9	55.8
Iron Ore Firms	85.9	1.7	192.7	2.3	172.5	1.4	285.2	0.7
Personal Income	88.8	1.8	266.9	3.1	494.0	4.1	856.0	2.2
Other Corporations	370.3	7.5	777.0	9.1	1304.7	10.7	2943.8	7.7
Inheritance & Donations	12.4	0.2	25.7	0.3	40.5	0.3	96.5	0.3
Customs Duties	516.8	10.4	478.5	5.6	693.4	5.7	2164.9	5.7
Production & Consumption	330.1	6.6	604.1	7.1	844.6	6.9	1206.7	3.2
Others	56.1	1.1	95.3	1.1	171.2	1.4	406.7	1.1
Non-Tax Income	*2246.9*	*45.2*	*3169.6*	*37.1*	*3379.5*	*27.7*	*8881.6*	*23.3*
Petroleum Exploitation	1631.2	32.8	2737.4	32.1	2793.6	22.9	6759.9	17.7
Exchange Operations	356.1	7.2	50.0	0.6	82.2	0.7	447.3	1.2
Central Bank Profits	17.0	0.3	49.9	0.6	77.2	0.6	706.2	1.9
Fees	152.6	3.1	202.6	2.4	261.1	2.1	400.7	1.1
Others	90.0	1.8	129.7	1.5	165.4	1.4	567.5	1.5
Total, Recurrent Income	4967.6	100.0	8539.0	100.0	12,191.3	100.0	38,124.3	100.0
Total, Recurrent Income Directly Associated with Petroleum Sector	2891.5		5666.6		7884.5		28,042.8	
Petroleum Sector Revenues as Proportion of Total	58.2		66.4		64.7		73.6	

Source: Sector Financiamiento, Dirección Nacional de Presupuesto, Ministerio de Hacienda de Venezuela, work sheets.

a) This classification is used by the Venezuelan Ministry of Finance. It can readily be argued that conceptually the most important non-tax sources (petroleum exploitation, exchange operations, and some of the fees) are, in reality, taxes. Nevertheless, the classification is presented here in unaltered form.

13.6 and 15.1 respectively, placed Venezuela near the top of the "tax effort" index in terms of comparative tax ratios. During the 1966-68 period only three of the forty-seven developing nations had a higher tax ratio than Venezuela, whereas during the 1969-71 time span six out of forty-seven countries had a superior tax ratio. [10]

Table 2 presents Venezuelan tax ratios for varying time periods. In all cases the denominator is represented by GNP, whereas the numerator is represented by total central government recurrent income and by tax income, both including and excluding petroleum--associated levies. The choice of the 1966-68 and 1969-71 time periods is intentional in that they correspond to the two periods covered in the Chelliah, Baas, and Kelly study. The tax ratios presented in column (1) of Table 2 are slightly higher than those of the IMF study for the 1966-68 and 1969-71 periods (20.7 and 20.4 in the IMF analysis versus 21.9 and 20.6 here) due to the use in this article of revised GNP data and to the lumping together of all recurrent income sources as a measure of taxes. Conceptually, some of the inclusions in recurrent income are not taxes, but this does not affect the points to be subsequently made.

To reiterate, on an internationally comparative basis Venezuela ranks near the top of a large group of developing nations *in terms of its relatively high tax ratio.* If the 1974-76 period is added it appears that, based on columns (1) and (2) of Table 2, that Venezuelan tax effort has increased substantially since the mid-1960s. However, a glance at columns (3) and (4) belies this impression. From these columns it is noted that the tax ratios pertinent to total recurrent income and tax income "ex-petroleum" have remained virtually constant (or have decreased) over the last ten years. Under this tax effort and/or tax performance proxy index, then, the only notable phenomenon is precisely the lack of increased internal tax effort; Venezuelan membership in the Organization of Petroleum Exporting Countries (OPEC) and OPEC-inspired crude petroleum price rises, obviously exogenous factors (to Venezuela), have accounted for whatever change occurred.

10. Reference is being made here to Table 1 of the Chelliah Baas, and Kelly study.

TABLE 2

TAXES AS PERCENT OF GROSS NATIONAL PRODUCT, VENEZUELA, SELECTED YEARS, 1960-1976

	Tax Ratios			
	(1)	(2)	(3)	(4)
Time Period	Total Recurrent Income	Tax Income	Total Recurrent Income Less Petroleum Incomes	Tax Income Less Petroleum Funds
1960	20.9	11.5	8.7	6.2
1967	22.3	14.0	7.5	6.4
1972	20.8	15.1	7.4	6.4
1976	28.6	21.9	7.6	6.0
1966-68	21.9	13.8	7.6	6.5
1969-71	20.6	13.7	7.6	6.5
1974-76	34.3	25.5	7.2	5.5

Sources: GNP data from the Banco Central de Venezuela; the 1976 figure only became available in August of 1977 due to estimation problems caused by the nationalization of the petroleum industry. The GNP figures for the entire 1960-76 period are to be revised in 1978. All tax data are from the Table 1 source.

Not only is the absence of internal change noteworthy, but the lack of correlation between the overall tax ratio — of column (1) — and the internal tax burden stands out. To repeat a point made previously, since Venezuelan petroleum taxes are exported through shifting to foreigners (in the form of higher crude petroleum prices), roughly three-quarters of central fisc inflows are financed by non-Venezuelans. Moreover, the recent jump in the overall tax ratio has not raised the tax burden on the average Venezuelan taxpayer (assuming, of course, 100 percent forward shifting of petroleum-related taxes).

In terms of the Venezuelan index of tax effort as derived by the (average) regression approach (calculated by dividing the actual tax ratio by the "predicted" ratio), Venezuela falls slightly below unity in both 1966-68 (0.971) and 1969-71 (0.958). Thus, although in some vague fashion Venezuela is not apparently fully taking advantage of its "taxable capacity" — whatever this may mean — its tax performance appears quite "reasonable." [11]

Undoubtedly, if and when its tax effort index is computed (using the regression approach) for the 1974-76 period, the value will fall well above unity. Thus, the superficial conclusion may be reached that Venezuela is making greater use of its taxable capacity; i.e., its tax effort/performance has increased. But reference to columns (3) and (4) of Table 2 gives lie to the correspondence between a higher tax effort index and a truly increased internal tax effort and/or domestic tax burden.

Of course, to be able to reach such a final conclusion one must have knowledge of the particular circumstances of a particular country. As illustrated, deriving the average of a group of countries as some sort of standard, and then comparing the performance of a specific country to that standard, really bears little meaning for both policy-making and academic purposes.

To carry out the assessment of tax performance in a developing country, Bird suggests use of other measures in addition to the "least meaningful" tax ratio. The buoyancy and the elasticity of the tax system (and of individual taxes) are two of these measures. The first measure, buoyancy, refers to the income-elasticity of a tax, where the tax figures include both automatic and discretionary changes; the elasticity measure excludes the effects of discretionary changes.

Unfortunately, it is not possible to readily separate the automatic from the discretionary changes in Venezuela's tax structure, for no governmental entity has systematically quantified them. However, these discretionary changes have been almost minimal in the last ten years. In 1974-75 the withholding system with respect to salaries was modified along with increased personal deductions associated with the personal income tax; in 1976 customs duties were converted to an ad valorem base. Thus, in recent years administrative and political efforts to raise effective tax rates have not been forceful.

TABLE 3

INCOME ELASTICITY COEFFICIENTS [a] OF TAXES, VENEZUELA, 1967-1976

Line	Tax/Income Source [b]	Value of Coefficient [c]
1.	Total Recurrent Income	1.15
2.	Tax Income	1.24
3.	Non-Tax Income	0.87
4.	Petroleum Firms	1.37
5.	Petroleum Exploitation	0.77
6.	Total Petroleum (lines 4 plus 5)	1.20
7.	Total Recurrent Income Ex of Petroleum-Related Income	1.00
8.	Tax Income Ex of Petroleum-Related Income	0.95
9.	Personal Income	0.95
10.	Other Corporations	1.05
11.	Customs Duties	1.15
12.	Production and Consumption	0.60
	(a) Liquors	0.61
	(b) Cigarettes	0.43
	(c) Gasoline	0.99
13.	Fees	0.59

Sources: See Table 2 sources.

a) Computed using the formula: $E_{ty} = \frac{T_1 - T_2}{T_1 + T_2} \div \frac{Y_1 - Y_2}{Y_1 + Y_2}$,
where T = taxes/income sources
Y = GNP.

b) Correspond to the breakdown of Table 1.

c) Some of these coefficients were additionally computed by the equation $\log T_t^i = a + b \log Y_t$, where T_t^i = income from tax i in the year t and Y_t = GNP. The values of b derived from this methodology did not vary significantly from those given in this table.

11. Bird (op.cit., pp.254-258) presents an excellent critique of this and other points related to the econometric construction of tax effort indices.

Employing "uncleaned" revenue series, some income-elasticity coefficients pertinent to the Venezuelan tax structure for the 1967-76 period are presented in Table 3. [12] Although the elasticities of the overall tax system and of tax income fall above unity (1.15 and 1.24 respectively), the coefficients of lines 7 and 8, which exclude directly related petroleum revenues from the calculations, reveal that the income-elasticity of the entire tax structure was due to the petroleum sector. Thus, the elasticity coefficient of 1.00 for total recurrent income exclusive of petroleum-related recurrent income reveals an underlying structure which generates no proportional growth in the tax ratio.

With respect to some of the components of the non-petroleum income sources, it is observed that personal income taxes are slightly income inelastic, whereas "other" corporate income taxes and customs duties are moderately income elastic. On the other hand, taxes on production and consumption and fees are quite income inelastic (they are specific levies). Thus, what might be gleaned from *Table 3* is the apparent "unwillingness" of the authorities to take discretionary measures to increase the relative tax burden. Not that this is necessary, of course, for petroleum-related public incomes have carried total public incomes to higher proportional levels. The point is that this conclusion does *not* surface from the general (and average) type surveys carried out by (for example) the IMF.

In conclusion, what has been attempted is an illustration, using the Venezuelan case, of the validity of the original Bird criticisms leveled at international comparative methodologies ostensibly aimed at measuring tax performance in developing countries. These "average" approaches bear little or no relevance to the specific situations found in particular countries. Rather, what is needed are separate analyses of conditions in individual countries. This type of "work will be more useful to policy-makers the more it focuses on changes and details, for the actual reality and basic issues of policy lie there." [13]

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12. Due to the low number of discretionary changes which were introduced over this period, there is actually little difference between the buoyancy and elasticity coefficients.
13. Bird, op.cit., p.264.

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Pakistan: SUMMARY OF TAX PROPOSALS FOR 1977-78 BUDGET

Extract from the Pakistan budget for fiscal year 1977-78 as announced by Finance Minister Abdul Hafeez Pirzada on June 11, 1977

A. DIRECT TAXES

In the field of direct taxation, certain tax reform measures are being introduced for the convenience of taxpayers. Measures are also being taken to encourage investments and to provide relief.

1. Income tax

A new scheme of self-assessment is being introduced for the convenience of the taxpayers. Assessments in all cases, except where a detailed scrutiny of the accounts is necessary, would be made on the basis of returns. Such assessments would also be completed within the financial year in which the returns are filed.

The procedure for the registration of firms for income-tax purposes is also being simplified. All applications for registration will be decided within three months of the date of filing of the return or six months of the close of the accounting period, whichever is earlier, failing which the firm will automatically be treated as a registered firm.

The rate of additional refund for delayed issue of refund is being raised from five to one percent above the bank rate. Further, all applications for refund will be disposed of before the end of the financial year next following the year in which such application is filed, otherwise the amount of refund claimed will ipso facto become due to the taxpayer.

To encourage investments in the corporate sector, two measures have been proposed: (i) Dividends received by taxpayers (other than companies) from public companies incorporated between July 1, 1977 and June 30, 1982 will be exempt from tax, and (ii) The rate of intercorporate tax in the case of private companies is being reduced from 50 to 30 percent.

Tax relief is also being provided to Pakistanis working abroad who maintain a house in Pakistan for their families. The mere maintenance of a house will no longer render a taxpayer liable to tax on foreign income. Further, the condition regarding short visits to Pakistan is also being relaxed and any taxpayer whose stay in Pakistan does not extend beyond 60 days will not incur any extra tax liability.

Income from fish-farming is being exempted from tax for a period of five years. Income from poultry-farming, dairy farming, fish-catching and cattle and sheep breeding is already exempt.

Pakistani companies providing technical services to foreign companies will not be liable to tax on the remittances made by them out of royalties, commissions, fees, etc.

The rate of additional tax for delayed payment of tax is being raised from 8 to 15 percent.

The upper limit of the value fixed for purposes of allowing depreciation in the case of motor vehicles is being raised from Rs. 40,000 to Rs. 75,000.

2. Estate duty

The exemption limit is being raised from Rs. 1 lakh to Rs. 3 lakh. [1]

Tax-free gratuities payable to the dependents of the deceased are being exempted from estate duty.

3. Wealth tax

The requirement regarding the production of wealth tax clearance certificate for transfer of assets is being removed.

B. INDIRECT TAXES

1. Customs

Tea other than tea in retail packings has been exempted from duty. Imported tea in retail packing has, however, been subjected to 40 percent duty.

Duty on 12 items of minerals reduced from the present 72.5-60 percent to 40 percent.

Duty on tyres and tubes for scooters and rickshaws reduced from 85 percent to 60 percent.

Duties on iron and steel in its basic and semi-rolled forms reduced from 42.5 percent and 47.5 percent to 30 percent and 40 percent respectively.

Duty on copper and copper wire reduced from 42.5 percent and 92.5 percent to 30 percent and 60 percent respectively.

Duty on timber increased from 60 percent to 100 percent.

Duty on imported machinery increased from 20 percent to 25 percent.

Adjustment of duties on manufactured items, other than tractors, tractor parts, petroleum products, man-made fibre and yarn, wood pulp, has been effected as a measure of rationalisation. Items at present exempt from duty continue to remain so. Specific rates of duties have been converted to metric rates and duties.

2. Central excise

Tea has been completely exempted from the excise duty.

The first schedule to the Central Excises and Salt Act, 1944 is being brought into the international metric system of weights and measures.

The tariff is being rationalised by including cement paints under the head "paints". Paper and paper-board are being combined into one item. Knitting yarn of wool and synthetic fibre are being combined into one item. Duty on wires and cables is being raised from 7.5 to 10 percent.

3. Sales tax

Locally manufactured iron and steel has been exempted.

4. Others

Passenger fares for all classes of railways are proposed to be increased by 20 percent

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1. One lakh is one hundred thousand.

from July 1 next with the exception that commuter fares for suburban areas of major cities of Lahore and Karachi will be left unchanged.

Freight rates for goods carried by rail are proposed to be increased by 12.5 percent.

Tea totally exempted from both excise and import duties but all types of packaged tea imports which cater for the rich subjected to import duty of 40 percent ad valorem.

Present rates of duty on timber and building boards increased from 60 and 85 percent to 100 percent.

Local call rates for telephones are proposed to be increased from 25 paisa to 35 paisa per call and correspondingly the charges for STD calls will be increased by 40 percent.

Manual trunk call rates are also being increased by 50 percent.

Rentals for telephone connections, telex rentals and other charges for telex are also proposed to be increased and rationalised.

Rates for telegrams, other than Press telegrams, are proposed to be increased by 23 percent.

The annual fee for TV sets is proposed to be increased from Rs. 100 to RS. 150 per annum.

The power rates of WAPDA are proposed to be increased by 15 percent. The present power rates for the domestic consumers viz. 22 paisa for first 20 units and 25 paisa for additional units, will however remain unchanged. The rates for tubewells will also remain unaltered.

The power tariff of Karachi Electric Supply Corporation (KESCO) is being rationalised and revised upward by about 18 percent. It is proposed that the present rate of 20 paisa per unit which applies for first 50 units may also apply to any additional units.

The price of cement is proposed to be increased from Rs. 350 per ton to Rs. 440 per ton.

Passport fee increased from Rs. 400 to Rs. 600 for urgent and from Rs. 100 to Rs. 200 for ordinary passports.

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Congress report for the International Fiscal Association containing national reports on the above-mentioned subject. A summary of each report in English, French, German and Spanish is append-

NEW OECD MODEL DOUBLE TAXATION CONVENTION

The report by the Committee on Fiscal Affairs presenting the new OECD Model Double Taxation Convention on Income and Capital is just out. Approved by the Council of OECD in April 1977, the Model Convention has been the subject of a new recommendation to Governments of Member countries to base their bilateral negotiations on the new text and to pursue generally their efforts to avoid international double taxation.

The 1977 Model Convention replaces an OECD Draft Convention issued in 1963 and, like its predecessor, is expected to exert a considerable influence on the numbers and the content of bilateral conventions concluded by OECD Member countries both with other Member and with non-Member countries. The new bilateral convention follows, in the main, the pattern and reproduces the essential provisions of the 1963 Draft. But the 1977 Model also takes account of the experience gained by Member countries in negotiating and applying bilateral conventions based on the 1963 Convention, as well as of changes in systems of taxation, the increased complexity of international fiscal relations and the development of new sectors of business activity that have been a feature of the international economy since the earlier text was drafted.

New provisions have been inserted in the 1977 Model to modify the scope of some Articles and, in a few cases, the rules laid down in the 1963 Draft Convention, where this was found necessary in the light of practical experience. However, the main work of the Committee on Fiscal Affairs has been to clarify, update and expand the Commentaries which are designed to illustrate and interpret the provisions of the Articles.

The most important modifications concern the taxation of permanent establishments (Article 5), Associated Enterprises (Article 9), Dividends (Article 10), Artistes and Athletes (Article 17) as well as non-discrimination by reason of nationality or residence (Article 24) and Exchange of information between tax administrations (Article 26).

These modifications are designed, inter alia, both to give additional protection to taxpayers against the possibility of double taxation and to facilitate the task of national administrations in combatting tax avoidance and evasion. To reduce the possibility of economic double taxation, a new provision requires the tax authorities of one contracting State to be prepared to make an appropriate reduction to the profits of an enterprise, when they are satisfied that the tax authorities of the other contracting state have correctly increased the taxable profits therein, provided the paying enterprise has acted in good faith (amendment to Article 9). An example of reducing abuse of double taxation conventions is that Article 17 of the Model Convention now makes it clear that its provisions should not apply to certain athletes and entertainers whose income is paid to companies established for the purpose of avoiding tax. Of more general importance in this field is the emphasis in the Commentary to Article 26 that exchanges of information between tax administrations can be far more extensive and take many more varied forms than was sometimes found in the interpretation of the 1963 texts.

The implementation of the new Model Convention, as the revision of existing conventions and the conclusion of new ones proceed, will permit the achievement of further progress towards the harmonisation of conventions and the elimination of double taxation, for the benefit of taxpayers from Member countries who undertake trading, industrial or financial activities in other Member countries.

"MODEL DOUBLE TAXATION CONVENTION ON INCOME AND ON CAPITAL"
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The Polish Tax on INHERITANCES AND GIFTS

by Dr. Apoloniusz Kostecki

The Law of December 19, 1975, on the inheritance and gift tax — which came into force on January 1, 1976 [1] — constitutes the legal basis for the taxation of inheritances and gifts in Poland and forms part of the changes in the Polish tax system. [2] Strictly speaking, the inheritance and gift tax is a new feature in the Polish tax system but its basic elements had already been included in the provisions of the Decree of February 3, 1947, on the property acquisition tax. [3] The reasons for the abolition of the provisions of that Decree are not quite clear. The argument that the structure of the tax was too sophisticated and not understandable for taxpayers does not seem a cogent enough one for abolition of the above-mentioned Decree.

The introduction of the tax on acquisition of property into the Polish tax system in 1947 reflected an interesting process which brought together principles of taxation relating to identical or similar subject matter in one legislative act. That correct process of integration resulted in a simplification of the tax system since it limited the number of taxes relating to the same or similar subject matter. It also eliminated the possibility of tax being assessed twice on the same subject matter. In the case of the tax on property acquisition, related phenomena such as gratuitous transfers and transfers for a consideration of property were consolidated in one act dealing with the tax on acquisition of property. This tax was created on the basis of the tax regulations existing between World War I and II in the following manner:
— with regard to the gratuitous acquisition of property it replaced the obsolete provisions of the inheritance and gift tax,
— with regard to non-gratuitous acquisitions it covered a portion of the stamp duties structure of that time.

It should be noted that the introduction of the present tax on inheritances and gifts resulted from a process contrary to the one which had been in operation in 1947 when the tax on acquisition of property was created. Thus the present tax was formed as the result of a process of division of the subject matter of taxation, this being now partly covered by the tax on inheritances and gifts and partly by the law on stamp duties.

To recapitulate, the tax on inheritances and gifts took over the functions of the tax on acquisition of property which was in force until December 31, 1975, as far as gratuitous acquisition of property was concerned. It explains the fact that some structural elements of the tax on property acquisition have been taken over by the tax on inheritances and gifts.

The inheritance and gift tax will be applicable only to individuals and legal entities and not to any unit of the socialized economy. Therefore, such subject matters of socialized economy as state enterprises, cooperatives and other social organizations dealing with economic activities have been excluded from the scope of this tax.

Under Article 1 item 1 of the Law, *the acquisition of the ownership of property and/or property rights* (by means of inheritance or gift) is subject to tax. Where ownership of property is deemed to be a property right, the property rights acquired by means of inheritance or gift might, in substance, be regarded as the subject matter of taxation. However, the scope of the tax has been extended in accordance with the provisions of Article 1 item 2 of the Law. Thus, it also covers the acquisition of savings deposit rights carried out on the depositor's instruction in contemplation of death [4] as well as acquisition of property by means of usucaption. [5] This extension of the scope of the tax resulted in considerable assimilation of the scope of both the inheritance and gift tax and its predecessor, the property acquisition tax, in relation to gratuitous transfers. Therefore, the definition of that tax as a tax on inheritances and gifts is not a precise one, particularly with respect to property acquired by means of usucaption.

It also follows from the rule contained in Article 1 of the Law that only transfers of rights relating to the acquisition of property and property rights situated and exercised in Poland will be subject to the inheritance and gift tax. If, however, the recipient is a Polish citizen or has a place of permanent residence in Poland at the time of the inheritance coming into existence, then acquisition of property or property rights situated or exercised abroad will also be subject to taxation.

By virtue of this principle, the obligation to pay the tax on inheritances and gifts on the acquisition of property or property rights situated or exercised in Poland arises irrespective of citizenship or domicile of both the recipient and decedent or donor.

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1. Dziennik Ustaw (Journal of Laws of the Polish People's Republic) No. 45 item 228.
2. The trends and nature of these changes were described in more general form in Bulletin for International Fiscal Documentation No. 10 of 1976. It was then proposed that the structure of the inheritances and gifts tax would be discussed in more detail in a separate article.
3. Dziennik Ustaw No. 27 item 106. The Decree was amended three times and after the first and second amendment the uniform text was published (the first one in Dziennik Ustaw No. 53 item 418 of 1949 and the second one in Dziennik Ustaw No. 9 item 74 of 1951). The third amendment was published in Dziennik Ustaw No. 7 item 77 of 1971.
4. It should be mentioned that by virtue of Article 40 para. 1 item 2, and para. 3 of Law of June 12, 1975 — Bank Law (Dziennik Ustaw No. 20 item 108) saving deposits of up to a total of 200,000 zloty are excluded from an estate which had been bequeathed by the depositor in writing to close relatives (spouse, children, parents, grandchildren, brothers and sisters).
5. Usucaption is a term denoting a mode of acquisition of property corresponding very nearly to prescription, i.e. the acquisition of ownership through the expiration of a certain period of time. (Editor's note.)

However, in the interests of reality, certain exclusions from the above principle have been made. Namely, acquisitions are not taxable if at the time of the inheritance coming into existence or the signing of the deed of gift, neither the recipient nor the decedent nor donor were Polish citizens nor had a permanent place of residence in Poland (Article 3 item 1). However, it follows from this rule that this exemption does not include the acquisition of rights in *real estate* situated in Poland.

In this article we shall deal with the details of the exemptions relating to transfers between Poland and abroad as well as those relating to agricultural real property.

The first exemption refers to the situation covered by Article 2 of the Law. In the case of gifts, this exemption applies when foreign currency has been transferred to the recipient's bank account in Poland after property or property rights situated or exercised abroad have been sold. Where the estate involved is situated abroad the exemption will apply when the amount due has been encashed by the Polish Consulate or — where there is no consulate in the decedent's country — when it has been transferred to the recipient's account in Poland. The purpose of the above-mentioned exemption is clear enough.

The second kind of exemption refers to the acquisition of property in private farms by means of inheritance, gift and usucaption. The exemption covers the acquisition of real property and other property rights in private farms or in a part thereof. This exemption, however, is not of universal application. It does not cover, for example, private farms situated within the bigger towns (i.e. towns of more than 100,000 inhabitants) nor apartment buildings forming part of a private farm within such a town.

In certain cases the exemption from the tax on property acquisition, in relation to specific components of private farms, is of a conditional nature. Such components are, in particular, buildings occupied for purposes of chicken farms and fur farms, greenhouses, hotbeds, refrigerating plant, buildings for the storage of fruit and others, as well as the excess value of orchards of an area larger than 3 hectares. Such components are exempted on condition that the property has been acquired by the spouse or descendants who must also make a written statement that they will run the farm for a period of at least five years from the moment of acquisition of the rights.

Property acquired by units of the socialized economy is always exempted and in that case the exemption is of a general nature.

The structure of the tax results in the tax liability falling on persons acquiring property. In the case of gifts, however, the donor and donee are jointly and severally liable. Because of its definition of the tax base the tax on inheritances and gifts is in fact a tax on the increase of net wealth. Namely, the tax base is the *net value* of the property acquired, i.e. the value free of debts and encumbrances. The value of the property acquired is calculated on the basis of (1) *the state of this property on the day of acquisition thereof*, (2) *the market price of this property on the day of the tax assessment.* Since the tax may be assessed a long time after the property has been acquired, the above principle may have a disadvantageous effect on the taxpayer's financial position, for example where the property has been sold before the tax is assessed and at prices lower than those prevailing on the day of the tax assessment.

In accordance with the executive regulations, [6] the market value of property is to be determined on the basis of average prices noted in the transfer of property of the same kind in a given locality on the day of the tax assessment. The legislature took this into consideration and foresaw the possibility of the state of the property changing during the period between the day of the acquisition of the property and the day of tax assessment due to reasons beyond the taxpayer's control. Such reasons have, however, been limited to force majeure only. In that case, the value of the property will be determined on the basis of their state on the day of the tax assessment, while the amount of any possible insurance indemnification will increase the taxable base.

Debts and encumbrances to be deducted from the value of the property acquired include the decedent's funeral costs, costs of inheritance proceedings, remuneration of the executor, legacies to be paid and orders to be carried out in accordance with the will.

The provisions of the Law state that the value of the property rights is the one declared by the acquirer. This value must equal the market value (see my explanation above) applied to goods of the same kind. Only the value of savings deposits and of apartments and other buildings is excluded from that principle. In the first case, the real amount of savings forms the tax base and in the second one the base consists of the value of the buildings where this is not lower than that estimated for fire insurance purposes in any given tax year. The regulations provide for special proceedings where a person acquires property for no consideration or the value given by him is lower than the market value. In the first stage of such proceedings the person acquiring the property is requested to estimate the value of the property acquired or to give a statement of the full value increase within 14 days. If such statement is not filed by the purchaser, then in the next stage of proceedings the value of the property will be established by a tax assessment body on the basis of expert opinion. If the value initially given by the purchaser was 33 percent lower than that fixed by the experts he will be obliged to pay the costs of the expert report. The limit of acceptable error has been relatively high.

The legislature employs two kinds of cumulation in calculating the tax. The first kind, which is of general application and objective character, consists of the taxation of the aggregate value of the property acquired *from the same person* over a period of six years. The cumulation is effected so that the value of property acquired from the same person over a period of five years preceding the year of the last acquisition is added to the value of the property

6. Ruling of Minister of Finance of December 30, 1975, on execution of Law on the inheritance and gift tax (Dziennik Ustaw No. 46 item 256).

last acquired. The tax previously levied on the property acquired at an earlier date is then deducted from the tax computed on the aggregate value of the property. The other kind of cumulation goes further but its application is limited to property acquired from abroad by way of gift. Here the cumulation has a subjective character and operates on two levels. On the one hand, the value of all property acquired by the donee from abroad by way of gift in any one calendar year is added together irrespective of the number of donors. On the other hand, the cumulation pertains to the value of the property received from abroad by all the family members of a joint household; all family members who receive gifts are liable to tax jointly and severally.

Both kinds of cumulation prevent evasion of tax by the taxpayer taking advantage of the institution of the exempted amounts and also evasion of the consequences resulting from the progressive nature of the tax.

The provisions relating to the tax exempted amounts provide for variation in the tax amount depending on the taxpayers' group in which the person acquiring the property is included. Under Article 9 item 1 acquisition of property is exempted if its value does not exceed 50,000 zloty where the taxpayer is included in Group I and 30,000 zloty where the taxpayer is included in one of the other three groups.

The tax on inheritances and gifts is progressive and varies according to the group to which the taxpayer belongs.

Taxpayers are divided into four groups depending on the relationship of the recipient to the deceased or donor. it should be noted that the present solution makes a more consistent classification of beneficiaries than the previous provisions, i.e. it classifies:

among Group I: spouse, descendants, adopted and step-children, sons- and daughters-in-law,

among Group II: ascendants and brothers and sisters,

among Group III: descendants of brothers and sisters,

among Group IV: other beneficiaries.

It seems doubtful whether it was necessary to separate Group III, which includes only descendants of brothers and sisters, who could have been included together with brothers and sisters in Group II. That would have simplified the progressive structure of the tax without contravening the accepted principles. Persons who acquire property by means of usucaption are treated uniformly by the Legislature and are included in Group IV which is subject to the highest level of taxation.

There is an exception to the principle that the kinship between the recipient and deceased or donor determines in which of the four groups the taxpayer will be classified. The exemption concerns acquisition of property by way of gift from abroad. In that case, the amount of tax will be determined purely on the basis of whether the taxpayer is an individual or a legal entity. With respect to individuals the tax is fixed irrespective of the kinship between the donor and recipient at an amount provided for Group III taxpayers. In the case of legal entities the amount of tax will be in accordance with that provided for Group IV taxpayers ("other beneficiaries").

There are separate tax tables for each tax group:

a) Tax table for Group I

Basis of taxation in zloty over	up to	*Tax amount in zloty*
50,000	100,000	10% of the excess over 50,000
100,000	200,000	5,000 + 12% of the excess over 100,000
200,000	400,000	17,000 + 14% of the excess over 200,000
400,000	600,000	45,000 + 16% of the excess over 400,000
600,000	800,000	77,000 + 18% of the excess over 600,000
800,000	1,000,000	113,000 + 20% of the excess over 800,000
1,000,000	1,200,000	153,000 + 22% of the excess over 1,000,000
1,200,000	—	197,000 + 24% of the excess over 1,200,000

b) Tax table for Group II

Basis of taxation in zloty over	up to	*Tax amount in zloty*
30,000	50,000	10% of the excess over 30,000
50,000	100,000	2,000 + 15% of the excess over 50,000
100,000	200,000	9,500 + 18% of the excess over 100,000
200,000	400,000	27,500 + 21% of the excess over 200,000
400,000	600,000	69,500 + 24% of the excess over 400,000
600,000	800,000	117,500 + 27% of the excess over 600,000
800,000	1,000,000	171,500 + 30% of the excess over 800,000
1,000,000	1,200,000	231,500 + 33% of the excess over 1,000,000
1,200,000	—	297,500 + 36% of the excess over 1,200,000

c) Tax table for Group III

Basis of the taxation in zloty over	up to	*Tax amount in zloty*
30,000	50,000	15% of the excess over 30,000
50,000	100,000	3,000 + 20% of the excess over 50,000
100,000	200,000	13,000 + 24% of the excess over 100,000
200,000	400,000	37,000 + 28% of the excess over 200,000
400,000	600,000	93,000 + 32% of the excess over 400,000
600,000	800,000	157,000 + 36% of the excess over 600,000
800,000	1,000,000	229,000 + 40% of the excess over 800,000
1,000,000	1,200,000	309,000 + 44% of the excess over 1,000,000
1,200,000	—	397,000 + 48% of the excess over 1,200,000

d) Tax table for Group IV

Basis of taxation in zloty over	up to	*Tax amount in zloty*
30,000	50,000	30% of the excess over 30,000
50,000	100,000	6,000 + 40% of the excess over 50,000
100,000	200,000	26,000 + 49% of the excess over 100,000
200,000	400,000	74,000 + 54% of the excess over 200,000
400,000	600,000	182,000 + 59% of the excess over 400,000
600,000	800,000	300,000 + 64% of the excess over 600,000
800,000	1,000,000	428,000 + 67% of the excess over 800,000
1,000,000	1,200,000	562,000 + 70% of the excess over 1,000,000
1,200,000	—	702,000 + 77% of the excess over 1,200,000

Even a rough analysis of the tax tables shows considerable difference in the tax burden put on the taxpayers of Group I and on the other groups. The differences between Group I and Group IV are particularly wide. Equitable considerations led the legislature to fix the tax burden for the taxpayers of Group I on a much lower level than for those included in the other groups. In addition, preferential treatment such as the increased tax exemption up to an amount of 50,000 zloty granted to Group I and lower tax rates up to a limit of 24 percent of the net value of the property seem inadequate with respect to those persons in Group I who, as a rule, have contributed in a direct or indirect way to the formation of or increase in property which afterwards is acquired by them by means of inheritance and gift. In the first place, it concerns the spouse and children of the deceased or donor. Undoubtedly, those were the reasons motivating the legislature to modify in certain cases the tax burden on those persons. For example, a special kind of tax reduction is given to the spouse and descendants of the donor which consists of a reduction in the tax on inheritances and gifts by 50 percent where a single-family house or apartment or rights to a cooperative apartment have been acquired by such persons by way of inheritance. However, that happens only on condition that the heirs were living in the above-mentioned house or apartment until the date when the inheritance came into existence.

These tax reductions are based on premises similar to the previously mentioned exemptions of certain elements of agricultural real property (being an object of inheritance or gift) acquired by the spouse or descendants.

In order to complete the picture of the scope of the exemptions from the tax, it should also be mentioned that some property acquired by means of inheritance is exempted on the grounds of the Ruling of the Ministry Council of December 29, 1975. [7] Among others, the exemption covers acquisition of:

a) furnishings (with a few exceptions) as well as household tools, subject to their being acquired by persons included in Group I of the tax.
b) objets d'art produced by the decedent and literary materials where the decedent was engaged in artistic production, research, fiction, journalism or educational activities.
c) Movable objets d'art as well as certain kinds of collections.
d) rights to the use of an apartment and its furnishings by the spouse and other close relatives of the deceased who had been staying with him until the day of his death, for a period of three months from that very day.

Also, property rights in machines, equipment and tools acquired by a craftsman by way of gift from abroad are exempted. This kind of exemption is quite significant since it is an exception to the above-mentioned principle of cumulation of the value of the property acquired by gift from abroad. However, that exemption is subject to the taxpayer's statement that the machines, equipment and tools which form the gift from abroad will be installed in his workshop and will not be sold or transferred free of charge to other persons for a period of three years from the day of acquisition.

In conclusion it should be noted that the structure of the tax on inheritances and gifts is — generally — a more modern one than the structure of the previous tax on acquisition of property. This can be seen in particular with respect to the structure of tax rates which, moreover, to a much higher degree ensure sufficiently high tax receipt for their government. This results mainly from the increase in the tax burden in the lower ranges.

7. Dziennik Ustaw No. 46 item 246.

IFA INTERNATIONAL FISCAL ASSOCIATION NEWS

VIENNA - CONGRESS 1977



GOODBYE DR. GMUER

On October 7, 1977 Dr. Paul Gmuer resigned as President of IFA after having led this Association successfully during four eventful years. The General Assembly, wishing to honor Dr. Gmuer's outstanding services rendered to IFA, unanimously elected him Honorary President. The International Bureau of Fiscal Documentation is happy to congratulate him on his election and expresses the wish that IFA may for many years benefit from his wisdom and experience.



WELCOME MR. DAVIES

On October 7, 1977 the General Assembly of IFA elected Vice-President Alun G. Davies President of its Association. The International Bureau of Fiscal Documentation, which is proud to have Mr. Davies as a Member of its Board of Trustees, congratulates him on his election and wishes him the best of luck.

SOME HIGHLIGHTS FROM THE SECRETARY GENERAL'S 1976-77 ANNUAL REPORT

At the highly successful 31st Congress of the International Fiscal Association held from October 4-8, 1977 in Vienna, the Secretary General, Professor Dr. Jan H. Christiaanse, presented his Annual Report on IFA's weal and woe during the past year. Fortunately there was very much weal and if there was any woe it is hardly worth mentioning. The following highlights appeared in the Annual Report:

- During 1976-77 the Norwegian National Branch — IFA's 26th branch — was recognized at the meeting of IFA's General Council in Jerusalem, while it was proposed that the New Zealand National Branch be recognized at the Vienna Congress. [1]
- On March 15, 1977 the total membership of IFA amounted to 5,014, a slight decrease compared with the previous year but resulting only from a more careful screening of membership lists.
- During the meeting of the Permanent Scientific Committee in Jerusalem it was decided to invite national reporters from countries where IFA has no branch to participate in the discussion of Subject I — Taxation of the extractive industries — of the 32nd IFA Congress to be held in Sydney (see the Conference Diary). Since this subject might be of minor importance in some of the countries where IFA does have a branch, their Secretaries were asked whether they intended to nominate national reporters for this subject. A negative answer was received from 7 Secretaries whereupon the General Secretariat nominated 7 national reporters (in addition to the national branch reporters) from non-branch countries, i.e. from Colombia, Indonesia, Iran, Nigeria, the Philippines, Saudi Arabia and Venezuela.
- The 33rd Congress will be held in Copenhagen (Denmark) from September 4-8, 1979. Subject I to be discussed at this Congress was phrased as: "The Taxation of transfers of ownership on death or inter vivos gifts with special reference to the continuity of family-held enterprises". The second subject was formulated (provisionally): "The effects of losses in a country on the tax treatment of the enterprise or group". For the Seminars the following subjects were suggested: "Trends in income tax treaties involving developing countries, with special reference to the U.N. Group of Experts" and "Trends in Scandinavian Taxation". The General Reporter for Subject I is Prof. T. Nielsen (Denmark), and for Subject II is Dr. Gerhard Laule (Germany).
- The United Nations Group of Experts on Tax Treaties between Developed and Developing Countries meets every second year and this did not get together during the period under review. The next meeting is scheduled in Geneva from October 25 to November 4, 1977. In addition to Mr. Sidney I. Roberts, Dr. Raoul Lenz — the Chairman of IFA's P.S.C. — has been nominated as co-Liaison Officer to attend this meeting on behalf of IFA.

In Jerusalem two meetings of the Executive Committee took place under the chairmanship of Dr. P. Gmuer, President of

1. The Vienna Congress accepted the New Zealand Branch as its 27th Branch.

IFA. Mr. Alun G. Davies and Dr. K. Antal had to withdraw, not being eligible for re-election. It was decided that they would be replaced, for a period of two years, by Dr. R. Bechinie and Mr. G.L. Herring, presidents of the Austrian and the Australian Branches respectively.

— On May 2, 1977 the Spring Meeting of the Executive Committee was held in Vienna. Mr. A.G. Davies attended the meeting in his capacity of President Elect. Dr. R. Halpern attended the meeting, representing the Austrian Congress organizing Branch; and Mr. P.V. Mayes came all the way from Australia to represent the Australian Congress organizing Committee. (Mr. Herring was not able to attend the meeting.) During this meeting the Executive Committee decided to recommend to the General Council and the General Assembly during the Vienna Congress that fees for 1978 be increased to US$ 30.-- for individual members of National IFA Branches, US$ 32.-- for direct individual members of IFA, and US$ 70.-- for corporate members, both direct and of National Branches. [2]

RESUME OF SUBJECT I: INFLATION AND TAXATION [3]

At the end of the Vienna Conference of IFA the following resumé was issued reflecting the results of the discussions of the first subject:

RESUME

The XXXIst IFA Congress dealt with the Subject "Inflation and Taxation". While it was generally recognized that the subject had a bearing on all categories of taxation, the discussion was concentrated on taxation of individual and corporate income including capital gains. In the following resumé, the main points of the proceedings are high-lighted.

Inflation seriously distorts the amount and the distribution of the burden of taxes on individual and corporate income unless tax laws are adjusted in order to reflect inflation. The conclusion to the General Report enumerates three relevant areas:

1. Tax brackets, credits and allowances.
2. The time lag between earning income and paying tax.
3. The basis of calculating the taxable income (tax base).

Ad. 1. The majority of countries adjust tax brackets, credits and allowances from time to time. Some do so at regular intervals with full or partial indexation, whilst others do so at their discretion without adhering to fixed periods or rates of adjustment. There have been in the past strong objections against inflation adjustments because the increase of the real rate of taxes was considered as a counterweight to inflationary pressure, functioning as a built-in stabilizer. While there remain supporters for that view, a growing number of countries have recently used inflation adjustments as an element of anti-inflationary policy.

Ad 2. Inflationary conditions, the different timing of tax payments may lead to either gains or losses for the taxpayers. Some countries deliberately refrain from adjusting the tax payable by adding interest or by index linking, because they consider the gain for the taxpayer from late tax payment as compensating for any loss caused by the absence of inflation adjustment. On the other hand — if inflation adjustments are made — the absence of interest or index linking would give undue benefits to taxpayers benefitting from such adjustments; moreover, it would cause inequities among different categories of taxpayers.

Ad 3. The principle of adjusting the method of calculating taxable income (the tax base) for the effects of inflation received strong support. Opposite views were, however, expressed, in particular with reference to such undesirable redistributive effects of inflation as are not offset and might even be aggravated by tax measures.
There are considerable difficulties in implementing inflation adjustments:
A. A full system of inflation adjustment would have to deal with such items as machinery and plant, inventories, monetary assets and liabilities, interest income and expenditure and capital gains. The methods would be different for each of these items.
B. There are various approaches to the adjustment, mainly general price level adjustment and current cost method. Other technicalities of adjustment are still under discussion. The development of generally accepted accountancy principles for inflation adjustment is seen as an important preparatory step.
C. Owing to the difficulties of implementing a full inflation adjustment, many countries, especially those with low rates of inflation and those which consider inflation to be temporary, have restricted themselves to granting various measures of relief as substitutes for full inflation adjustment, for instance accelerated depreciation allowances, liberal inventory valuation rules and reduced rates on certain items of income or gain.
Some participants opposed those limited measures because they do not always reduce the extent of distortion in the distribution of the tax burden created by inflation, especially where these substitute adjustments do not cover monetary assets and liabilities.
Any incomplete system of inflation adjustment may lead to new distortions in the distribution of the tax burden and only a fully-integrated system can avoid them. Opinions varied whether either for reasons of principle or owing to the high social cost of compliance, in a fully-integrated system, systems of partial adjustment would nevertheless be preferable.
D. Because there appears to be no other way to remove the distortions, those countries with higher rates of inflation and which expect those rates to continue move gradually towards systems which fully reflect inflation. So far it seems that difficulties of implementation rather than objections of principle set the pace of progress.
While specifically dealing with the adjustment of tax systems to inflation, the Congress recognized the overriding importance of all measures, fiscal and others, to combat the world-wide evil of inflation.

NATIONAL BRANCHES

NETHERLANDS BRANCH

On November 5, 1977 the Netherlands Branch held its annual meeting in Amsterdam. The discussion focussed mainly on the reports drafted for the 1978 Sydney Congress.
It was also announced that the Dutch and German Branches envisage organizing a joint conference (tentatively on May 19-20, 1978) in Hamburg. The subjects to be discussed will be made known at a later date.

U.S.A. BRANCH

The principal topic for discussion at the National Meeting of the U.S.A. Branch to be held January 12-13, 1978 in New York City's Plaza Hotel has now been selected: "International and comparative aspects of corporation-shareholder integration". This subject will be broken down into two parts: Part I — "Towards

2. The contribution increase was approved by the Vienna Congress.
3. The original version is in the English language. No resolutions or resumé were proposed regarding Subject II: Determination of the taxable profits of corporations.

tax reform in the United States"; and Part II — "The view from outside the United States". The speakers for Part I include Prof. Bernard Wolfman of Harvard University (Background on integration in the U.S.A.); Dr. Lawrence Woodworth, U.S. Assistant Secretary of the Treasury for Tax Policy (The position of the Carter Administration); Prof. David Bradford of Princetown University (The economic viewpoint); and Mr. Jennings Smith of Exxon (Implementation at corporate level): For Part II some prominent foreign speakers have been invited, including Mr. Pierre Kerlan (France) and Dr. Albert Rädler (Germany).

In addition, a portion of the program will be devoted to highlights of the U.S. national reports. Speakers on Subject I (Taxation of extractive industries) will be Mr. Edward C. Osterberg and Mr. Francis J. Walsh and speakers on Subject II (Differences in tax treatment between local and foreign tax investors and the effects of international treaties) will be Mr. Samuel M. Frohlich and Mr. James O'Brien.

It has also been announced that Mr. Richard M. Hammer will resign as President of the U.S.A. Branch and will be succeeded by the present Executive Vice President, Mr. Richard C. Pugh.

OECD Council Recommendation on Tax Avoidance and Evasion*

OECD's 24 Member countries have decided to strengthen their co-operation in combatting tax avoidance and evasion. At a meeting today the OECD Council approved the following Recommendation, which was prepared by the Organisation's Committee on Fiscal Affairs.

Under the terms of the Recommendation, Member governments are called upon in particular, to strengthen, where necessary, their national powers to detect and prevent tax avoidance and evasion, and to develop exchanges of information between national tax administrations in this respect, notably by making more use of existing international agreements, and seeking new arrangements as appropriate.

As part of the working programme on this subject, a special two-day meeting of 75 tax inspectors from Member countries opened today at OECD headquarters. The meeting is devoted to exchanges of views and experiences on detection of tax evasion during tax audit.

RECOMMENDATION OF THE COUNCIL ON TAX AVOIDANCE AND EVASION

The Council,

Having regard to Article 5(b) of the Convention on the Organisation for Economic Co-operation and Development of 14th December, 1960;

Considering that tax avoidance and evasion are contrary to fiscaly equity, have serious budgetary effects and distort international competition;

Noting that tax avoidance and evasion schemes involving international transactions have become increasingly complex and more difficult to detect;

Considering that effective action against such schemes requires strengthened co-operation between OECD Member countries;

I. RECOMMENDS Governments of Member countries:
   a) to strengthen, where necessary, their legal, regulatory or administrative provisions and their powers of investigation for the detection and prevention of tax avoidance and evasion, with regard to both their domestic and international aspects, and to exchange experiences with respect to such action;
   b) to facilitate, improve and extend exchanges of information between their national tax administrations, with a view to combatting tax avoidance and evasion, notably by making more intensive use of international conventions or instruments in force and by seeking new arrangements of a bilateral or multilateral character, with due regard to the provision of adequate safeguards for taxpayers;
   c) to exchange experiences on a continuing basis on tax avoidance and evasion practices, on techniques for detecting and preventing them and on ways and means of improving tax compliance in general.

II. INSTRUCTS the Committee on Fiscal Affairs to pursue its work with a view to facilitating the achievement of the above aims and to submit to the Council, as appropriate, specific proposals for increased co-operation between Member countries in this field.

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* Press-release of September 21, 1977.

COUNTRY BY COUNTRY SURVEY OF LOOSE-LEAF PUBLICATIONS . . .

UNITED KINGDOM

BRITISH TAX ENCYCLOPEDIA

G.S.A. Wheatcroft.
General Editor Philip Lawton.
Consulting Editor G.S.A. Wheatcroft.
Sweet & Maxwell Ltd., 11 New Fetter Lane, London EC4.
Supplemented: regularly.

Loose-leaf publication in five volumes comprising annotated text of the income tax, corporation tax and capital gains tax laws. The commentaries and explanations thereto are published in separate bound textbooks entitled Whiteman & Wheatcroft on Income Tax; Wheatcroft and Whiteman on Capital Gains Tax, and Richard Bramwell Taxation of Companies, which are supplied automatically to subscribers to the British Tax Encyclopedia, but which are also sold as separate publications.

BRITISH TAX GUIDE

Commerce Clearing House, Inc., 4025 W. Peterson Av., Chicago, Illinois 60646, U.S.A.
Supplemented: monthly.

Loose-leaf publication in four volumes primarily concerned with commentary to and reproduction of legal texts relating to income tax, corporation tax and capital gains tax levied in the United Kingdom designed primarily for the use by firms and tax consultants in the United States and Canada. The commentaries are reproduced by special arrangements from the bound volumes accompanying the British Tax Encyclopedia published by Sweet & Maxwell Ltd., London.

CAPITAL TAXES ENCYCLOPAEDIA

Capital Transfer Tax.
Editorial Board Sir John Foster, B.J. Sims and E.E. Ray. Editor for Scottish Law W.F. Bowes.
Managing Editor Leslie J.P. Livens and many contributors.
Butterworth & Co., 88 Kingsway, London WC2B 6AB.
Supplemented: at irregular intervals.

Loose-leaf publication in two volumes comprising explanation, statutes and regulations relating to capital transfer tax.

DE VOIL ON VALUE ADDED TAX

By Paul W. de Voil.
Butterworth & Co., 88 Kingsway, London WC2B 6AB.
Supplemented: monthly.

Loose-leaf publication containing an extensive description of the value added tax legislation followed by the reproduction of all the relevant statutes and regulations, cross references, annotated and indexed.

TAX ON PROPERTY

Industrial and commercial aspects (inc. property investors, developers and dealers generally).
By A.D. Weatherall.
Kluwer-Harrap Handbooks, Rembrand House, 539 London Road, Isleworth, Middlesex TW7 4DA.
Supplemented: regularly.

Loose-leaf publication of a handbook primarily concerned with transactions relating to industrial and commercial properties; private residences, agricultural property and woodlands are outside the scope of this work. Taxes covered include income tax and corporation tax, capital gains tax, development land tax and its predecessor, development gains tax.

SIMON'S TAXES

Editorial Board: Sir John Foster, K.S. Carmichael and B.J. Sims.
Editor for Scottish Law: W. Menzies Campbell. Managing Editor: John Jeffrey-Cook.
Butterworth & Co., 88 Kingsway, London WC2B 6AB.
Supplemented: at least four times annually.

Loose-leaf publication in nine volumes covering income tax, corporation tax and capital gains tax. Volumes A, B and C deal with administration, procedure and computation of these taxes. Volume D deals with the taxation of companies and Volume E with the taxation of individuals and trusts. Volume F is devoted to double taxation relief. Volume G and H contain Acts, statutory instruments and extra-statutory concessions. Each of these volumes has its own index, while Volume I comprises a comprehensive index to the whole work, together with Tables of Cases and Statutes.

SIMON'S WEEKLY TAX SERVICE

Butterworth & Co., 88 Kingsway, London WC2B 6AB.
Supplemented: weekly.

Loose-leaf publication entitled SIMON'S WEEKLY TAX SERVICE comprising SIMON'S TAX INTELLIGENCE and SIMON'S TAX CASES each with its own binders.
(1) SIMON'S TAX INTELLIGENCE, edited by John Jeffrey-Cook, records recent developments on tax matters, provides detailed summaries of all tax cases decided during the week, all relevant statutory instruments reproduced in full, all press releases issued by the Inland Revenue and by the Customs and Excise regarding value added tax and announcements as to the publication of Command Papers and explanatory booklets, Finance Bill Amendments, etc.
(2) SIMON'S TAX CASES, edited by Rengan Krishnan, John Jeffrey-Cook and R.N.G. Harrison, records United Kingdom tax cases, covering income tax, corporation tax, capital gains tax, capital transfer tax, stamp duty and value added tax. All tax cases decided by the Courts are included. Cross-references to SIMON'S TAXES are made.

Income tax on real estate transactions in Brazil

by Aleksas Juocys*

Real estate transactions have become very important in Brazil in view of the rapid increase of value of real property as a result of the continuous development of residential, commercial and industrial areas. Inflation may be considered another reason for the growth of the real estate market. Investments in real property are nowadays still a safe recourse to avoid the dilution of savings by inflation. The prices of real estate have accompanied — and have often exceeded — inflation, particularly in some areas where residential, commercial or industrial progress has resulted in an increase of value of the property. In view of the important position that real estate transactions occupy in the Brazilian economy, specific legislation has been enacted in this area, also affecting the income tax on the profit earned by the purchase and sale of real estate.

Individuals or legal entities resident or established abroad may acquire Brazilian real estate, although subject to some exceptions, which include the acquisition of rural land for which a specific Governmental authorization is required. The direct purchase of real estate by foreign residents is, however, not of great interest at the moment, since the Central Bank of Brazil is not willing to register the foreign currency remittance as a "foreign investment" in Brazil. This means that the funds obtained at the time of sale of the property may not be remitted abroad and that not even the original sum invested may be repatriated.

For this reason, foreign purchases of Brazilian real property are usually made through Brazilian companies incorporated with the funds remitted by foreign residents. However, rural *real estate acquisitions made by these Brazilian companies funded with foreign capital are subject to the same restrictions as direct acquisitions by foreign residents if the share capital of the Brazilian company is controlled by one or more foreign residents. In the event of transfer of residence from Brazil to another country or of decease leaving a foreign resident heir, the Central Bank of Brazil has permitted the sales proceeds of local real estate to be remitted abroad, although only after specific examination of each case.*

In order to examine the income tax levied on the profit made in real estate transactions, we have divided this study into three sections:

1— sales of real estate by individuals;
2— sales of real estate by companies and other legal entities not engaged in real estate activities;
3— sales of real estate by companies and other legal entities engaged in purchases and sales of real estate.

1. Sales of real estate by individuals

1.1. Real estate transactions effected by individuals resident in Brazil are generally not subject to income tax. This exemption is naturally only of interest in cases in which there is a positive difference between the purchase and sales price of the property. Any profit thus made by an individual will not be subject to income tax. In Brazil, as explained, it is very rare for real property to be sold at a loss, i.e. at a price below the purchase price.

1.2. In the event that real estate transactions effected by an individual become habitual or refer to land division or "building incorporation", [1] the law holds the transactions equivalent to taxable commercial operations. There are several circumstances which may lead to this possibility and the law even makes a distinction between property acquired before and after June 30, 1977 for this purpose.

1.3. The individual will thus be subject to income tax as a commercial firm if he:

i) sells real estate to a company with which he is connected, provided that the purchasing company in any way engages in real estate construction or sale or in forestation or reforestation activities;
ii) habitually sells real estate in his own name; or
iii) provides for the incorporation of condominium buildings or land divisions.

1.4. The transfer of real property to a company to pay up subscribed capital is also deemed to be a sale as mentioned in i) above. The habitualness mentioned in ii) above arises if more than three properties acquired over a two-year period are sold during the same two-year period, or if more than five properties acquired over a five-year period are sold over the same five-year period. This rule applies to property acquired after June 30, 1977 and sold after such date. As an exception to this rule, an individual who sells in 1977 more than three properties acquired in 1977 or who sells more than six properties acquired in the periods from 1975 to 1977 or 1976 to 1978 in these same three-year periods, will also be held equivalent to a commercial firm.

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* Accountancy degree in 1948 and law degree at the University of Law of São Paulo in 1958, with several courses of specialization in taxation law. One of the senior partners of the law firm Pinheiro Neto & Cia. — Advogados, of which he became a member in 1958.

1. Ed. note: i.e. the promotion of the creation of condominium property.

1.5. This same rule will apply in the case of incorporation of a building or land division when the documents are filed for registration by the Real Estate Registry. Another instance is when a land owner, although not having filed "building incorporation" or land division documents, provides for the construction of a building with more than two real estate units or for a land division and then starts selling the real estate units or divided land during the 60 months following the date of approval of the building or division by the Real Estate Registry.

1.6. When an individual is held to be equivalent to a commercial firm, he will be obliged to determine his profits as if he actually were a commercial firm. The annual profit earned by the individual will automatically be considered as a profit distributed in the base year and a balance sheet will have to be drawn up as of each December 31st to have the profit taxed with the 30 percent corporate income tax which applies to commercial companies in general. This tax is payable in portions of twelfths during the following fiscal year. The total tax is deducted from the profit and the result is considered as automatically distributed to the individual, who may opt between having the distributed sum taxed at source at the rate of 10 percent payable within 90 days, or including the distributed sum in his annual income tax return for taxation at progressive rates which may reach 50 percent in the case of net income in excess of Cr$ 675,000.00 in the fiscal year 1977.

2. Sales of real estate by companies and other legal entities not engaged in real estate activities

2.1. Companies and other legal entities engaged in the most diversified lines of business but not in real estate transactions often have fixed assets in the form of real property used for the installation of their plants, offices, warehouses and the like. These companies are free to sell the property at their convenience but the profit or loss ascertained in these sales will reflect on their taxable income.

2.2. Consequently, the sales price of real estate will be included in the company's income subject to income tax and will thus be computed in the annual balance sheet for purposes of determining the annual net profit which will be subject to the 30 percent corporate tax. The ascertainment of the profit made on the sale of real estate should consider the annual monetary correction of the book value of the acquisition of the property according to the Government inflation correction indices, as well as the depreciation.

2.3. The exception to this rule is that companies which have had real estate in their fixed assets for more than five years may sell such real estate exempt from income tax, provided that the sale is effected prior to December 31, 1978 and that the sale proceeds are used to increase the company's capital. The shares or quotas distributed as a result of such capitalization are also exempt from income tax in the hands of the recipients, regardless of whether they are resident in Brazil or abroad. The Central Bank of Brazil has, however, been refusing to register such capital increases as a "foreign investment" in cases in which the partners of the company are resident abroad.

3. Sales of real estate by companies and other legal entities engaged in purchases and sales of real estate

3.1. Brazilian commercial companies in general draw up their annual balance sheets on an accrual basis including all sales of goods even if their value has not yet been realized.

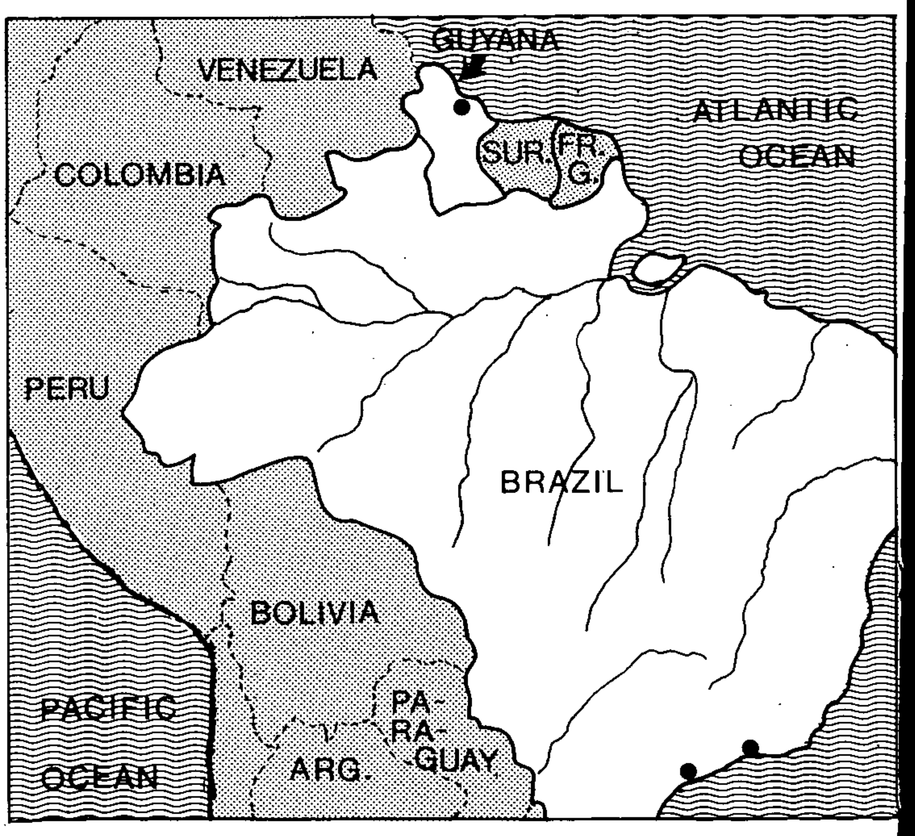
3.2. Real estate companies are, however, permitted to determine their profits on a cash basis by considering only the amounts actually received for real estate sales.

3.3. Companies which engage in selling real property or rights on a credit basis or in constructing buildings for a credit sale, i.e. sale with immediate delivery of possession but with deferred payment, should keep separate accounts for the installments received in each fiscal year by way of:

a) interest;
b) cost of acquisition or of construction of the property or rights sold;
c) profit from the transaction;
d) monetary correction of the outstanding balance of real estate contracts according to the monetary correction criteria applied to tax debts.

3.4. Companies engaged in such activities may correct the monetary expression of the cost of the land or buildings according to the same correction indices applicable for the monetary correction of the fixed assets of companies in general. The variations determined are thus added to the cost of the land or buildings transacted, for the purposes of ascertaining the taxable income.

3.5. The profit is determined annually in the balance sheet, the net profit being subject to 30 percent corporate tax payable in portions of twelfths during the fiscal year following the base year.



Taxation in developing countries
A Case Appraisal of Guyana

by Kempe R. Hope

I. INTRODUCTION

The most salient characteristic of taxation is its compulsory nature. There is no quid pro quo *relationship of taxes paid and benefits received by the citizenry. So far, all attempts to establish a relationship between taxes paid and benefits received by the citizenry have failed. There is no way of "ascertaining the true benefits".* [1] *Where public goods are relatively "pure" and the exclusion principle does not apply, there are "no discrete outputs that are appropriable by individuals".* [2] *However, the generally accepted goals of taxation are (1) efficient resource allocation; (2) full employment with price stability; (3) a satisfactory distribution of income; and (4) a high stable rate of economic growth. These generally accepted goals of taxation have to be judged by certain criteria as how they are fulfilled.*

Four general criteria can be developed to evaluate taxes. These are (1) allocational efficiency; (2) equity; (3) administrative feasibility; and (4) revenue productivity. The first criterion, allocational efficiency, is concerned with the economic effects of taxation on the pattern of resource allocation. Equity refers to different taxes and how each tax redistributes income and wealth among the citizens in such a way as to narrow the gap between the poor and rich. Administrative feasibility encompasses the problems dealing with how efficiently a particular tax can be administered. And finally, revenue productivity deals with the ability of a tax to maximise government revenues. These are standard criteria used in taxation theory for the purpose of evaluating various taxes. However, while the criteria for evaluating various taxes are generally agreed upon, there is no agreement on an ideal tax system for all countries. A country's tax system must be reviewed periodically as development proceeds. Dependence on various taxes for revenues must be modified as the economy of a country changes. The aim should always be a tax system that will be adequate, flexible, and in harmony with the emerging pattern of economic activity. [3] *Furthermore, these general criteria for appraising a tax system may be in conflict with each other. Neutrality may be in conflict with revenue productivity criteria, and revenue productivity may be in conflict with equity criteria. This paper first examines taxation in developing countries in terms of the theoretical literature and then appraises, within that framework, taxation in Guyana.*

II. TAXATION IN DEVELOPING COUNTRIES

In examining the literature on tax structure in Less Developed Countries (LDC's) it is found that almost all of the authors seem to agree that the tax system must transfer resources from the private to the public sector so that the public sector will have the capability to carry out those functions which are basic to the role of government as well as those functions which are related to the development of the countries. [4] The tax system must also induce a transfer of resources within the private sector away from low-priority toward high-priority uses. Taxes put resources in the hands of governments and these resources can be used for carrying out certain investment programs which are supposed to be productive to the economy, especially in the long-run.

In the early stages of the economic development of the United Kingdom and the United States, their fiscal structure as a whole favoured the act of accumulation and capital formation and discriminated against the act of consumption. The economic development of these countries has been brought about largely by the efforts of a dynamic private enterprise; and to enable it to plough back its increasing incomes into investment, the structure of taxation was made highly regressive and the fiscal structure as a whole tended to redistribute the national income in favour of the investors and savers.

But in the LDC's, as the public sector is obliged to play an increasingly important role in accelerating development, it may not be reasonable to finance the development outlay of the public sector by depending entirely on regressive taxes. In a democratic type of country, such a distribution of tax burden, apart from being, as Kaldor points out, "contrary to the sense of justice and equity of a democratic society", [5] may also create social discontent which may hinder the process of economic development itself. Besides, there exists a much greater concentration of income and wealth in the hands of a very small proportion of the population in a developing

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1. R. Musgrave, *The Theory of Public Finance* (New York: McGraw-Hill, 1959), p. 134.
2. Jesse Burkhead and Jerry Miner, *Public Expenditure* (Chicago: Aldine, 1971), p. 196.
3. Robert B. Bangs, *Financing Economic Development: Fiscal Policy for Emerging Countries* (Chicago: University of Chicago Press, 1968), pp. 145-146.
4. Vito Tanzi, "The Theory of Tax Structure Development and the Design of Tax Structure Policy for Industrialisation" in David T. Geithman (ed.), *Fiscal Policy for Industrialisation in Latin America* (Gainesville: University of Florida Press, 1974), p. 50.
5. N. Kaldor, *Indian Tax Reform: Report of a Survey* (New Delhi: Government of India, Ministry of Finance, 1956), p. 1.

country, and the process of economic development itself will tend to magnify these concentrations. Some of these concentrations of income and wealth emanate from non-entrepreneurial sources such as rent and interest, and the persons in possession of such wealth and income have no tradition of saving and productive investment; but they are inclined to dissipate their incomes into non-functional consumption and unproductive investment.

Therefore, as noted by Tripathy, "tax policy in the developing country, as an instrument of development finance for the public sector, has to be geared effectively to the taxation of non-entrepreneurial incomes, providing at the same time adequate incentive to the private sector undertaking useful production and essential investment." [6]

Though in the early stages of the economic development of the United Kingdom and the United States, the tax structure was predominantly regressive with complete dependence of the tax system on outlay taxes, the position has been fundamentally reversed in modern times, and the taxes on income and wealth are more important in their tax structure than the taxes on outlay.

Public savings in the developing countries are bound to remain small if their tax-income ratios are not substantially raised. The existing tax structure in many developing countries is not conducive to a rapid growth of tax revenues unless there are frequent changes in coverage and rates of taxation. In a 1971 publication, Chelliah found that the average tax ratio in developing countries was 13.6 percent compared to 15.1 percent in his 1975 publication. [7] But in spite of this general increase in tax ratios, the average level of taxation in these countries is still considerably less than in developed countries. The primary reason for this difference is, of course, the wide difference in per capita income levels. When a comparison is made between the two groups of countries, per capita income differences are clearly seen to be associated with tax level differences. [8]

Tax ratios measure the level of taxation in a country. This is usually judged in terms of the ratio of taxes to some measure of national product. What elements should be included in the numerator and the denominator of the ratio depend on what aspects of the governmental role one wishes this ratio to reflect or signify and what one intends to show by international comparisons of tax levels. The standard approach has been to use the ratio of all taxes and tax-like charges to gross national product at market prices. Hence, the overall tax ratio shows the proportion of national income that is "compulsorily" transferred from private hands into the government sector for public purposes. As such, the ratio gives an idea of (a) the division of responsibilities between the public and private sectors and (b) the degree of control that the government can potentially exercise over the disposition of purchasing power in the economy. [9]

Tax ratios and changes in them over time are matters that are subject to control by governments. Nevertheless, the changes in tax ratios brought about in different developing countries are partly dependent on major characteristics of the economy that have a bearing on taxable capacity.

Tax ratios have been widely regarded as an index of the size of the public sector, and many authors have attempted to explain the variations in the size of the public sector as reflected in tax ratio differences between different countries as well as over time. These studies have tried to discover whether there is any measurable relationship between economic characteristics including the existing level of development and tax ratios. The majority of the studies have been in the nature of cross-section analysis.

The pioneering study of tax ratio variations, explained by different economic and sociopolitical factors, was done by Martin and Lewis. [10] They concluded that the proportion of national income spent on basic public services varies not so much with income as with the "progressiveness" of the rules or electorate of the state. Williamson used per capita income as an indicator of the stage of development and fitted an exponential function to data for a sample of 33 developed countries. [11] His result indicated that there was a significant positive relationship between the revenue ratio and per capita income, although differences in the revenue share were less pronounced than those in per capita income.

Plasschaert used per capita income and import/GNP ratio as determinants to explain variations in the ratio of government revenue to GNP. [12] The import ratio turned out to be significant both when used alone and when used in conjunction with per capita income, per capita income itself did not emerge as a significant determinant of the revenue ratio. Hinrichs also found that "openness", as measured by the import ratio, not per capita income, is a major determinant of government revenue shares of gross national product. [13]

Lotz and Morss in their 1967 publication sought to examine the relationship between tax ratio differences and differences in per capita income and degree of openness. [14] They used the ratio of the sum of imports and

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6. R.N. Tripathy, *Public Finance in Underdeveloped Countries* (Calcutta: World Press Private, 1964), p. 96.
7. See Raja Chelliah, "Trends in Taxation in Developing Countries", *IMF Staff Papers* 18 (July 1971), pp. 254-331; and Raja Chelliah et al, "Tax Ratios and Tax Effort in Developing Countries, 1969-71", *IMF Staff Papers* 22 (March 1975) pp. 187-205. The 1971 publication covers the period 1953-55 to 1966-68 while the 1975 publication covers 1969-71.
8. Raja Chelliah, "Trends in Taxation in Developing Countries", pp. 280-281.
9. *Ibid.*, p. 258.
10. Alison Martin and W. Arthur Lewis, "Patterns of Public Revenue and Expenditure", *Manchester School* 24 (September 1956), pp. 203-244.
11. J. Williamson, "Public Expenditure and Revenue: An International Comparison", *Manchester School* 29 (January 1961) pp. 43-56.
12. S. Plasschaert, *Taxable Capacity in Developing Countries* (Washington, D.C.: World Bank Report No. EC-103, 1962).
13. H. Hinrichs, "Determinants of Government Revenue Shares Among Less-Developed Countries", *Economic Journal* 75 (September 1965), p. 546-556.
14. J. Lotz and E. Morss, "Measuring 'Tax Effort' in Developing Countries", *IMF Staff Papers* 14 November 1967), pp. 478-497

exports to GNP, rather than the import ratio or the export ratio, as the index of openness. They found both income and openness to be significant explanatory factors positively related to the tax ratio; and together they explained a high proportion of the variance.

In a later paper, Lotz and Morss introduced new variables to the above-mentioned analysis. [15] The introduction of the degree of monetisation as an explanatory factor resulted in a significant increase in the explained variance but lowered considerably the significance of per capita income. While important gaps remain to be covered, their results suggested that the availability of taxable bases is a more important determinant of tax levels in developing countries than variations in the demand for government expenditures. Their suggestion was based on findings that factors measuring tax administrative capacity, while not very meaningful as indicators of demand for public services, are highly significant in explaining the tax ratios in developing countries.

It can be claimed that, "conceptually, the tax ratio or share of national income appropriated by the government can be determined by four broad groups of factors." [16] On the demand for government services side, there may be two groups of factors. These are (1) the need for services arising out of "objective" conditions, and (2) the preferences of the people and the leaders as between public and private services, including the institutional arrangements arising from them. On the side of raising resources or supply of funds, two operative factors may be suggested. The first one being the ability of the people to pay taxes and the second factor being the ability of the government to collect taxes.

However, while a simple comparision of tax ratios gives some indication of the relative levels of taxation in various areas, any inferences on tax performance or effort based merely on such a comparison fails to take into account the fact that some countries are more favourably placed to levy taxes. That is, they can be said to have greater taxable capacity than others. It has been pointed out though, that the successful measurement of taxable capacity, used in many studies, depends critically on the *a priori* justification of the explanatory variables as affecting only taxable capacity and not at all either demands for higher public expenditures or willingness to tax. [17] It is not surprising, therefore, that Richard Bird has argued quite convincingly that the distinction between "capacity" and "willingness" is a very fuzzy one and indeed "it is inherently extremely difficult to specify correctly any model of (usable) taxable capacity to quantify what Musgrave has called the "tax handles" available to a country." [18]

Accepting, however, that something called "taxable capacity" exists, then the next step is that of calculation of tax effort. Tax effort is defined as the ratio of the actual tax ratio in a particular country to that which would be predicted on the basis of the taxable capacity concept. A tax effort ratio of less than one is usually taken to mean that the country exploits its estimated tax potential less than the average, in other words, that it has a preference for a level of taxation below the average, or a low tax effort.

Tax effort is a process which may take several forms, including reform of existing taxes, improvement in administration, and introduction of new taxes. The indices of tax effort should not be used in a mechanistic way but rather should be considered useful additional information in judging the scope for more taxes.

The tax ratio and tax effort concepts discussed above are based on two sets of techniques for comparative analysis. One technique equates tax effort to the ratio of taxes (or revenues) to income. Such a straightforward comparison implicitly assumes total income to be the only relevant indicator of intercountry differences in taxable capacity. The second technique, a stochastic approach, gives markedly different results. It involves the assumption that the tax ratio (T/Y) is an appropriate reflection of taxable capacity if it is adjusted for intercountry variations in factors that are assumed to reflect intercountry differences in the size of the tax base and the ability to collect taxes.

While clearly preferable to a straight tax ratio for comparative purposes, the stochastic approach has a number of methodological problems. In general, the aggregative regression approach does not allow a desirable examination of the kinds of explicit relationships between particular taxes and particular economic structure variables that would seem useful for purposes of making intercountry comparisons of taxable capacity and tax effort.

Bearing these facts in mind, therefore, Roy Bahl proceeded to develop an alternative method for making intercountry tax effort comparisons in which the tax effort index derived may be related to the intensity of use of specific taxes. [19] He designated his methodology as the "representative tax system approach", and it involves application of average effective rates to a standard set of tax bases. This approach does allow an examination of marginal effects. Taxable capacity is defined in this approach as the total tax amount that would be collected if each country applied an identical set of effective rates to the selected tax bases, that is, as the yield of a representative tax system.

The application of the representative tax system approach gave a distribution that did not differ significantly from that obtained in the analyses employing the aggregate regression approach. [20] However, three general observations can be pointed out. First, the level of taxable capacity responds most to changes originating in basic sector income. Second, the yield of a representa-

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15. J. Lotz and E. Morss, "A Theory of Tax Level Determinants for Developing Countries", *Economic Development and Cultural Change* 18 (April 1970, pp. 328-341.
16. R. Chelliah, "Trends in Taxation in Developing Countries", p. 292.
17. R.W. Bahl, "A Regression Approach to Tax Effort and Tax Ratio Analysis", *IMF Staff Papers* 18 (November 1971) pp. 571-573.
18. R. Bird, "Assessing Tax Performance in Developing Countries: A Critical Review of the Literature", *Finanzarchiv*, N.F. 34, Heft 2 (1976), p. 253.
19. Roy Bahl, "A Representative Tax System Approach to Measuring Tax Effort in Developing Countries", *IMF Staff Papers* 19 (March 1972) pp. 97-122.
20. *Ibid.*, p. 119.

tive system is more responsive to a change in income generated in a particular sector if it is accompanied by a change in total income than if it reflects only a sectoral redistribution of some constant amount of income. Third, the criticism that tax effort indices and rankings vary erratically with changes in the estimating procedure used was not strengthened by the representative approach.

Other studies, in recent times, have attempted other approaches to measure what essentially seems to be tax ratios and tax efforts. Peter Heller developed a utility maximisation model of the fiscal behaviour of the public sector by assuming that the public sector reflects the actions of a set of public decision makers. [21] His results confirmed that only a small proportion of marginal tax increases is allocated to investment, with the bulk used for public consumption. Hence, increases in tax revenue positively influence the expenditure categories, tend to reduce total borrowing and vice versa. [22]

Tax effort studies and methodologies, however, have not been immune from criticism. The IMF itself, where most of these studies were conducted, pointed out that "due caution must be exercised in interpreting the tax effort indices". [23] Vito Tanzi noted with regard to tax structure development that clearly up to now the marriage between the general theories and the statistical analysis carried on thus far to verify those theories has not taken place yet. [24] He further stated that "the truth of the matter is that we still do not have an answer to the question of what kind of tax structure a country should have at a given stage of economic development." [25]

Richard Bird postulated five propositions which he considered to be his basic criticisms of the tax effort studies. [26] These are: (1) There is inadequate *a priori* justification for the use of the selected variables as measures of taxable capacity; (2) The data are very bad. These data problems are very serious, and no one can truthfully claim to be aware of all the biases they impart to the result; (3) Virtually all of the work which has been done on quantitative international comparisons is cross-sectional in nature: yet the policy inferences which are drawn from this work are invariably concerned with changes in particular areas; (4) The nature of the norms applied in tax effort analysis lend themselves to distortions. Further, the implicit norm in the usual use of the tax effort index may also be criticised as being proportional; (5) The conventional tax effort exercise lends itself too readily to misuse to be worth further attention at this stage of our knowledge.

Despite these worthy criticisms, however, the general tendency has been to use these studies, particularly in the international lending agencies, as the background for policy decisions.

Apart from tax structure, tax effort, and tax ratio studies, a significant amount of work has been done on tax incidence in developing countries. It seems though that the major reason for that amount of work has been "the desire to provide quatitative, and therefore supposedly definitive, support for particular policy positions — which usually means to demonstrate the case for a more progressive tax system." [27] Luc DeWulf has provided a survey and critique of the major studies. [28]

The shifting assumptions used in those studies are the traditional ones. Indirect taxes were generally assumed to be shifted forward, and direct taxes unshifted. Corporate profits taxes were assumed to be shifted forward in various proportions, but no backward shifting was considered. The shifting assumptions adopted on property and wealth taxes varied. Some studies assumed no shifting while others allowed for some forward shifting of the property tax on rental property. The proportion of this tax that is assumed to be shifted forward varried greatly from study to study.

Three major reasons for making tax incidence studies can propably be distinguished. First, most studies wanted to analyse the redistribution of income through the fiscal system and concentrated on the effects of taxes on different income size classes of the population. They were concerned with vertical equity.

A second group of incidence studies concentrated on the differential tax burden between the rural and the urban sectors and on the transfer of resources between these two sectors. This emphasis stems from concern with both horizontal equity and policy for development.

The third category of studies was also concerned with the horizontal equity between various geographical areas or between various ethnic components of a country.

All of the studies favoured redistribution of income from the rich to the poor. A progressive tax system was also deemed a desirable feature of fiscal policy and, as such, results showing the redistributive effects of fiscal policy were welcomed even though the lowest-income classes were often found to contribute a considerable fraction of their incomes in taxes, and those showing regressive taxes led to recommendations for the elimination of the regressivity.

Basically, both from a conceptual and statistical point of view, tax incidence studies are too questionable to bear the weight of interpretation that is sometimes put upon them. "At most, properly constructed and heavily qualified incidence estimates can be a useful supplement to efforts to appraise and improve tax systems in developing countries: they cannot in themselves provide a road map to the better world, however". [29]

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21. Peter Heller, "A Model of Public Fiscal Behavior in Developing Countries: Aid, Investment, and Taxation", *American Economic Review* 65 (June 1975), pp. 429-445.
22. *Ibid.*, p. 441.
23. *IMF Survey* (June 3, 1974), p. 164.
24. Vito Tanzi, "The Theory of Tax Structure Development and the Design of Tax Structure Policy for Industrialisation", pp. 62-63.
25. *Ibid.*, p. 63.
26. R. Bird, "Assessing Tax Performance in Developing Countries: A Critical Review of the Literature", pp. 257-258.
27. R. Bird and L. DeWulf, "Taxation and Income Distribution in Latin America: A Critical Review of Empirical Studies", *IMF Staff Papers* 20 (November 1973), p. 664.
28. L. DeWulf, "Fiscal Incidence Studies in Developing Countries: Survey and Critique", *IMF Staff Papers* 22 (March 1975) pp. 61-131.
29. R. Bird and L. DeWulf, "Taxation and Income Distribution in Latin America: A Critical Review of Empirical Studies", p. 677

III. MAJOR TAXES IN GUYANA

The major taxes in Guyana are the personal income tax, the company tax, the withholding tax, the property tax, import duties, the consumption tax, excise duties, and export duties. [30]

The personal income tax is levied on chargeable income. Chargeable income is defined as aggregate income minus applicable personal allowances and deduction. All persons whose chargeable incomes are less than G$500 [31] are exempt. Since 1974, there has also been a National Development Surtax of 5 percent on the chargeable income of all individuals, including unincorporated enterprises. The Surtax is levied on the chargeable income in excess of G$500.

Company taxes are levied partly through an income tax and partly through a corporation tax. The major difference between a company income tax and a corporation tax in Guyana is that the shareholders receiving dividends can claim credit against their income tax liability for the former, but not the latter. For the computation of taxable income, all expenses wholly and exclusively incurred in the production of income are allowed. The major restrictions are as follows:

(a) "Expenses in excess of the amount which the Commissioner considers reasonable and necessary, having regard to the requirement of the trade and business", are not deductible.
(b) No deduction is allowed for head office expenses in excess of 1½ percent of sales or gross income in the case of a commercial company and 1 percent in the case of a company other than a commercial one.
(c) Property tax payable cannot be deducted.

A withholding tax is imposed on all "distributions" made to non-resident individuals and all companies, resident as well as non-resident. It is also imposed on "payments", which constitute income arising in Guyana, made to non-resident individuals and companies. The recipient of such income is liable for the tax, but the person (including a company) making "payments" and "distributions" is required to collect the amount of tax due. In addition, some insurance transactions are also subject to the withholding tax. [32]

Guyana's property tax is imposed on net property. The definition of property includes immovable and movable property situated in Guyana or elsewhere. Net property is defined as the aggregate value of the property minus the aggregate value of the allowable debts. In the case of an individual, debts in excess of 50 percent of the value of the property are not taken into account, whereas companies can only deduct debts up to 20 percent of the value of the property. These limitations do not apply to the deposit liabilities of banks and the liabilities of insurance companies in respect of life assurance policies.

Specified individuals, corporations, and institutions such as ecclesiastical and educational institutions are exempt from the scope of the tax. Any company granted a tax holiday under the Income Tax Ordinance is also exempt during the tax holiday period in respect of property employed in business, income from which is exempt from income tax.

Import duties are applicable to all imports except those originating in the Caribbean Common Market Area (CARICOM). A product is considered to be of regional origin if materials imported from outside the region do not exceed 50 percent of the export price of the product. Apart from a few exceptions, Guyana adopted a common external tariff on joining CARICOM.

The consumption tax was introduced in 1969 to counteract the revenue loss resulting from the removal of import duties on goods originating from the other members of the then Caribbean Free Trade Association. The tax is applicable to specified goods, whether imported or locally manufactured, except goods utilised as materials by a registered manufacturer, are taxable. Exports are exempt from the tax.

Excise duties are levied on specified domestically produced goods. However, similar goods imported from CARICOM bear import duties ar rates equivalent to the rates of excise duties. Thus, in effect, locally-produced goods and goods originating from CARICOM can be regarded as constituting the tax base for excise duties.

Export duties are confined to specified commodities exported to non-CARICOM countries. The CARICOM treaty prohibits the imposition of export duties on goods exported by one member State to another.

IV. IMPACT OF TAXATION IN GUYANA

As shown in Table 1, indirect taxes constitute the major component of tax revenues in Guyana. Indirect taxes are comprised primarily of import and excise duties. From the data given in the table, it can be seen that indirect taxes increased from G$29.9 million in 1960 to G$75.7 million in 1973 while direct taxes increased from G$17.7 million to G$67.5 million from 1960 to 1973. At the present time, company taxes constitute the major direct tax. The personal income tax is still the major direct tax on individuals.

The personal income tax is a compulsory payment to government that is now imposed by legislation. Tax systems differ markedly from country to country because of differences in history, political systems and attitudes toward government — apart from other reasons. The more developed nations characteristically have higher ratios of taxation to domestic product than do developing countries. In the developed nations tax ratios are usually 30 to 40 percent of national product compared

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30. A thorough discussion of the structure of major taxes in Guyana can be found in Nizar Jetha, "The Structure of Major Taxes in Guyana", *Bulletin for International Fiscal Documentation* 30 (February 1976), pp. 47-59. This section draws from that publication.
31. G$1.00 = US$0.40 or US$1.00 = G$2.55.
32. See Victor J. Gangadin, "Guyana: A Brief Outline of the Imposition in Guyana of Income Tax, Corporation Tax, Capital Gains Tax, Withholding Tax and Property Tax with Special Reference to Foreign Corporations Operating in Guyana, Through a Branch Establishment or an Agency", *Bulletin for International Fiscal Documentation* 27 (November 1973), pp. 455-463.

TABLE 1

TAX REVENUE IN GUYANA, 1960-1973
(Millions of Guyana Dollars)

Year	Indirect taxes	Direct taxes	Total
1960	29.9	17.7	47.6
1961	31.5	19.4	50.9
1962	29.3	20.2	49.5
1963	30.4	23.2	53.6
1964	35.0	22.9	57.9
1965	40.5	25.3	65.8
1966	47.1	25.4	72.5
1967	51.6	29.0	80.6
1968	54.1	36.3	90.4
1969	61.4	35.9	97.3
1970	66.5	52.5	119.0
1971	66.4	45.8	112.2
1972	68.2	71.9	140.1
1973	75.7	67.5	143.2

Sources: Government of Guyana, *Annual Statistical Abstract* 1970; Bank of Guyana, *Annual Reports.*

to 10 or 15 percent in developing countries. In Guyana the ratio of taxes to domestic product is a little more than 23 percent.

During the past five years, tax revenues in Guyana grew at an average annual rate of approximately 9 percent. Indirect taxes had a growth rate of just about 3 percent while direct taxes had a growth rate of approximately 5 percent. From 1970 onwards, government revenue from company taxes increased at an annual average rate of 19 percent. This resulted from the introduction in 1970 of a withholding tax; a distinction between commercial and non-commercial companies; a corporation tax to replace the income tax on companies; and the implementation of restrictions on the deductibility of the headquarters expenses of companies.

TABLE 2

TAX REVENUE AS A PERCENTAGE OF TOTAL REVENUE AND GNP AT MARKET PRICES, 1960-1973
(Millions of Guyana Dollars & Percentages)

Year	Tax revenue	Total revenue	GNP	Tax Revenue as a % of total revenue	Tax Revenue as a % of GNP
1960	47.6	56.2	267.8	84.7	17.8
1961	50.9	60.0	297.3	84.8	17.1
1962	49.5	59.8	296.4	82.8	16.7
1963	53.6	64.0	272.7	83.8	19.7
1964	57.9	67.7	304.5	85.5	19.0
1965	65.8	79.0	334.9	83.3	19.6
1966	72.5	85.4	355.9	84.9	20.4
1967	80.6	93.0	392.0	86.7	20.6
1968	90.4	110.4	429.2	81.9	21.1
1969	97.3	116.9	456.8	83.2	21.3
1970	119.0	135.8	490.5	87.6	24.3
1971	112.2	132.0	524.9	85.0	21.4
1972	140.1	152.7	576.0	91.7	24.3
1973	143.2	164.0	617.0	87.3	23.2

Sources: Same as for Table 1.

Tax revenues represent the major proportion of all revenues collected in Guyana by the Central government. Currently, tax revenues are about 87 percent of total revenue. Taxes, therefore, constitute an important part of the public finances of the Guyana economy and as such a very significant fiscal tool. In examining taxes and tax structure, it is important not only to look at the aggregate but at the component parts also. By far the most impactful component are the indirect taxes. Indirect taxes in developing countries tend to work positively, for the most part, by encouraging saving and conserving foreign exchange for the necessary import of capital goods. Such taxes also help to prevent prices from rising too rapidly when ongoing investment is increasing personal incomes faster than the output of finished goods and services is rising.

While indirect taxes are inadequate, by usual standards, as sole measures of tax capacity, it would seem that Guyana's prevailing indirect tax structure is satisfactory both from a point of view of equity and from the criteria of income elasticity. This argument may be further strengthened from the premise that there is effective enforcement of income and property taxes and accordingly, it is not necessary to rely on the indirect taxes more heavily than would otherwise be regarded as optimal.

Indirect taxes in Guyana have also been instrumental in bringing about an allocation of resources to priority uses. Excise taxes have resulted in the reduction of the production of goods not regarded as essential for development and thus, resources have been channeled into the production of high priority goods under the assumption that demand is not perfectly inelastic.

In general, indirect taxes in Guyana have played a key role in the development process. To what extent, if any, they have affected the level of employment and prices cannot be determined in this study due to the paucity of data.

For the past five years, indirect taxes in Guyana have been growing both in magnitude and as an important source of revenue. This has been brought about by increases in company taxes and the effective administration of personal income taxes. Income taxes logically belong to a fairly advanced stage of economic development; yet they are found in operation in a large number of developing nations. The reasons being quite simply that everyone is expected to contribute toward the expenditures that lead to development. This contribution being derived from income.

Taxation of net income in Guyana is complicated by numerous problems relating to permissible business expenses, including treatment of depreciation, exemptions and credits, capital gains or casual profits, and loss offsets. Hence, the measurement of net income for tax purposes is difficult and, as such, requires a high standard of administration for equitable results.

Quite unlike most developing countries, personal income taxes in Guyana have been reasonably effective in reaching wage and salary income, where concealment is difficult, and also business income, where concealment is much easier, especially so, since many business transactions are conducted in cash rather than through cheque payments. The reason for this has been the sudden and recent campaign of the Guyana government to collect all taxes that have been deemed legitimately due. A rather interesting feature of the administration of taxes in Guyana is the amount of power vested in the Tax Commissioner. He can aritrarily make decisions on tax returns and enforce them in the name of the government. It sounds dictatorial and indeed has been seen to be that way. Many businessmen have been heard to say that the Tax Commissioner, by his decisions, determines whether they remain in business or become bankrupt.

Direct taxes, or more specifically income taxation, is a very convenient device for introducing the principle of equity in tax structure. Due to its capacity to introduce an element of built-in flexibility in the tax structure, it is regarded even in advanced countries as a very important counter-cyclical device for achieving economic stabilisation. Thus, in the analysis of taxation in developing economies, the traditional objectives of progressivity and equity in taxation, have pointed strongly to, and have resulted in, more aggressive use of net income and wealth taxation.

Though a highly progressive income tax with high marginal rates on upper income ranges is a very desirable fiscal instrument both on grounds of resource mobilisation for the public sector and redistributive considerations which are very important in less developed countries, it tends to conflict with the criteria of economic efficiency and progress in a context where the growth of private savings and investment occupies an important place in the process of economic development, as is the case in Guyana, where current attempts are being made to finance the expenditure of the public sector through internal sources of funds.

The increasing importance of the taxation of income and corporate profits in Guyana underlines the need therefore, for encouraging the growth of individual and business savings, and the ploughing back of retained profits of businesses into the expansion of investment. The tax policy should therefore be directed to further mobilisation of resources for development and allocating them according to development planning priorities.

Tax revenues in Guyana are rather high, amounting to more than 23 percent of gross national product. The yield from taxation has shown the response that might be expected in a period of growing output as the country moves forward on its path to development. The incidence of taxation on various income groups, economic sectors, and regions cannot be analysed at present for lack of comprehensive studies on family budgets and on distribution of personal and rural-urban incomes. The fragmentary data available permits, however, some broad judgments. It appears that direct taxation has borne more heavily on non-agricultural than on agricultural incomes. The indirect taxes have fallen on both the urban and rural sectors, but their incidence seems to have been greater on the urban sector in view of its consumption pattern and its monetised character.

V. CONCLUSION

Guyana is heavily dependent on indirect taxes which account for 53 percent of total tax revenue. However, in recent years the relative importance of direct taxes has increased. The share of direct taxes increased from 25 percent of total tax revenues in 1969 to 46 percent in 1973.

In the past, tax policy in Guyana has been guided more by the need for revenue than by the requirements for capital formation. This meant that the tax system lacked a clear focus. The broader economic implications of some taxes, like the consumption tax, were not given sufficient weight compared with their revenue-yielding aspects and tax policy was not, and still is not used, extensively as an anti-inflationary device.

Given the level of revenue now received from taxation, then Guyana's tax system need only to be directed increasingly towards meeting the long-term needs of development. This will imply a tax system with more administrative flexibility, one where incidence can be rationalised, and one which can be used as a means for controlling inflation — a significant problem in the Guyana economy.

CONFERENCE DIARY

DECEMBER 1977

British Branch of I.F.A.: The role of the Special Commissioners, London (U.K.), December 8 (English).

U.S. Branch of I.F.A.: Luncheon seminar organized by the Mid-Atlantic Committee on "Worldwide Integrated Tax Systems", December 8 (English).

JANUARY 1978

British Branch of I.F.A.: Tax workshop: Pensions and their tax benefits, London (U.K.), January 11 (English).

U.S. Branch of I.F.A.: National meeting. Subject: International and comparative aspects of corporation-shareholder integration. New York City, January 12 and 13 (English).

Business Perspectives: Tax Planning and International Trade; Taxation of Personal Wealth of Individuals; Sales Taxes, Value Added Taxes and Double Taxation Conventions, Honolulu (Hawaii) January 22-27 (English).

FEBRUARY 1978

British Branch of I.F.A.: Stamp duties (including corporate reorganizations and EEC requirements, London (U.K.), February 2 (English).

British Branch of I.F.A.: Tax workshop: Taxation of profits from European oil and gas, London (U.K.), February 22 (English).

MARCH 1978

British Branch of I.F.A.: Tax workshop: Tax developments in the EEC, London (U.K.), March 16 (English).

APRIL 1978

*British Branch of I.F.A.:*The Meade Report, London (U.K.), April 5 (English).

Business International Institute: International Seminar (including International Taxation Theory, Transfer Pricing etc.). Port Chester, (N.Y. (U.S.A.)), April 17-28 (English).

MAY 1978

British Branch of I.F.A.: Anglo-U.S. Seminar, London (U.K.), May 4 and 5 (English).

SEPTEMBER 1978

32nd Annual Congress of I.F.A.: I. The Taxation of Extractive Industries; II. The Differences in the Tax Treatment between Local and Foreign Investors and the Effects of International Treaties. Sydney (Australia) September 17-23 (English, French, German, Spanish).

SEPTEMBER 1979

33rd Annual Congress of I.F.A.: I. The Taxation of transfers of ownership on death or inter vivos gifts with special reference to the continuity of family-held enterprises; II. The effects of losses in one country on the tax treatment of the enterprise or group (provisionally). For the Seminars the following subjects are suggested: Trends in income tax treaties involving developing countries, with special reference to the U.N. Group of Experts. Trends in Scandinavian Taxation. Copenhagen (Denmark) September 4-8 (English, French, German, Spanish).

FOR FURTHER INFORMATION PLEASE WRITE TO:

Australian Branch of I.F.A.: Bank of New Zealand House, 12th Fl. 333 George Street, Sydney 2000 (Australia).

British Branch of I.F.A.: Secretariat, c/o Williams & Clyn's Bank Ltd., P.O. Box 448, 20 Birchin Lane, London EC3P 3DP (United Kingdom).

Business International Institute: One Dag Hammarskjold Place, New York, N.Y. 10017 (U.S.A.).

Business Perspectives: 11 Alexander Place, London, SW7 2SG. Tel. 01-589-3197. Telex: 917036.

Hawaii Tax Institute, Chaminade College of Honolulu, 3140 Wailalae Avenue, Honolulu (Hawaii).

International Fiscal Association (I.F.A.): General Secretariat, Woudenstein, Burg. Oudlaan 50, P.O. Box 1738, Rotterdam (Netherlands).

U.S. Branch of I.F.A.: Secretary of U.S. Branch of I.F.A., Suite 44-27, 345 Park Avenue, New York, N.Y. 10022 (U.S.A.).

1977
OECD Model Convention

The 1977 Model Convention which replaces the OECD Draft Convention issued in 1973 is expected to exert a considerable influence on the number and content of the tax treaties to be concluded by OECD member countries, both with other member countries and non-member countries. The OECD Model Convention has also been used — with certain adjustments — as a basis for the conclusion of tax treaties between Western and Eastern European countries and between industrialised countries and developing countries. Considering its significance the text of the 1977 Model Convention is reproduced below.

CHAPTER I
SCOPE OF THE CONVENTION

Article 1
Personal scope

This Convention shall apply to persons who are residents of one or both of the Contracting States.

Article 2
Taxes covered

1. This Convention shall apply to taxes on income and on capital imposed on behalf of a Contracting State or of its political subdivisions or local authorities, irrespective of the manner in which they are levied.

2. There shall be regarded as taxes on income and on capital all taxes imposed on total income, on total capital, or on elements of income or of capital, including taxes on gains from the alienation of movable or immovable property, taxes on the total amounts of wages or salaries paid by enterprises, as well as taxes on capital appreciation.

3. The existing taxes to which the Convention shall apply are in particular:

a) (in State A): . . . . . .

. . . . . .

b) (in State B): . . . . . .

. . . . . .

4. The Convention shall apply also to any identical or substantially similar taxes which are imposed after the date of signature of the Convention in addition to, or in place of, the existing taxes. At the end of each year, the competent authorities of the Contracting States shall notify each other of changes which have been made in their respective taxation laws.

CHAPTER II
DEFINITIONS

Article 3
General definitions

1. For the purposes of this Convention, unless the context otherwise requires:

a) the term "person" includes an individual, a company and any other body of persons;

b) the term "company" means any body corporate or any entity which is treated as a body corporate for tax purposes;

c) the terms "enterprise of a Contracting State" and "enterprise of the other Contracting State" mean respectively an enterprise carried on by a resident of a Contracting State and an enterprise carried on by a resident of the other Contracting State;

d) the term "international traffic" means any transport by a ship or aircraft operated by an enterprise which has its place of effective management in a Contracting State, except when the ship or aircraft is operated solely between places in the other Contracting State;

e) the term "competent authority" means:

(i) (in State A): . . . . . .

. . . . . .

(ii) (in State B): . . . . . .

. . . . . .

2. As regards the application of the Convention by a Contracting State any term not defined therein shall, unless the context otherwise requires, have the meaning which it has under the law of that State concerning the taxes to which the Convention applies.

Article 4
Resident

1. For further purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature. But this term does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein.

2. Where by reason of the provisions of paragraph 1 an individual is a resident of both Contracting States, then his status shall be determined as follows:

a) he shall be deemed to be a resident of the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident of the State with which his personal and economic relations are closer (centre of vital interests);

b) if the State in which he has his centre of vital interests cannot be determined, or if he has not a permanent home available to him in either State, he shall be deemed to be a resident of the State in which he has an habitual abode;

c) if he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident of the State of which he is a national;

d) if he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

3. Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, then it shall be deemed to be a resident of the State in which its place of effective management is situated.

Article 5
Permanent establishment

1. For the purposes of this Convention, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

2. The term "permanent establishment" includes especially:

a) a place of management;
b) a branch;
c) an office;
d) a factory;
e) a workshop, and
f) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.

3. A building site or construction or installation project constitutes a permanent establishment only if it lasts more than twelve months.

4. Notwithstanding the preceding provisions of this Article, the term "permanent establishment" shall be deemed not to include:

a) the use of facilities solely for the

purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;

b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;

c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by by another enterprise;

d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;

e) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character;

f) the maintenance of a fixed place of business solely for any combination of activities mentioned in sub-paragraphs a) to e), provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.

5. Notwithstanding the provisions of paragraphs 1 and 2, where a person — other than an agent of an independent status to whom paragraph 6 applies — is acting on behalf of an enterprise and has, and habitually exercises, in a Contracting State an authority to conclude contracts in the name of the enterprise, that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph.

6. An enterprise shall not be deemed to have a permanent establishment in a Contracting State merely because it carries on business in that State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business.

7. The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either company a permanent establishment of the other.

CHAPTER III
TAXATION OF INCOME

Article 6
Income from immovable property

1. Income derived by a resident of a Contracting State from immovable property (including income from agriculture or forestry) situated in the other Contracting State may be taxed in that other State.

2. The term "immovable property" shall have the meaning which it has under the law of the Contracting State in which the property in question is situated. The term shall in any case include property accessory to immovable property, livestock and equipment used in agriculture and forestry, rights to which the provisions of general law respecting landed property apply, usufruct of immovable property and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources; ships, boats and aircraft shall not be regarded as immovable property.

3. The provisions of paragraph 1 shall apply to income derived from the direct use, letting, or use in any other form of immovable property.

4. The provisions of paragraphs 1 and 3 shall also apply to the income from immovable property of an enterprise and to income from immovable property used for the performance of independent personal services.

Article 7
Business profits

1. The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the proftis of the enterprise may be taxed in the other State but only so much of them as is attributable to that permanent establishment.

2. Subject to the provisions of paragraph 3, where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment.

3. In determining the profits of a permanent establishment, there shall be allowed as deductions expenses which are incurred for the purposes of the permanent establishment, including executive and general administrative expenses so incurred, whether in the State in which the permanent establishment is situated or elsewhere.

4. Insofar as it has been customary in a Contracting State to determine the profits to be attributed to a permanent establishment on the basis of an apportionment of the total profits of the enterprise to its various parts, nothing in paragraph 2 shall preclude that Contracting State from determining the profits to be taxed by such an apportionment as may be customary; the method of apportionment adopted shall, however, be such that the result shall be in accordance with the principles contained in this Article.

5. No profits shall be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods or merchandise for the enterprise.

6. For the purposes of the preceding paragraphs, the profits to be attributed to the permanent establishment shall be determined by the same method year by year unless there is good and sufficient reason to the contrary.

7. Where profits include items of income which are dealt with separately in other Articles of this Convention, then the provisions of those Articles shall not be affected by the provisions of this Article.

Article 8
Shipping, inland waterways transport and air transport

1. Profits from the operation of ships or aircraft in international traffic shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.

2. Profits from the operation of boats engaged in inland waterways transport shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.

3. If the place of effective management of a shipping enterprise or of an inland waterways transport enterprise is aboard a ship or boat, then it shall be deemed to be situated in the Contracting State in which the home harbour of the ship or boat is situated, or, if there is no such home harbour, in the Contracting State of which the operator of the ship or boat is a resident.

4. The provisions of paragraph 1 shall also apply to profits from the participation in a pool, a joint business or an international operating agency.

Article 9
Associated enterprises

1. Where
a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or
b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State,

and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accued, may be included in the profits of that enterprise and taxed accordingly.

2. Where a Contracting State includes in the profits of an enterprise of that State — and taxes accordingly — profits on which an enterprise of the other Contracting State has been charged to tax in that other State and the profits so included are profits which would have accrued to the enterprise of the first-mentioned State if the conditions made between the two enterprises had been those which would have been made between independent enterprises, then that other State shall make an appropriate adjustment to the amount of the tax charged therein on those profits. In determining such adjustment, due regard shall be had to the other provisions of this Convention and the competent authorities of the Contracting States shall if necessary consult each other.

Article 10
Dividends

1. Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State.

2. However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that State, but if the recipient is the beneficial owner of the dividends the tax so charged shall not exceed:
a) 5 percent of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) which holds directly at least 25 percent of the capital of the company paying the dividends;
b) 15 percent of the gross amount of the dividends in all other cases.

The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of these limitations. This paragraph shall not affect the taxation of the company in respect of the profits out of which the dividends are paid.

3. The term "dividends" as used in this Article means income from shares, "jouissance" shares or "jouissance" rights, mining shares, founders' shares or other rights, not being debt-claims, participating in profits, as well as income from other corporate rights which is subjected to the same taxation treatment as income from shares by the laws of the State of which the company making the distribution is a resident.

4. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the dividends, being a resident of a Contracting State, carries on business in the other Contracting State of which the company paying the dividends is a resident, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the holding in respect of which the dividends are paid is effectively connected with such permanent establishment or fixed base. In such case the provisions of Article 7 or Article 14, as the case may be, shall apply.

5. Where a company which is a resident of a Contracting State derives profits or income from the other Contracting State, that other State may not impose any tax on the dividends paid by the company, except insofar as such dividends are paid to a resident of that other State or insofar as the holding in respect of which the dividends are paid is effectively connected with a permanent establishment or a fixed base situated in that other State, nor subject the company's undistributed profits to a tax on the company's undistributed profits, even if the dividends paid or the undistributed profits consist wholly or partly of profits or income arising in such other State.

Article 11
Interest

1. Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

2. However, such interest may also be taxed in the Contracting State in which it arises and according to the laws of that State, but if the recipient is the beneficial owner of the interest the tax so charged shall not exceed 10 percent of the gross amount of the interest. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation.

3. The term "interest" as used in this Article means income from debt-claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits, and in particular, income from government securities and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures. Penalty charges for late payment shall not be regarded as interest for the purpose of this Article.

4. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the interest, being a resident of a Contracting State, carries on business in the other Contracting State in which the interest arises, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the debt-claim in respect of which the interest is paid is effectively connected with such permanent establishment or fixed base. In such case the provisions of Article 7 or Article 14, as the case may be, shall apply.

5. Interest shall be deemed to arise in a Contracting State when the payer is that State itself, a political subdivision, a local authority or a resident of that State. Where, however, the person paying the interest, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment or a fixed base in connection with which the indebtedness on which the interest is paid was incurred, and such interest is borne by such permanent establishment or fixed base, then such interest shall be deemed to arise in the State in which the permanent establishment or fixed base is situated.

6. Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the interest, having regard to the debt-claim for which it is paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.

Article 12
Royalties

1. Royalties arising in a Contracting State and paid to a resident of the other Contracting State shall be taxable only in that other State if such resident is the beneficial owner of the royalties.

2. The term "royalties" as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, any patent, trade mark, design or model, plan, secret formula or

process, or for the use of, or the right to use, industrial, commercial, or scientific equipment, or for information concerning industrial, commercial or scientific experience.

3. The provisions of paragraph 1 shall not apply if the beneficial owner of the royalties, being a resident of a Contracting State, carries on business in the other Contracting State in which the royalties arise, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right or property in respect of which the royalties are paid is effectively connected with such permanent establishment or fixed base. In such case the provsions of Article 7 or Article 14, as the case may be, shall apply.

4. Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the royalties, having regard to the use, right or information for which they are paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.

Article 13
Capital gains

1. Gains derived by a resident of a Contracting State from the alienation of immovable property referred to in Article 6 and situated in the other Contracting State may be taxed in that other State.

2. Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services, including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise) or of such fixed base, may be taxed in that other State.

3. Gains from the alienation of ships or aircraft operated in international traffic, boats engaged in inland waterways transport or movable property pertaining to the operation of such ships, aircraft or boats, shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.

4. Gains from the alienation of any property other than that referred to in paragraphs 1, 2 and 3, shall be taxable only in the Contracting State of which the alienator is a resident.

Article 14
Independent personal services

1. Income derived by a resident of a Contracting State in respect of professional services or other activities of an independent character shall be taxable only in that State unless he has a fixed base regularly available to him in the other Contracting State for the purpose of performing his activities. If he has such a fixed base, the income may be taxed in the other State but only so much of it as is attributable to that fixed base.

2. The term "professional services" includes especially independent scientific, literary, artistic, educational or teaching activities as well as the independent activities of physicians, lawyers, engineers, architects, dentists and accountants.

Article 15
Dependent personal services

1. Subject to the provisions of Articles 16, 18 and 19, salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State.

2. Notwithstanding the provisions of paragraph 1, remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State if:

a) the recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in the fiscal year concerned, and
b) the remuneration is paid by, or on behalf of, an employer who is not a resident of the other State, and
c) the remuneration is not borne by a permanent establishment or a fixed base which the employer has in the other State.

3. Notwithstanding the preceding provisions of this Article, remuneration derived in respect of an employment exercised aboard a ship or aircraft operated in international traffic, or aboard a boat engaged in inland waterways transport, may be taxed in the Contracting State in which the place of effective management of the enterprise is situated.

Article 16
Directors' fees

Directors' fees and other similar payments derived by a resident of a Contracting State in his capacity as a member of the board of directors of a company which is a resident of the other Contracting State may be taxed in that other State.

Article 17
Artistes and athletes

1. Notwithstanding the provisions of Articles 14 and 15, income derived by a resident of a Contracting State as an entertainer, such as a theatre, motion picture, radio or television artiste, or a musician, or as an athlete, from his personal activities as such exercised in the other Contracting State, may be taxed in that other State.

2. Where income in respect of personal activities exercised by an entertainer or an athlete in his capacity as such accrues not to the entertainer or athlete himself but to another person, that income may, notwithstanding the provisions of Articles 7, 14 and 15, be taxed in the Contracting State in which the activities of the entertainer or athlete are exercised.

Article 18
Pensions

Subject to the provisions of paragraph 2 of Article 19, pensions and other similar remuneration paid to a resident of a Contracting State in consideration of past employment shall be taxable only in that State.

Article 19
Government service

1. a) Remuneration, other than a pension, paid by a Contracting State or a political subdivision or a local authority thereof to an individual in respect of services rendered to that State or subdivision or authority shall be taxable only in that State.
   b) However, such remuneration shall be taxable only in the other Contracting State if the services are rendered in that State and the individual is a resident of that State who:
      (i) is a national of that State, or
      (ii) did not become a resident of that State solely for the purpose of rendering the services.

2. a) Any pension paid by, or out of funds created by, a Contracting State or a political subdivision or a local authority thereof to an individual in respect of services rendered to that State or subdivision or authority shall be taxable only in that State.
   b) However, such pension shall be taxable only in the other Contracting State if the individual is a resident of, and a national of, that State.

3. The provisions of Articles 15, 16 and 18 shall apply to remuneration and pen

sions in respect of services rendered in connection with a business carried on by a Contracting State or a political subdivision or a local authority thereof.

Article 20
Students

Payments which a student or business apprentice who is or was immediately before visiting a Contracting State a resident of the other Contracting State and who is present in the first-mentioned State solely for the purpose of his education or training receives for the purpose of his maintenance, education or training shall not be taxed in that State, provided that such payments arise from sources outside that State.

Article 21
Other income

1. Items of income of a resident of a Contracting State, wherever arising, not dealt with in the foregoing Articles of this Convention shall be taxable only in that State.

2. The provisions of paragraph 1 shall not apply to income, other than income from immovable property as defined in paragraph 2 of Article 6, if the recipient of such income, being a resident of a Contracting State, carries on business in the other Contracting State through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right or property in respect of which the income is paid is effectively connected with such permanent establishment or fixed base. In such case the provisions of Article 7 or Article 14, as the case may be, shall apply.

CHAPTER IV
TAXATION OF CAPITAL

Article 22
Capital

1. Capital represented by immovable property referred to in Article 6, owned by a resident of a Contracting State and situated in the other Contracting State, may be taxed in that other State.

2. Capital represented by movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contrracting State or by movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services, may be taxed in that other State.

3. Capital represented by ships and aircraft operated in international traffic and by boats engaged in inland waterways transport, and by movable property pertaining to the operation of such ships, aircraft and boats, shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.

4. All other elements of capital of a resident of a Contracting State shall be taxable only in that State.

CHAPTER V
METHODS FOR ELIMINATION OF DOUBLE TAXATION

Article 23A
Exemption method

1. Where a resident of a Contracting State derives income or owns capital which, in accordance with the provisions of this Convention, may be taxed in the other Contracting State, the first-mentioned State shall, subject to the provisions of paragraphs 2 and 3, exempt such income or capital from tax.

2. Where a resident of a Contracting State derives items of income which, in accordance with the provisions of Articles 10 and 11, may be taxed in the other Contracting State, the first-mentioned State shall allow as a deduction from the tax on the income of that resident an amount equal to the tax paid in that other State. Such deduction shall not, however, exceed that part of the tax, as computed before the deduction is given, which is attributable to such items of income derived from that other State.

3. Where in accordance with any provision of the Convention income derived or capital owned by a resident of a Contracting State is exempt from tax in that State, such State may nevertheless, in calculating the amount of tax on the remaining income or capital of such resident, take into account the exempted income or capital.

Article 23B
Credit method

1. Where a resident of a Contracting State derives income or owns capital which, in accordance with the provisions of this Convention, may be taxed in the other Contracting State, the first-mentioned State shall allow:

a) as a deduction from the tax on the income of that resident, an amount equal to the income tax paid in that other State;
b) as a deduction from the tax on the capital of that resident, an amount equal to the capital tax paid in that other State.

Such deduction in either case shall not, however, exceed that part of the income tax or capital tax, as computed before the deduction is given, which is attributable, as the case may be, to the income or the capital which may be taxed in that other State.

2. Where in accordance with any provision of the Convention income derived or capital owned by a resident of a Contracting State is exempt from tax in that State, such State may nevertheless, in calculating the amount of tax on the remaining income or capital of such resident, take into account the exempted income or capital.

CHAPTER VI
SPECIAL PROVISIONS

Article 24
Non-discrimination

1. Nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances are or may be subjected. This provision shall, notwithstanding the provisions of Article 1, also apply to persons who are not residents of one or both of the Contracting States.

2. The term "nationals" means:

a) all individuals possessing the nationality of a Contracting State;
b) all legal persons, partnerships and associations deriving their status as such from the laws in force in a Contracting State.

3. Stateless persons who are residents of a Contracting State shall not be subjected in either Contracting State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of the State concerned in the same circumstances are or may be subjected.

4. The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favourably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities. This provision shall not be construed as obliging a Contracting State to grant to residents of the other Contracting State any persoanl allowances, reliefs and reductions for taxation purposes on account of civil status or family responsibilities which it grants to its own residents.

5. Except where the provisions of paragraph 1 of Article 9, paragraph 6 of Article 11, or paragraph 4 of Article 12, apply, interest, royalties and other disbursements paid by an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable profits of such enter-

prise, be deductible under the same conditions as if they had been paid to a resident of the first-mentioned State. Similarly, any debts of an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable capital of such enterprise, be deductible under the same conditions as if they had been contracted to a resident of the first-mentioned State.

6. Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which other similar enterprises of the first-mentioned State are or may be subjected.

7. The provisions of this Article shall, notwithstanding the provisions of Article 2, apply to taxes of every kind and description.

Article 25
Mutual agreement procedure

1. Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of the Contracting State of which he is a resident or, if his case comes under paragraph 1 of Article 24, to that of the Contracting State of which he is a national. The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the Convention.

2. The competent authority shall endeavour, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with the Convention. Any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting States.

3. The competent authorities of the Contracting States shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention. They may also consult together for the elimination of double taxation in cases not provided for in the Convention.

4. The competent authorities of the Contracting States may communicate with each other directly for the purpose of reaching an agreement in the sense of the preceding paragraphs. When it seems advisable in order to reach agreement to have an oral exchange of opinions, such exchange may take place through a Commission consisting of representatives of the competent authorities of the Contracting States.

Article 26
Exchange of information

1. The competent authorities of the Contracting States shall exchange such information as is necessary for carrying out the provisions of this Convention or of the domestic laws of the Contracting States concerning taxes covered by the Convention insofar as the taxation thereunder is not contrary to the Convention. The exchange of information is not restricted by Article 1. Any information received by a Contracting State shall be treated as secret in the same manner as information obtained under the domestic laws of that State and shall be disclosed only to persons or authorities (including courts and administrative bodies) involved in the assessment or collection of, the enforcement or prosecution in respect of, or the determination of appeals in relation to, the taxes covered by the Convention. Such persons or authorities shall use the information only for such purposes. They may disclose the information in public court proceedings or in judicial decisions.

2. In no case shall the provisions of paragraph 1 be construed so as to impose on a Contracting State the obligation:

a) to carry out administrative measures at variance with the laws and administrative practice of that or of the other Contracting State;
b) to supply information which is not obtainable under the laws or in the normal course of the administration of that or of the other Contracting State;
c) to supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or information, the disclosure of which would be contrary to public policy (ordre public).

Article 27
Diplomatic agents and consular officers

Nothing in this Convention shall affect the fiscal privileges of diplomatic agents or consular officers under the general rules of international law or under the provisions of special agreements.

Article 28
Territorial extension

1. This Convention may be extended, either in its entirety or with any necessary modifications [to any part of the territory of (State A) or of (State B) which is specifically excluded from the application of the Convention or], to any State or territory for whose international relations (State A) or (State B) is responsible, which imposes taxes substantially similar in character to those to which the Convention applies. Any such extension shall take effect from such date and subject to such modifications and conditions, including conditions as to termination, as may be specified and agreed between the Contracting States in notes to be exchanged through diplomatic channels or in any other manner in accordance with their constitutional procedures.

2. Unless otherwise agreed by both Contracting States, the termination of the Convention by one of them under Article 30 shall also terminate, in the manner provided for in that Article, the application of the Convention [to any part of the territory of (State A) or of (State B) or] to any State or territory to which it has been extended under this Article.

NOTE: The terminal clause concerning the signing shall be drafted in accordance with the constitutional procedure of both Contracting States.

CHAPTER VII
FINAL PROVISIONS

Article 29
Entry into force

1. This Convention shall be ratified and the instruments of ratification shall be exchanged at .....
as soon as possible.

2. The Convention shall enter into force upon the exchange of instruments of ratification and its provisions shall have effect:

a) (in State A): .....
.....
b) (in State B): .....
.....

Article 30
Termination

This Convention shall remain in force until terminated by a Contracting State. Either Contracting State may terminate the Convention, through diplomatic channels, by giving notice of termination at least six months before the end of any calendar year after the year .....
In such event, the Convention shall cease to have effect:

a) (in State A): .....
.....
b) (in State B): .....
.....

TERMINAL CLAUSE

NOTE: The words between brackets are of relevance when, by special provision, a part of the territory of a Contracting State is excluded from the application of the Convention.

Some observations on five sales taxes –

Sudan ~ Guyana ~ Bolivia ~ Mexico ~ Brazil

by John F. Due*

Through the work of Sijbren Cnossen, now at Erasmus University in Rotterdam, [1] *other persons who have been on the staff of the Fiscal Affairs Department of the International Monetary Fund, and others, the literature on world experience with sales taxation has expanded rapidly. But there remain dark corners and missing information, with which this article primarily deals, as a supplement to the author's article that appeared in the November-December, 1976 issue of the* Bulletin. [2] *Specifically, the article summarizes the sales tax (called the development tax) in the Sudan, the rather complex manufacturers sales tax in the Republic of Guyana, and the little-known value added tax in Bolivia, all relatively new levies, and offers some comments on two long-established taxes, those of Mexico and Brazil.*

THE SUDAN [3]

The Middle East and the Caribbean are the last areas in the world in which sales taxes are still uncommon. One of the few countries in Northern Africa to move into the field is the Sudan — in a sense a bridge country between the countries of North and Tropical Africa. Sudan uses a very extensive system of excises, with 32 categories and a number of subcategories, and the sales tax was placed on top of this excise structure. The tax was imposed in the 1974-75 budget, based on a similar levy imposed by the Southern Region government 18 months before.

The levy, called the development tax, is essentially a manufacturers sales tax, but with some cascade elements, and thus would be classified as a production tax under the Cnossen terminology. The coverage of the tax is very broad; only four types of manufactured goods are exempt: medicines, wheat flour, compressed dates, and milk for babies. Domestically produced fruit and vegetables are not taxed because they do not pass through a manufacturing stage, but import of these goods is taxed (except for wheat, specifically exempted). The tax does not apply to services. This is one of the few sales taxes that applies to exports as well as imports and domestically produced goods.

The tax is confined to the manufacturing level, but at that level some cascading is involved, since there is no general system for excluding from impact of the tax products that enter into other products as materials or are otherwise used in the production process. Domestically produced raw materials are not taxed if not passing through a manufacturing process, but imported materials are taxed as well as the finished products made with them.

There is no exemption of small manufacturers, per se, although handicraft producers not using machinery are not subject.

The development tax also applies to income, but this is essentially a supplement to the income tax and is treated as such.

The sales tax is administered by the Excise Division of the Customs and Excise Department, so far as domestic production is concerned, in conjunction with the administration of the exercises, and by the Customs Division on imports. As of May 1977, there were 510 firms registered for excise taxes and sales (development) tax and an additional 316 firms registered for development tax alone, for a total of 826. About half of the firms are in the Khartoum area, the center of manufacturing in the country. Government-owned firms are subject as well as private firms. The administration is relatively decentralized. A ledger card for each firm is kept in the district office and a master index in Khartoum, firms are required to file returns every two weeks (30 days for some) together with a statement of withdrawals or merchandise from the factory and copies of all invoices and information on purchases. An annual return is also required. Actual payment, however, is not made in the usual fashion, but in either of two ways, the first primarily used for excises, the second for sales tax:

1. Provision of a deposit, payments being made by the firm on roughly ten day intervals, charges made against it whenever goods are withdrawn from the factory.
2. Provision of a bank guarantee, covering tax for a two week period. Actual payments must be made every two weeks or the guarantee will be exhausted.

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1. "Sales and Excise Systems of the World", *Finanzarchiv*, Vol. 33, No. 2 (1975), pp. 177-236, "Recent Developments in Excise and Sales Taxation", *Bulletin for International Fiscal Documentation*, Vol. 31, No. 10 (1977) p. 457 and more recent unpublished material.

2. "A Comparison of Four Manufacturers Sales Taxes and Two Retail Sales Taxes — Ghana, Kenya, Tanzania, Zambia, Barbados, Iceland", *Bulletin for International Fiscal Documentation*, Vol. 30 (Nov.-Dec., 1976), pp. 464-76.

3. The author is indebted to officials of the Ministry of Planning and the Ministry of Finance in the Sudan for their assistance.

Traditional excise controls, involving the stationing of a Customs and Excise officer within the plant to ensure payment of both excise and sales tax by making physical checks, are used for most firms. Usual accounting controls are employed for the others.

The system used for control of delinquents differs from the common pattern: if the deposit is exhausted or payment is not made on the basis of the bank guarantee, further shipment of merchandise from the factory is stopped — by locking the gates if necessary. This action is rarely necessary, as the threat to stop shipments is usually adequate. Customs and Excise has power to close a firm down and put it out of business — but in fact has never found this necessary. As in other countries, some of the more difficult problems have arisen with government owned corporations when disputes arise over payment.

The tax rate, initially 2 percent, went to 3 percent and then to 5 percent in the 1976-77 budget. The tax yielded about 7 percent of the total tax revenue in 1976-77 compared to 35 percent for customs duties and 19 percent for excises. Indirect taxes as a whole, including the exchange tax, yield 86 percent of total government tax revenues — one of the highest percentages in the world. Of sales tax revenues, domestic production yields 21 percent, imports 49 percent, and exports 30 percent.

The tax as it stands was introduced essentially as an emergency measure to raise revenue quickly. It should be regarded only as a transitional step to a more common form of sales tax, likely on the pattern of the usual manufacturers sales tax. The objections to the cascade features in the tax are recognized.

BOLIVIA

One of the lesser known value added taxes is that of Bolivia, established in 1972 to replace a turnover tax. Technically *Impuesto sobre Ventas*, the tax has the usual characteristics of value added tax, employing the tax credit technique, applying to domestic sales and all imports by unregistered firms and excluding exports. However, it is highly restrictive with respect to tax credit on capital goods, credit being allowed only for tax on purchases of materials, parts, and other goods used directly in production but not constituting fixed assets. Imports by registered firms are not subject to tax. The tax applies throughout production and distribution channels, including retailers, but small firms — those with annual gross sales in excess of $B200,000 (US$10,000) are not subject to the tax (tax therefore applying to their purchases). Firms are required to issue invoices and indicate the tax separately. The actual sale price is the taxable price except on sales not at arm's length. On imports by non-registered persons, a 50 percent markup is applied to the CIF value, reflecting typical margins.

The tax, like that of Brazil, does not apply to services, real property, securities, or to vehicles subject to special taxes. The coverage of commodities is relatively broad; exemption is limited to the following:

1. Basic foods, but not most processed foods.
2. All grain, including livestock feed and seed, live animals.
3. Soap, candles.
4. Petroleum products, coal, cement.
5. Other articles subject to excises, such as liquor and tobacco products.
6. Books, periodicals, newspapers and newsprint.
7. Raw materials and semi-finished goods used in manufacture (many are exempt outright; on others, of course, the purchasing firm receives a tax credit).

The tax rate is a uniform 5 percent. There is no provision for cash refunds when tax on purchases exceeds tax due on sales. The excess can be carried forward or used to meet other obligations. The tax is administered by *Renta Interna*, the income tax administration, even at importation.

Registration is required of all firms making sales in excess of the specified figure; there are about 2,000 registered firms, about half of which are in the La Paz area. Firms are required to file bi-monthly returns with payment of tax. Return forms are not provided. The returns which must be filed in person, not may mail, are filed in the regional offices, and are kept in these offices; payments are recorded on ledger cards, although there are plans for computerization. Delinquency is determined manually, intent being to do so within 24 hours after the due date. An automatic penalty of 50 percent is applied for late filing, but frequently arrangements are made for deferred payment. The delinquency rate has been high, averaging about 30 percent, despite the severe penalty. The audit program has been under development in the last two years; initially there was essentially no audit at all.

Bolivia employs the same type of "lottery" system as Chile long used to aid enforcement. Vendors are required to issue invoices on all sales over $B100 and to indicate the tax as a separate item, an unusual rule with regard to sales to consumers. Invoices must be issued on prescribed numbered forms. Purchasers, in turn, may exchange the invoices for lottery tickets, to an amount depending on the amount of tax. The possibility of winning lottery prizes is designed to make persons more interested in obtaining invoices. Inspectors are sent out by Renta Interna to ensure that the sellers have reported and paid the amounts of tax indicated on the invoices.

The tax has yielded relatively small amounts — in 1974 only 4 percent of the total tax revenue. So far the tax has not been effectively implemented; it would appear that many firms are not registered; delinquency is heavy; and underreporting of sales and tax is believed to be widespread. But there are extensive plans for computerization, delinquency control and audit. The extreme decentralization of tax administration may be an obstacle to effective operation.

GUYANA

The Republic of Guyana in South America, the former British Guiana, introduced a sales tax in 1969 as a result of the establishment of CARICOM, the Caribbean area community, which lessened each member country's flexibility in the use of customs duties and reduced customs yields in two ways — by ending customs revenue on imports from other member countries, and by reducing customs rates to a common level.

The tax, designated as consumption tax, is essentially a manufacturers sales tax on the importation and manufacture of finished products. It applies uniformly to imports and domestic manufacture, but not to exports. As of 1975, 62 percent of the revenue was collected at importation, 38 percent on domestic manufacture. Registered firms can import free of tax, thus reducing the relative revenue collected at importation.

The tax differs from most sales taxes in that the rates are specified by BTN category, as under the Brazil federal tax and the levies of Uganda and Tanzania, rather than being imposed in general form. There are 27 different ad valorem rates and nine specific rates, with an overall range from 2 to 76 percent. There is a continuous spectrum from 2 and 2 1/2 to 20 percent, missing only the figure 19, plus the higher figures. The particular figures were designed to ensure that each commodity class would provide the same revenue as the amount that was being lost by the revision of the customs tariff, and thus the differentials largely reflect the principle of the customs tariff of placing higher rates on luxury goods. The coverage of the tax is relatively broad, only unprocessed food and some goods used in production being excluded from coverage. Gasoline, diesel oil, cigarettes, liquor, soft drinks, and garments are the largest revenue categories.

The tax applies to the actual selling price on domestic goods, to the CIF value plus customs duties on imports.

Cascading is largely eliminated by the rule that allows manufacturers to buy materials and parts free of tax, under the same pattern as the Canadian manufacturers sales tax. Not all goods used in industrial production or in distribution are excluded from tax, however.

The tax is administered by the Customs and Excise Department rather than by Inland Revenue. The portion at importation is collected in conjunction with the customs duties, that on domestic firms on the basis of monthly returns. A bond is required through a commercial bank to ensure payment. Firms are required to keep separate records on their "registered stock" — materials, etc. bought tax free. The returns must show statements of receipts, delivery, and inventory balances of materials acquired free of tax. There is a small consumption tax division in Customs and Excise, personnel of which check the returns and inspect the stocks of materials and finished goods on the firms' premises.

To avoid the problems of control of small firms, those with annual turnover under G$10,000 (G$50,000 in the furniture and jewelry industries) are exempt from the registration requirement, and thus tax applies to their purchases. The G$10,000 figure is approximately US$ 4,000. There were, as of 1975, only 134 registered manufacturers, approximately one-third of them in two categories — clothing and furniture.

In 1973 the tax yielded 12 percent of total tax revenue, compared to 19 percent for excises, 22 percent for import duties, and 44 percent for income tax; few LDCs make more effective use of the income tax than Guyana. Figures for years following 1973 were distorted by the high temporary yield of the sugar export tax.

The government has given some consideration to reform of the tax, particularly to reduce materially the number of rates, and possibly to shift to a value added tax. But thus far no change has been made.

Of the other major CARICOM countries, Barbados imposed a retail sales tax, but in 1976 suspended it as a new government pledged to the elimination of it, mainly because of complaints of retailers, was elected. The tax appeared to be working reasonably well. The other two, Trinidad and Jamaica, have not introduced sales taxes, but make substantial use of excises. The purchase tax in Trinidad applies to a wide range of commodities at the manufacturing level, and approaches a manufacturers sales tax in coverage.

MEXICO [4]

Mexico is one of the few remaining countries to employ the old turnover cascade form of sales tax, and substantial attention is being given to its replacement.

The tax, Impuesto Federal sobre Ingresos Mercantiles, is imposed upon all transactions through which commodities pass on the way from initial production to final sale to the consumer, with the exception of the sale of unprocessed farm produce by the farmer and certain basic materials subject to special levies. The tax is therefore cumulative, producing an overall burden relative to consumer spending far in excess of the nominal rate. The tax, technically a levy upon receipts of business firms, does not apply to imports. Receipts for exports are freed from tax, and a refund is given at export provided at least 30 percent of the value is of domestic origin, the amount of refund depending upon the percentage. The refund, given to a manufacturer or a firm buying directly from the manufacturer, is intended to reimburse the exporter only for tax paid on purchases of the good itself and parts and materials entering into it.

The tax has relatively broad coverage of both commodities and services, though less so on the latter. Except those specifically exempted, all commodities and all services rendered to consumers as distinct from those rendered to employers are taxable. Retailers are included in the scope of the tax. The tax applies to rentals other than of real property and to commission charges.

The major exemptions include:

1. Basic foods, but not most processed foods. The principal exempt items are water, maize, rice, wheat, sugar, salt, fresh meat and fish; poultry,

4. The tax is described in great detail in Secretaria de Hacienda Y Credito Publico, *Impuesto Sobre La Renta E Ingresos Mercantiles*, Mexico City, 1976.

eggs, fresh fruit and vegetables, flour, and milk in all forms.
2. Coal, electricity, and gas.
3. Books and magazines.
4. Banking, insurance, transportation, and professional services.
5. Sales by farmers of unprocessed farm products.
6. Sales by small business firms, including small repair and work shops.
7. Sales by certain industries exempted from tax as "new or necessary".

The basic rate of the tax is 4 percent (3 percent prior to 1973), but higher rates are applied to a group of commodities and services regarded as luxury in character:

5%	subcompact cars
10%	compact cars, motorcycles
	cigarette lighters
	cosmetics, lotions, perfumes, etc.
	certain fishing equipment
	expensive furniture
	cameras
	electrical appliances (specified types)
15%	standard automobiles; auto accessories
	cabarets, night clubs, bars, restaurants serving liquor
30%	expensive automobiles
	yachts, private planes
	expensive watches
	precious stones, jewelry
	fur coats
	firearms
	sporting goods
	cable television service

The tax is administered by the states, under agreement with the Federal government, and the revenue is shared on the basis of 60 percent to the states and 40 percent to the Federal, but with substantial Federal supervision. The tax is a major revenue source for the states, and yields about 13 percent of Federal revenue. State administration is a possible obstacle to optimal operation but politically would be difficult to eliminate. The operation of the tax is more or less standard; firms are registered and file and pay on the basis of monthly returns. Large firms are required to keep detailed records, while smaller firms are assessed on a *forfait* basis. The exact number of registrants is not available, but is estimated to be in the neighborhood of 700,000.

Mexico has a long history of indirect taxation, dating back to the *alcavala* of Spanish rule. The present tax was introduced in 1948, replacing a number of state levies and Federal stamp taxes. In the mid-1960s, there was extensive discussion of the defects of the tax, and a value added tax was developed, [5] but was never introduced, stress being placed on income tax reform. In 1976-77, once again, attention was directed to the replacement of the tax by a value added levy. Concern has been expressed throughout the last decade that firms would not reduce prices when the turnover tax was eliminated but would add on the value added tax, thus boosting prices. There has been little evidence of this in other countries when the value added tax has replaced other forms of sales tax.

BRAZIL

Brazil is one of the few countries in the world in which sales taxation is of primary importance at both the state and Federal levels. The details of the state taxes have been described in detail by Michèle Guerard, [6] and will not be repeated here; only some of the most significant features of the two taxes and their relationship will be noted.

The Federal Tax (referred to in Brazil as IPI) is essentially a value added tax, but it is limited to manufactured goods and basically the manufacturing (and import) sector levels and therefore is usually classified as a manufacturers sales tax. The state levies (ICM) are value added taxes of the usual form, applying to all sectors, and therefore overlapping the Federal tax at the import-manufacturing sector.

The backgrounds of the two taxes are very different. The Federal tax evolved out of an extensive system of excises imposed at the manufacturing level, some dating back many decades. Ultimately the coverage became so broad that the tax came to be regarded as a sales tax, and the value added feature was introduced into it. But the tax still applies to specified commodities, listed by BTN category; and the rates vary widely — from 3 to 365 percent — but most are in the 10 percent to 20 percent range. The usual tax credit form of VAT is used. By contrast, the state levies resulted from a reform of their previous cascade turnover taxes; Federal legislation forced the change in 1965, over opposition of some of the states. The transition was relatively simple, since the firms were already registered under the turnover taxes and the machinery had been developed for dealing with large numbers of papers. The state levies differ from the Federal in two major respects: a uniform rate is used (prescribed by Federal legislation) and the tax is not confined to manufactured goods or to the manufacturing sector. In most other respects, such as the use of the tax credit feature, the two taxes are identical.

The Federal tax is the largest single source of Federal revenue, yielding 40 percent of total revenue in 1976, compared to 28 percent for the income tax, 10 percent for import duties, 9 percent for fuel taxes, and 13 percent for other taxes.

At the state level the value added tax is dominant; for the state of Rio de Janeiro in 1976, the tax yielded 95 percent of state tax revenues and 86 percent of all state revenues. The local governments receive 20 percent of the ICM collected in the state; this amounted to 31 percent of the revenues of the municipal district of Rio de Janeiro in 1976, for example. Of locally collected taxes, the tax on services is by far the most important, yielding 54 percent of the total; the tax on real estate yielded 25 percent and other 21 percent (Rio de Janeiro).

5. A. Guiterrez Kirchner, "Estudio sobre Impuesto a las Ventas en Mexico", in Centro Interamericano de Administradores Tributarios, Estado Actual de la Legislación Comparada Relativo al Impuesto Sobre Ventas, Panama, 1970; *Investigación Fiscal* (Mexico), January 1969 issue.
6. Michèle Guerard, "The Brazilian State Value Added Tax", *International Monetary Fund Staff Papers*, Vol. 20 (March 1973), pp. 118-69.

The total number of firms paying the Federal IPI is 135,000; while no total figure is available for the ICMs, in the state of Rio de Janeiro there are 131,000 taxpaying firms.

A few major features of the taxes will be noted briefly. Exports are free of both taxes, with credit for IPI and ICM accumulated up to the point of export. The Federal government will pay cash refunds, but the states in general do not, but authorize credit against other taxes. Imports from abroad are taxed under both levies. Credit is allowed for value added tax paid on purchases of goods for resale, materials, packaging, industrial machinery, and other goods used directly in the production process, but not building materials, office supplies and equipment, and some other items. Thus the levies are not as pure consumption taxes as are those of the EEC countries but there is little cascading.

There is no exemption of small firms as such under either Federal or state levies, but there is widespread use of the *forfait* system; small firms are assessed a fixed amount based on the inspector's estimates of likely sales. They do not receive credit for tax paid on purchases. Farmers are not subject to the Federal tax (confined to manufactured goods) but are not formally exempted from the state levies in most states. The smaller ones are not in fact subjected to tax, though larger commercial ones are. Basic farm inputs — feed, seed, fertilizer — are exempted from tax to avoid cascading since unregistered firms cannot receive credit for tax paid on purchases.

The Federal levy, applied to specified classes of commodities, exempts most foods and some other necessities, and zero rates exports and ships and some other items. All ICMs have broad coverage, with some variation among the states. Some states exempt food; others do not. Services are not taxed, being subjected to separate municipal levies. Rentals are not taxed; builders are treated as final consumers.

The interstate tax relationships are somewhat different than in most Federal countries. The state of origin ap-

TABLE I

Basic Features of the Sales Taxes of the Five Countries

					Brazil	
Type of Tax	Sudan	Bolivia	Guyana	Mexico	Federal	State
Year Introduced	Manufacturers 1974	Value Added 1972	Manufacturers 1969	Turnover 1948	Manufacturers (1)	Value Added 1965
Tax Replaced	none	turnover	none	(2)	(1)	turnover
Imports Taxed	Yes	Yes *	Yes *	No	Yes	Yes
Exports Taxed	Yes	No	No	No	No	No
Designation of taxed items	general	general	BTN	general	BTN	general
Cascade Elements	some in mfg.	tax credit only on parts, materials, consumables	limited	general	limited	limited
Industrial Machinery	taxed	no tax credit	most not taxed	taxed	tax credit	tax credit
Services	not taxed	not taxed	not taxed	many taxed	not taxed **	not taxed **
Food exempt	unprocessed; flour, milk for babies	unprocessed	unprocessed	unprocessed	most	in some states
Basic or major rates, %	5	5	10, 15, 20	4	10 to 20	14
Other rates	none	none	27 rates, 2 to 76, plus specific	5, 10, 15, 30	3 to 365	11-interstate
Sales tax revenue as % of total tax revenue	7	4	12	13 (fed.)	40	95 ***
% of sales tax revenue collected at importation	21	na	38	0	na	na
Administration	Customs & Excise	Inland Revenue	Customs & Excise	States	Federal	States
Basic return period	2 weeks	bi-monthly	monthly	monthly	monthly	monthly
Number of Registered Firms	826	2000	134	700,000 est.	135,000	na****
Treatment of small firms	taxable except handicraft	exempt by law	exempt	*forfait*	*forfait*	*forfait*
Population, millions	17.1	5.3	.8	56	101	
Per Capita GNP, $US	130	230	410	890	760	

* Imports by registered firms exempt in Bolivia and Guyana
** Services taxed by municipalities
*** State of Rio de Janeiro; figure varies by state
**** In the State of Rio de Janeiro there are 131,000 registered firms
(1) Evolved out of excise system
(2) Replaced a number of state and local taxes

plies its tax on sales for delivery in another state, but at a reduced rate — 11 percent instead of 14 percent — and the state of destination, which gives credit for tax paid the state of origin, therefore receives 3 percent. By contrast to retail sales taxes, a value added tax based primarily on origin gives much more of the total sales tax revenue to the manufacturing states. This has been a source of substantial contention in Brazil, since manufacturing is heavily concentrated, particularly in São Paulo, and the non-manufacturing states complain that they do not receive a reasonable share of the total.

The system of operation is comparable to that for sales taxes in other countries. Firms are registered and file monthly returns. The system is highly computerized in the larger states. Rio is moving toward cross checking of data supplied by various firms by computer. Check is made on delinquents, and most firms receive at least a brief check each year; Rio de Janeiro state, for example, 95 percent of all vendors were contacted during 1976. Many of these visits would, of course, not constitute a true audit. During that year, 31 percent of the firms were penalized for late filing or other offenses. Enforcement is facilitated by the fact that much of the revenue comes from relatively large firms; in Rio, 100 companies provide 80 percent of the tax revenue. It is widely recognized that there is considerable evasion by small firms; estimates have been made ranging from 15 to 20 percent in Rio to as much as 50 percent in some states.

There is substantial overlap of Federal and state sales tax administration but as yet little coordination.

Summary

Table I presents in summary fashion the basic information about the taxes in the five countries. The taxes are in various stages of development; the Brazilian levies are the best developed and most sophisticated ones, with extensive use of computers in operation and long experience in dealing with numerous taxpayers. The duplication of Federal and state administration in the manufacturing sector is of course wasteful and the use of the *forfait* system for small firms is always open to question; outright exemption (and taxation of sales to these firms) may be preferable. These taxes yield unusually high percentages of the total tax revenue of the country. The long-standing Mexican tax, one of the last turnover taxes left in the world, is basically defective, a fact long recognized in Mexico, being tolerated as long as it has only because the rate has been relatively low. But reform in the form of conversion to a value added tax is likely to occur in the next several years. Brazil and Mexico, both Federal (or at least semi-Federal) states, use quite different approaches to the intergovernmental problem. Mexico avoids duplication by allowing the states to administer the states tax and share the revenue with the Federal government, but the states have no control over the rate or the tax structure. Brazil specifies the rates of the state levies, and limits power to vary coverage. The origin rule is basically used to allocate revenue by state, but the interstate sales are subject to a lower rate, so that the state of destination gets 3/14ths of the revenue.

The other three levies are much less fully developed. Bolivia has made the shift to value added, but essentially of the product variety, one of the few such taxes that take this form, since no credit is allowed for tax on capital goods. The Guyana and Sudan manufacturers taxes employ a form of tax basically satisfactory for countries relatively early in the development process, but both require modifications — in Guyana to lessen the number of rates, in the Sudan to eliminate cascade features. The Sudan still relies very heavily upon custums duties; Guyana by contrast has successfully moved to substantial reliance on income taxation.

Hungary:
Standing Representation of Foreign Financial Institutions*

Under Decree No. 1/1977 of the Hungarian Minister of Finance foreign financial institutions can obtain permission to establish a standing representation in Hungary in order to develop international financial banking relations. Such a representation may carry out activities within the scope determined in the permit issued by the Hungarian Minister of Finance. It carries out this activity for and on behalf of the foreign financial institution; such activity and the income derived therefrom will be exempt from Hungarian tax.
Additional permission is required for representation activities on behalf of other foreign individual firms and companies; in that case, the representation is subject to the Hungarian agency tax in accordance with the rules laid down in Decree 18/1975. The rates of this tax are 3, 5 or 8 percent of the agency's turnover (depending on the type of activity).

The text of the Decree reads as follows:

In agreement with the President of the National Bank of Hungary I decree as follows:

§ 1

(1) Foreign financial institutions may establish a standing representation in the Hungarian People's Republic, with the permission of the Minister of Finance, in order to develop international financial and banking relations. The standing representation is discharged by the representatives of the foreign financial institutions delegated to Hungary.

(2) For the implementation of the present decree the representation is a standing one if

a) the stay of the delegate in the territory of Hungary exceeds three months on one occasion, or a total of six months in a calendar year on several occasions, or
b) the stay in the territory of Hungary of several representatives of the same financial institution consecutively exceeds a total of six months in one calendar year. In calculating the period of the stay, any stay shorter than 14 days must be disregarded.

(3) The representation is a standing one, if the delegate carries out his activity — irrespective of the length of the stay — in conditions indicating a standing character (e.g. leasing of premises, designating such premises as a representation, etc.).

§ 2

(1) The representation may carry out activities within the scope determined in the permit issued by the Minister of Finance. It carries out this activity for and on behalf of the foreign financial institution, while complying with the dispositions of Hungarian domestic legislation. Within this activity it can maintain contacts with Hungarian enterprises by appointment of its financial institution. Within the scope of its activity it may mediate banking transactions, but is not permitted to conclude or to implement such transactions.

(2) The National Bank of Hungary observes and assists the activity of the representation.

§ 3

(1) If the representation carries out activity beyond that of bank representation not by appointment of the foreign financial institution but of an other foreign individual firm, enterprise, company, other business organization or institution as a standing representation, it must obtain for this in advance also the permission of the competent minister (head of organ of nationwide competency).

(2) The representation may carry out commercial representative activity on the basis of the effective statutes only with the permission of the Minister for Foreign Trade.

(3) The permission mentioned in paragraphs (1) and (2) above must be obtained through the National Bank of Hungary.

§ 4

(1) The application for the establishment of the representation must be submitted to the President of the National Bank of Hungary.

(2) The application must contain:

a) the name of the foreign financial institution, the form of its incorporation, its domicile, the date and place of its incorporation,
b) the nominal and actual paid-up capital of the foreign financial institution, as well as the scope of its activity,
c) the scope of activity of the representation that it is intended to establish, the number of alien and Hungarian citizens desired to be employed by it, the planned period of time for its operation.

(3) In addition to the particulars contained in paragraph (2) above, the application may contain all information and data which are apt to serve as a foundation for the consideration of the organ issuing the permit, including primarily plans and ideas concerning financial co-operation, especially those which promote the achievement of the goal defined in Section 1 above.

(4) In order to decide the application, the organ issuing the permit may ask for further information and data, as well as the authentification of the data.

§ 5

(1) The President of the National Bank of Hungary forwards the applications presented to him to the Minister of Finance with his opinion.

(2) The Minister for Finance decides in respect of the permit for operation within three months after receipt of the application. But if the Minister of Finance requests a supplementary measure from the applicant in order to decide the application (paragraph (4) of Section 4), the dead-line must be counted from the fulfilment of this request. The decision of the Minister for Finance is communicated to the applicant by the National Bank of Hungary.

(3) In the resolution entertaining the application the following must be laid down:

a) the scope of activity of the representation;
b) the number of alien and Hungarian citizens that may be employed with the representation;
c) the period of time for which the permit is valid or that the permit is issued for an indefinite period, as well as
d) other provisions concerning the activity of the representation.

(4) The Minister of Finance may withdraw the permit concerning the operation of the representation if the authorized does not carry out its activity in accordance with the conditions laid down in the permit or with the provisions of the statutes of law.

(5) No reasons must be given for the resolution made concerning the application or for the withdrawal of the permit for operation.

* HUNGAROPRESS, No. 4/1977 at SD 35.

§ 6

The activity carried out by the standing representation of the foreign financial institution in accordance with paragraph (1) Section 2 above is tax-free. But if the representation carries out beyond the activity of bank representation such activity defined in Section 3 above for which by virtue of the said Section separate permission is needed, it must be taxed in accordance with Decree No. 18/1975/IV.23/ PM on the taxation of the commercial and other business representations of aliens.

§ 7

(1) The National Bank of Hungary must be advised of

- the alien employees of the foreign financial institution working at the representation before the start of their activity, with communication of their personal data,
- the address of the office of the representation, before beginning operation.

The person concerned may begin his activity and the representation its operation only when the National Bank of Hungary has advised the informant of the acknowledgement of the information.

(2) The National Bank of Hungary keeps a register of the representations.

§ 8

The contents of the present Decree do not affect the validity of the provisions contained in Decree No. 24/1966 (IX.25.) Korm. on the entry and exit of aliens as well as their sojourn on the territory of Hungary and the statutes issued in implementtation of this Government Decree, nor the statutes on the employment of aliens on the territory of the Hungarian People's Republic and the entry of Hungarian citizens into the employment of alien employers, nor those on the taxation of the employees of representations.

§ 9

This Decree enters into force on the day of its promulgation. Its provisions must be applied also to the representations already existing at the entry into force of the Decree, provided that the Decree does not affect the validity of the permission already issued.

Attila Madarasi m.p.
Secretary of State in
the Ministry of Finance

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TAX GLOSSARY

by H.W.T. PEPPER *

CABARET TAX — A tax, either in the form of levy on the admission price (whether separately identified or included as a "cover charge" in the customer's bill) or on the total charged to the customer by cabarets, nightclubs, etc. The tax is sometimes collected as a form of local revenue and sometimes levied by the central government. In either case it represents a luxury tax, with some connotations of a registration levy, since the government will be responsible for supervising, to a greater or less degree, the activities of such institutions, e.g., to protect the customer from "exploitation", to ensure compliance with liquor laws, fire safety regulations, etc.

CANONS OF TAXATION — The name given to the four rules of taxation propounded by Adam Smith in his *Wealth of Nations* and still valid today. The four points were:

1. Equity. The tax payable should accord with ability to pay or TAXABLE CAPACITY (q.v.).
2. Certainty. The taxpayer should know exactly what tax he has to pay, which means that the law should be clear and the Tax Department's interpretation of it should be readily available.
3. Convenience. The tax should be payable in a manner and at a time convenient to the taxpayer, e.g., tax on salaries when the salary is due (now generally achieved by PAYE Schemes). For example, taxes on farmers might be made payable when the proceeds of their products were received (such results are achieved, e.g., by export duties levied on agricultural produce when exported).
4. Economy. A tax should be economical to collect. In present times the "ideal" expense ratio may be regarded as not more than 1 percent of the tax yield for sales taxes and not more than $2\frac{1}{2}$ percent for income tax and other direct taxes but these percentages are in practice only likely to be achieved in industrialised countries where there is reasonably good tax compliance. Small countries are unlikely to achieve comparable ratios because the minimum administrative headquarters and "overhead" expenditure are spread over a relatively small number of taxpayers.

CAPITAL ALLOWANCES — Allowances normally intended to give relief for depreciation of assets used in a business. In Britain the term covers initial allowances, granted when assets are first acquired and calculated as a percentage of cost, annual allowances also calculated as a fixed annual percentage, either on original cost (straight-line method) or on the REDUCING BALANCE (q.v.), and BALANCING ALLOWANCES or CHARGES (q.v.) which adjust the total capital allowances to the difference between original cost and final proceeds when the depreciated asset is disposed of. Capital allowances are usually granted in respect of factories or other industrial buildings and works, agricultural buildings, plant and machinery including vehicles. They are less commonly applied to commercial buildings such as office blocks, hotels, and blocks of flats.

The original reason for the distinction between industrial and commercial properties was that the former were subject to *material* wear and tear, e.g. vibration from machinery. But the argument cannot be carried to a completely logical conclusion. In general, governments try to encourage both new industries, and the re-equipment of old industries with modern machinery, and therefore grant depreciation allowances on a more or less generous basis. For revenue reasons it is often not possible to grant such reliefs also to commercial and residential properties. Moreover, especially where the non-industrial building and lands are in the same ownership, values do not usually diminish, whereas there may be actual depreciation of value in the case of industries, particularly where technological changes may cause the termination of one type of industrial activity and its replacement by an entirely different type of activity. (See also DEPLETION, DEPRECIATION.)

CAPITAL DISTRIBUTION — A distribution, e.g., by a company, not of profits but of capital generated either (a) by the sale of assets at a profit or (b) by return of capital where a company finds its capital greater than the foreseeable needs of its business. A *return of capital* to shareholders will not normally attract income taxation but a *distribution of capital* may require examination to ascertain whether (i) capital gains tax applies or (ii) whether transactions giving rise to the profit or surplus should be regarded as transactions forming part of the ordinary trade of the company, such that income tax would apply.

CAPITAL GAINS DIVIDENDS — (U.S.A. term) See REGULATED INVESTMENT COMPANIES.

CAPITAL GAINS TAX — A tax charged on the disposal, other than in the course of carrying on a business or trade, of ASSETS and CHATTELS (q.v.) at a price higher than was paid for them. The tax usually extends to assets acquired by bequest or gift, as well as by purchase.

Where the asset was already owned by the taxpayer when the tax was introduced, it is usual to allow substitution of the value at the inception of the tax for the purchase price at the taxpayer's option. Where the option is not exercised, the total gain over the period from acquisition to disposal is usually apportioned so that only the proportion of gain relative to the period since the tax came into force is taxed. "Disposal" is usually defined as covering a sale or gift, and may sometimes be applied to bequests or transmissions on the death of the owner of the asset.

The tax is usually justified by the argument that realised gains on capital are equivalent to income in that the taxpayer may use such gains in the same way as income. Where the gain arises merely on a change of investments (including an involuntary change where one company is taken over by another on a share-exchange basis), there may be no spendable gain, the old proceeds being totally absorbed in the new investment. In such cases some tax codes allow ROLL-OVER RELIEF (q.v.) such that no taxable

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* *With the assistance of the staff of the International Bureau of Fiscal Documentation.*

gain arises. Some taxable gains arise from monetary inflation rather than real increases in value and a few tax systems allow indexed relief in computing the taxable gain. (See MONETARY CORRECTION and INDEX-LINKED ADJUSTMENTS.)
In Italy, capital gains in respect of real estate, ships, and securities owned for not less than 3 years and not otherwise taxed are taxed as business profits, subject to roll-over relief if the proceeds are re-invested. (See also SHORT-TERM GAINS TAX, LONG-TERM GAINS TAX.)

CAPITAL GOODS — The term is used in sales taxation to distinguish goods that are purchased for use in a business as part of the fixed capital of that business as distinct from goods for processing or re-sale. Where a sales tax is intended to be purely a consumption tax, there may be an exemption of capital goods from the incidence of the tax. Under a V.A.T. system, no special exemption is necessary because an offset of (input) tax on such goods is made against the tax payable on the sale of products. (Capital goods may also be known as "Production Goods".)

CAPITAL LEVY — A tax on a taxpayer's capital, or one which is based on his income at a rate higher than 100 percent and thus has to be met partly out of capital. The commonest example of a capital levy in general use is the death, inheritance, or succession duty payable on the assets of a deceased person. There have also been several examples of capital levies on the living, e.g., Federal Germany and Norway imposed such taxes after World War II and Britain has imposed two quasi capital levies, a SPECIAL CONTRIBUTION (q.v.) and a SPECIAL CHARGE (q.v.) which were based on investment income but in fact were graduated so as to exceed the income, when added to income tax thereon, where that income was above certain limits. A fairly recent example is the 1971-72 Sri Lanka levy of 5 percent on the capital of companies in excess of Rs. 1,000,000, accompanied by corresponding levies on individuals.

CAPITAL LOSSES — In countries which have capital *gains* taxation, it is usual and logical to give allowances for capital losses. Such losses may generally be offset against capital gains of the same year or subsequent years. It is not usual to allow capital losses other than on disposal of plant and machinery used in a business to be offset against income. One reason is that if relief were available, taxpayers might take advantage of a severe drop in stock market values by selling stocks and shares at a loss and offsetting the loss against their income with disastrous effects on income tax yield to Governments in years of depression. (See also CASUALTY LOSS.)

CAPITAL TAX — The term has two meanings, either as a tax on wealth (see WEALTH TAX) or as a tax on the capital of companies (see also FORMATION TAX).
It is fairly common to charge a small tax on the nominal or issued capital, which may be in the form of an initial or annual stamp duty. These latter taxes may be regarded as "administration" taxes since the government must exercise supervision over the activities of corporate bodies in order to protect shareholders' interests. Alternatively, such taxation may be regarded as a fee for the privilege of limited liability.

CAPITAL TRANSFER TAX — This term may refer to taxes on the transfer of real property (see TRANSFER TAXES) and also to levies which apply to gifts and bequests (thus combining gift taxation and DEATH or SUCCESSION TAXES q.v.).
Such a tax has recently been adopted in Britain in succession to ESTATE DUTY (q.v.) and consists of levies on gifts out of capital made during a person's lifetime as well as to bequests on his death, the liability being determined on a cumulative basis where the same beneficiary receives more than one "capital transfer". Transfers between spouses are not taxed and there are annual exemptions for small transfers (under £100) and "lifetime exemptions" up to £15,000, as well as annual exemptions of £2,000 to any person, subject to the cumulative total of £15,000.

CAPITAL VALUE TAX — This term may be used to relate to a CAPITAL or WEALTH TAX (q.v.) or may relate to real property taxation based on capital values rather than annual values.

CAPTIVE USE — When a manufacturer makes machinery or equipment or other goods and takes some for use in his own business, this is termed "captive" use — the term is also sometimes applied to goods extracted from a person's buisness for personal or domestic consumption. For income tax and sales tax purposes it is usual to add an appropriate sum to profits or sales to represent the value of goods thus used.

CAROUSEL — A method of avoidance or evasion of indirect taxation, based either on loopholes in the customs duty and sales tax codes, or on fraudulent mis-classification or mis-description of goods. Typically the goods are brought into a country paying the duty and tax applicable to a low-tax classification on entry and are then immediately re-exported under a high-tax classification, when a greater refund of duty or tax is obtained. The process of import and re-export may be repeated with the same goods.
The classification schedules of goods chargable at different rates of duty and tax have to be drafted with considerable precision. If there is any imprecision it may be possible for goods which are capable of being classified in different ways to be "legally" imported in a low-rated classification and then entered in a high-rated classification for export refund purposes. Fraudulent mis-classification on the other hnad may result in loss of tax only when the fraud has not been discovered by inspection of the goods by the tax authorities on export.

CARRIAGE TAX — A tax imposed in Britain in 1747 as one of a series on "outward and visible signs of wealth". A tax on ARMORIAL BEARINGS (q.v.), where such devices were impressed on carriages, etc., continued well into the 20th century. (See also EXTERNAL INDICIA OF WEALTH.)

CARRY BACK — Some income tax codes provide for retrospective (or "carry back") relief where a business makes losses in its final years of trading (see TERMINAL LOSSES) or is entitled to DEPRECIATION or CAPITAL ALLOWANCES (q.v.) which cannot be fully offset against current income, if any. By carrying back reliefs which would otherwise be frustrated, the ideal situation may be achieved whereby the total assessment of profits to tax is equal to the total net profits actually achieved during the existence of the business.
A limiting factor is that for budgeting purposes it is desirable that incoming revenue should be as final as possible, so that the income tax yield is not subject to a double erosion in times of recession. The modern tendency, however, is to give more emphasis to equity, especially in a context of high corporate and personal taxation rates.

CARRY FORWARD — Most income tax codes provide for the carry forward of unexhausted reliefs for losses and DEPRECIATION and CAPITAL ALLOWANCES (q.v.). Apart from according with equity (i.e., the running total of net profits is enabled to correspond with the tax assessments on profits) the practice ensures the cash flow benefit to the new venture which is intended by the enhanced capital allowances or FREE DEPRECIATION (q.v.) now provided in some tax systems.

CASCADE TAX — A sales tax imposed on traders at all levels of economic activity and at all stages in the chain of distribution of goods and services, without offset for tax paid at an earlier stage. The tax thus "cascades" on all traders, except any specifically exempted or excluded, and repeatedly on goods passing through more than one stage of distribution. The imperfections of the tax, which falls unevenly on different parcels of the same goods if they pass through differing channels of distribution — some passing through more stages than others — have led to its replacement in some countries by Value Added Tax.

CASCATA — CASCADE TAX (q.v.).

CASE LAW — Where the tax law charges tax on fairly brief and simple concepts such as the "profits of a trade or business", disputes commonly arise as to what is covered by the terms used and these disputes are continued by the appeal procedures into the law courts. Decisions on such matters by the Judiciary form a body of case law which supplements or clarifies statute law.

CASH BASIS — In the case of certain liberal professions the taxpayers are sometimes permitted to adopt the "cash" basis instead of being assessed on "earnings". The cash basis applies such that the taxpayer is allowed to compute profits on cash in-comings less cash out-goings relating to his profession instead of by reference to amounts "earned", i.e., work done during the basis year for which bills will be sent to clients. One justification for the adoption of this basis was the former reluctance of professionals to take drastic action to recover fees due to them, an inhibition not necessarily affecting a trader. The tax department will normally not allow adoption of the cash basis until the earnings of the professional commencing to practice have reached a certain level and once the system is operating will endeavor to ensure that the inflow of cash is not unduly depressed by, for example, delays in sending out bills.

CASH VOUCHERS — A form of FRINGE BENEFIT (q.v.) whereby an employer gives his employee vouchers having a fixed cash value, e.g., to exchange for goods or services. Anti-avoidance legislation may specifically levy tax on such vouchers, particularly where they are seen as an attempt to avoid tax, rather than as a small goodwill amenity for employees, and especially where they may be readily converted into cash. In Britain examples of taxable items include "savings certificates", a form of investment repayable with interest after a fixed number of years, but which may also be cashed at original face-value immediately after acquisition. On the other hand, luncheon vouchers, a benefit sometimes afforded by employers in Britain to employees for whom no canteen facilities exist, are exempted from tax up to a certain limit of value per employee.

CASINO TAX — A tax levied on casinos and other places where legalised gambling takes place (usually on such games as roulette, chemin de fer, baccarat). The tax may be on the gross turnover but is more usually levied upon the commission which comes to the proprietors of the establishment ("house percentage"), for example the casino management will take the money placed on roulette bets where the number coming up is 0 or 00 and may also make an admission charge. (The admission fee may however be subjected to separate taxation — see ADMISSION TAXES.) It is now becoming more usual for the taxation of a casino to be embodied in a license agreement between government and casino proprietors.

CASUALTY LOSS — A loss relating to non-business assets resulting from theft, fire, storm, shipwreck, or other "casualty" is allowable for income tax purposes in the *U.S.A.* The relief is primarily of concern to individual taxpayers sustaining damage to non-business property.

Similar relief is also due from *Japanese* income tax in respect of loss of non-business assets arising from earthquake, storm, fire, theft, etc. The relief given in Japan is the proportion of the loss which exceeds 10 percent of total income. In addition, the resident taxpayer may claim a deduction for fire, etc., and insurance premiums payable on his residence and its contents.

CATALYST — In chemistry a "catalyst" is a substance which must be present before certain types of chemical change can take place, or which speeds up changes which would otherwise occur more slowly. The catalyst itself is unchanged during the chemical action it assists. In sales tax parlance, the meaning given to "catalysts" includes the strict technical meaning but is often slightly wider to include such items as lubricants which are "consumed" in the manufacturing process but are not physically embodied in the products.

CATCH-ALL — The term sometimes given to a tax provision, especially one to embrace, for example, (a) all types of activity or income in making a tax as wide in scope as possible, or (b) in anti-avoidance legislation, e.g. to set aside all transactions which have the effect of reducing tax liability. The last example clearly goes too far since it would set aside a marriage where the tax code provided tax relief for a wife!

CEILING TAX — Sometimes the impact of direct taxation on an individual is subject to a "ceiling", for example, the U.S.A. Federal Income Tax Code applies graduated rates rising to 70 percent on earned income, but the maximum or ceiling tax is 50 percent of gross earnings. The maximum charge to both income tax and wealth tax in Sweden is limited to 80 percent, and in Norway the ceiling is 85 percent of income. In the British Solomon Islands the top personal rate of tax is 35 percent but the maximum or ceiling tax is 25 percent of the gross income excluding reliefs.

CEMETERY TAX — See BURIAL TAX.

CENTIMES ADDITIONNELS — A Belgian term meaning a surcharge.

CERTAINTY — One of Adam Smith's CANONS OF TAXATION (q.v.).

CESS — A levy, usually upon the gross receipts from, e.g., a plantation crop to provide funds for government-directed research or improvement schemes such as re-planting with high yielding planting materials. The device is commonly found in countries with plantation crops such as rubber, oil-palms, coconut palms (and sometimes cesses are similarly levied on minerals extracted) and differs from an ordinary tax in that the proceeds are specifically "ploughed-back" into the industry.

CESSATION ADJUSTMENTS — Certain extra adjustments are necessary in computing the income tax of a business on its cessation than occur in the ordinary year-to-year computations. For example, reserves against possible future provisions can be substituted by actual expenditure, stock-in-trade may be valued at its precise final disposal price, and unused capital and other allowances may be allowed, e.g., if there are CARRY-BACK (q.v.) provisions. If assessments have been made on a conventional basis, e.g., on the profits of the previous year, there will normally be some statutory provision, (a) for making an automatic adjustment of the final year's assessment to actual profits, and (b) some form of anti-avoidance provision to adjust earlier years' assessments as well if there is evidence (sometimes even if there is not) of attempts to "load" extra profits into a year the profits of which would not ordinarily enter into the calculation of tax liability.

CHAIN SUCCESSION RELIEF — See QUICK SUCCESSION RELIEF.

CHARGES — A concept used in the British income tax system in connection with deduction of tax at the source, a principle which is widely employed in Britain. When one person has legal liability to pay an annual sum to another for example, interest on a private mortgage, he is required to deduct tax at the STANDARD RATE (q.v.) and account for this tax along with his own income tax liability. The recipient of income from which tax has been deducted at source receives a credit for such tax deduction when his income tax liability is computed.

CHARITIES, DONATIONS — Some income tax systems provide relief to taxpayers who make donations to charities. To qualify for the application of this relief a charity will have to be registered under the law governing charities but sometimes (and preferably, if the tax department is to keep reasonable control of the situation) there will be special rules regarding registration of charities for tax purposes. A narrower concept of the term "charity" may be desirable in order to limit the amount of tax relief which may be granted in this way. (See also COVENANTS.)

CHARITIES, EXEMPTION OF INCOME — It is fairly common for the income of charities to be exempted from income tax. As mentioned above, charities for this purpose normally have to be registered and submit annual accounts and other information to the registrar. The prinicple favouring exemption is that charities might undertake welfare work which would otherwise have to be undertaken and paid for by the government. The tax relief may therefore be a cheaper way for the government to achieve the charitable or social object than if the full expenditure was incurred directly by a public department of social welfare.

CHATTELS — A chattel may be described as a tangible, movable property and would include jewelery, furniture, motor-cars, yachts, and oil paintings, among many other items. Capital gains tax systems may charge to tax gains made on the disposal of chattels (there is a £1,000 lower limit on chargeable chattels in Britain) as well as on the more usual subjects of charge, real property, stocks and shares. Inclusion of chattels in the scope of gains tax (and WEALTH TAX, q.v.) varies from country to country. There are obvious difficulties in securing compliance with tax laws on articles which are movable, and often quite portable. (See also NATIONAL HERITAGE RELIEF.)

CHILD — A "child" for certain tax purposes is not necessarily the same as an INFANT (q.v.). It is fairly common in income tax codes for relief to be given to a taxpayer for each child of himself or his wife below a certain age (usually the school-leaving age). Relief is also given for older children provided they are in full-time education at a college, university, etc.

Similar tax codes aggregate for tax purposes the income of children, settled on them by their parents, with the income of the parents as an anti-tax-avoidance measure. Such measures are designed to set aside schemes whereby a parent divests himself of income, but, placing it in the name of his children, is still able to maintain effective control of the divested income. (See also FAMILY ALLOWANCES.)

CHINA TRADE ACT CORPORATION — Under U.S. Federal income tax law, a corporation trading in Hong Kong or Formosa (Taiwan) and satisfying the provisions of the China Trade Act could claim special deductions in computing taxable income from sources within Hong Kong and Taiwan. Shareholders in such corporations who were resident in either of those countries could exclude dividends from the corporations in computing their gross income. The relief is being phased out and will disappear altogether for fiscal years commencing in 1978.

C.I.F. VALUE — The value of imported goods which includes carriage, insurance, and freight, C.I.F. value is the base usually adopted for the purpose of levying customs duty and sales taxation on imports since it normally corresponds with the landed price. A few countries use F.O.B. value, or domestic market price in the country of origin, as the base for customs duties in which case higher *rates* of duty have to be imposed to produce the same level of taxation as duties charged on C.I.F. value.

CIGAR TAX — Taxes on tobacco products are usually charged mainly on the import or production of the tobacco leaf but sometimes an additional "luxury" tax is charged upon cigars, usually as a specific rather than an ad valorem levy. (See also CIGARETTE TAX.)

CIGARETTE TAX — Some countries adopt a system of taxing cigarettes by the "piece" or "stick", in addition to any tax which may have been imposed at the factory, and are often highly productive where tax administration is efficient owing to the present tendency for cigarettes to contain less tobacco and more filter materials. Such taxes are not, however, equitable in their impact on cigarettes of different size and length since the "king-size" cigarettes pay the same duty as the smallest sizes.

CINEMA TAX — A tax on admissions to cinemas (see ADMISSION TAXES) which is usually levied as a series of graduated specific charges increasing with the price of the seats so that each ticket may bear a specific tax charge or as a percentage of receipts which may or may not be graduated upwards on the higher seat prices.

CINEMATOGRAPH FILM TAX — A tax on the "rent" or hire charge paid by exhibitors to producers and distributors for the right to exhibit films commercially. There are some examples of the tax being charged at a specific rate per foot of length of the film (see FOOTAGE TAX), but it is preferably levied at a flat percentage rate on the hire charges. Sometimes a tax is levied on the notional profits of the producers from the exhibition of the film where the producer is outside the tax jurisdiction of the country in which the films are exhibited. For this purpose a certain percentage of the gross rent will be deemed to represent profit and a tax in the form of income tax charged on this notional profit. This may be advantageous to the producer who is able to offset notional income tax against the income tax in his home country on his total film production profits.

"CIRCUIT BREAKER" – TAX RELIEF — A U.S. system for relieving low income groups from property tax in excess of their ability to pay. Typically the property tax will be restricted to a certain percentage (e.g. 7 percent in Vermont) of the total family income. The assessed tax will either be credited against other state tax liability or rebated in cash. (See also NEGATIVE INCOME TAX.)

CITY PLANNING TAX — Because of the opportunities for making profits in respect of the development of sites in a city, once planning permission has been granted, some countries have endeavoured to gain some extra tax, apart from ordinary income tax, on the development profits. One example is the City Planning Tax in Japan, another the DEVELOPMENT LAND TAX (q.v.) in Britain.

Some countries, e.g., New Zealand, make another form of levy as the price of granting permission to develop. The developer will be required to yield up part of his land for a public garden or playground, and will be expected to provide adequate parking or garaging facilities for those who would work or reside on the developed

property. (See also LAND DEVELOPMENT TAX.)

CLASSIC SYSTEM — The term applied to the system of charging corporation tax on the income of corporate bodies and income tax on the shareholders when that corporate income is distributed to them as dividends, without giving any credit to the shareholders for the tax paid on the corporate income.

CLEARANCE — The term is used in connection with customs duty; goods being imported and a vessel coming into the customs' jurisdiction must be "cleared" by the Customs Department. Vessels leaving port must also be cleared, e.g., in regard to duty-free stores on board to ensure that such stores, commonly sealed while a ship is in port, have not been disposed of irregularly.

In dealing with CLOSE or CLOSELY HELD COMPANIES (q.v.) for corporation tax, there is sometimes a "clearance" procedure. Usually such companies are required to distribute minimum proportions of their profits to shareholders (who are then taxed thereon at the higher personal rates of tax). There is usually some discretion to the Tax Department if there are special circumstances such as the need to conserve capital for re-equipment or expansion. A company may ask for a "clearance" from the tax office for the distribution policy it is proposed to pursue. (See also TAX CLEARANCE.)

CLIENTELE — GOODWILL (q.v.) in Belgium.

CLOSE ("CLOSELY-HELD") COMPANY — A close company (the term is used, e.g., in connection with the 1965 corporation tax on corporate income in the U.K.) is a company which is under the control of not more than five persons or which is controlled by its directors (as defined in U.K. legislation). In income tax or corporation tax codes there are usually special provisions in respect of such companies of an anti-avoidance nature, in particular directed at such devices as under-distribution of corporate income (to avoid or defer additional personal income tax on the shareholders) or excessive payments of directors' remuneration (where such remuneration would attract a lower rate of tax than dividends) and against special arrangements made between a corporate body and those who control it in respect of such matters as loans, payments for restrictive covenants and benefits in kind.

CLOSED-END FUND — In the U.S.A., a domestic corporation formed to invest shareholders' funds in securities. Dividends out of investment income and capital gains from the realisation of investments are usually fully distributed. Unlike UNIT TRUSTS (q.v.) and OPEN-END FUNDS (q.v.) the share capital of the fund is fixed. (See also REGULATED INVESTMENT CORPORATIONS.)

CLUB — A club is usually run as a "mutual" organisation, by and for its members, and thus cannot make a "profit" in the commercial sense (see also MUTUALITY PRINCIPLE). In practice it *may* "trade" with non-members by allowing the use of facilities, provided for members, by outsiders for a fee, such as the "greens fees" charged by golf clubs. Income tax liability usually extends to income from non-members and from investments, and some tax codes provide a formula for computing liability which is designed to cope with cases where a business seeks to avoid tax by pretending to be a club.

CODE, TAX — The tax law consisting of the statutes, rules, and regulations which impose a tax in a country.

CODING — A term used in connection with PAYE (q.v.) schemes. The reliefs allowable to an individual employee in computing his income tax liability are convertible to a factor, code, or "coding" which is applied to tables supplied to the employer by the tax department, and from which the tax applicable to the week's or month's pay can be read off at a glance.

COLLAPSIBLE CORPORATION — A tax avoidance device whereby an enterprise would be conducted by a company set up for the purpose. Instead of selling the product (e.g., the device was used in the making of films) the company was liquidated, involving "capital" profit. Such profits attract capital gains taxation instead of income taxation on what would otherwise have been the earned income profits of the entrepreneurs.

COMMENCING ADJUSTMENTS — When a person sets up in a business or profession, it is not usually possible to determine his income tax liability *during* the first year or two, since accounts of the profit or loss made will not be available until after the accounting year-end. In a few countries, tax relating to year 1 income is payable in year 2, tax on income of year 2 is payable in year 3 and so on. More usually tax payments are looked for in the income year, so that provisional figures are used (in *U.S.A.*) which are corrected after the end of the year. In the *U.K.*, a similar procedure is adopted for year 1, but the liability of year 2 is based on the income of the first 12 months' trading, and that of year 3 on the profits of the accounting year ended within year 2: there is an option to have the actual profits for years 2 and 3 substituted for the CONVENTIONAL BASIS (q.v.) if this is more favourable to the taxpayer. In *Australia*, tax is always based on the actual income of the year, but tax is provisionally charged — as from year 2 — on the income of the previous year, the assessment being in due course "corrected" to the actual income.

COMMISSION SECRETE — Bribe money (BELGIUM).

COMMODITY TAX — A Sales Tax on commodities, usually at the import/manufacture or wholesale level. The tax may be selectively based on a limited number of commodities or more broadly on commodities in general consumption. The tax may take the form of a MANUFACTURERS' TAX (q.v.) or a WHOLESALE TAX (q.v.), but the term is not normally applied to a retail tax. The "manufacturers' tax" is broadly similar to the comparable Canadian levy and to the U.S. federal excises, and the retail tax to the Provincial and State retail taxes in Canada and the U.S.

COMMON AGRICULTURAL POLICY (C.A.P.) — A feature of the E.E.C. arrangement which protects food-stuffs produced within the member countries, such as wheat, rye, barley, maize and rice, pig meat, beef and veal, eggs and poultry, milk and milk products, sugar, fruit and vegetables and wine. C.A.P. involves the maintenance of high farm incomes by means of support prices fixed well above world market prices, involves variable levies on imports to ensure protection in the E.E.C. market for domestic producers and the subsidising of agricultural exports to other regions. Exports of surpluses are subsidised through the European Agricultural Guidance and Guarantee Fund (FEOGA) which was set up in 1962 and funded from annual contributions from member states and receipts from import levies.

COMMON MARKET — See EUROPEAN ECONOMIC COMMUNITY.

[to be continued]

U.S.A.: Visiting Professors

The U.S. Revenue Service recently ruled (Rev. Rul. 77-242) that a United Kingdom professor who visits the United States to teach at universities for short periods of time twice a year is entitled to the tax exemption on U.S. source income offered under Article XVIII of the U.K.-U.S. tax treaty of April 16, 1945 (as amended by the Supplementary Protocols of June 6, 1946, May 25, 1954 and August 19, 1957).

This Article provides:

"A professor or teacher from the territory of one of the Contracting Parties who visits the territory of the other Contracting Party for the purpose of teaching, for a period not exceeding two years, at a university, college, school or other educational institution in the territory of such other Contracting Party shall be exempted by such other Contracting Party from tax on his remuneration for such teaching for such period."

The full text of the Ruling reads as follows:

"Advice has been requested wheter, under the circumstances described below, Article XVIII of the United States-United Kingdome Income Tax Convention (Convention), T.D. 5569, 1947-2 C.B. 100 is applicable.

The taxpayer, an individual, is a resident of the United Kingdom and a professor at a university located in that country. Since 1974, the taxpayer has been making annual trips to the United States to lecture at various educational institutions. During 1974, the taxpayer was present in the United States from February 8 to March 23 and from September 26 to November 8; during 1975, the taxpayer was present in the United States from March 12 to April 28 and from September 28 to November 13; and during 1976, the taxpayer was present in the United States from April 2 to May 23 and from October 5 to November 18. These visits were each arranged pursuant to agreements covering certain stated periods and had to be separately approved by the respective boards of trustees of the various schools the taxpayer visited in the United States.

The question presented is whether the taxpayer's United States sourced income from these teaching engagements is exempt from United States income tax for the taxable years in question pursuant to Article XVIII of the Convention.

Article XVIII of the Convention provides, in part, that a professor or teacher from the United Kingdom who visits the United States for the purpose of teaching, for a period not exceeding 2 years, at a university, college, school, or other educational institution in the United States shall be exempted by the United States from tax on remuneration for such teaching for such period.

A technical memorandum of the Treasury Department explaining the operation of the articles of the Convention was incorporated into the *Senate Executive Report No. 6*, 79th Cong., 1st Sess. 14, dated July 3, 1945. With regard to Article XVIII, the memorandum reads, in part, as follows:

. . . Its effect is to exempt from United States tax, upon a reciprocal basis, compensation for personal services rendered in the United States by a resident of the United Kingdom who is temporarily present in the United States for the purpose of teaching at a United States university or other educational institution in the United States. The intent is to allow an exemption for 2 years in any event. Thus, if the individual comes to the United States under circumstances which indicate a stay within the United States in excess of 2 years, the exemption will apply in such case for the first 2 years.

. . . It is the purpose of the article that such exemption shall cease at the end of 2 years from the date of his initial arrival in the United States. Thus, if he reaches the United States on July 1, 1945, he is exempt with respect to his remuneration earned in the United States up to June 30, 1947. If he then leaves the United States on vacation but resumes his duties in the United States at the beginning of the school term in the fall of 1947, he is not exempt with respect to his remuneration earned thereafter. If, however, he leaves the United States for an entire year or more and then returns to the United States, it is the intendment of the article that he will enter upon another exemption period of 2 years.

Rev. Rul. 56-164, 1956-1 C. B. 848, holds that the exemption language in Article XVII of the United States-Netherlands Income Tax Convention, T. D. 5778, 1950-1 C. B. 92, which is similar to that contained in Article XVIII of the United States-United Kingdom Convention, requires a visiting Netherlands teacher to be absent at least 1 year from the United States before a new 2-year exemption period can begin, based on the above-quoted explanation of Article XVIII in the Treasury Department technical memorandum. Rev. Rul. 56-164 further provides that the principles set forth with respect to the United States-Netherlands Income Tax Convention also apply to other income tax conventions that contain similar language, including the United States-United Kingdom Income Tax Convention.

The taxpayer in the subject case, who is a resident of the United Kingdom, has completed a "visit. . . for a period not exceeding two years," pursuant to Article XVIII of the Convention, on November 13, 1975, which was the last day that the taxpayer was present in the United States for the purpose of teaching within the 2-year period beginning on February 8, 1974, and ending on February 7, 1976. In order to become entitled to another such exemption period the taxpayer must be absent from the United States for at least 1 year, commencing November 14, 1975, and still meet the requirements of Article XVIII. The requirement is not affected by the fact that each of the taxpayer's visits to the United States was a relatively brief duration (approximately 1½ months) as opposed to a continuous stay of 2 years as may be inferred was the case in Rev. Rul. 56-164.

Accordingly, the taxpayer's United States sourced income for teaching in the United States during taxable years 1974 and 1975 is exempt from United States income tax pursuant to Article XVIII of the Convention. The taxpayer's United States sourced income for 1976 is taxable income and subject to withholding at source pursuant to Section 1441 of the Internal Revenue Code of 1954."

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THE AUTHOR IS . . . Professor of Law, Associate Dean for Academics, and Director of the Institute on International and Comparative Law, University of San Diego.

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Limits to International Tax Planning*

by Prof. Dr. F. H. M. Grapperhaus**

Long before Rome rose to power the Etruscans chose Italy as their home. At that time, the country was threatened by wars with Gallic forces. These drained the country's resources to such an extent that the government was compelled to introduce emergency measures in the form of high taxation. The effect of these taxes was to drive many wealthy Etruscans to the tax haven of Carthage, where they settled and lived happily and prosperously ever after.

As far as I am aware this is the first known example of international tax planning in history.

If we accept that certain limits should be imposed on tax planning — and I hope, in the course of my speech, to convince you of this — we can also extend our view to maintain that certain limits should be imposed on those persons who are professionally occupied with international tax planning, namely entrepreneurs and their advisors. And with that we have already arrived at the much farther reaching issue of free enterprise. In my speech I should like first to pay some attention to free enterprise in general and then to free enterprise in particular, as outlined in national and international fiscal law.

Less room for freedom of enterprise but still enough to make business exciting.

There can, in my opinion, be no further argument that during the past decades in many, if not most, countries of the Western world — to which I should like to limit my remarks — freedom of enterprise has decreased, not only because this freedom has been more and more limited by laws and regulations, but also because of the growing awareness of the entrepreneur's responsibility for the "external effects" of his operations. In this connection I would mention the responsibility of the entrepreneur, together with the government and the trade unions, for maintaining full employment, and the requirements of the environment which are increasingly met by the entrepreneur. Besides, the freedom of the entrepreneur has been limited as a result of the fact that his movements have been restricted in the markets in which he operates. The labour market forms a clear example. The fact should also be mentioned that in many countries the government has taken over wholly or partly the shares of private companies or in another way acts as an entrepreneur. In contrast to the limitations imposed on free enterprise, the field of the entrepreneur has been enlarged by the increased prosperity — and notwithstanding the pessimism shown by many in this respect, I expect a sustained increase in the near future — by an internationalization that is growing in significance and by rapid technological progress.

All these factors give new dimensions to enterprise and open up new fields for expansion while leading to more sophisticated and improved products and services.

I presume that there is freedom of enterprise if and as far as the entrepreneur can make a real choice out of available alternatives, both in deciding which goods and services to provide and in the organization of the production process directed towards the most favourable combination of production factors.

This freedom entails his accepting the uncertain consequences of that choice: uncertain because the production process must be established in anticipation of the uncertain or at least unknown demand for goods and services of consumers and consequently of other entrepreneurs. Even though the entrepreneur attempts to influence this demand, the apt description of enterprise, given by the present Prime Minister of The Netherlands, *Mr. Den Uyl*, in 1967, still stands: "enterprise still means choosing between uncertainties".

The freedom of the entrepreneur is limited by laws and regulations and by current political and ethical concepts about what an entrepreneur may (still) or may not (any longer) do. However, even although margins have narrowed in this respect, it seems that there is still enough elbow room left for the entrepreneur to make enterprise as equally exciting an occupation as, for instance, science or politics.

In addition to those concrete matters which can be expressed in terms of money, the entrepreneur has to consider imponderables, which certainly are of no less importance. In this respect we might think of employment, job satisfaction, environment, international distribution of labour, etc. One entrepreneur will be more advanced in his thinking than another, but neither is able, by himself and according to his own personal conviction, to dispense with the importance he would attach to these imponderable values in doing business. As a result, the entrepreneur may attempt to influence the balance on the market in a certain way. Here we are aware of a comparison with the politician. Both are called upon to translate the wishes of the consumer, or,

*) Speech held at the 7th International Planning Conference, November 9-10, 1977, Amsterdam.

**) Professor extraordinary in the Faculty of Tax Law at Leiden University, Special Advisor to Peat, Marwick, Mitchell & Co., Member of the Board of Trustees of the International Bureau of Fiscal Documentation, former Under Secretary of Finance of the Dutch Government.

more generally, the citizen, into more concrete matters, while both, I may add, try to influence those wishes. Just as his personal conviction can constitute for the entrepreneur an addition to and, if necessary, a correction of the market mechanism, so the people's representative has the right, nay, the duty, when voting, to act according to his conscience even if he were to vote against the policy of his party.

Freedom of enterprise in tax law: the tax authorities may not evaluate business decisions.

In dealing with the question of the freedom of the entrepreneur in tax law I should like to state that this freedom exists if, and in so far as, the entrepreneur can make his choice from a number of possibilities and make decisions which influence or may influence his legal relationship with the tax authorities in one or more countries, as the case may be.

With regard to these entrepreneurial decisions I should like to distinguish between, on the one hand, decisions which might entail tax consequences resulting from certain transactions, regardless of whether these consequences were intended or only assumed, decisions therefore without a fiscal purpose, and, on the other hand, decisions with a prime or even secondary fiscal motive. For the sake of simplicity I shall limit my remarks to taxation on profit, even though I realize that the question of entrepreneurial freedom may arise with other taxes too.

If in a certain country freedom of enterprise exists, it then follows that from a fiscal standpoint the entrepreneur has in principle freedom of action with regard to his management policy, and consequently may influence the tax due, namely by making more or less taxable profit. I have, of course, only stated the principle of this, which needs further elaboration dependent on the country concerned. Because of the time element I shall only elaborate in general terms and I hope I can describe the relevant criteria in such a way that each of you can relate what I say to the situation in your own country.

Please bear in mind that in my elaboration I have been guided by the ideas prevalent in my own country.

In the Netherlands, freedom of enterprise in fiscal law is still considered of great importance. Put into plain words this means that the tax inspector cannot assume the position of the entrepreneur. In its jurisprudence the High Court — in the Netherlands the supreme judge in fiscal matters — has constantly and carefully guarded against the fiscal administration or fiscal judge pronouncing judgment on the question whether an expense based on business considerations is also commercially justified.

The underlying philosophy is that the basis for the levying of income and corporation tax is the business profit which was actually realized and not the business profit which, in a careful and prudent business practice, might have been realized.

Consequently, the tax authorities have to await the result of the business transactions. Whether the entrepreneur is successful or not, whether he passed by opportunities for profit or did not control his expenses, all this must be accepted by the tax authorities. Their undoubted neutral position in the Netherlands towards the final results of business enterprise could be considered a special aspect of a universal legal principle to the effect that in general the law should be applied to the facts as they have occurred. This attitude of the tax authorities implies that fiscally the entrepreneur is free to determine his own management policy. In the Netherlands this neutrality towards business practice is maintained to such an extent that expenses incurred because of unlawful activities, such as fines, are deductible, while profits illegally obtained are taxed, which causes some people to accuse the tax authorities of immorality. In my opinion this accusation is unfounded. In order to be able to assess the actual financial capacity, the tax authorities must consider the facts, past or present, and should not enter into what ought to have happened.

Shift in public opinion: bribes and fines no longer tax deductible.

In the meantime, public opinion on this subject is shifting. One hears more and more demands that the illegal bribes and fines for illegal business transactions should no longer be treated as deductible. In a number of countries, for instance in the U.S.A., tax laws have been adjusted accordingly. I do not want to delve deeper into this subject, but will merely point out that, no matter how much illegal practices should be opposed, one should not close one's eyes to the fact that it would mean an infringement of the principle of freedom of enterprise in tax law, if such items were no longer deductible. [1] Weighing up the respective interests, I would rather that illegal practices be countered by means other than by an improper use of the concept of tax profit which should not, after all, be considered from an ethical point of view. In my opinion profit is a concept which varies in accordance with the development of social needs, aiming at a fair division of overall burdens while taking an objective view of the freedom of action and of evaluation of the entrepreneur.

A question which arises regularly is whether it would not be advisable to consider some specific expenses for luxury goods as non-deductible business expenses.

It is, for instance, the intention of President Carter — if the newspapers quoted him correctly — to make business lunches and dinners no longer completely deductible. To exclude certain expenses by specifying them, however, would mean an arbitrary interference in the concept of tax profit. It would be wrong in principle if the tax authorities were to be able to intervene in management policy, unless in a given situation intervention were called for because of the necessity for a fair division of tax burdens which would then prevail over the

1. Editor's note: see "Tax treatment of bribes" in 16 EUROPEAN TAXATION 382 (November 1976).

principle of neutrality with regard to enterprise and oblige the fiscal legislator to deviate from this principle.

My comments do not mean that an infringement of the principle of freedom of enterprise in tax law would never be justified, but that there would be a deviation from a generally prevailing system. I would describe this system thus, that economically profit should be considered as a remainder, which should be accepted as it stands as a source of taxation by the tax legislator and consequently by the tax authorities. The question arises as to in which cases the tax legislator might intervene in the principle of tax profit. To answer that question I should like to distinguish the main object of tax law from secondary objects and treat them here consecutively.

The main object of tax law is to raise revenue for the Government, secondary objects include affecting business decisions.

In my opinion the main object of tax law is to create room for government expenditure. This object entails a number of rules peculiar to tax law, which I have summarized before as the necessity to have a fair division of tax burdens.

I should now like to pay attention to those cases in which the tax legislator, on the basis of a secondary object of tax law, attempts to influence the final results of the management policy of the enterprise. This secondary object should then be considered of sufficient importance for the national economy to justify the use of taxation as a means to realise this object, even if it were at the cost of a fair division of tax burdens. In the fiscal literature this is referred to as tax incentives and tax expenditures. There are several examples in which the tax legislation, on the basis of such a secondary object, attempts to influence management decisions as, for instance, the investment incentives which have been adopted by many countries.

The purpose of these incentives is to exercise influence on business investment apparently with success. The tax legislator is then, of course, no longer neutral towards that particular aspect of business practice. But that does not imply that freedom of enterprise has disappeared because of this government intervention. Just as freedom of enterprise consists of selecting genuine possibilities from a number of alternatives while taking into consideration the positive and negative factors, this is also the case with freedom of investment, in which the fiscal investment incentive is neither more nor less than one of many factors influencing this choice, next to the wage level, the level of interest and the anticipated profit. Freedom of enterprise is not fundamentally affected by all this: the actual business activities are only affected by the investment deduction and perhaps not very strongly at that.

Sometimes business decisions are taken with a view to reducing the entrepreneur's tax liabilities.

While accepting on the one hand the fiscal legislator's influence on the entrepreneur's activities, on the other hand these activities can be directed by him towards an alleviation of his total tax burden.

Now I have arrived at business decisions with a fiscal object in view, which could be described more explicitly as decisions which are exclusively, mainly or partially directed towards influencing the legal relationship with the tax authorities. There are numerous other business decisions with a fiscal object or secondary motive such as establishing a company in a country with low taxation rates or investing with the object of acquiring investment incentives; decisions regarding the company's financial structure, participations, investments, insurances and many others and, generally speaking, activities with a view to securing the most favourable tax position in one or more countries.

The question arises to what extent the entrepreneur is free to make decisions which are mainly or partly aimed at influencing the legal relationship with the revenue authorities or, in other words, when is the entrepreneur overstepping legal bounds in his attempt to effect lawful tax savings. In this connection I would distinguish between "legal" and "moral" freedom, and pay attention to the legal aspect first.

Apart from fraud, which is obviously unlawful, and apart from bogus transactions, to which by definition the law cannot be applied, I assume that there is unlawful tax saving only in those cases where methods are used which, on close inspection and irrespective of the legal point of view, are considered to be artificial while the desired fiscal end is contrary to the purport of the law and the attained legal position does not in any real sense deviate from a position acquired through so-called normal channels.

Freedom of enterprise in searching for tax savings is legally limited. The entrepreneur is free to search for tax savings but will be transgressing "legal" bounds if he should act improperly. Thus it appears that such is the case if he should pursue tax savings contrary to the purport of the law and by means of an artificial method, leading moreover to a final result not or hardly different from any which could have been achieved through the normal channels.

In order to explain the "ethical" aspect I should like to expound on the element "contrary to the purport of the law". The purport of a law or legal regulation should be viewed in the context of the relevant section of the fiscal legislation as well as of the fiscal legislation as a whole. Now tax law is unquestionably very complicated in most countries. Its complexity does not only reflect a society with a sophisticated system of labour allocation but also the product of striving for perfection and the result of exaggerated expectations regarding the possibility of using taxation as an instrument for government purposes. One can definitely not maintain that the system is so clear-cut and comprehensive that it is always evident what tax should be paid according to the tax system. This applies both to the entire fiscal system and to the individual tax laws. Even if the entrepreneur as a member of society is, to a certain extent, morally co-responsible for the observance of the law, this responsibility decreases according to the extent to which

the fiscal legislation is less clear to him and is applied less strictly.

To answer the question whether, in principle, he is morally free to look for the fiscally most advantageous procedure — even if as a result less tax is paid, or revenues are paid at a later stage than is required according to the tax system — I repeat that the manner in which freedom of enterprise is used is bound not only by law and by right, but also by the concepts of morality and decency upheld by the society in which we live. In the quickly changing world we live in, concepts of morality and decency constantly vary. The entrepreneur, active in an important section of economic life, namely, the provision of goods and services, must constantly remain conscious of the difference between the concepts of today and those of tomorrow. In the last instance, however, he is the final judge of his own actions. This also applies to the question of how far he may go morally in his pursuit of tax savings. The legal freedom of enterprise within tax law is ultimately endorsed by the ethical freedom to decide, according to one's own personal convictions, where to draw the line morally in one's pursuit of tax savings.

What I have said previously about the relation between the taxpayer and the national tax authorities also applies to an international situation when more than one country and consequently various tax authorities are involved. That in many cases international tax planning is a matter of avoiding double taxation — notwithstanding the numerous treaties between nations — is still not readily understood by the public at large. Considering the far more complicated relations governed by international tax law I would say that the above is still more applicable in an international situation.

As far as the legal aspect is concerned, I would stress that the three points I have made are of a much more complex nature when viewed within international relations than within national tax law. As you will remember, these points are: the purport of the law, the question of whether an artificial method has been used, and the question of whether that method has led to the same result as if the normal channels had been used.

With regard to the ethical aspect, it is quite certain that the differences in opinion on ethics are even greater between individuals on an international basis than already exist at a national level.

Does this mean that within international tax planning there exist no limitations whatsoever from the legal or ethical point of view? No, indeed. This is not so. The principles which I touched on briefly before apply in the same way. The only difference is that it is more difficult to ascertain where the limits are.

However, where tax is fundamentally a price for government services then international tax planning means a sophisticated solution on the part of the entrepreneur and his advisors to this special aspect of the market mechanism, and finds therein its justification.

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The Definition of Gross Taxable Income in Schedular or Global Income Taxes*

by Prof. Dr. Sylvain R.F. Plasschaert**

I. INTRODUCTORY REMARKS

A. Schedular and global income taxes defined

From a structural viewpoint, two basic types of income tax systems can be distinguished. In a previous article the two basic types of income taxation were described as follows, as a first attempt:

- *in a* schedular *income tax system, each of the various* incomes *— such as salaries, dividends or business profits — that flow to the same taxpayer is subjected to a separate tax. In other words, the schedular system of income taxation consists of a co-ordinated set of separate taxes on various types of* income;
- *in a* global *income tax, all partial* incomes, *from whatever source, that accue to the same taxpayer are taxed jointly, as a single mass of* income;
- *a* mixed or composite *system consists merely of the juxtaposition of a set of schedular taxes and of a global-type tax, that both apply to the same income. Thus, a mixed frame of income taxation is not original, structurally speaking.*

It was also emphasized that, nowadays, a set of schedular taxes [1] *seldom exists in pure fashion. Usually, the schedular taxes are the mainstay (from a revenue viewpoint) in a so-called mixed system. In the latter, a complementary tax on global income is added to the schedular taxes. It follows that if a taxpayer obtains income subject to a given schedular tax, say, the wage tax, the same income item is, in addition, taxed by the complementary tax — provided that income exceeds the exemption level specified in the complementary tax.* [2]

B. Tax design and compatibility test

Any income tax system, whether of schedular or global mold, ought to provide technical answers to such questions as how to define the taxable object and the taxpaying unit, the geographical reach of the country's fiscal claims, the applicable tax formulas (rates), etc. The techniques used in those different segments of the income tax law must not only be consistent among each other, but also be compatible with the tax canons which the legislator intends to implement. In other words, the tax parameters must meet what we may call a "compatibility test". In fact, the same test can be applied to the schedular and global frames of income taxation respectively which, in essence, are technical devices. One may ask, for example, whether the schedular set-up is compatible, in a rational system, with the ability-to-pay principle. By a rational system is meant the set of technical arrangements, i.e. of the tax design, that allow implementation of intended tax principles, without entailing inconsistencies and distortions.

The above does not imply that only one technique is available to implement a given tax principle. Progressive rate scales, for example, can be modulated in many different ways. One should also remember that existing or historical phenotypes of income taxation do not entirely conform to the rule-book or rational prototypes. In case the actual arrangements deviate from the prescriptions of a rational system, it is worthwhile to ascertain why such divergencies occur; there may, for example, be a trade-off between two tax principles, such as when deductions, intended as an incentive towards savings, conflict with the ability-to-pay principle.

On account of the great variety in (a) tax techniques, (b) tax canons, as adhered to in different countries, and (c) the wide dispersion in economic, political and cultural circumstances between various countries, it is advisable to have a look at the arrangements adopted in a number of existing income tax systems. Such an approach usefully complements the teachings of public finance theory. Hence, the Appendix illustrates how in a selected number of countries the definition of gross taxable income has been designed. The selection comprises both developed and developing countries.

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* This article is part of an extensive enquiry into the tax design and tax policy aspects of alternative income tax patterns, with particular reference to developing countries.

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1. *Sylvain R.F. Plasschaert,* "First Principles about Schedular and Global Frames of Income Taxation", Bulletin for International Fiscal Documentation 1976, No. 3, p. 99-111.
2. A variant is the present Mexican system, outlined in the Appendix, in which, depending on the level of the total taxable income, either schedular taxes or the global tax apply.

C. Taxable gross income

The first step which is required in designing a system of income taxation consists in ascertaining gross taxable income, i.e. which receipts, for tax purposes, are to be viewed as income.

No tax design problem, except perhaps the treatment of the corporation, has elicited as much literature and discussion, both on the academic and the political level. No such extensive analysis of the stubborn problem of defining gross income can and should be attempted here. Before discussing the conformity of given definitions of gross income with the respective schedular and global prototypes, and examining whether developed and developing countries tend to behave differently, a summary of the conflicting theories that have been evolved to define gross taxable income, of their relevance and limitations, is in order.

II. TWO DIVERGING THEORIES

The proper definition of gross taxable income was, long ago, the subject matter of considerable debate and give rise to two competing theories. A considerable number of publications was devoted to it in Continental Europe, especially in Germany, during the latter part of the 19th century. In 1938, in the United States, Henry Simons canvassed most of the relevant German-language literature and added some valuable insights of his own. [3]

The two theories are known respectively as the "Source Theory" ("Quellentheorie) and the "Net Accretion Theory" ("Reinvermögenszugangstheorie"). In theoretical writings, nowadays, there is general consensus that only the net accretion theory provides adequate tax criteria. And, yet, we shall be led to discover that, in existing tax systems, the net accretion theory is far from being fully implemented — a fact which calls for explanation.

A. The source theory

The "source theory", which has been defended by Adolf Wagner amongst others, was described as follows by Fritz Neumark: "only those receipts should be viewed as components of (taxable) income which arise from a "source" whose permanence allows for the regular flow of the receipts". [4] The source theory, however, is not monolithic. Various scholars, especially among the early writers on the subject, postulated that the flow of receipts from a given permanent source should also be regular. As against such a restrictive version, the more widespread view, as represented in the citation from Neumark, posits that even irregular receipts are taxable, provided the source from which they originate has a permanent character. For example, to the novelist, the proceeds from a best-seller, while normally an exceptional event would then be included in gross taxable income, on account of the permanent availability of literary talent and the fact that literary output can be repeated ("Wiederholbarheit"). While the expression "source" is by no means perfectly clear, it is usually linked to the traditional categories in the functional distribution theory, i.e. land, capital, labour and entrepreneurship.

This source approach fundamentally contrasts yields to a permanent source, or, in other words, income to capital. Seltzer has noticed that this conception derives from the "harvest tradition" in agricultural societies, where land produces its fruits at regular intervals. [5] In that conception, the appreciation in the value of the capital itself, or, the so-called capital gains, should not be subjected to income tax. Not the value of the capital but its yield, not the appreciation of the tree but the value of the fruit is the proper object of taxation.

The non-taxability of non-recurrent receipts, such as lottery proceeds and more particularly of capital gains, that cannot be traced to one of the traditional permanent sources of income was objectionable to a great many scholars. Such gains do provide spendable income, indeed. Their irregular occurrence should not prevent taxability. Some ethical connotation is also involved. A person who realizes with no effort a substantial gain when selling land which he inherited twenty years ago and who has benefited from the increase in land value as a result of the suburbanization process should not be favored as against the salary earner. Such discrimination usually offends accepted feelings of equity.

B. The net accretion theory

In a topical article, in 1891, Georg von Schanz enunciated the "net accretion theory", by defining gross taxable income as follows: "hence, we include in income all net proceeds and benefits ("Nutzungen"), the money value of services rendered by third persons, all gifts, inheritances, legacies, lottery gains, payment of insurance capital and annuities, cyclical gains of whatever sort ("Konjunkturgewinne"), we deduct all interest liabilities and capital losses".

This definition proceeds in a casuistic manner, by way of itemizing a variety of taxable receipts, many of which would normally be disallowed under the source theory. Schanz wanted to convey a dual message. First, taxable gross income is a comprehensive concept. It includes capital gains and, more generally, irregular, "windfall" receipts. Besides, as a corollary to the taxability of capital gains, the statute should provide for the deductibility of losses on capital assets.

Subsequently, other scholars have attempted to reformulate Schanz' Reinvermögenstheorie in an analytically

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3. *Henry C. Simons*, "Personal Income Taxation", University of Chicago Press, Chicago 1938. In the same year, another American scholar, *P.M. Wueller*, in "Concepts of Taxable Income", Political Science Quarterly, March 1938, December 1938 and December 1939, exhaustively surveyed the contributions of German, American and Italian scholars.

4. *Fritz Neumark*, "Theorie und Praxis der modernen Einkommensbesteuerung", Bern 1947, p. 38. (Non-English texts, cited throughout this article, were translated by the author).

5. *Lawrence H. Seltzer*, "The Nature and Tax Treatment of Capital Gains and Losses", National Bureau of Economic Research, New York 1951, p. 103-108.

more satisfactory fashion. *R.M. Haig*'s formulation (1921) has become widely quoted in the United States. Income is: "the increase or accretion of one's power to satisfy his wants in a given period in so far as that power consists of (a) money itself or, (b) anything susceptible of valuation in money terms". [6] In other words, receipts in kind should also be taxable. Besides, Haig stresses the fact that the addition to purchasing power, from whatever origin, is the relevant criterion.

Henry Simons defined personal (gross taxable) income as: "the algebraic sum of (i) the market value of rights exercised in consumption and (ii) the change in the value of the store of property rights between the beginning and end of the period in question" (p.50). Or, "in other words, it implies estimate of consumption and accumulation" (p. 48). In the same vein he writes: "the essential connotation of income, to repeat, is *gain* [Simon's italics] — gain to someone during a specified period and measured according to objective market standards" (p. 51). [7]

In our view, a more useful definition of the net accretion theory, which avoids some of the vague expressions in the citations above, is given by *John Due*. Gross taxable income contains three ingredients:

"(i) the total amount received from other persons during the period,
(ii) the value of consumption activity enjoyed by the person, which does not involve receipt or money or goods from other persons during the period,
(iii) the increase in the value of assets, held during the period". [8]

These components relate to areas in which the problems of defining gross taxable income have proven more stubborn. Due's first ingredient covers not only cash receipts but also *receipts in kind* in consideration of the services rendered by the taxpayer himself (labor input) or by his capital assets. Due's first sentence can also be interpreted as encompassing so-called *transfer receipts*, such as social security benefits, which are obtained without any *quid pro quo* from the taxpayer. Due's second category refers to so-called *imputed income*, whereby the taxpayer is both the producer and the consumer of a given commodity or service. By definition, no market transaction is thereby involved; yet, the "enjoyment" by the taxpayer amounts to the avoidance of an outlay which otherwise he would have to defray in order to purchase the commodity or service on the open market.

We shall briefly mention some of the difficult problems, both conceptually and in terms of implementation, that arise with respect to each of the above items. We focus primarily on capital gains, the area where the source and the net accretion theories basically diverge.

III. LIMITATIONS AND AMBIGUITIES OF THE NET ACCRETION THEORY

A. Income in kind

When remuneration for services rendered is paid for in kind, instead of cash, difficult evaluation problems arise. In given cases, one may wonder whether such receipts-in-kind should be taxed at all, even when one adopts the tenets of the accretion theory. Free luncheons, for example, should, in principle, be taxable. They add to real income of the employee, as they substitute for basic expenses which otherwise would have to be defrayed out of his own packet; they are an element of "indirect" salaries or wages. Already, the question arises whether they should be evaluated at cost to the employer or in terms of the probably higher sum which the employee would pay if he had to go to a restaurant. The problems become even less manageable when a business executive is entertaining his business contacts in the fanciest restaurant in town. Such "expense account" entertaining may be quite conducive to fruitful business contracts and results, and the executive may feel elated in having access, at no cost, to upper-class restaurants. Yet, he may also view the dinner-party as a tedious obligation and fear the damage to his liver. Should the price of the menu be included in his gross taxable income? Or should he be taxed only at the price of a more modest dinner which he would have ordered if he had not been "on duty" and which represents the cost-saving which the business dinner has made possible? Should the perquisite be taxed at all, as the cost is primarily incurred in the interest of the employer?

Similar examples could be construed almost *ad libitum* and have been described by some writers at length, and with obvious delight, indeed. Kleinwächter, for example, mentioned the Kaiser's Flügeladjudant, who accompanied his sovereign to the Opera but was allergic to music. [9] Such cases are picturesque but as, fortunately, they are unimportant in aggregate terms and even to the enjoyer-of-income-in-kind, they may be rightly overlooked by the legislator. Perfectionism would be self-defeating, anyhow.

Yet, even with due regard to the difficult valuation problems involved, a blanket exemption of income-in-kind, received in consideration for services rendered or commodities transferred to others, cannot possibly be rationalized. Such overall exemption would transgress the principles of both the source and net accretion theories. This can adequately be demonstrated by the two following cases. First, if the above-mentioned fringe-benefits to employees, and especially to executives, were not subject to taxation with the recipient and remained fully deductible with the company, tax-avoiding schemes of remuneration, with large fringe-benefits content, would be eagerly devised. Understandably, most countries have taken action to strictly control, taxwise, such benefits-in-kind. Second, in a great many de-

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6. *Robert M. Haig*, "The Concept of Income — Economic and Legal Aspects", in Haig, ed., "The Federal Income Tax" Columbia University Press; reprinted in *Richard A. Musgrave* and *Carl S. Sharp* in "Economics of Taxation", Irvin 1959, p. 59.
7. *H.C. Simons*, cit., resp. p. 50, 48, 51.
8. *John Due*, "Government Finance", Idlewood, Ill., 1954, p. 134-135.
9. *Friedrich Kleinwächter*, in his "Das Einkommen und seine Verteilung", Leipzig 1896, as cited by *H.C. Simons*, cit. p. 53.

veloping countries, such as the heavily-populated Indian subcontinent, the (high) rents paid by the tenant tend to be discharged, to a large extent, in kind by way of sharing the crop with the landlord. Considering the highly unequal distribution of land and of incomes in many developing countries, the exemption of such income-in-kind would obviously be inequitable and remove a sizeable portion of the national income from the reach of taxation.

The arrangements in actual tax laws tend to be pragmatic, even at the risk of not conforming well to theoretical principles. In many countries, meals and other benefits granted to employees freely or at concessional prices tend to be exempted for the recipients and are even encouraged by affording some degree of deductibility for the company. In India, statutory provisions with respect to fringe benefits and other perquisites are quite elaborate, whereas in Mexico the same perquisites appear largely and explicitly to escape taxation.

B. Transfer incomes

Such incomes are here defined as those which are received by the taxpayer from other persons or through the government, with out any *quid pro quo*. They result from a secondary circuit of income distribution which somewhat alters the primary one, whereby the taxpayer receives income on account of his role as a producer. Two typical examples may be cited. Alimony payments are normally legally due by the divorced income-earner to his non-working spouse and the children in her custody. Various benefits that are meted out through more or less comprehensive (in terms of workers covered and types of benefits) social security systems have become quantitatively much more important.

In the case of alimony payments, purchasing power is transferred from the husband to the spouse and the latter's household. The compulsory nature of these payments and common sense would anyhow overrule any strict interpretation of the source theory whereby income would remain taxable when and where it originates in the primary production cycle, i.e. with the husband. Social security benefits, such as family cash subsidies, would also come, in principle, within the compass of gross taxable income as they are ingredients of indirect wages and salaries. According to the net accretion theory any reshuffling of primary income distribution patterns through secondary redistribution schemes should be acknowledged and income made taxable with the ultimate income recipient. In both cases, and under either theory, the husband, employer and employee, contributors to the transfer incomes would be entitled to deduct the sums paid or contributed from their gross income. [10]

Thus, on the level of basic tax principles, transfer payments should not create any major problem. Income should be taxed, and only once, with the income recipient. And yet, existing systems frequently exempt social security benefits, without disallowing the deductibility of the contributions made. In countries as diverse as the United States, Mexico and Colombia, for example, fairly whosesale exemptions of social security benefits exist.

Such exemptions may be rationalized by the social objectives they intend to foster and by the fact that, if the benefits were taxable, the government might have to compensate by raising the amount (before tax). In similar fashion, family cash subsidies in countries with low birth rates may be linked to demographic objectives. It is clear, however, that one item of purchasing power and of income is thus withdrawn from the gross income tax base. Besides, as global-type systems should rationally feature progressive rate scales and treat the household as the taxpaying unit, the exemption of, say, family allowances does entail some distortion in the tax liabilities of households with the same number of dependents but at different levels of total income, as the higher-income unit would benefit from a proportionately higher reduction in its tax liability.

C. Imputed income

The receipts comprised in Due's third category also accrue in kind. But imputed receipts raise an additional difficulty. They do not arise from a market transaction, at arm's length, between unrelated parties, but imply the production and the consumption of a commodity or a service by the taxpayer himself.

Tax legislators have, on the whole, restricted their claims to two fairly important items of imputed income. The first relates to the services which dwellings yield to the occupying owner. If he did not occupy his house, he would have to rent another house in order to meet the need for shelter; or he could have rented his house to a tenant. Obviously, any income tax should tax the (net) cash and income-in-kind from rented dwellings. Exemption of the services from owner-occupied dwellings does discriminate against tenants and in favor of occupying owners. Countries such as Belgium, Italy and Colombia do impose the imputed income from owner-occupied dwellings on the basis of a notional, rental value, which in principle is intended to approximate the (net) cash rents which owners obtain from dwellings of similar location and quality. A system of cadastral records becomes a prerequisite for an efficient implementation, but cadastral records are frequently deficient. In the United States and many other countries, the imputed rents remain tax exempt.

Another major item of imputed incomes consists of the agricultural products, particularly food, which are not marketed but are consumed on the farms themselves. In recent decades, in high-income countries such auto-consumption has tended to substantially decline. [11] In low-income countries, however, with a dominating agricultural sector, auto-consumption is relatively much more

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10. Problems deriving from a time lag between the contributions made and the benefits enjoyed by the same person are ignored.

11. According to Department of Commerce estimates, the value of food and farm produce in the United States declined from 6.3 percent in 1950 to a mere 1.4 percent in 1970. See *Richard Goode*, "The Individual Income Tax", revised edition, The Brookings Institution, 1975, p. 142.

important. [12] Some countries do attempt to reach such income-in-kind albeit quite inadequately and through simple rules of thumb. The prevalence of low-income peasantry in developing countries, anyway, greatly reduces the wisdom of such an approach, as such income-earners should largely be left out of the reach of the income tax, both on equity and on administrative grounds.

The criteria that justify the taxability of imputed incomes emerge from the two previous examples. The income a person obtains from making available factors of production — land, a housing unit or his labor force — to somebody else is taxable, beyond any doubt. The commodities and services that accrue to the producer-consumer "in a closed circuit" should not escape taxation on account of their origin outside the framework of the (interpersonal) division of labor that characterizes modern society. As a matter of fact, the auto-consumption which such person enjoys allows him to economize on consumption outlays in the market.

But, according to the same logic, a great many items beyond the two above-mentioned cases would, in principle, have to be brought under the gross income concept, including the services which self-use of various consumer durables — such as cars, refrigerators — yields to its owner. Equally, the vegetables grown in one's garden add to the owner's income, when consumed. What about the flowers? They economize on purchases in the market. But perhaps the owner would not buy flowers, anyhow. And should the product of his gardening, practised as a hobby, outside his office hours, also be made subject to taxation? If the answer is yes, the (net) expenses which men economize by shaving themselves, instead of availing themselves of the services of the specialist, i.e. the barber, could also be held taxable. Along the same lines, the cost-saving which the wife's services allow to the household would also qualify for inclusion. For, as Vickrey notices "if two housewives were to do each other's work for pay, the income under present laws would be greater than if they each do their own work". [13]

In actual fact, existing tax laws do not extend the reach of the income tax to the types of imputed incomes mentioned in the preceding paragraph. The reasons are manifold and fairly obvious. First, the value of many items is comparatively small and would not be worth the substantial trouble which the assessment would involve. More importantly, one reaches areas of human activities in which the borderline between production and leisure-enjoyment becomes tenuous. At those outposts of the income concept, the inherent "welfare" connotations of income cannot be approached in easily quantifiable categories of physical output, but differences in psychic dispositions and the taxpayer's preferences between production and leisure would have to be taken into account. Such endeavors would engage the tax authorities in next to impossible evaluations which excessively intrude on privacy.

Anyhow, somewhere, and on pragmatic grounds, the boundaries of the taxable domain with respect to imputed goods and services would have to be drawn. And no clear-cut criteria would be available, as the definition of income itself, when extended as in the net accretion theory to the consumption of goods and services, remains uncertain and somewhat ambiguous — as economists readily admit. [14]

D. Capital gains

As already intimated, the main difference between the source and the net accretion theories relates to the taxability of capital gains. As the latter are non-recurrent and do not flow from a permanent source, they should not be subject to income taxation, according to the source theory, whereas they are rightly part of taxable income, on the premises of the net accretion theory. And yet, as documented in the Appendix, despite some discernible tendencies towards inclusion of capital gains in the income tax network, no country, to our knowledge, has succeeded in or even dared to fully implement the net accretion theory, which implies taxation at ordinary income tax rates of the full spectrum of capital assets.

The many reasons for the wide gap between theory and practice are more technical than conceptual. As a matter of fact, capital gains could be comprehensively assessed if each taxpayer were to keep a "balance sheet" of his assets. They would be listed and evaluated every year. The appreciation during the taxable year would constitute the total capital gain, after deducting any losses on capital assets. There would be serious evaluation problems, especially as regards assets that are not commonly brought to market, but some rules of thumb could conceivably be applied. This approach to capital gains accruing to the individual taxpayer would in essence be similar to the one commonly adopted in most countries to corporate bodies which maintain orderly balance sheets. Such enterprises lend themselves to the assessment of profit taxes on the basis of the changes in net wealth between two tax assessment dates, recorded in the balance sheets. The taxable profits, then, encompass both the ordinary profits and the capital gains on the assets used in the business unit. In fact, as shown in the Appendix, several countries proceed in that way. Capital gains are then a component of total income and are taxed on an accrual basis, i.e. imposition of the gains is not conditional upon actual realization — sale or exchange — of the asset.

Obliging individuals to maintain accounting records as to the value of a great many capital assets — such as household appliances, furniture, etc. — would be utterly unenforceable and politically unacceptable. Such an approach would also extend the reach of taxation to gains on assets that are not held for investment but that yield consumption services. Consequently, the taxation of

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12. Household budget survey in Tanzania, carried out in 1969, found that about 40 percent of total income and 65 percent of food and drink was in-kind. See *Yukon Huang*, "Distribution of the Tax Burden in Tanzania", Economic Journal, 1969, I, p. 73-86.

13. *William Vickrey*, "Agenda for Progressive Taxation", The Ronald Press, New York, 1947.

14. See *Nicholas Kaldor*, "An Expenditure Tax", Allen & Unwin, 1955, p. 54-78.

capital gains as regards individuals tends to be restricted to a few, selected capital assets among which real estate and securities are by far the most prominent.

But, even then, the application of the accrual criterion cannot easily be implemented. First, as already indicated, the taxpayer would have to evaluate annually the taxable assets. While an easy task for securities listed on the stock exchange, such assessment would be based on less objective standards for assets which are not traded on open markets, such as real estate, with their greatly differentiated locational and other features.

Besides, accrued capital gains only produce cash when the capital assets are sold, i.e. realized. The need for liquidity to pay tax may therefore force the taxpayer to liquidate his assets prematurely and in less favorable circumstances. For those reasons, capital gains legislation tends to hit only realized capital assets — at least as regards individuals, not companies.

But adoption of the realization test, in turn, raises another thorny problem. Although the gain may have matured over a span of many years, the "bunching" of the gain in the year of realization entails heavy tax liabilities, when progressive rates apply. This drawback, however, could be alleviated or even eliminated by averaging schemes, which base tax liabilities on the average income over a number of years. [15]

Under inflationary conditions, nominal capital gains may be largely illusory. This may, however, be remedied, by an upward adjustment of the base, i.e. of the initial value of the capital asset by an appropriate index. But assets differ greatly in their ability to offset inflation through higher prices.

Transfer of ownership by way of inheritance raises a problem. If such a transfer is not deemed to be a realization, capital gains (some of them substantial, as they have matured during the life of the decedent) would be left untaxed. Actual income tax practice, however, generally forsakes taxing the gains at the time of death, as such property is normally subjected to death or inheritance taxes. The latter, however, are a species of wealth taxes whose base is the current value, not the appreciation in the value. Similar remarks apply to gifts of appreciated and taxable capital assets. [16]

To this incomplete list of the difficulties involved in the taxation of capital gains, various economic considerations should be added. However, the available empirical findings on the allegedly negative impact of the tax on such economic variables as the turnover rate of assets or risk-taking are controversial. [17]

In the circumstances, the finding, in countries where conscious attempts are made to impose capital gains, that the statutory provisions are very complex and that the actual arrangements differ greatly between countries should not come as a surprise. In the Appendix, the main features of actual tax regimes with respect to capital gains are recorded for a selected set of countries.

One should add that the revenue significance of capital gains taxation is usually very limited. In the U.S.A., in the 1950-1968 period, the yield from capital gains tax only averaged 5 percent of the proceeds from the individual income tax. [18] In France, the additional yield from capital gains taxation, in 1976, was officially reported as quite minor. The limited contribution to tax revenue also stems from the need to allow realised losses on capital assets to be deductible as an indispensable counterpart to the imposition of capital gains, if (interpersonal) equity is to be preserved.

And yet, the same considerations of equity provide a strong case for taxing capital gains as comprehensively as appears feasible. Otherwise, receipts are left untaxed which do provide the taxpayer with spending power and which are frequently obtained through a stroke of luck and/or with little effort. Such "unearned increments" should not receive preferential treatment. Besides, capital gains tend to be heavily concentrated in the higher income echelons, as evidenced by data on the United States and on Colombia. [19] Leaving them unscathed, taxwise, would undermine the intended vertical distribution of tax burdens, which a nominal scale of progressive rates obviously intends to achieve. Exemption of capital gains also allows the avoidance of taxes on distributed company profits. As a matter of fact, retained company profits tend to improve the market value of shares; upon the sale of the shares, the incremental value could then be realised, tax-free.

IV. DEFINITIONS OF GROSS TAXABLE INCOME AND TREATMENT OF CAPITAL GAINS IN ACTUAL INCOME TAX SYSTEMS

Amidst the thick forest of various statutory arrangements that are surveyed in the Appendix, it is not easy to discern the paths of more generally applicable principles or yardsticks. But the following findings appear to be well substantiated.

A. Definition of gross taxable income

None of the statutes surveyed, and indeed no other country, to our knowledge really adopts one of the academic definitions, discussed above. Two different for-

15. On problems and devices for averaging fluctuating incomes, see, among other sources, *R. Goode*, cit., p. 192-193 and a set of contributions in "Compendium of Papers on Broadening the Tax Base", submitted to the *Committee of Ways and Means*, U.S. Government Printing Office, 1959, Volume I, p. 579-678.

16. Perhaps the most ambitious proposals for a comprehensive imposition of capital gains were formulated by the so-called *Carter Commission in Canada* (1967). Realized capital gains would become taxable at ordinary income tax rates. Transfers at death or by way of gifts would be construed as realisations. Gift and estate taxes would be abolished. See, for a summary of the proposals, "Excerpts from the Report of the Royal Commission on Taxation", *Canadian Tax Journal* 1967 II. The proposals with respect to capital gains were not implemented by the Government.

17. For an appraisal of the empirical studies in the United States, see *Richard Goode*, "The Individual Income", cit., Ch. 8. See also, *Gary P. Gillum*, "Capital Gains — Perennial Subject for the Tax Reform Debate", Federal Reserve Bank of Philadelphia Business Review, September 1973, p. 3-11.

18. *R. Goode*, ibid., p. 187.

19. *R. Goode*, ibid., p. 188 and (with respect to shareholdings)

mulas appear to be in use. According to the first approach, which is adopted in the United States, a rather losse enumeration of taxable items, comprising a catch-all clause, is given. This allows a wide scope for income tax, but remains vague in some respects. The residual clause is intended to avoid any overtly restrictive interpretation of the realm of taxable receipts.

In another approach, gross income is defined as the sum total of various incomes, assessed in exhaustively listed categories, which may be called "heads" (India) or "schedules" (Great Britain). The connotation is that incomes which cannot be interpreted as belonging to one of the schedules are left untaxed. But the tax legislator has taken care to provide for a residual category, where specific items can be located. Yet, most of the countries surveyed have attempted to extend the reach of gross taxable income beyond the confines of the source theory proper, although the practical and conceptual difficulties, already mentioned, seriously constrain the implementation of the broader concept of income. In a way, the restriction of income taxation to specifically enumerated items can be viewed as a remnant of the schedular approach to income tax. However, as will be recalled at a somewhat later stage, a global tax base can only be construed by way of adding the different items of net income flowing to the same taxpayer.

One should not at all exaggerate the discrepency between the two approaches. The most important and traditional categories of receipts, such as wages, profits or rents, are unquestionably part of gross taxable income. When the second approach, i.e. the exhaustive itemization, is adopted, an extension of the objective reach of the income tax is easily achieved by way of specifically locating the corresponding item in a special category or schedule — as happened in Great Britain in recent years with respect to capital gains and lottery proceeds. And finally, for borderline cases, one must closely investigate how tax law and judiciary interpretation shape the tax treatment of a particular item.

B. Capital gains

The statutes, surveyed in the Appendix, also show a great variety in treatment, but some fairly general features or major alternatives nonetheless clearly emerge. Capital gains, when realized or recorded within a business unit, now appear to be taxable, although in many countries (among them, the United States) at a separate, preferential rate. As regards individuals, some countries (e.g. Belgium) do not have a generalized system of capital gains taxation. Elsewhere, as in the United States and the United Kingdom, a large set of private capital assets are subject to tax, but at rates — which considering the concentration of the capital gains in the higher income echelons — are usually concessional. Several countries attempt to distinguish speculative and investment gains: only the length of the asset-holding period appears to provide an operational criterion to distinguish between those two categories.

All in all, there appears to be a trend towards inclusion of capital gains, albeit in a haphazard fashion and at preferential rates. Such a differentiated statute significantly adds to the complexity of income tax legislation, the more that concessional treatment, and *a fortiori* exemption of capital gains, provides a strong inducement to clothe some transactions in the capital gains instead of the ordinary income category, particularly as the borderline between the two categories is rather blurred in some cases.

V. EXEMPTIONS FROM GROSS TAXABLE INCOME

For proper perspective, the steps undertaken, so far, in our analysis, should be recalled. Defining gross taxable income is the first, unavoidable task for the income tax draftsmen. Although fiscal economists have convincingly stated the case for a comprehensive concept of gross taxable income, it was found that the existing laws adopt an essentially pragmatic attitude. The combination of conceptual ambiguities, technical constraints and economic considerations results in a situation whereby several receipts that are conceivably part of gross taxable income are tacitly left untaxed — or, as in the case of capital gains, given special treatment.

Exemptions, as the term is usually understood in fiscal jargon, also refer to untaxed receipts. But the difference from the above untaxed items lies in the fact that exemptions represent items which the statute explicitly frees from the income tax, although they unquestionably qualify as gross income. Exemptions are also conventionally distinguished from deductions and allowances. The latter also result in amounts of income becoming freed from income tax, but they result from steps which reduce gross taxable to net taxable income.

Exemptions may be granted to specific items of receipts or to given sets of taxpayers. It would be of little relevance for our purposes to attempt a full listing of the large number of exemptions contained in the actual tax statutes of the countries covered in the Appendix. A few illustrations may be given. In many countries, interest from government bonds, or from specific issues or types of saving instruments, are exempted. As already mentioned, social security benefits also tend to be exempted, in a wholesale fashion. Some exemptions may be peculiar to given countries. In Colombia, for example, Catholic priests are exempted. A pseudo or partial exemption is granted in Mexico on profits from publishing books.

Exemptions should be based on solid arguments. They carry a cost, as they imply some distortion in vertical and horizontal tax burdens. Hence, a conflict between different objectives arises and a trade-off becomes unavoidable. The need to promote savings and real capital accumulation, on the one hand, and equity, on the other hand, provides a well-known and frequent example. If equity is based on the principle of ability-to-pay, it follows that the progressive tax rates should be administered to the taxpayer's total (net) taxable in-

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Andrew C. Quale, jr., "The Capital Gains Tax" in Fiscal Reform for Colombia. Final Report and Staff Papers of the Colombian Commissions on Tax Report, Harvard Law School, International Tax Program 1973, p. 349-86.

come. If receipts are explicitly exempted, the theoretically valid perimeter of taxable receipts is narrowed. Given the concentration of income with well-to-do taxpayers, exemptions normally result in proportionally larger tax reductions to higher than to lower income classes.

VI. GROSS TAXABLE INCOME DEFINITIONS AND THE SCHEDULAR OR GLOBAL PROTOTYPES

We may now attempt to answer the question whether the adoption of a schedular or global approach to the design of an income tax system, also calls for a specific definition of gross taxable income. More specifically, should one conclude that the source theory conforms to the schedular approach, whereas the net accretion theory meets the conformity test with respect to the global system? The following remarks, in our view, allow a qualified answer.

First and foremost, the taxpayer's total income, which the modern income tax ought to reach, results from the aggregation of various (partial) (net) incomes, in the event a given taxpaying unit obtains income from various "sources". The different taxable receipts or the partial incomes, not total income, are originally given: those items of income are prior, both logically and chronologically, to the taxpayer's aggregate income. Furthermore, each of those taxable receipts displays some specific economic features (e.g. profits are a residual, calculated by subtracting production costs from gross receipts) and assessment possibilities or difficulties (wages and dividends, for example, can be taxed at source, profits not). Hence, unavoidably, even in a global-type system, the tax statute contains rules differentiated between types of income.

The difference between the schedular and the global system is, so to say, of a "second order" nature. In the words of a previous article:

> ". . . Hence, there exists a *first-stage concordance* between schedular and global income tax systems, in the sense that both require the "analysis" or identification of (partial) incomes, that may accrue to a given taxpayer. Once those partial incomes have been identified, however, the two income tax systems part ways and display a *second stage dissimilarity*. According to what we might call the "schedular principle" — or, at the cost of a neologism, the "compartmentalization principle" — each of the various types of income is assessed separately and subjected to the rate set in the corresponding schedule. When the "global" or, "aggregation-principle" prevails, the assessment proceeds with a "synthesis" of the primary schedular incomes and subjects their sum total to a single progressive rate scheme." [20]

It follows that, in essence, there is no foundation in the claim that a global system necessarily postulates the net accretion theory and the taxation of capital gains, whereas the more restrictive source theory would be inherent in the schedular system. As some of the examples in the Appendix suggest, even at a fairly early stage some schedular systems provided for the taxation of capital gains, whereas several global systems refrained for a long time from taxing capital gains. Not the width of the income concept, i.e. the number of taxable receipts, but whether those incomes are taxed separately or aggregately determines the schedular or global character of an income tax system.

And yet, one cannot deny all affinity between the two prototypes of income taxation and the two competing concepts of gross taxable income. The aggregation of (partial) incomes under the global tax intends subjecting total (net) taxable income to a progressive tax. Both this aggregation and the progressive rates are instruments to distribute interpersonal tax burdens, vertically and horizontally, according to the ability-to-pay principle. All incomes, all the purchasing power flowing to the taxpayer, contribute to that ability-to-pay (taxes). Hence, the global-type system logically asks for as comprehensive a gross income concept as feasible. Hence, the taxation of capital gains is an inherent ingredient of a global prototype. As indicated in Sec. III, however, practical constraints and conceptual ambiguities do not allow the ful implementation of the comprehensive income concept, à la *Simons*, not even as regards capital gains. In many global systems the imposition of capital gains at preferential rates, in fact, introduces a schedular element (i.e. a separate rate for a given income category) in an otherwise global structure.

There also exists an affinity, to a degree, between a schedular frame and the source definition of income. Admittedly a schedular system would still retain the same basic form, if an additional schedule, on capital gains, were added. In some developing countries today, and at earlier times in some developed countries, some types of capital gains are or were brought within a schedular income tax system. But the schedular prototype is quite compatible with a more restrictive concept of taxable income. In a schedular system, as emphasized at length by the earlier German fiscal theorists, the emphasis is on the tax object and on the moment income is produced. Schedular taxes, according to those authors, are close to, or even coterminous with, "taxes on produce" (Ertragsteuern) which do not take into account the personal circumstances of the taxpayer. [21] Equally, in the source theory, the "objective" side of taxation is also stressed. As mentioned with respect to imputed income, attention is centered on the production of the goods and services that give rise to income.

When looking at existing tax systems, one notices that schedular taxes (despite the possible adjunction of a complementary global-type income tax) did adhere mainly to the source theory. This coincidence is not without significance. In our view, however, the link is not a direct one but should be related to a less advanced

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20. *Sylvain R.F. Plasschaert*, ibid., p. 102.

21. The German authors have mainly approached this issue within a stage theory of fiscal development. The use of the term "Ertragsteuern" is not monolithic. For example, *Fritz Neumark*, in his writings, tends to view schedular taxes as Ertragsteuern, not as genuine income taxes.

level of development. It was mentioned earlier that the source theory seems well suited, intellectually and operationally, to a predominantly agricultural society, in which, apart from rural and urban real estate, there are fewer types of other capital assets. On the basis of the historical record, schedular prototypes appear to be typical for countries at less advanced levels of development, as suggested by the shift in quite a few countries in recent years from a schedular-mixed to a global prototype. [22] But it would be misleading to carry this argument too far. The prevalence of the schedular pattern cannot only be explained by "objective" economic variables, but also owes much to "cultural" factors. The schedular prototype is typically a Latin phenomenon, both in Southern Europe and in those (present-day) developing countries in which the administrative and fiscal set-up was profoundly shaped by French and Spanish influences.

VII. THE DESIGN OF GROSS TAXABLE INCOME IN DEVELOPING COUNTRIES

The question here is whether on the positive level there appears to be a systematic difference in the tax arrangements of developing as compared to highly-industrialized countries with respect to the definition of income, and whether, in normative terms, the developing countries should be advised to adhere to a specific concept of taxable gross income. We may restrict the discussion to the main issue that emerges from the previous discussion, i.e. the taxability of capital gains.

The Appendix contains some indications of the actual statutory arrangements in a few developing countries, but that sample is too small to draw solid conclusions. Fortunately, a 1968 article has covered the capital gains matter in greater detail and on the basis of the experience of about 20 developing countries. [23]

Typically, even in developing countries with a global system the taxation of capital gains — other than those on business assets, which are normally taxed as ordinary corporate profits — tends to be restricted mainly to gains on real estate; in some cases, only urban real estate is encompassed. Only in a few countries, as in India, are gains on the realization of securities made taxable.

This almost exclusive emphasis on real estate is quite understandable. In less industrialized societies, real estate is the main category of wealth, as evidenced by some statistical data. [24] Its yield may be fairly high, particularly in rapidly expanding cities or where the cultivable land/population ratio is low. Real estate ownership is highly concentrated in upper-income classes. In fact, the implementation of an effective land reform is held by several development economists as a deterrent not only of a more equitable distribution of wealth and income but of economic development itself. [25] Land ownership tends to bestow prestige and political power. Real estate also functions as a preferred conduit for speculation and hence for "unearned increments". Investments in real estate, except in agricultural land, are of low social priority. For all those reasons, a strong theoretical case exists for taxing capital gains on real estate thus inhibiting, hopefully, the allocation of resources in such assets. A fair number of developing countries appear to have taken action, to this effect, although any capital gains taxation should be carefully dovetailed with other forms of taxation on real estate.

The scope for extending taxation to gains on other capital assets appears much more limited on practical grounds. As in developed countries, capital gains on personal assets, even if the latter (such as gold and jewelry) tie up investments of low priority, cannot easily be detected. Security markets are thin for many reasons. The number of actual and potential shareholders is naturally limited to a small group of well-to-do people. Most indigenous companies are of the closely-held, family type, in which the transfer of ownership rights does not occur frequently or through open, stock-exchange mechanisms. The shares of local subsidiaries of foreign multinational companies tend to be held, wholly or predominantly, by the foreign parent company. The prevalence of bearer shares, especially in Latin America, renders the imposition of stock exchange transactions less practicable and opens wide avenues for evasion.

Another argument supports the view that, in developing countries, and extension of the capital gains taxation beyond the case of real estate should only be attempted after careful consideration. The capital gains tax is a sophisticated piece of fiscal engineering. It is also a major source of complexity in the tax statutes; preferential schemes induce the search for legal arrangements that qualify deals as a capital transaction and not as income. Capital gains taxation, therefore, puts a comparatively heavy burden on scarce administrative resources, which could possibly be better allocated to strengthen the implementation of the other existing segments of the income tax law.

VIII. SUMMARY AND CONCLUSIONS

The following major conclusions can be reported as emerging from our analysis:

(a) In terms of modern tax principles, and more particularly of the ability-to-pay principle, the comprehensive definition of taxable income, known as the "net accretion" theory — which implies the inclusion of capital gains — is superior to the more restrictive "source" definition of income.
(b) Adherence to the extensive income concept is not postulated by the choice of the global technique to tax income — as against the schedular approach — although a global prototype calls for as extensive an income concept as feasible.

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22. France (1949), Belgium (1962), Mexico (1964), Spain (1964), Peru (1973), Italy (1974).
23. *Juanita D. Amatong*, "Taxation of Capital Gains in Developing Countries", IMF Staff Papers, July 1968, p. 344-384. We shall draw heavily on this paper and on *Quale*, cit. Quale, however, advocates a fairly comprehensive capital gains tax.
24. *Amatong*, cit., p. 346-348.
25. See, for example, various contributions of *Irma Ade[illegible]an.*

(c) Conceptual ambiguities (with respect to imputed income) and technical constraints (more particularly in the capital gains area), however, result in a wide gap between actual arrangements and the extensive, net accretion theory.
(d) On the whole, there appears to be some tendency towards including capital gains in taxable income. The treatment of capital gains, however, is usually very complex and restrictive, both in terms of its coverage and of the applicable rates.
(e) It cannot be claimed that the restrictive income concept is a prerequisite for a schedular prototype of income taxation, and that the extensive net accretion income concept is essential to the global prototype. But a degree of afffinity between the above pairs cannot be denied, both theoretically and as suggested by historical experience.
(f) Specific economic features and the need to use scarce tax-administrative resources efficiently reduce the scope for taxing capital gains in developing countries. Several among them, however, have taken more or less successful steps to tackle the most prevalent type of capital gains, namely on real estate — assets with low social priority.

Appendix

RELEVANT FEATURES OF THE DEFINITION OF GROSS INCOME IN SELECTED COUNTRIES

1. The purpose here consists in outlining the main features of the statutory provisions in a selected group of countries as to the treatment of taxable income — disregarding exemptions. Three aspects are examined. First, we indicate whether the system can be labeled as schedular, global or mixed. Second, we investigate whether the statute — and/or, to the extent the available materials allow a clear statement, the "living practice" of income tax, as resulting from the interpretation by the tax authorities and the Judiciary — contains an explicit or implicit definition of gross taxable income. Finally, the main lines of the treatment of capital gains are mentioned. Again, no detailed description is intended for use by tax practitioners but only those features of the income tax structure that are of relevance to the fiscal economist are mentioned.

2. It is appropriate to start with *Great Britain*, the country where a modern income tax system was first introduced (1799-83). Scholars are generally agreed that the system evolved from an originally schedular pattern to a global system which, for purposes of applying the tax rates, views all types of income aggregately.

— "The term 'income' is nowhere defined in the statute and is but loosely defined in the court decisions. Instead, the law lists in so-called 'Schedules' certain described types of income (interests, rents, annuities, etc.) and income from certain designated sources (trades, professions, employments, securities, etc.) which are subject to tax. Thus, not all benefits which might be considered as income in a generic sense are subject to tax but only the types of income set out in the schedules" (World Tax Series, p. 37). The Royal Commission which investigated in depth the income tax system during the early fifties thought that: '. . . no real advantage could possibly result from the introduction of a general definition that had to cover so multifarious a subject as taxable income" and stuck to the schedular approach for defining taxable income (Royal Commission, p. 7). Since 1803, taxable income has been divided into five Schedules, some of them further subdivided in "Cases". As of 1975/76, not less than 16 such categories can be distinguished. One of them is of a residual nature and comprises incomes not enumerated in other Schedules.

— The income tax system as strictly defined did not provide for the taxation of capital gains. In other words, the British system adhered to the source theory, even with respect to fixed assets used in the business. In 1962, short-term capital gains were made taxable and located in a new "case". The speculative character of transactions in capital gains was derived from the short span of time between acquisition and realization. After this attempt at taxing capital gains quickly proved to be a failure, a full-fledged capital gains tax was introduced in 1965. Although legally distinct, capital gains tax can, in terms of substance, be viewed as integrated with the income tax system. Some exemptions notwithstanding (as on small-fry gains), the sweep of the new tax extends to a comprehensive set of capital assets. A flat rate applies to gains realized by individuals. A similar treatment is secured for companies, as only a given fraction of the capital gains base is subject to the company tax (flat) rate. As of 1971/72, the distinction between the short-term and long-term capital gains of individuals was discontinued.

3. From its inception (1913), the Federal income tax system in the *United States* was undoubtedly of a global nature.

— "The U.S. Statutes do not attempt a general definition of income; they rely mainly on the enumeration of items to be included, excluded or deducted. However,

the statutory listing is not exhaustive"! The Internal Revenue Code, quoting the language of the Sixteenth Amendment, refers "to income from whatever source derived and states that taxable income includes 'but (is) not limited to' the enumerated items. The limits of the income concept have to be determined by administrators and the courts on a case-by-case basis. Although the courts have tended to become more permissive and to allow a broadening of the concept, many important items that qualify as realized income are omitted from the tax base in the United States" (Richard Goode, p. 14).

— The capital gains statute has undergone several profound legislative changes and is still the subject matter of much controversy. A broad range of capital assets are subject to tax; among them even some "pseudo" capital gains, such as income from cutting or disposal of timber. There are many special rules and exemptions, e.g. with regard to the taxpayer's principal residence. Short-term gains viewed as speculative are added to ordinary income. Only half of the long-term gains of individuals is taxable or total capital gains are subjected to a 25 percent rate — whichever is lower. The preferential treatment of capital gains also extends to corporations, although the techniques are somewhat different.

4. In *Belgium*, the mixed system, with a distinct preponderance of the schedular layer that had been introduced in 1919, was replaced by a global-type income tax in 1963. As several deductions which elsewhere would be applied to global income are linked to one of the Schedules, the global structure is somewhat "impure".

— The general statutory definition of gross income holds that the taxable income is the sum of the net incomes, assessed in four categories. Such a definition, however, is not very helpful, as it does not state how the income items in the various Schedules ought to be defined. There is a category of "miscellaneous incomes" but the latter are exhaustively enumerated. Except for a special tax on gains from unbuilt land, no capital gains tax applies to individuals. Gains on corporate assets were subjected to tax in 1936, after the judiciary had been wavering between the source and net accretion theories. There are some exceptions to the general rule.

5. *Italy* effectuated the change-over from a mixed system (that originated when a global "complementary tax" in 1925 was added to a pre-existing set of schedular taxes) to a global-type tax in 1974. Taxable income is now enumerated in five categories. The last one lists specified "miscellaneous income".

– Under the previous mixed system the source theory was adhered to, in principle; yet, it became largely breached by the judiciary as speculative gains were considered taxable income. The speculative nature had to be inferred from the intentions of the taxpayer — a test difficult to administer. In 1956, capital gains in the corporate field were made taxable. Under the new 1974 legislation, as regards individuals, certain capital gains, considered to be of a speculative nature on account of the type of asset (basically real estate or art objects) or of the short holding period, are subjected to income taxation, as a specified item in the category of "miscellaneous income". The new law, contrary to the previous one, contains a general statement on taxable gross income. The possession of income, in cash or in kind, originating from whatever source, regularly or occasionally, gives rise to taxability. This implies clearly an explicit conversion to the net accretion theory. Total gross income, however, is the sum of the net incomes assessed in the exhaustively listed categories.

6. Turning now to developing countries, *Colombia*, which received a more than proportionate share of advice on taxation reforms by high-level missions, provides a rather interesting case. Colombia was apparently the first country in the Western Hemisphere to follow Great Britain's lead. It introduced a short-lived income tax, of a schedular-type, in 1821. In 1918, the income tax system was resurrected, again in schedular form. In 1920, upon the recommendations of the first Kemmener mission, the schedular system was replaced by a global one. A major, and badly overdue, overhaul of the system, in 1960, maintained the global set-up. Administratively and legally, however, two complementary taxes, respectively on excess profits and on net wealth, are part and parcel of a single income tax.

— "The fundamental criterion for income under the 1960 Income Tax Law is enrichment. Anything that adds to the taxpayer's wealth (and hence to his capacity to pay) is income, unless expressly excluded or exempted by law. Hence, gross income comprises all receipts, ordinary and extraordinary. . ." (World Tax Series, p. 115).

— The actual treatment of capital gains, however, falls short of the wide sweep of the above enrichment concept, rooted in an equivalent expression of the net accretion theory. Gains on business assets are part of ordinary taxable profits. Individuals are only taxable on real estate capital gains, with the taxable gains progressively being scaled down as the holding period lengthens. Securities held by individuals are exempted.

7. In 1860 *India* instituted income tax legislation which was structurally similar to the (then existing) British system. It was repealed in 1865. A general income tax was introduced in 1886 and has been maintained since. Graduated rates were introduced only in 1916. One peculiarity in India is that the Constitution vests the right to tax (agricultural) incomes with the States. Thus, the global income tax, at the Center, does not reach agricultural income. In 1973/74, a measure was introduced to partially remedy this dichotomy. Henceforth, the Center will notionally include agricultural incomes in the tax base for purposes of calculating the global tax liability.

— Although the Center's income tax relates to total income "from whatever source" derived, the term "income", as such, has not been defined. Receipts are only taxable when they fall within one of the six "heads" into which taxable income has been divided. Casual and non-recurring receipts are also interpreted as non-taxable, although in 1972 gambling and lottery gains were specifically brought under the tax law. It follows that the "source theory" has a strong impact in shaping actual income tax practice and in restricting somewhat the reach of the tax. One of the six heads of the income tax

system relates to capital gains. Short-term gains are consolidated with ordinary income (individuals) and profits (companies). Longer-term gains are taxed at a special rate which is clearly concessional for individuals but much less for companies.

8. For the last two developing countries in this survey, the available materials do not afford as much detail as for the previous countries.

— In *Mexico*, a schedular system with seven schedules was introduced in 1925. This pattern remained basically unchanged until 1961 when, after an abortive attempt in 1953, a global tax was super-imposed on taxpayers with comparatively high total income, provided such total income derived from more than one schedule. In 1964, the mixed system was largely abandoned and replaced by a structurally hybrid system. Lower income recipients are subject to one or two schedular taxes, those on labor incomes and on capital incomes. If total income exceeds a given amount, the tax on global income applies. Thus, unlike the usual mixed system in which the higher income is subject to both the complementary and the schedular taxes, in Mexico the taxpayer only owes the tax on global income and the schedular taxes are reserved to lower income taxpayers.

— Until 1971, gains on corporate assets were taxed, separately, at a special rate. Since 1971, they are part of ordinary profits. Individuals are subject to a tax on gains on urban real estate.

9. In the *Sudan*, the system is of schedular type, in the sense that three categories of income are distinguished, (a) business profits, (b) land rent income and (c) personal income, i.e. income from dependent and independent labor, respectively. There are — slightly different — progressive rate scales for the first two classes, and also for the third one. In other words, each schedule is taxed separately. There is no global-type complementary tax. Capital gains are apparently not subject to tax.

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— *Anil Kumar Jain*, "A Note on the Concept of Income under the Indian Income Tax", Public Finance/Finances Publiques, 1975, I, p. 86-95.

Mexico:
— "Tax and Trade Guide Mexico", second edition, Arthur Anderson, 1972,
— *Ignazio Pichardo Pagaza*, "Cambios en la Estructura Juridica Tributaria de Mexico", Comercio Exterior, Jan. 1968, p. 869-879.

Sudan:
— Provisional Order, The Income Tax Act, 1967.

Tax Levels and Structures in OECD Member Countries*

The OECD has just published its annual statistical bulletin on tax levels and structures in OECD Member countries. [1] The bulletin contains the most comprehensive information that is at present available on an internationally comparable basis, concerning the amounts of receipts collected by OECD Member countries and the varying ways in which these receipts are raised.

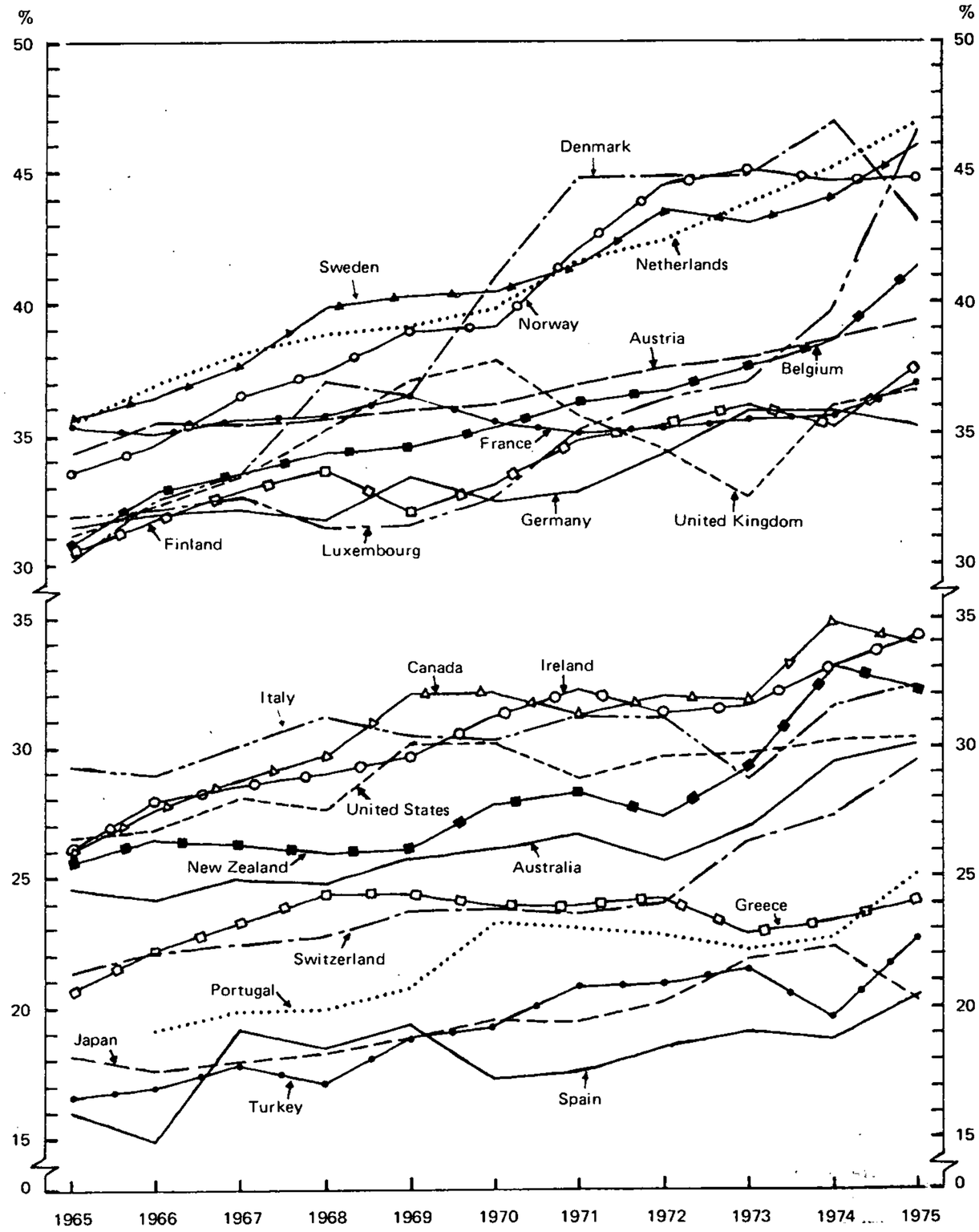
The 35 comparative tables contained in the report, as well as the numerous country tables, show how countries differ in the proportion of their Gross Domestic Product taken in taxes and the different reliance that they place on the various kinds of taxes: income taxes, social security contributions, consumption taxes, etc. The commentary which accompanies the tables draws attention to how the level and composition of tax revenues have changed between 1965 and 1975. In all countries the ratio of tax-to-GDP has increased during this period and in the Nordic countries, Belgium, Luxembourg and the Netherlands, this increase has been very large. Most countries have tended to place more reliance on personal income taxes and/or social security contributions as well as value added taxes, while corporation taxes, property taxes and taxes on tobacco and alcoholic drinks have somewhat declined.

A special feature of this edition is that for the first time, provisional estimates for the main categories of tax for the previous calendar year (in this case 1976) have been provided for most OECD countries. [2] Even though these estimates are subject to revision, and for this reason are reproduced in an annex in order not to confuse them

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* Press release of November 14, 1977.

1. "Revenue Statistics of OECD Member Countries 1965-1975 — A Standardized Classification".
2. All OECD countries except Australia, Italy, Portugal and Spain.



GRAPH 1

Proceeds from taxes and social security contributions as a percentage of the gross national product (1965-1975)

with the more definitive data in the main body of the publication, some interesting tentative results emerge as to what has been happening to tax levels and structures in the most recent period.

In Finland, France, Greece, Ireland and Sweden, there appears to have been a large increase in the tax-to-GDP ratio between 1975 and 1976. This contrasts with the situation in Austria, Belgium, Netherlands and the United States, where this ratio declined somewhat. In the remaining countries for which information is available (Canada, Germany, Japan, Luxembourg, Norway, Switzerland and the United Kingdom), there was a small increase in this ratio. These differences may to some extent reflect short term economic policy changes and some of them may indeed disappear when the data are eventually revised. Countries' relative reliance on the three main groups of taxes — taxes on income and profits, social security contributions and taxes on goods and services — has slightly altered, the general tendency appearing to be to place somewhat greater emphasis on social security contributions, in comparison with taxes on goods and services. Personal income taxes continue to be the most important source of revenue for most countries.

Another feature of this year's edition is the inclusion of data on the allocation of tax revenues by levels of government during 1973 and 1974. The report highlights the wide differences in the proportion of tax revenues accruing to each level of government and the vaying methods that are used to finance local government. The definitions used in each country when making the breakdown should be carefully noted.

A table attached to this press release compares the total taxes in OECD Member countries, as a ratio of GDP, in 1975 and a graph indicates how this ratio has changed since 1965. A second graph illustrates the structure of government tax receipts.

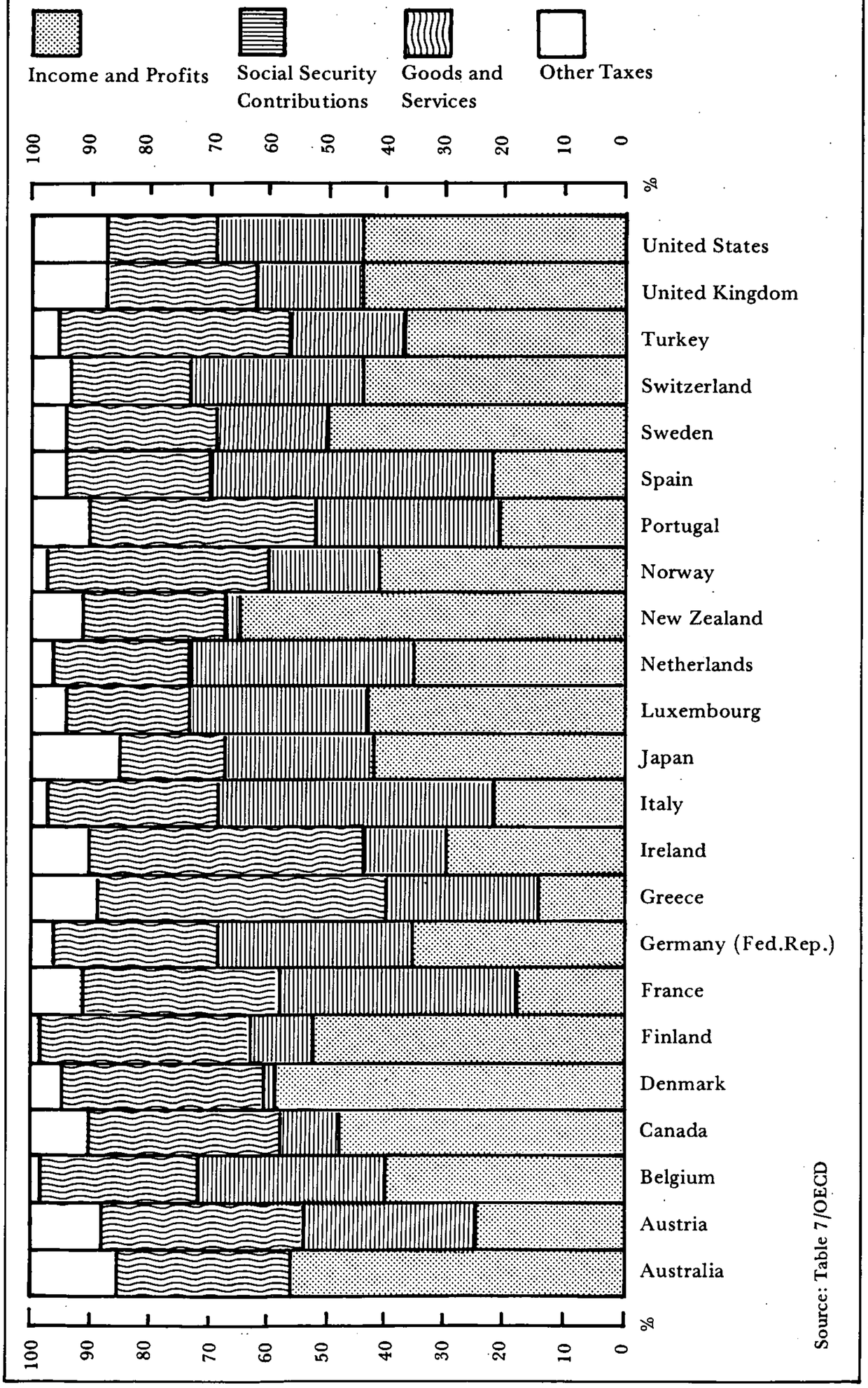
Review copies of the report may be obtained from the OECD News Division, 2 rue André Pascal, 75775 Paris Cedex 16 (Tel: 524 80 89).

"Revenue Statistics of OECD Member Countries 1965-1975 — A Standardized Classification".
222 pages, OECD, Paris, 1977.
$10.00 — £4.90 — F 40.
ISBN 92-64-01704-6.
Available from OECD Sales Agents.

TABLE 1
TOTAL TAX REVENUE AS PERCENTAGE OF GDP-1975

Netherlands	46.90
Luxembourg	46.54
Sweden	45.96
Norway	44.70
Denmark	43.05
Belgium	41.43
Austria	39.27
Finland	37.57
France	36.90
United Kingdom	36.77
Germany	35.22
Ireland	34.09
Canada	33.98
Italy	32.34
New Zealand	32.20
United States	30.31
Australia	30.11
Switzerland	29.49
Portugal	25.02
Greece	24.03
Turkey	22.63
Spain	20.34
Japan	20.23

GRAPH 2 Tax revenue of main headings as percentage of total tax revenues (1975)



COUNTRY BY COUNTRY SURVEY OF LOOSE-LEAF PUBLICATIONS . . .

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The Supreme Court remanded the case to the Lower Tax Court in order to examine whether or not the taxpayer had suffered from a mental derangement which influenced his capability to appear in court at the moment of the withdrawal of the complaint.....

Supreme Tax Court, February 15, 1977, No. VII R 42/74 BLICK DURCH DIE WIRTSCHAFT, June 6, 1977, at 4.

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INDIA:

Taxation and Government Consumption

by G.Thimmaiah*

During the post-war era of too much publicized economic planning for achieving rapid development of underdeveloped countries, the role of Government expenditure in initiating development processes was overemphasized. [1] *As a consequence of this, opposition to growing public expenditure, expanding the public sector and mobilization of financial resources through fiscal measures lost its ground. But after a generation, doubts have come to be slowly raised about the achievement of the public expenditure and the results of an enormous increase in the size of the Government revenue particularly in developing countries. In recent years these doubts have become more vocal. Economists have started gathering circumstantial as well as empirical evidence to show the futility of the Government expenditure in developing countries. For instance, Mr. Stanley Please* [2] *has analysed the influence of the growth of tax revenue on the consumption expenditure of the Governments in developing countries. His analysis has become a subject of discussion in some recent studies* [3] *of the World Bank relating to taxation and savings.*

1. PLEASE'S HYPOTHESIS

Mr. Please has emphasized what could be considered as a most obvious fact that when Governments in developing countries find more revenue, the tendency is to spend more for non-productive purposes. He has maintained that "The disappointing behaviour of public savings in the less developed countries in spite of impressive records of tax performance is due to the growth of Government's current expenditure, and this is a phenomenon which is widely recognised". [4] Further, he has pointed out that "the gloomy record of inadequate budget surpluses, despite increased tax performance over the years such as that for a development strategy, based on increased compulsory savings underestimated and more frequently ignored the effect that the increase in taxation might have on public consumption. In these circumstances, there is a danger that those who recommend increased taxation in the interest of economic growth might be looking at a mirage". [5] Therefore, he has concluded that "In particular, pressures to spend are made less resistable when it is apparent to everyone that the funds are immediately available to the Government in the exchequer". [6] Mr. Please's views on the effects of increased tax revenue on Government savings and consumption have evoked much interest as is evident from the attempts made to test his views empirically. For the purpose of these empirical studies, his statements had to be precisely formulated and specified. But it has also been alleged by Mr. J. Holsen [7] that some of the empirical studies like that of Mr. Elliott R. Morss, have not properly specified Mr. Please's hypothesis.

Mr. Holsen has maintained that Mr. Please's statements imply two hypotheses: a weak and a strong one. This point of view has been accepted by Mr. Please himself

* Senior Fellow in Economics, and Head of the Economics Unit, Institute for Social & Economic Change, Bangalore, India.

1. A well known fact is that during pre-war years J.M. Keynes was responsible for justifying the expansion of public expenditure for maintaing economic stability. During the post-war years, perhaps Gunnar Myrdal was the most vocal advocate of the role of Government in initiating a development process in underdeveloped countries. See his *Economic Theory and Underdeveloped Regions.* Gerald Duckworth & Co., London, 1957, and *Beyond the Welfare State,* Gerald Duckworth & Co., London, 1960.
2. "Saving Through Taxation — Reality or Mirage?", *Fund and Bank Review: Finance and Development,* March 1967. A similar opinion has been expressed by Mr. C. Northcote Parkinson with reference to Governments in general. Mr. Parkinson, in his usual sarcastic way, has observed that when Governments find more revenue the only economy they make is in thinking how to spend it. This is called Parkinson's second law. This law when carried to its logical end ultimately means the same as the Please hypothesis. See C. Northcote Parkinson, *The Law and the Profits.* John Murrey, London, 1960, p. 1.
3. See for instance K. Krishnamurthy, "Savings and Taxation in Developing Countries: An Empirical Study". *IBRD Working Paper No. 23,* August 1968; E. Dziadek, "Government Savings in LDC's". *AID,* February 15, 1968; Ratan J. Bhatia, "A Note on Consumption, Income and Taxes". *IMF. DM/67/70,* November 2, 1967; Elliot R. Morss, "Fiscal Policy, Savings, and Economic Growth in Developing Countries: An Empirical Study", *Finanzarchiv,* Vol. 28, No. 3, August 1969; J. Holsen, "Savings, Taxation and the 'Please Hypothesis' ". *IBRD Memorandum,* August 5, 1968, and S.K. Singh, "The Determinants of Aggregate Savings", *IBRD Working Paper No. 127.* March 1972.
4. *Op.cit.,* p. 25.
5. *Op.cit.,* p. 26.
6. *Op.cit.,* p. 32.
7. *Op.cit.*

in his subsequent paper where he has observed that "what comes out from the empirical work that has been undertaken. . ., is that I should have distinguished more clearly than I did between what might be called the "weak" hypothesis and the "strong" hypothesis. The former simply argues, . . . that the increase in Government current expenditure which accompanies higher tax revenue makes such large inroads into the additional revenue that the effect upon Government savings is small. The strong hypothesis states that this effect of the policy on Government savings is so small that it is more than offset by the decline in private savings and thus aggregate savings are reduced". [8] Perhaps, the only empirical study which has specified both these hypotheses is that of Mr. S.K. Singh. In his own words, "The hypothesis may be formulated in terms of the size of the marginal propensity to save of the Government out of its revenue. If the Government's MPS is lower than the MPS of the rest of the economy, rising of the tax rate would lower the overall saving rate. This would be "stronger version". . . However, it is the weaker version of the Please hypothesis which has interest and the overall reading of his paper clearly points to the weaker version. What Please emphasizes is that the increase in the tax rate is not going to solve the problem of a significant step up in saving investment rate because current expenditure rises too. The *weaker* version while admitting that the overall saving rate may increase would *posit that the increase* is not likely to be very substantial". [9] In fact, Mr. Singh has tried to point out the similarity between Please's hypothesis and Parkinson's second law. To quote him again, "Another interpretation of Please hypothesis would be something suggestive of Parkinson's Law: If revenue surpluses are available, Government expenditure rises faster than what would have been otherwise". [10]

In this study of fiscal policy and savings relating to 46 developing countries, Mr. Elliot R. Morss has christened Please's hypothesis as "Please effect". He has observed that ". . . Please has noted that higher taxes need not go into investment. Indeed, he has even suggested that total consumption may well increase when taxes are raised because Government consumption will increase by more than the cutback in private consumption".[11]

It would appear from the foregoing discussion that Mr. Please's views can be formulated in terms of the weaker version of the hypothesis attributed to him which is very similar to Parkinson's second law. However, Mr. Please has maintained that this statements do imply two hypotheses as shown above and he has made his point very clear by observing that "For what the hypotheses state is that the rate of growth of current expenditure is *causally related to revenue* growth". [12] Further, he has particularly stressed "that it is only through institutional studies that the hypothesis can be substantiated. This means, in effect, that such studies must be on a country-by-country basis". [13]

The empirical studies carried out by the World Bank experts have revealed contradictory results. For instance, Sing's cross-section study of 54 developing countries including India, has supported the weaker version of Please's hypothesis. He has found that "In the weaker form the "Please Hypothesis" is clearly confirmed". [14] However, Krishnamurthy's study has shown that "the results for India revealed a significant negative association between the tax rate and the marginal rates of private and total consumption and hence a positive link to the saving rate. Inclusion of other variables did not alter the result for the tax variables". [15] Even Morss's study based on a cross-section analysis of 46 developing countries, excluding India, has disproved Please's hypothesis. He has found that "The . . . relationship is contrary to any widespread "Please effect", i.e., of a negative relationship between domestic savings and taxes. The result suggests that on the average, savings increase by 64 percent of any tax increase. Putting it another way, it is clear that the reduction in private consumption resulting from a tax increase more than offsets any accompanying increase in public consumption". [16]

This contradiction may be due to may reasons. Sing has obtained his conclusions by testing directly the influence of marginal taxation on marginal Government savings whereas Krishnamurthy and even Morss have derived their conclusions indirectly by relating taxation to total savings and/or private and total consumption which may not be an adequate method. Further, the periods of their study differ. This may be a probable reason for the contradiction in the results of their studies. But we cannot attribute the entire contradiction to this reason alone. Therefore, it would be rewarding to make a fresh study of Indian experience based on the data for recent years. This would also be in keeping with Mr. Please's recent opinion that this hypothesis should be empirically tested with reference to individual developing countries like India.

2. TAXATION AND GOVERNMENT CONSUMPTION IN INDIA

An attempt is made in this paper to study the influence of taxation on the Government's consumption in India. The period of this study is between 1960-61 and 1972-73. The choice of this period is mainly dictated by the availability of uniform and fairly reliable data for recent years published by the Central Statistical Organisation. [17] The choice of this period can also be justified on the ground that most of the additional tax measures intro-

8. "The 'Please Effect' Revisited", *IBRD Working Paper No. 82*, July 1, 1970, pp. 10-11.
9. "The Determinants of Aggregate Savings", *IBRD Working Paper No 127*, March 1972, p. 33.
10. *Ibid.*
11. "Fiscal Policy, Savings and Economic Growth in Developing Countries: An Empirical Study", *Finanzarchiv*, Vol. 28, 1969, p. 462.
12. *Op.cit.*, p. 6.
13. *Op.cit.*
14. *Op.cit.*, p. 33.
15. "Saving and Taxation in Developing Countries: An Empirical Study", *IBRD Working Paper No. 23*, August 28, 1968, p. 10.
16. *Op.cit.*, p. 462.
17. *National Income Statistics:* 1960-61 — 1972-73, Department of Statistics, Ministry of Planning, Government of India, New Delhi, January 1975.

duced by the Central and the State Governments in India became effectively productive during the Third Five Year Plan period. The package of direct tax measures originating from Kaldor's report were introduced in the middle of the Second Five Year Plan whose yield stabilized in the Third Five Year Plan period. Further, during the Third Five Year Plan period, the target of additional taxation was exceeded and this trend continued even during the Fourth Five Year Plan period. For instance, the originally estimated targets of additional resource mobilization (including additional taxation and surplus from public enterprises), where Rs. 1,710 crores and Rs. 3,198 croses (1 crore = 10 million) during the Third and Fourth Five Year Plan periods respectively. The actual targets achieved were Rs. 2,892 crores and Rs. 4,238 crores respectively. Furthermore, in this process of mobilizing additional resources mainly through taxation, additional tax efforts were directed more towards indirect taxes, particularly Union Excise duties and States' sales taxes. As a result the relative importance of indirect taxes in the Indian tax structure has increased particularly from the period of the Third Five Year Plan. This is evident from the fact that nearly 80 percent of the total tax revenue is yielded by indirect taxes. Direct tax revenue as a proportion of GNP contituted about two percent in 1960-61 and has increased to only 3.5 percent in 1972-73 whereas indirect taxes as a proportion of GNP have increased from 7 percent in 1960-61 to 11.5 percent in 1972-73. Though the total tax revenue/GNP ratio has increased by more than fifty percent during these thirteen years, this increase has been achieved through the increased importance of indirect taxes. In other words, the Indian tax structure has changed during the thirteen years in favour of indirect taxes without at the same time decreasing the importance of the direct taxes in terms of the relative share of their yield in the GNP.

Juxtaposed to this impressive increase in the tax revenue in India, the importance of Government savings in the total domestic savings has been declining. [18] Correspondingly, the share of Government's consumption in the total tax revenue has been increasing. An alarming trend is that the non-development expenditure at times exceeded the total tax revenue of the Government as is evident from Table 1. This circumstantial evidence indicates that additional taxation might not have gone to increase the Government savings but instead might have gone to meet increasing Government consumption expenditure as hypothesized by Mr. Please. However, this broad statement will have to be qualified by a further investigation into the influence of taxation on Governments consumption expenditure and savings by using some statistical methods.

TABLE 1
Relative shares of Government consumption and non-development expenditure in total tax revenue in India

Year	Government consumption expenditure as % of total tax revenue	Non-development expenditure of the Government as % of total tax revenue
1960-61	71.40	79.40
1961-62	69.80	69.90
1962-63	70.60	86.70
1963-64	74.60	88.50
1964-65	71.50	91.00
1965-66	73.30	85.10
1966-67	71.30	100.30
1967-68	74.70	95.90
1968-69	75.60	86.30
1969-70	75.50	85.10
1970-71	73.70	89.00
1971-72	73.10	85.70
1972-73	70.20	75.70

Notes:

a) Government consumption refers to the consumption expenditure of the Central Government including centrally administered territories, consumption expenditure of the State Governments and of local authorities.

b) The Government's non-development expenditure refers to the non-development expenditure of the Central Government including centrally administered territories and of the State Governments.

3. EMPIRICAL RESULTS

For this purpose we have used the linear multiple regression analysis. In order to estimate the extent of influence of taxation on Government consumption, we have regressed marginal Government consumption on marginal direct tax and indirect tax ratios along with marginal per capita income, rate of growth of income and rate of increase in the price level. Though what is relevant for our purpose is the influence of taxation on Government consumption, that influence operates on Government consumption along with the influence of other important variables. Hence, we have included other important variables to isolate the effect of taxation on Government consumption.

Further, in order to verify the results obtained in this way, we have also examined the influence of taxation on Government savings. This would confirm any conclusion derived from the analysis of the relation between taxation and Government consumption. Besides, following Krishnamurthy and Morss, we have also tried to make indirect verification by studying the influence of taxation on total domestic savings and on private consumption.

The consumption expenditure of the Government includes current expenditure on purchase of goods and services and payment of wages and salaries to the employees and excludes interest charges, subsidies and other current transfer payments. The price index used here is the Economic Adviser's wholesale price index whose base is shifted back from 1961-62 to 1960-61. [19]

18. See G. Thimmaiah, "India: Taxation and Government Savings", *Bulletin for International Fiscal Documentation*, June 1977, Table 2.
19. *Reserve Bank of India Bulletins.*

It would have been more appropriate to use the all India consumer price index or cost of living index. However, such price indices are not available for the entire population of the country. Hence we have used the wholesale price index.

As we have noted earlier, additional taxation has been used to divert an increasing portion of the national income to savings. In order to investigate whether taxation has achieved this objective or not, it is only appropriate to study the relation between marginal tax revenue and marginal Government consumption and savings. Further, we have assumed that marginal Government consumption and savings are influenced (if at all) by marginal tax revenue in the same fiscal year without any time lag.

The results relating to the relationship between marginal Government consumption and marginal tax ratios are as follows:

$$\left(\frac{\Delta Cg}{\Delta NNP}\right) = \underset{}{0.03449} \underset{(0.73689)}{-1.35227}\left(\frac{\Delta Td}{\Delta NNP}\right) + \underset{(11.13589)}{1.62441}{}^{*}\left(\frac{\Delta Ti}{\Delta NNP}\right)$$

$$\underset{(-1.66009)}{-0.01663}\left(\frac{\Delta NNP}{\Delta P}\right) + \underset{(17.5654)}{214.28015}\left(\frac{\Delta NNP}{NNP}\right) \underset{(-1.67112)}{-9.13277}\left(\frac{\Delta PW}{PW}\right) \quad \ldots\ldots\ldots\ldots\ldots (1)$$

$$\bar{R}^{2} = 0.91935$$

Where:

Cg	= Government consumption expenditure at current prices	Δ	= Change in the revelant variable over the fiscal year
NNP	= Net National product at current prices	$\bar{R}^{2}$	= Adjusted coefficient of multiple determination
Td	= Revenue from direct taxation	*	= t-coefficient (shown in parentheses) is significant at 1 percent level
Ti	= Revenue from indirect taxation		
P	= Population of the country		
Pw	= Wholesale price index with 1960-61 base		

The foregoing results indicate that Government consumption varies inversely with direct taxation and directly with indirect taxation. However, only the direct association between indirect taxation and Government consumption is significant. This would imply that as the yield from indirect taxation has been increasing by leaps and bounds, the Government has been encouraged to go on increasing its consumption expenditure. Though direct taxation shows a negative influence any such influence is not statistically significant.

It would be necessary, however, to examine the relation between taxation and Government savings with a view to verifying the results obtained above. The results regarding the influence of taxation on marginal Government savings are as follows:

$$\left(\frac{\Delta Sgn}{\Delta NNP}\right) = \underset{}{0.41354} \underset{(-1.03172)}{-0.57398}\left(\frac{\Delta Ta}{\Delta NNP}\right) \underset{(-1.80517)***}{-0.38581}\left(\frac{\Delta Ti}{\Delta NNP}\right)$$

$$\underset{(0.48866)}{+0.00179}\left(\frac{\Delta NNP}{\Delta P}\right) \underset{(-0.43761)}{-20.38641}\left(\frac{\Delta NNP}{NNP}\right) \underset{(-2.17572)***}{-1.71654}$$

$$\left(\frac{\Delta Pw}{Pw}\right) \underset{(1.40713)}{+0.18549}\left(\frac{\Delta Cg}{\Delta NNP}\right) \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots (2)$$

$$\bar{R}^{2} = 0.61148$$

Where:

Sgn	= Net Government savings at current prices
SgG	= Gross Government savings at current prices
GNP	= Gross National product at current prices
***	= t-coefficient is significant at 10 percent level
**	= t-coefficient is significant at 5 percent level

$$\left(\frac{\Delta SgG}{\Delta GNP}\right) = \underset{}{0.35264} \quad \underset{(1.16292)}{-0.93762}\left(\frac{\Delta Td}{\Delta GNP}\right) \quad \underset{(-1.95820)^{**}}{-0.88984}\left(\frac{\Delta Ti}{\Delta GNP}\right)$$

$$\underset{(-1.39925)}{-0.00760}\left(\frac{\Delta GNP}{\Delta P}\right) + \underset{(0.10784)}{0.08577}\left(\frac{\Delta GNP}{GNP}\right)$$

$$\underset{(-1.28172)}{-0.88974}\left(\frac{\Delta Pw}{Pw}\right) + \underset{(1.45974)}{0.46692}\left(\frac{\Delta Cg}{\Delta GNP}\right) \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots (3)$$

$$\bar{R}^2 = 0.22249$$

Where:

Sgn	= Net Government savings at current prices
SgG	= Gross Government savings at current prices
GNP	= Gross National product at current prices
***	= t-coefficient is significant at 10 percent level
**	= t-coefficient is significant at 5 percent level

Thus it becomes clear that both net and gross marginal savings ratios of the Government are inversely associated with taxation. But the negative influence of indirect taxation on Government savings is significant in both these equations which corresponds to the earlier finding of the significant positive influence of indirect taxation on Government consumption.

The foregoing results indicate the significant direct influence of taxation on Government consumption. However, in order to verify these results indirectly, we have to study the influence of taxation on total domestic savings and on private consumption. It is all too well known that domestic savings of a country are influenced by various economic and non-economic factors. However, we have selected only some important economic determinants of domestic savings for the purpose of this study. We have related marginal net domestic savings to direct tax revenue, indirect tax revenue, per capita income, rate of growth of net national product, wholesale price index and interest rate. As we have already observed earlier, though we have included important economic determinants of domestic savings in the regression, we are interested only in finding out the nature and extent of influence which taxation yields on marginal net domestic savings. The results obtained are as follows:

$$\left(\frac{\Delta Sn}{\Delta NNP}\right) = -0.79601 + \underset{(0.46695)}{2.63037}\left(\frac{\Delta Td}{\Delta NNP}\right) + \underset{(2.21097)^{***}}{0.89280}\left(\frac{\Delta Ti}{\Delta NNP}\right)$$

$$+ \underset{(0.06116)}{0.00175}\left(\frac{\Delta NNP}{\Delta P}\right) \underset{(-0.06223)}{-22.67882}\left(\frac{\Delta NNP}{NNP}\right)$$

$$+ \underset{(0.44942)}{6.90163}\left(\frac{\Delta Pw}{Pw}\right) \underset{(-0.74338)}{-1.18744}(\Delta r) \quad \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots (4)$$

$$\bar{R}^2 = 0.03481$$

Where:

Sn	= Net domestic savings at current prices
r	= average rate of interest on one-year deposits
***	= t-coefficient is significant at 10 percent level

The foregoing results indicate that both direct and indirect taxation exert a positive influence on marginal net domestic savings. So do per capita income and wholesale prices. But the t-coefficients for those variables are not significant. This is true of the t-coefficient for direct taxation also. However, the regression coefficient for indirect taxation is significant thereby indicating the substantial positive influence of indirect taxation on marginal net domestic savings.

But here again, in order to confirm the influence of taxation on marginal net domestic savings, we must study the alleged restraining influence of taxation, particularly indirect taxation, on private consumption. Ac-

cordingly, we have examined the nature of the influence of taxation on private consumption in the following way:

$$\left(\frac{\Delta Cp}{\Delta GNP}\right) = -0.76815 + \underset{(0.46486)}{1.94026}\left(\frac{\Delta Td}{\Delta GNP}\right) + \underset{(1.30145)}{2.99601}\left(\frac{\Delta Ti}{\Delta GNP}\right) + \underset{(2.01830)***}{0.05247}\left(\frac{\Delta GNP}{\Delta P}\right) + \underset{(0.27949)}{1.23584}\left(\frac{\Delta GNP}{GNP}\right) \underset{(-0.88004)}{-4.62621}\left(\frac{\Delta NNP}{NNP}\right)$$

$$\bar{R}^2 = 0.64595$$

Where:
Cp = Private consumption expenditure at current prices
*** = t-coefficient is significant at 10 percent level

The results indicate that direct and indirect taxation do not exert any restraining influence on private consumption. However, such non-restraining influence is not significant as evidenced by the low value of t-coefficients. Therefore, we cannot come to any definite conclusion in regard to the effect of taxation on private consumption.

TABLE 2
Changing composition of the Indian tax structure

Composition of tax structure	1951-52		1956-57		1961-62		1966-67		1971-72	
	Rupees crores	% of appropriate group	Rupees crores	% of appropriate group	Rupees crores	% of appropriate group	Rupees crores	% of appropriate group	Rupees crores	% of appropriate group
1	2	3	4	5	6	7	8	9	10	11
I. *Direct Taxes:*										
1) Corporation Tax	41	(17)	51	(17)	157	(33)	331	(40)	472	(37)
2) Other Income taxes	152	(62)	163	(56)	223	(48)	422	(51)	716	(56)
3) Land Revenue	50	(21)	79	(27)	87	(19)	79	(9)	87	(7)
Total Direct Taxes	243	(28)	293	(27)	467	(27)	832	(24)	1,275	(21)
II. *Indirect Taxes:*										
1) Customs duties	235	(44)	174	(27)	213	(18)	586	(23)	696	(15)
2) Excise duties (including sales tax)	135	(25)	235	(36)	727	(61)	1,552	(60)	3,132	(69)
3) Stamps	24	(5)	29	(4)	44	(04)	71	(03)	123	(03)
4) Other taxes and duties	137	(26)	208	(33)	206	(17)	385	(14)	564	(13)
Total Indirect Taxes	531	(61)	646	(59)	1,190	(69)	2,594	(74)	4,515	(74)
III. Total Tax *Miscellaneous:* Receipts	100	(11)	150	(14)	71	(4)	83	(2)	274	(5)
Total Tax Revenue	874	(100)	1,089	(100)	1,728	(100)	3,509	(100)	6,,064	(100)

Notes: 1. The percentage in the case of each tax relates to its appropriate group. The percentages of direct taxes and indirect taxes relate to the total tax revenue.
2. All figures are at current prices.
3. Tax Revenue includes the yield from Central, State and Local Government's taxes.

Source: *C.S.O. Estimates of National Product, Savings and Capital Formation* (February 1964, Table No. 6, p. 11 and November 1971, Table No. 4, p. 5) and January 1975, Table 21, page 46.

4. CONCLUSIONS

The empirical results of this study support the weaker version of Please's hypothesis that taxation does not necessarily contribute to the increase in Government savings in India. These results agree with those obtained by Singh but differ from the results obtained by Krishnamurthy and Morss. In the case of Morss's study India was not included and hence we cannot strictly compare our findings with his. Even in the case of Krishnamurthy's study, the results refer to the period preceding our period of study. All these lead us to certain broad conclusions: (1) the influence of taxation on Government consumption and savings differ from one developing country to another within the group of developing countries, (2) more statistical tests cannot be taken for granted as they have to be backed by other relevant circumstantial evidence, (3) the influence of taxation on Government consumption cannot be inferred indirectly by merely studying the influence of taxation on total savings and on private consumption, and (4) this study reveals that both direct and indirect results and circumstantial evidence support the operation of Please's hypothesis in India.

TAX TREATY BETWEEN JAPAN AND CZECHOSLOVAKIA

On October 11, 1977 Japan and the Czechoslovak Socialist Republic concluded a comprehensive income tax treaty, the text of which was recently released by the Japanese authorities. The official text is in the English language, so that in case of litigation only this text is authoritative.

The treaty applies to persons (including legal entities) who are resident of one of the Contracting States or — which will rarely be the case — who are resident in both States. However, where the treaty applies to a "resident of a Contracting State", the case of dual residence will be resolved by mutual agreement of the competent authorities of the two Contracting States. The taxes which are the subject of the treaty are (i) in Japan: the income tax, the corporation tax and the local inhabitant taxes and (ii) in Czechoslovakia: the taxes on profits, the wages tax, the tax on income from literary and artistic activities, the agricultural tax, the tax on population income and the house tax. The treaty will also apply to any identical or similar taxes which may be introduced at a later date.

The new treaty is largely based on the O.E.C.D. Model Convention and contains only few deviations. Some of the most significant features are discussed below.

Business income derived by an enterprise established in one of the States is only taxable in the other State if it can be attributed to a permanent establishment situated in the latter State (Art. 7). For the purposes of the computation of the income of such a permanent establishment it will be deemed to be a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment. Executive and general administrative expenses will be deductible. However, where it is customary in a Contracting State to determine the income of a permanent establishment by way of apportionment this will also be allowed.

The definition of the term "permanent establishment" is the usual one and comprises a place of management, branch, office, factory, workshop, a mine quarry etc, and a building site or construction or assembly project existing for more than 12 months (Art. 5).

Dividends distributed by a company of one of the countries to a shareholder resident in the other country will be subject to a tax which may not exceed 15 percent of their gross amount. Where the recipient is a company which owns at least 25 percent of the voting shares of the distributing company the rate of tax will be further reduced to 10 percent (Art. 10).

Interest paid by a debtor resident in one of the countries to a creditor in the other country may be subject to tax at a maximum rate of 10 percent of its gross amount in the country from which it has been derived. However, a complete exemption is available in two cases, i.e. if the interest is received by the government of the other Contracting State, including local authorities, the Central Bank or any financial institution wholly owned by that government and if the interest is received by any other resident of the other Contracting State provided that the interest pertains to debt-claims guaranteed or indirectly financed by the government of the other Contracting State or any other of its institutions listed above (Art. 11).

Royalties paid by a person resident in one of the Contracting States to a resident of the other State will be subject to a maximum rate of tax of 10 percent in the State from which they are derived if they are "industrial royalties" but will be completely exempt if they are "cultural royalties". "Industrial royalties" include consideration for the use of, or the right to use, patents, formulae, processes, designs etc. "Cultural royalties" denote consideration paid for the use of, or the right to use, copyright of literary, artistic or scientific work including movies and films or tapes for radio and television broadcasts (Art. 12).

Income derived from professional services rendered by physicians, lawyers, engineers, architects and the like and from activities of a scientific, literary, artistic, educational or teaching nature independently carried out will only be subject to tax if attributable to a fixed base in one of the countries (Art. 14).

As far as employment income is concerned, the usual rules apply, i.e. wages and salaries will be taxed in the country where the employment is exercised. Special rules apply if the employee is present in the other country for a period or periods of time not exceeding 183 days in the calendar year concerned (Art. 15). Remuneration received by a resident of one of the countries in his capacity as a member of the Board of Directors of a company established in the other country is subject to tax in the latter country (Art. 16).

With respect to the prevention of double taxation Japan will apply the tax credit method and Czechoslovakia either the exemption with progression method or — for dividends, interest, royalties, remuneration of company directors and income derived by entertainers — the credit method (Art. 23).

The treaty is subject to ratification and it will enter into force on the 30th day after ratification. It will then become effective for income of the tax year beginning on or after January 1 of the calendar year next following the year in which the treaty entered into force (Art. 28).

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JANUARY 1978

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SEPTEMBER 1978

32nd Annual Congress of I.F.A.: I. The Taxation of Extractive Industries; II. The Differences in the Tax Treatment between Local and Foreign Investors and the Effects of International Treaties. Sydney (Australia) September 17-23 (English, French, German, Spanish).

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Business Perspectives: 11 Alexander Place, London, SW7 2SG. Tel. 01-589-3197. Telex: 917036.

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Management Centre Europe: 4 Avenue des Arts, B-1040 Brussels (Belgium).

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POLISH PEOPLE'S REPUBLIC:

The Principles of Taxation of Income Derived by Foreign Individuals and Legal Entities

by Dr. Apoloniusz Kostecki

The increase of international economic cooperation between Poland and other countries on a permanent basis has led to activities being carried out by foreign individuals and legal entities on the territory of the Polish People's Republic. Such foreign individuals and legal entities are regarded as being domiciled abroad. It may also be the case that, although such persons do not carry out any direct activity, they derive income or receive a salary in respect of those activities in Poland. It should be pointed out that the principles of taxation of the foreign individuals are also applied to those individuals who have obtained permission for a permanent stay in Poland and are carrying on activities — such as handicrafts, domestic trade, catering and hotel services, as well as other services — by virtue of the permission granted by administrative bodies. However, those principles are applicable to the above mentioned individuals only for a period of ten years.

Under Polish tax law, income derived from such activities carried out by taxpayers of the non-socialized economy (apart from agricultural activities) will be liable to different taxes. In this connection, the following taxes are of primary importance: turnover tax, [1] *income tax,* [2] *and the tax on salaries* [3] *which will be levied depending on the kind of activities carried out. Under certain conditions, the taxpayers in question may also be liable to the equalization tax which is fairly high, being an additional tax on those incomes which exceed a certain fixed limit.* [4] *The way in which the said taxes apply in relation to foreign individuals and legal entities varies and depends directly or indirectly on the Act regulating any given tax. Specific regulations regarding the scope of the taxes are included in the provisions of the Laws on turnover tax, income tax and the tax on salaries.*

I. IN GENERAL

A. TURNOVER TAX

Pursuant to the provisions of Article 1 of the Law on turnover tax, any activity in the field of handicrafts, trade, industry and services — as well as other activities — will be taxable when carried out within the Polish territory by individuals, partnerships which are not legal entities and legal entities which are not units of the socialized economy. The provisions of that article stipulate unequivocally that taxpayers living or domiciled abroad are also subject to tax. It is immaterial whether their activities are carried out personally, or through agents operating from offices in Poland or other permanent establishments within the Polish territory.

B. INCOME TAX

It follows from Article 1 item 1 and Article 3 of the Law on income tax that foreign individuals and legal entities are subject to income tax *only* with respect to income derived from activities on the territory of the Polish People's Republic. It should be mentioned that they will be liable to tax irrespective of the location of the source of income if they have been in Poland for a period of time exceeding six months.

C. TAX ON SALARIES

In turn, Article 2 item 1 of the Law on the tax on salaries stipulates that individuals whose salaries are paid on Polish territory are obliged to pay the tax on salaries irrespective of their address or place of permanent residence. The Law itself, however, provides for certain exceptions from that principle with respect to foreign

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1. See the Law of December 16, 1972 on turnover tax (Dziennik Ustaw — the official periodical publication on laws and regulations — No. 53 item 338) and amendment Dziennik Ustaw 1976, No. 40 item 232.
2. See the Law of December 16, 1972 on income tax (Dziennik Ustaw No. 53 item 339) and amendment Dziennik Ustaw 1976, No. 40, item 231.
3. See the Law of February 4, 1949 on the tax on salaries (Dziennik Ustaw No. 7) and amendments in Dziennik Ustaw 1956 (No. 44 item 201), Dziennik Ustaw 1959 (No. 11 item 60) and Dziennik Ustaw 1963 (No. 57 item 309).
4. See the Law of December 19, 1975 on equalization tax (Dziennik Ustaw, No. 45 item 227) and amendment in Dziennik Ustaw 1976 (No. 40 item 233).

individuals. The Legislature, for various reasons, introduced three kinds of exemptions from the tax.

The first kind of exemption relates to salaries paid out of funds of a foreign country, funds of self-governed associations and other public funds of the same kind.

Another exemption relates to salaries paid in the territory of a foreign country, but for activities carried out within the Polish territory. This exemption is of a conditional nature. Namely, it must be proven that the salary is liable to the same kind of tax abroad and that the foreign country concerned applies the reciprocity principle concerning such salaries from sources in Poland as well as salaries paid within the Polish territory for work carried out in the foreign country.

The third exemption relates to salaries received by diplomatic and consular representatives of foreign countries as well as by their officials and other employees who are foreigners. The exemption from the tax on salaries for persons who are exempt from tax under international tax agreements or international law is based on the same reasons.

II. PRIVILEGED TREATMENT FOR FOREIGN TAXPAYERS

It should be stressed that, with regard to foreign individuals and legal entities, there are some exceptions from the taxation provisions which normally apply. These exceptions are, to a great extent, of an advantageous nature. The provisions of the Ruling of the Minister of Finance of November 2, 1973, regarding taxation of persons living or domiciled abroad and deriving income from the territory of the Polish People's Republic, [5] constituted the legal basis for the above mentioned exceptions in the taxation of foreign individuals and legal entities until June 30, 1977. These provisions have been abolished and, on July 1, 1977, substituted by the Ruling of The Minister of Finance of May 23, 1977 regarding taxation of foreign individuals and legal entities. [6] Only in those cases which the Ruling does not provide for, will the provisions which normally apply to Polish individuals and legal entities (not being units of the socialized economy) be applied. Moreover, if a tax agreement between the Polish People's Republic and another country lays down specific rules of taxation the provisions of the Ruling will not be applied.

A. EQUALIZATION TAX

The first main exception from the general rules of taxation — to the advantage of foreign individuals — provides that they are not subject to the particularly heavy *equalization tax*. [7] Until December 31, 1975, the legal basis for that specific tax privilege was contained in the above-mentioned Ruling of the Minister of Finance of 1973. Instead, it follows a contrario from the amended provisions of the Law on the Equalization Tax (in force as from January 1, 1976) that its provisions do not apply to foreign individuals, i.e. the provisions of Article 1 item 1 of the Law state quite definitely that individuals domiciled *in the territory of the Polish People's Republic* are liable to the equalization tax. It should be noted that the Law which had previously been in force did not include such a provision. Therefore, the exemption was introduced only by the above-mentioned provision of paragraph 14 of the Ruling of the Minister of Finance of 1973 which provided for the equalization tax not being levied on income derived by foreign individuals.

Apart from that general exclusion from taxation, foreign individuals and legal entities also benefit from specific exemptions from turnover tax and income tax.

Generally speaking, these taxpayers are entitled to exemptions on condition that their activities are carried out mainly for the benefit of or through the Polish units of the socialized economy.

B. TURNOVER TAX

As far as the *turnover tax* is concerned, the above-mentioned taxpayers are entitled to the exemption therefrom without any limitations, provided that they are building or assembling for the benefit of the units of the socialized economy. However, income derived from such activities is only exempted from income tax for a specific period of time. Namely, the exemption will only apply if the building or assembling works last no longer than six months. In that regulation one can see some encouragement to the intensification of the investment process.

Export-import activities are also exempt from turnover tax, on the condition that they are carried out for their own account and that trade partners are represented *exclusively* by the Polish units of the socialized economy. Where all commercial operations are performed by foreign taxpayers through Polish agency enterprises — apart from the offices they have established on the territory of the Polish People's Republic — they will benefit in addition from the exemption from income tax with respect to income derived from that activity. It would be noted that, unlike commercial activities carried out for their own account, export-import activies carried out by foreign individuals and legal entities on behalf of and for the account of other foreign individuals will not benefit from the tax exemptions. Such taxpayers will be obliged to pay turnover tax up to an amount of 10 percent out of the commission received. It should also be noted that the temporary exemption from the turnover tax relates also to those foreign individuals and legal entities who are carrying on activities such as hotel services, handicrafts, domestic trade, catering and other services, by virtue of the permission granted by administrative bodies. Hotel services are exempted for a period of three years, other activities for two years. That exemption is also an interesting innovation in the system of taxation of foreign individuals and legal entities.

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5. Dziennik Ustaw, No. 46 item 274.
6. Dziennik Ustaw, No. 18 item 71.
7. This tax was discussed in general in BULLETIN FOR INTERNATIONAL FISCAL DOCUMENTATION, No. 10 at 421 (October 1976).

C. INCOME TAX

In some cases, the exemption from taxation of gross income and net income derived by foreign individuals and legal entities is based on the reciprocity principle. Thus, sea and air navigation enterprises of those countries which do not tax Polish enterprises of that kind are exempted from Polish income and turnover tax. The reciprocity principle also constitutes a reason for exemption from turnover tax and income tax of activities carried out in cultural centers of foreign countries. On the basis of the same principle, those individuals and legal entities living or domiciled abroad who derive income from interest on loans granted to the Polish units of socialized economy are also entitled to an exemption. Such an exemption was not included in the principles of taxation of foreign individuals and legal entities previously in force.

III. REGULAR TURNOVER AND INCOME TAX LAW

In cases not covered by the exemptions from turnover tax and income tax discussed above, tax will be computed on the basis of the rules which normally apply or on the basis of special rules laid down in specific Acts as well as in the Ruling of the Minister of Finance of 23rd May, 1977.

A. TURNOVER TAX

As far as turnover tax is concerned, taxation is in general based on the provisions which normally apply to Polish taxpayers on the non-socialized economy, i.e. on the above-mentioned law of December 16, 1972 on turnover tax, as amended by the law of December 18, 1976.

Rates of turnover tax vary greatly and differ according to the kind of work carried out. The rates are as follows:

a)	publishing activities	1%
b)	commercial activities	5%
c)	catering activities consisting of the sale of drinks containing more than 18% alcohol	8%
d)	agency agreements, immediate job orders, brokerage and commission business, the sale of tobacco and matches: of the commission fee	10%
e)	hotel business	15%
f)	entertainment and sporting activities	30%
g)	for other activities, rates are fixed by the Minister of Finance between	1 and 6%

As can be seen from the amounts of the turnover tax specified above, the taxpayers dealing in the hotel business by virtue of the permission granted by administrative bodies are benefitted by a marked tax relief. Namely, the respective tax will be decreased to 8% for a period of ten years from the date of the beginning of the activity. Guest houses and tourist camps have been excluded from such relief.

In order to avoid a possible misunderstanding in interpretation of the concept of the turnover in foreign trade activities, the Legislature has stated explicitly (paragraph 7 item 2 of the above-cited Ruling) that by turnover it is meant the value of goods sold to Polish customers, with the place of contract signing being irrelevant. Such value is equal to the contract price, with the freight and insurance costs deducted.

B. INCOME TAX

As from January 1, 1977 (the date when the provisions amending the Law on income tax of December 16, 1972 came into force) a considerable simplification was introduced in relation to the taxation of income of foreign individuals and legal entities. Namely, they will be taxed at a rate of 50 percent of their income derived from the Polish territory. In this way, the progressive rates previously used which varied according to the source of income have been replaced by proportional taxation which represents a rare phenomenon in the field of income tax.

That principle has been abandoned in relation to those foreign individuals and legal entities who — by virtue of

A SHORT BIBLIOGRAPHY ON POLISH TAX LAW

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the permission granted by administrative bodies — are carrying on activities in the hotel business, handicrafts, domestic trade, catering and other services. In those cases, the taxation is advantageous for the taxpayers since the lowest — i.e. the first — of the tax rates will be applied, with the additional reservation that the income tax must not be higher than 50%.

1. *Basic exemptions*

The difference between that kind of taxation and the rules normally applicable will be better understood if we outline the principles applicable to Polish taxpayers. The Law on income tax of 1972, as amended by the provisions of the Law of December 18, 1976, [8] gives three tax tables according to the sources of income involved. It is significant that the tax exempt basic amount has been fixed at a relatively high level, i.e. at 72,000 zloties per year. This amount will be increased by the amount of personal social insurance paid by the taxpayer, i.e. 24,000 zloties if the taxpayer is married, and also by an amount of 12,000 zloties for each child supported by the taxpayer as well as for his parents and spouse and each brother and sister who are incapable of working and financially dependent on the taxpayer. Note that with respect to certain kinds of income derived from other than the taxpayer's labor and business activities (e.g. capital income), a lower basic tax exempt amount of 30,000 zloties will apply.

2. *Rates*

The Polish income tax system is a schedular one. There are three different schedules aggregating the income from certain defined sources of income. Consequently, there are three appropriate tax tables.

As can be seen from an analysis of the tax tables the taxation of foreign individuals and legal entities is, in general, more favourable only in relation to the higher incomes. However, those taxpayers will not be eligible for the basic tax exempt amount.

Tax table I applies to income from hotel services, restaurants (not selling alcoholic beverages), some transportation services, income from some independent services such as scientific, artistic, literary, journalistic and educational activities and income from handicrafts. This tax table is as follows:

Annual income in zloties (in excess of the lump-sum tax-free amount)		*Annual tax*	
over	up to	zloties	zloties
	24,000	20%	
24,000—	48,000	4,800 + 25% for any sum over	24,000
48,000—	72,000	10,800 + 30% for any sum over	48,000
72,000—	96,000	18,000 + 40% for any sum over	72,000
96,000—	120,000	27,600 + 50% for any sum over	96,000
120,000—	240,000	39,600 + 60% for any sum over	120,000
240,000—	360,000	111,600 + 70% for any sum over	240,000
360,000—	480,000	195,600 + 80% for any sum over	360,000
480,000		291,600 + 85% for any sum over	480,000

Tax table II applies to income from commercial and industrial activities and from services other than those mentioned under tax table I. It is as follows:

Annual income in zloties (in excess of the lump-sum tax-free amount)		*Annual tax*	
over	up to	zloties	zloties
	24,000	25%	
24,000—	48,000	6,000 + 30% for any sum over	24,000
48,000—	72,000	13,200 + 40% for any sum over	48,000
72,000—	96,000	22,800 + 50% for any sum over	72,000
96,000—	120,000	34,800 + 60% for any sum over	96,000
120,000—	240,000	49,200 + 70% for any sum over	120,000
240,000—	360,000	133,200 + 75% for any sum over	240,000
360,000—	480,000	223,200 + 80% for any sum over	360,000
480,000		319,200 + 85% for any sum over	480,000

Table III applies to income, e.g. income from property rights and from capital (i.e. income from annuities granted by donation or inheritance, income from copyright royalties and patent royalties, income from the leasing of films, interest from loans, dividends and other income distributed by legal entities). This table is as follows:

Annual income in zloties (in excess of the lump-sum tax-free amount)		*Annual tax*	
over	up to	zloties	zloties
	24,000	30%	
24,000—	48,000	7,200 + 40% for any sum over	24,000
48,000—	72,000	16,800 + 50% for any sum over	48,000
72,000—	96,000	28,800 + 60% for any sum over	72,000
96,000—	120,000	43,200 + 65% for any sum over	96,000
120,000—	240,000	58,800 + 70% for any sum over	120,000
240,000—	360,000	142,800 + 75% for any sum over	240,000
360,000—	480,000	232,800 + 80% for any sum over	360,000
480,000		328,800 + 85% for any sum over	480,000

IV. MODIFICATIONS

Until the Law on income tax was amended, foreign individuals and legal entities were taxed in accordance with the tax tables which normally applied, with certain modifications resulting from the provisions of the Ruling of the Minister of Finance of November 2, 1973.

A. TOP RATES

The main modifications introduced by the latter provisions consisted of fixing the top rate of tax at 30 percent in respect of income derived from property rights and capital with a steeper progression, and at 50 percent in respect of income derived from other sources, however, with a less steep progression. It is necessary to explain that income derived from property rights and capital is defined in the provisions of the Ruling as

8. Dziennik Ustaw 1976, No. 40 item 231.

THE EFFECT OF POLISH TAX TREATIES

A. 30% tax on dividends, interest and royalties paid to non-residents:

1. *Dividends*
— reduced to 15% (or 5% in the case of a 25% holding) under the tax treaties concluded by Poland with the Federal Republic of Germany, Sweden, Denmark and the United Kingdom;
— reduced to 15% (or 5% in the case of 10% holding) under the tax treaties concluded by Poland with the United States and France;
— reduced to 15% (only in the case of a 33 1/3% holding) under the tax treaty between Poland and Pakistan; and
— reduced to 10% (in all cases) under the tax treaty between Poland and Austria;

2. *Interest*
— only taxable in State of residence (the Polish tax thus being reduced to zero) under all treaties concluded by Poland, except the Poland — Pakistan tax treaty;

3. *Royalties*
— reduced to zero under the tax treaties concluded by Poland with the Federal Republic of Germany and Austria;
— reduced to 10% under the tax treaties concluded by Poland with the United States, Sweden, France, Denmark and the United Kingdom; and
— reduced to 20% (cultural royalties) or 15% (patent royalties) under the Poland — Pakistan tax treaty.

B. Employment income earned by foreigners who are present in Poland for a period of time not exceeding 183 days is not subject to the Polish tax on salaries according to the tax treaties concluded by Poland. Moreover, this term is extended to one year under the tax treaty between Poland and Austria.

follows: dividends and other income from sharing of profits of legal entities, interest on loans, patent royalties, charges for the hire of films, for the showing of films on television and in the cinema, etc. It should be noted that the tax on dividends and other income from the sharing of profits of legal entities may be reduced in specific cases upon application to the Minister of Foreign Trade.

B. LUMP-SUM TAXATION

The system of taxation of foreign individuals and legal entities also contains a characteristic solution which consists of the turnover tax and income tax being assessed in the form of a lump-sum. This will only apply to certain kinds of activities carried on by such taxpayers. Apart from simplifying the tax assessment, the lump-sum assessment contains substantial tax relief. The lump-sum turnover and income tax assessment will apply, in the first place, to income from show business, entertainment and sporting activities carried on by foreign entrepreneurs but organized by Polish show business, etc. enterprises. The lump-sum tax amounts to 12 percent of the fee for the services rendered. A lump-sum assessment of 10 percent will also apply to foreign air navigation and merchant shipping enterprises if the above-mentioned tax exemptions are not applicable. The lump sum assessment will apply to such enterprises with respect to income derived from Poland; however, as regards merchant shipping enterprises it will apply to income derived from the transport of goods and passengers *from* Polish ports (except for transit traffic).

C. TAX ON SALARIES

Some kinds of income have been granted special tax privileges, the Legislature having made them subject to the above-mentioned tax on salaries instead of the income tax. Generally speaking, the kinds of income involved are derived from job agreements or immediate job agreements as well as from employment. The first group of income, subject to the tax on salaries, includes income from creative work, research, artistic production, fiction writing, journalistic and educational activities and the like. They are taxed in accordance with the Ruling of the Minister of Finance of May 23, 1977 at a rate of 30 percent of the salary which is transferred abroad *in foreign currency*. It should be noted that, in this case, costs incurred in generating the income may not be deducted, unlike in the case of salaries paid in Poland for the same kinds of activities.

The tax on salaries is progressive. The same amount of tax is collected from foreign individuals as from Polish individuals. To give an example, in relation to earnings from employment it may amount to up to 12 percent of the salary received from the first employer [9] and, in relation to earnings from an immediate order agreement for a job agreement to up to 21 percent of the salary received from the first principal orderer. The taxation of earnings from further employers or principal orderers is levied at considerably higher rates.

9. At present the tax on earnings from employment is of much less importance in Poland, since in relation to employees of the socialized economic units it has been replaced by a tax on payroll which is levied on the employers.

D. PROCEDURE

There are certain provisions of a procedural nature which apply to foreign individuals that are worthwhile mentioning. The provisions of paragraph 7 item 1 of the Ruling of May 23, 1977 are particularly interesting. They provide that in the absence of accounts or if it is impossible to determine income because of insufficient records, taxable income will be estimated at the following standard profits in relation to the turnover:
10% — from building or assembling activities;
5% — from export-import activities;
20% — from other activities; and
60% — from brokerage.

In such a case, the taxpayer involved may prove that the portion of profit in the turnover resulting from all activities both abroad and within the territory of the Polish People's Republic is, according to the balance sheet, lower than that calculated as above. The income will then be fixed for tax purposes within the amount proved; however, not at less than 3%.

Still, the above-mentioned principles will not be applied to those foreign individuals and legal entities who are carrying on economic activity on the basis of permission granted by administrative bodies. The above taxpayers are not obliged to keep accounts and so neither are those who derive income from property rights and capital, creative work, research, educational activities, artistic production, fiction writing and journalism, as well as income subject to lump-sum assessment.

In order to improve the tax collection procedure, the tax is collected by the Polish units of the socialized economy at the moment the earnings are received by the above-mentioned taxpayers.

U.S.A.:

Economic Prospects

Just at a time when there is a need for tax reduction to assure that the economic recovery continues next year, the immediate prospect is for actual increases in federal taxes for individuals and corporations. The most imminent change will be the sharp rise in Social Security taxes for workers and businesses next year. Then there will be added energy costs, once Congress finishes its energy program. The economic impact of these measures, along with the new higher minimum wage for next year and possible oil price increases by the oil nations, cannot yet be fully known until their details are worked out. Even before the added tax costs on the new Social Security financing plan are known, there is a legislated increase in that area for next year for both workers and employers. There is also a higher cost of unemployment insurance to be borne by employers next year. These two existing programs alone will add about $8.5 billion to government revenues, out of taxpayers' pockets.

The President has announced that he is delaying his tax plan for next year. This will allow the tax reform to take into account the final Social Security and energy legislation. Some analysts outside the government think the greatest benefit of the delay will be a bigger, and less complex, tax package. Another analyst felt that it might cause the tax program to emphasize the encouragement of private investment to spur the economy and create more jobs, rather than the consumption side, as originally expected. There could also be less immediate interest on the part of the administration in eliminating the special treatment of capital gains.

The international Bureau of Fiscal Documentation envisages to report on these and other tax developments in the U.S.A. in upcoming issues.

TAX GLOSSARY

by H.W.T. PEPPER *

COMMONWEALTH PREFERENCE — Most goods imported from the Commonwealth are entitled to admission to the U.K. free of PROTECTIVE DUTY (q.v.). Certain manufactured goods are excluded from preference (e.g., motor vehicles, watches, silk). ("Commonwealth" for preference purposes includes Burma, Eire, and South Africa which are not members of the Commonwealth.)

COMMUNITY PROPERTY — A U.S. citizen married to a non-resident alien may, under a community property regime, reduce his/her income tax bill by attributing one half the community income to the non-resident spouse. Where no election is made, there are now rules for allocating the various types of income accruing to the two spouses.

Some countries have rules relating to DEATH DUTIES (q.v.) regarding property acquired by husband and wife during marriage, when applying duty or tax on the death of one spouse. (See also INCOME-SPLITTING.)

COMMUTATION — During the currency of succession duty in Britain it was possible to commute the duty in certain circumstances, for example, where the purchaser of property subject to duty stipulated that he wished to buy the property clear of prospective liability to duty. Where duty was prospectively payable on the death of a person the duty on the property could be commuted in his lifetime by the tax department in certain circumstances.

It is unusual in the ordinary way for tax to be commutable, but it is fairly common for *tax plus penalties* to be commuted, for a figure smaller than the maximum exigible under the tax law, in settling a tax evasion case. There have also been examples of tax liability being commuted at less than normal tax rates when tax amnesties have been granted in certain countries to give tax evaders and defaulters an opportunity to wipe the slate clean.

COMPANY TAX — Income tax on the income of companies and corporate bodies (see also CORPORATION TAX). Occasionally the term may be applied to other types of levies on companies such as an annual percentage charge on nominal or issued capital, particularly in countries which have no income taxation.

COMPENSATION, LOSS OF EMPLOYMENT — Non-contractual compensation for the loss of employment is commonly exempted from income tax but some countries have taken steps to deem such receipts chargeable to tax. In Britain tax is payable on the excess of such compensation over £5000, this measure having been introduced to combat tax avoidance in the case of compensation to directors and others in CLOSE COMPANY (q.v.) situations.

COMPENSATORY TAX — A tax included by the E.E.C. as one of the harmonisation proposals for Community countries, and based broadly on the French and British systems of company tax. If dividends are paid out of corporate resources not, or not fully, charged to tax, compensatory tax would be levied equal to the amount of the tax credit relevant to the dividends, less any tax actually charged on the distributed income. In France the credit is the AVOIR FISCAL (q.v.) and a PRECOMPTE (q.v.) is levied when the company tax is deficient. In Britain the A.C.T. (ADVANCE CORPORATION TAX, q.v.) is levied when dividends are paid, may be offset against MAINSTREAM TAX (q.v.), but is not refundable if it exceeds mainstream tax. Under the French system a deficiency for compensatory tax purposes arises where profits, otherwise available to cover dividends, were earned more than 5 years ago — in Britain there is a 2-year limitation.

COMPLEMENTARY TAX — A tax sometimes imposed on total income in SCHEDULAR TAX SYSTEMS (q.v.). Under a schedular system the tax is usually charged at flat rates on various classes of income, a complementary tax being introduced to apply an element of graduation to the wealthier taxpayers who have greater TAXABLE CAPACITY (q.v.).

COMPLIANCE, TAX — The degree to which taxpayers fulfil their duties of correctly declaring their liability to tax and paying the tax due.

COMPONENT — In sales taxation care is usually taken to avoid double taxation which may ensue, e.g., if sales tax is levied both on the finished product and on the parts or components which are used in making that product. The term "component" may also be used broadly to cover all types of parts or ingredients which form part of the finished product.

COMPOUNDING — See COMMUTATION.

COMPOSITE RATE — In Britain, building societies pay tax at a composite rate (based on the average marginal personal tax rates of their depositors) in respect of the collective income tax liability of the depositors on the interest received from money deposited with the societies. (See BUILDING SOCIETY ARRANGEMENT.)

CONCESSIONS, EXTRA-STATUTORY — In the administration of taxes some anomalies or hardships which were not intended by, and are not within the spirit of, the tax law may be corrected by the administration's granting a concession. In some cases such concessions may merely precede projected changes in the law — in other cases it may be more convenient not to try to mould a law to deal with all types of exceptional cases but to continue to deal with these by concession. Obviously great care has to be exercised in granting such concessions and to control the way in which the concessions are implemented by the tax department. In Britain the extra-statutory concessions granted by the Board of Inland Revenue are published in booklet form for the information of the public.

CONCESSIONS, LAND OR MINERAL — Sometimes territorial concessions are made to entrepreneurs on the basis that they will have the sole rights within a particular area to prospect for and extract minerals. Formerly such concessions might have extended to exempt the entrepreneurs, e.g., from customs duties on their equipment and consumable stores although it is not usual to exempt such items as income

* With the assistance of the staff of the International Bureau of Fiscal Documentation.

tax on staff salaries, profits from the undertaking (unless fixed by clauses in the concessions agreement) or duties on personal consumption of goods by personnel.

CONDUIT COMPANIES — A company may be set up in connection with a scheme for tax avoidance whereby income is paid into such a company so giving the income the new identity of distributions by that company when paid out to the shareholders. There will normally be a favourable tax situation for the company in question through its being situated in a tax haven, or in a country which has a low rate of company taxation and beneficial tax treaties with other countries. The promoters of the company use the company as a "conduit" for the income which it is desired should be "franked", or taxed at a reduced rate under the avoidance scheme. Such companies are known as "conduit" companies.

CONSANGUINITY — A feature of many ESTATE DUTY (q.v.), SUCCESSION DUTY (q.v.) and GIFT TAX (q.v.) regimes is that lower duty is often charged on bequests or gifts made to nearer rather than more distant relatives, i.e., according to the degree of consanguinity. Between spouses, who are thus regarded as "one flesh" for tax purposes, there is often no duty at all.

Curiously, however, where gifts or bequests to charities (where there is no relationship to the testator or donor at all) are exempt, the exemption seems inconsistent with the "consanguinity principle", although charitable gifts are socially desirable.

A taxpayer usually has a legal as well as a moral liability to provide for his children and widow and this factor is the main reason for favouring, for tax purposes, transfers of wealth in those directions.

CONSEIL FISCAL — TAX CONSULTANT (France, Belgium, Luxembourg).

CONSOMME SUR PLACE — Expression used in France to describe services which are "consumed" or expended the moment they are rendered, as distinct, e.g., from the, hopefully, more lasting services of plumbers, electricians, carpenters and plasterers. The ephemeral type of service includes those rendered by restaurants and places of entertainment and many of those rendered by hairdressers and barbers.

CONSORTIA — Companies may come together ("consort") for the purpose of a particular venture or ventures sharing profits or losses, providing capital, etc., in fixed ratios. The joint enterprise may take corporate form, the share capital being divided appropriately among the consorting group. In such cases special tax treatment is usually afforded on the same basis as that accorded to GROUPS (q.v.). Under U.K. tax law the consortia treatment is granted where five or fewer companies jointly own another (trading) company, either directly or through an investment company.

CONSUMPTION TAX — A sales tax on goods and services in general consumption as distinct from a tax on luxuries. The term "consumption taxation" is, however, sometimes applied to taxes on all forms of consumption whether of necessities, semi-luxuries, or luxuries.

CONTINENTAL SHELF AREAS — The sea-bed off a country's coasts is referred to as the "continental shelf" and is defined by international convention as

"(i) the seabed and subsoil of the submarine areas adjacent to the coast but outside the area of the territorial sea to a depth of 200 metres, or beyond that limit where the depth of the superjacent waters admits the exploitation of the natural resources of the area, and

(ii) to the seabed and subsoil of similar sub-marine areas adjacent to the coast of islands."

Such areas are now divided between littoral states mainly for the purposes of oil, gas, and other mineral exploration and exploitation. Where an ocean or sea separates two states and the seabed between them is entirely or partly continental shelf it is usual to divide the "shelf" by a "median line".

CONTRA ACCOUNTS — Where goods or services are transferred to or performed by one trader or professional for another and there are two-way transactions of this kind, settlement may be made only as to the net balance at the end of an accounting period. For income tax and sales tax purposes, however, it is normally necessary to bring the gross figures into account both for in-comings and outgoings in order to compute the liability correctly. (See also BARTER.)

CONTRACT OR ESTIMATE BASIS — Where the records kept, particularly by small traders, are inadequate for the precise calculation of sales tax — in some cases income tax also — the tax due may be assessed on the basis of calculations made annually, biennially, or at longer intervals on the basis of the best information that can be obtained by the tax department. (See also ESTIMATIVA and FORFAIT.)

CONTRIBUTION — Tax (France, Belgium, Luxembourg).

CONTRIBUTION FONCIERE — Land tax (France).

CONTRIBUTION DES PATENTES — Business tax (France).

"CONTROL" — The difficulty of computing liability, particularly income tax, but in some cases sales tax also, may be increased where one taxpayer is controlled by another with whom he has business dealings or where two such taxpayers are controlled by a third. The reason is that transactions between them may be entered into other than on the ordinary trading terms which would apply if the taxpayers were at arms' length. (See also ARMS' LENGTH TRANSACTIONS.) It is often a matter of some difficulty to define "control" in such a way as to cover all situations where control is effectively exercised and this is one of the subjects within the province of ANTI-AVOIDANCE MEASURES (q.v.) in general.

CONTROLLED COMPANY (CORPORATION) — In tax parlance, a controlled company is usually one in which the voting share capital is owned or controlled by another company — the two companies then form a GROUP (q.v.). A company controlled by one person or a small number of persons may be a CLOSE (or CLOSELY-HELD) COMPANY (q.v.). The degree of control may vary for different tax and company law purposes, e.g., 51 percent may constitute control for GROUP TREATMENT, but 75 percent and 100 percent control may be significant for certain other purposes. (See also CONSORTIA.)

CONVENIENCE — One of Adam Smith's CANONS OF TAXATION (q.v.).

CONVENTIONAL BASIS OF ASSESSMENT — A system adopted in the British tax code for taxing the profits of businesses and professions on current income, but measured on a conventional basis, usally as the income of the previous year. Other bases are adopted during the commencement year and two following years, and the cessation and two previous years. (See also CESSATION ADJUSTMENTS and COMMENCING ADJUSTMENTS.)

CONVEYANCE TAX — This term has two meanings and may relate to the levying of stamp or other duties (usually charged on an ad valorem basis) levied when real property is legally "conveyed" from one person to another.

The term may also relate to taxes on conveyances, i.e., vehicles. (See CARRIAGE TAX, ROAD TAXES, VEHICLE TAXES.)

CO-OPERATIVE SOCIETIES, TAXATION OF — In many countries co-operative societies are exempted from income tax and other forms of taxation either by application of the MUTUALITY PRINCIPLE (q.v.) or as a means of encouraging development of such organisations. Such societies are often promoted by governments as a means of fostering self-help, as well as greater prosperity, among small traders and farmers; and consumers may set up retail or wholesale co-operative societies in order to obtain their supplies at competitive prices.

COPYRIGHT — Payments for use of copyright, whether by ROYALTIES (q.v.) or outright purchase, are generally taxable. The latter type of payment may occasionally not be regarded as income if it does not arise out of the owner's trade or profession.

Copyrights are of two kinds, (a) industrial or commercial, and (b) literary, musical, and artistic, and royalties for the two groups are frequently dealt with in a double taxation treaty in the case where the owner is in one country and the licensee in another. As a subdivision of group (b), cinematograph royalties may be treated separately, as such "royalties" normally constitute a gross receipt rather than a net income to the recipient.

CORPORATION PROFITS TAX — This tax (C.P.T.) was imposed at the rate of 5 percent on the profits of companies in Britain during the period 1920 to 1924. C.P.T. was a special tax additional to income tax on corporate bodies, the latter tax being often known simply as CORPORATION TAX (q.v.).

CORPORATION TAX — The term applied to income tax on corporate profits, often where such profits are taxed under the CLASSIC SYSTEM (q.v.) or some variant of that system. Corporation tax in Britain was introduced in 1965 on the income of corporate bodies.

The term corporation tax is sometimes applied to levies on the income of corporate bodies on the footing that such bodies do not "die" and are therefore never subject to death duties, corporation tax, therefore, being a substitute for the periodic levying of death duties. Such taxes are imperfect instruments, however, since death duties will be payable by individual shareholders in respect of their holdings in corporate bodies and it would be a matter of some complexity to draft a corporation tax to apply only to that part of the income of a corporate body which was not ultimately likely to form part of the estate of a deceased person.

COST OF COLLECTION — The cost of collecting a tax is partly the administration cost incurred by the government in providing a tax department (see also ADMINISTRATION COST, EXPENSES RATIO), but also includes the additional cost to the private sector of compliance with the tax laws. Complaints are sometimes made by the private sector about the cost to them, for example of collecting employees' income tax by deduction at source from salaries and wages and of keeping special books or special types of records in order to comply with sales tax requirements, especially in multi-rate systems. Some of the states in the U.S.A. and some of the provinces in Canada allow a small percentage deduction to businesses to compensate them for the cost of complying with state or provincial retail sales tax laws. Such allowances are, however, the exception to the general rule that governments do not normally make any contribution towards the cost of tax compliance by the private sector except to the extent that such expenses may be deductible in arriving at profits for income tax purposes.

COUNTERVAILING DUTIES — This term is used in two senses:

(1) In Britain there are countervailing duties in respect of goods which are imported and which are of the same type as locally produced goods upon which excise duties are charged. For example, there is an excise duty on British manufactured beer and a countervailing customs duty on imported beer.

(2) The other sense in which duties may be said to countervail other duties is where some goods may be substituted for others. For example, in Britain matches are taxed fairly heavily (approximately 1 p — U.S. 2.5 cents — per 100) and mechanical cigarette and gas lighters which could serve as a substitute for matches are subjected to a specific tax of from 30 p to 35 p per unit, apart from the duties on the fuel used by some types of lighters.

COUNTY SALES TAX — In some parts of the U.S.A. retail sales taxes are levied by counties (e.g., in Calafornia). The administration of such taxes is usually undertaken jointly with that of the municipalities' and the states' retail taxes.

COUPON TAX — Dividends and interest on bearer securities are normally claimed by the owner clipping a coupon from the sheet of coupons issued with the security on purchase. Since the owner of a bearer security may not be known to the tax authority, some tax codes provide for tax (i.e., a coupon tax) to be deducted at source from all coupon payments. Should the deduction exceed the holder's tax liability he may normally reclaim the excess, declaring (if he has not already done so) his ownership of the security.

COVENANTS — Deductions for charitable donations are permitted in some countries' tax codes, and may be allowable on general principles where the charity has some relevance to the taxpayer's business, or the welfare of his employees. In Britain deductions are due for donations to registered charities where made in the form of a contractual annuity under a covenant for a period of not less than 7 years. (See also CHARGES; CHARITIES, DONATIONS.)

CREDIT BAIL — A French term, meaning the hire purchase of real property.

CREDIT D'IMPOT — A term used for credits against income tax in France in respect of tax withheld at an earlier stage (see also AVOIR FISCAL); in Belgium more particularly a credit similar to the French "avoir fiscal".

CREDIT, POST WAR — A system introduced in World War II in Britain whereby additional tax was charged to take money out of circulation and thus restrict consumer spending but with the provision that the extra money would be refunded after the war. The process of repaying the credits has, however, been extended beyond what was intended originally by linking payment of the credit to either the death or the reaching of retirement age by the person entitled to a refund. A final refund of the amounts outstanding was begun in 1972 (see also POST WAR REFUNDS). A somewhat similar system in South Africa which has functioned on a continuing basis during the last two decades but which was not related to the specific crisis of the second World War is referred to under LOAN LEVY.

CREDIT, PRECOMPTE AND PAYMENT — Where tax is deducted or withheld at source from certain income a credit is normally allowed in making the assessment on the income in the hands of its recipient by making a credit for the tax actually deducted against the total tax charged in the assessment.

CREDIT, TAX, DOUBLE TAXATION RELIEF — Most countries give relief in their assessments on the foreign income of their resident taxpayers in respect of tax charged on such income in the country of origin. The relief is usually given in the form of a credit for the foreign tax or a part thereof against the tax charged on that income in the country of residence. (See also DOUBLE TAXATION.)

CREDIT, V.A.T. — Under value added tax systems tax is normally charged on the total value of the sale at each level of distribution but a credit is given for the tax paid on the same goods by the seller when he himself acquired them. (See VALUE ADDED TAX.)

CREDITABILITY — The term used to label the tax relevant to a particular item of income, which if it may be credited under the tax law against other tax liability is said to have "creditability" or be "creditable".

CREMATORIA TAX — A tax, sometimes levied by a local authority on the use of crematoria. (See BURIAL TAX and CEMETERY TAX.)

CRIMINAL PENALTIES — The penalties applied where a taxpayer has been guilty of tax fraud rather than mere neglect of his duties and responsibilities under the tax code.

CROWN CORK TAX — A method of levying consumption tax on aerated drinks which are sealed by means of crown corks. The tax is normally a flat rate levy on the crown corks which may be administered efficiently by keeping tight administrative control of the output of the crown cork factory. The disadvantage is that the tax cannot be related to value and therefore falls unevenly, in ad valorem terms, on drinks of different quality and on bottles of different sizes which take the same size of crown cork. Moreover the tax is discriminatory against aerated drinks and does not fall upon what may be a substantial consumption of non-aerated beverages. Avoidance may occur by use of other methods of sealing bottles.

CUMULATIVE SYSTEM OF PAYE DEDUCTIONS — Under the British system of withholding tax on employees' remuneration from the salaries and wages paid to them the tax is calculated on a cumulative basis by reference to the total remuneration accrued from the date of commencement of the tax year to the date of payment of the remuneration, the tables being prepared on the assumption that the remuneration paid to date will continue at the same rate for the whole year, a deduction being made, however, for the tax already deducted from previous payments of remuneration within the same tax year. This is a refinement compared with most other tax deduction schemes for employees which normally apply the rate of tax deduction appropriate to the salaries or wages of each particular month or week on the assumption that the level of remuneration is the rate which will apply to the full year. Under the British system the total tax calculated is in fact adjusted cumulatively at each pay day so that at the end of the tax year no further adjustment is necessary. Under non-cumulative systems an annual comparison has to be made between the total deductions and the actual liability, a refund then being made or an additional amount being collected.

CUMULATIVE TAX — A sales tax which is charged on a commodity which applies at each level of distribution so that the total tax incidence is cumulative. Also known as CASCADE TAX.

CURRENT USE VALUE — A concept used in the BRITISH DEVELOPMENT LAND TAX (q.v.) in connection with the computation of the development gain, which is defined as not (inter alia) to exceed proceeds of sale less 110 percent of current use value. Current Use Value is itself defined to take account only of the "non-material" development, a term which includes use for agriculture, forestry, and advertising.

CUSTOMS, DUTIES — Customs duties are levied on goods imported into a country, usually on the AD VALOREM (q.v.) basis, but sometimes on the basis of specific duties being charged on particular items. Where imported goods are not to be consumed immediately or where they may later be re-exported, they may be kept in BONDED WAREHOUSES (q.v.) in which case duty will be charged only when the goods are brought out of bond for consumption within the importing country. (See also FREE PORT, FREE TRADE AREA.)

CUSTOMS, HANDLING CHARGES, ATTENDANCE FEES — In some countries small charges are made on all goods imported as a form of EAR-MARKED REVENUE (q.v.), ostensibly to cover the cost of providing customs checks on goods imported (see also PACKAGE TAX). Although the imposing of customs handling charges is now rather rare it is quite usual for countries to charge attendance fees for customs officers' services when these services are supplied for the convenience of traders in order that goods may be imported or withdrawn from bond at times outside normal working hours.

CUSTOMS REGULATOR — Provision in U.K. (renewable annually by Parliament) by means of which Treasury can make an Order increasing or decreasing the principle revenue duties by up to 10 percent. (See also REGULATOR TAX.)

CUSTOMS UNION — A union of countries which maintains tariffs against the rest of the world but aims at free trade among union members. A historical example is the German Zollverein which provided for duty-free movement of goods within German states before their unification under Bismarck. In modern times free trade areas and Common Market combinations are forms of customs unions.

[to be continued]

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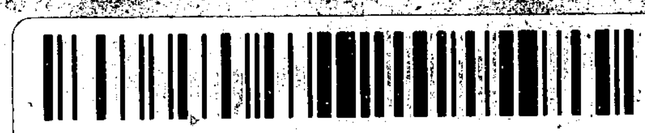
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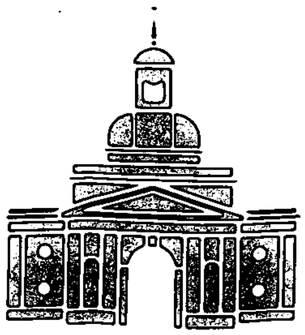
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The Financing of the Southern Region and other Regional Governments of the Sudan

by John F. Due and Jean M. Due*

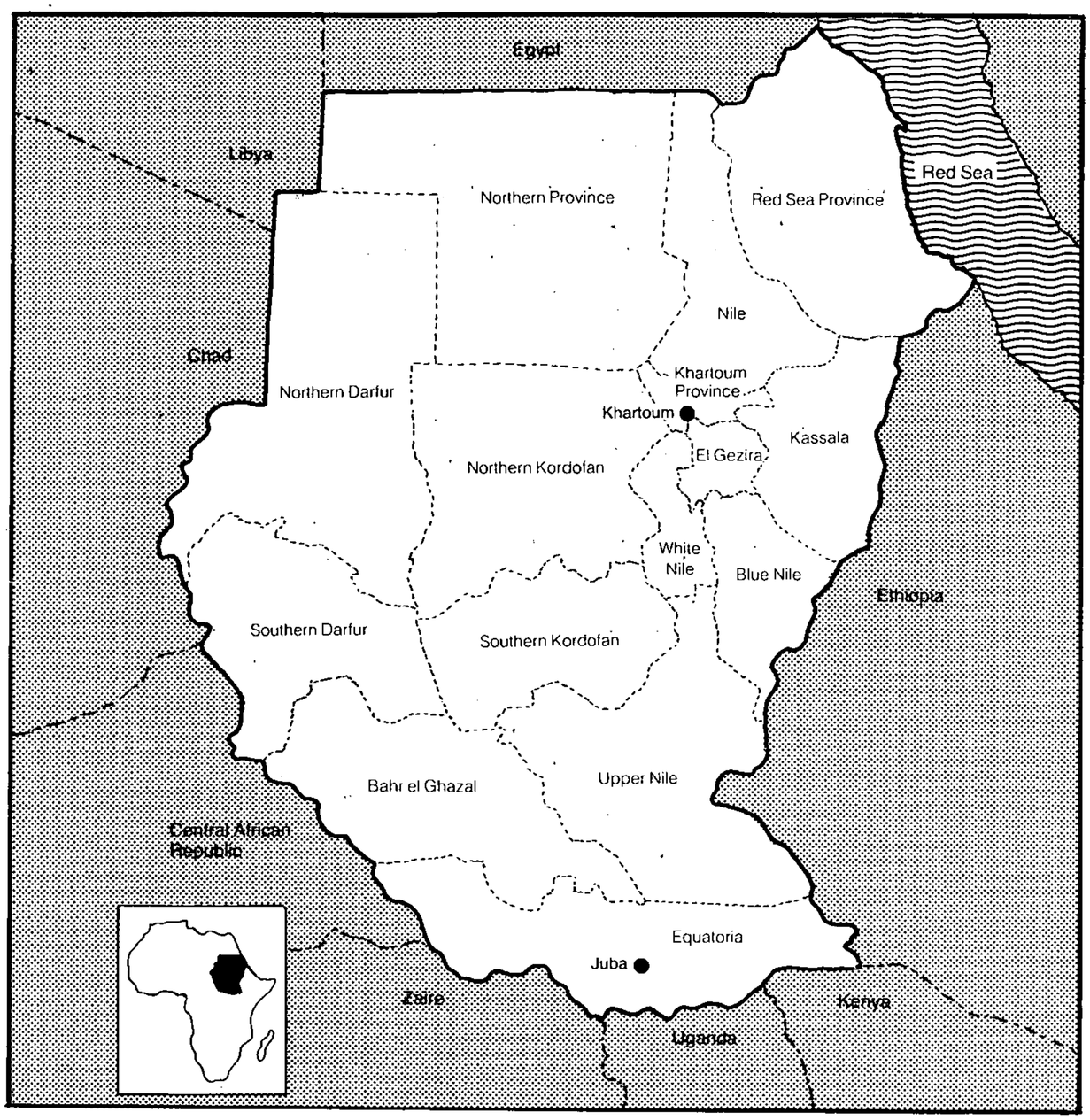


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I. INTRODUCTION

The Southern Region of the Sudan was given a high degree of autonomy in 1972, as a move to end the seventeen-year civil war. The Southern Region (SR) has its own elected assembly, cabinet, and president, who is also vice president of the Central Government. Most governmental functions in the South, other than defense, foreign relations, and services of a national character, such as the post office, were given to the SR government. The SR is relatively isolated from the rest of the country, and differs sharply in other respects; it is primarily non-Moslem, with English, not Arabic, as the common language. The semi-subsistence typically tropical agriculture, the basis of the livelihood of most of the population, contrasts with the irrigated and dry land mechanized farming of the rest of the country.

It is the purpose of this paper to review the methods of financing of the SR, and the significance that this financing may have for the newly-created (December 1980) regional governments in the rest of the country.

* The authors are Professor of Economics and Professor of Agricultural Economics at the University of Illinois, Urbana. They are indebted to the officials of the government of the Southern Region of the Sudan for their assistance, and particularly to Dr. David Bassiouni, Director General of Agriculture of the Southern Region.
This paper is based upon a study of the financing of agricultural development projects in the Southern Region for the government of the Southern Region, under World Bank auspices in 1980, and additional study in Khartoum in 1981.

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II. THE TAX SYSTEM OF THE CENTRAL GOVERNMENT

The financing of the subordinate units in a Federal system must be considered in the light of the central government tax structure. A brief review will suffice. Table 1 provides the figures for 1979/80 and the revised budget figures for the 1980/81 fiscal year (ending June 30, 1981). The relative figures have not changed greatly over the last decade. There are several significant features. The relative reliance on direct taxes is one of the lowest in the world, even among developing countries. The percentage reliance on customs duties is very high by present day standards, nearly half of the revenue raised from this source. The figure is, however, somewhat misleading, since imports by government, which constitute about half of the total, are subject to the duties.

A few major characteristics of the tax system can be summarized.

A. Direct taxes

The direct tax system is schedular; the most important revenue element is the business profits tax, applied to all businesses, corporate and noncorporate. The rate ranges from 15 to 60% on resident individuals, 25 to 60% on corporations and non-resident individuals. The personal income tax, collected largely through withholding, applies only to wage and salary incomes, with rates from 15 to 70%, and a flat LS 1,000[1] exemption regardless of family size. Wives are treated as separate taxpayers. The other two elements in the income tax structure, land rent (taxed at the same rates as business profits) and capital gains, with rates ranging from 5 to 25% (40% on limited companies), are of minor revenue importance.

B. Indirect taxes

1. *Customs duties*

The tariff is very complex, with over 25 ad valorem rates and a number of specific rates. The basic rate is approximately 40%. Exemptions are very limited, to medicine, a few foods, and some items used in farming.

2. *Excises*

There is an unusually wide range of excises – 33 as of 1981 – applying to most domestic production, with compensating levies on imports, called consumption duties, on five major commodities. The majority of the excises have ad valorem rates, but some are specific.

3. *Development tax*

In 1974-75 the government introduced a general sales tax at the manufacturing level, called a development tax. The rate is currently 5%. Exemptions are very limited, although unprocessed foods are not reached. At times the levy has applied to imports as well, but not currently; it does apply to exports, an unusual policy.

There is also a 10% tax on specified services, including hotels and restaurants, called a sales tax.

TABLE 1

Current revenue sources, Democratic Republic of the Sudan
1979/80 – 1981/82

	Revenues, millions of LS			*Percentage of total tax revenue*		
	1979/80	1980/81 [1]	1981/82 [2]	1979/80	1980/81	1981/82
Direct taxes	79.8	100.0	130.0	17	17	16
Indirect taxes:						
Customs duties [3]	229.2	254.7	381.0	48	44	48
Excises [4]	100.3	122.5	182.2	21	21	23
Development (Sales) tax	36.5	33.0	45.0	8	6	6
Sales ((Services) tax	–	2.0	5.0	–	neg	1
Sugar monopoly	20.2	0	0	4	–	0
Total indirect	392.8 [5]	412.2	613.2	81	71	78
Export duties	9.7	66.0	54.0	2	12	6
Total taxes	482.3	578.2	797.2	100	100	100
Nontax revenue	106.9	118.4	251.0			
Total current revenue	582.5	756.6	1048.0			

1. Revised budget figures.
2. Budget figures.
3. Including defense tax and exchange fund.
4. Including consumption duties and stabilization fund excise.
5. Including miscellaneous.

Source: Sudan, Ministry of Finance and National Economy.

1. 1 LS = $1.25.

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4. *Export duties*

There is a substantial list of export duties, all with ad valorem rates, most between 5 and 15%. The major one, revenue wise, on cotton was eliminated in 1980 to increase cotton exports.

The tax system has undergone little basic change for several decades, apart from the introduction of the development tax.

III. THE SOUTHERN REGION (SR)

The SR contains about 650,000 square kilometers, about one-fourth of the total area of Sudan, and is somewhat larger than Kenya. The population is about three and three-fourths million, about one-fifth of the country's total population. The per capita income data in the Sudan are by no means accurate; the figure for the South is estimated to be $ 150, or one-third the average for the entire country. The South is highly dependent on agriculture, including livestock. Most cultivation is semisubsistence, with shifting cultivation comparable to that of tropical Africa. Rainfall is adequate without irrigation. Dura, a form of sorghum, is the most important food crop, plus maize, millet, groundnuts and sesame. Currently there is little production of previous export crops: cotton, coffee and tobacco.

Recurrent expenditures of the SR government are made for a number of purposes: the largest items are education and agriculture and natural resources, each 13% of the total, followed by roads, health and welfare, and general administration. The provinces of the Region – there are currently six – concentrate their activities on education, health and welfare, and prisons, which together account for about 80% of their total spending (1980). In the development budget, agriculture and health are the major items (each 17%), followed by communications and roads. The development budget totals are typically far in excess of the actual amounts spent, which are restricted by availability of funds. At the provincial level, agriculture, industry, and transportation are the chief elements in the development budget, agriculture alone reaching nearly 50% in Western Equatoria province.

A. The financing of the Southern Region

Table 2 shows the overall recurrent budget data for 1980/81; grants from the Central Government constitute two-thirds of the total. In other words, the SR is far from being autonomous in terms of financing its activities.

The tax structure of the SR government is very complex. There are three distinct types of levy:

B. Taxes imposed by the Central Government, but collected by the Regional Government and retained for its own use

These consist of the income taxes plus the stamp duty. For a time the provinces collected the business profits tax on small firms and retained the revenue; in more recent years SR government has collected the tax.

TABLE 2

Summary of the recurrent budgets of the Government of the Southern Region of the Sudan in LS, 1977/78 – 1980/81.*

	1977/78	1978/79	1979/80	1980/81
Recurrent expenditures:				
Own recurrent expenditures	23,393,680	28,138,624	34,236,068	38,203,407
Transfer to development budget	2,400,000	2,500,000	2,500,000	2,500,000
Transfer to the provinces	8,935,460	9,300,000	19,800,000	20,707,000
Total	34,629,140	39,939,624	56,536,068	61,410,407
Recurrent revenues:				
Tax revenue	8,427,400	11,412,000	14,370,700	15,053,700
Nontax revenues	5,601,140	5,026,624	6,165,368	6,356,707
Total, own revenue	14,028,540	16,438,624	20,536,068	21,410,407
Grants from Central Government [1]	20,800,000	23,500,000	36,000,000	40,000,000
Total	34,828,540	39,938,624	56,536,068	61,410,407

1. Including funds transmitted to the provinces.

* *Source:* Democratic Republic of the Sudan, Southern Region, ***Budget Speeches,*** respective years, 1977/78–1980/81.

C. Taxes imposed and collected by the Central Government but the revenue shared with the SR

Most are indirect taxes, but customs duties are not shared:

a. Excises. The revenue of three excises, cigarettes, beer and liquor, are shared with the SR, on the basis of destination. These are collected at the factory.

b. Consumption duties, the counterparts of certain ex-

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cises on imports. The revenue of these is shared with the SR government on the basis of destination of the goods.

c. Export duties, on goods exported from the SR to foreign countries. As such exports are now negligible, this is not a significant source of revenue.

D. Taxes imposed and collected by the Southern Region Government

The SR government has imposed a large number of taxes, which yield nearly half of its total tax revenue.

a. Surcharge on imports. When the Central Government removed comparable taxes in 1979-80, the SR imposed a 10% surcharge on imports into the region from other countries, collected by SR personnel at the borders (most of the imports come in via Kenya or Uganda, and some from Zaire). Ultimately the plan is that this tax will be collected by Sudan Customs.

b. A number of separate levies called development taxes.

1) On incomes, with rates from 1 to 11%, collected by the SR government in conjunction with the income tax. Most is collected from employers monthly.
2) On license holders, as for example on motor vehicles, LS 1 a year.
3) On profits of government corporations, 5%. The tax yields little, as most are not profitable.
4) Taxes upon the sales of a number of commodities and the provision of services:
   i) Sugar – 5 piastres (p)[2] per rottle, paid to the tax office to obtain a certificate to buy sugar. Sale of sugar is controlled.
   ii) Petrol and diesel fuel – 5p. per gallon; collected from the seller.
   iii) Telegrams – 5p. each.
   iv) Hotels – 10%.
   v) Airport embarkation – LS 1.
   vi) Dates – LS 20 per bag (100 kg).
   vii) Sale of products of mechanized farms: from Renk, dura (10p. per sack), sesame (50p. per sack); from Aweil, rice, grade 1, LS 3 per sack, grade 2, LS 2, grade 3, LS 1.
   viii) Cigarettes, which are produced at the Haggar cigarette factory in Juba, 2 p. per 10 cigarettes.
   ix) Taxes on certain imports:
   Vehicles – LS 35 on autos, LS 25 on heavy vehicles.
   Miscellaneous appliances – LS 5 to LS 20 each.
   Liquor – LS 1 per half litre.
   Coffee – LS 150 per ton.
   Tea – 8 p. per kg.
   These are collected at the border points, by the SR tax offices, with cooperation of the police and customs guards, with an attempt to catch goods smuggled in, as for example, at Yei, coffee from Zaire. Tax applies regardless of final destination.
   x) Crocodile skins, 5p. per inch.
   xi) Exports from the SR to foreign destinations:
   Fish.
   Salt.
   Soap.
   Edible oil.
   Ready made clothes.
   Dumuria and dabalan (types of textiles), 20% factory price.
   Utensils.
   Onions.
   Aspro (aspirin), 20% factory price.
   Bicycles and parts, 20% of export price.
   These are collected at border points on locally produced or imported goods when reexported.
   xii) Road tolls, on entrance into the Sudan of foreign registered vehicles. Present rates: truck, LS 35, with trailer, LS 70. Much of the revenue is collected in Nairobi on departure of the trucks for the Sudan.
   xiii) Contracts, made in the SR by firms located elsewhere and not subject to profits tax, LS 100 to LS 200 per LS 10 million.

c. Purchase tax on second hand motor vehicles.

d. Share of the profits of the sugar monopoly, classified as a tax, based upon total consumption of sugar in the SR as a percentage of the national total (4%), remitted by the Central Government.

Other taxes have been used in recent years. Until 1980/81 a 5% tax was applied to the construction cost of new Central Government capital projects in the SR; this was eliminated in the belief that it was hampering development. Until 1979, an education tax was imposed as a supplement to the tax on wages and salaries and license holders (comparable to the present development tax). This had replaced school fees, which were believed to be restricting school attendance.

The government has planned a sales tax, to apply to local manufacturing and to goods brought into the SR and resold, on the pattern of Kenya's manufacturers sales tax. But implementation has been delayed because of concern about administration.

Table 3 provides an overall picture of taxes and other nongrant revenues of the SR government for recent years. Table A-1 in the appendix provides a detailed breakdown of expected revenues by individual tax. As these tables show, over 40% of the tax revenue is collected for the SR by the Central Government. The most important tax revenue sources are the personal income tax; the share of Central Government excises and consumption duties; the surcharge on imports and exports, now locally collected but to be centrally collected; the personal income tax and the development tax on wages and salaries; the tax on sugar; and the profits of the sugar monopoly. Another major hoped-for source is additional revenue arising from revision of Decree 39, which allocated various taxes to the SR, to give the latter a share of excise taxes on additional commodities.

By usual definitions, about 17% of the total revenue other than grants is derived from direct taxes, the remainder from indirect. Since the Central Government revenue from direct taxes is 17% of its total tax revenue, on the whole in the SR the direct levies are providing less than 20% of the total tax revenue.

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2. 100p. = LS 1.

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TABLE 3

Major budgeted tax and other own-source recurrent revenues, Government of the Southern Region of the Sudan 1978–1981*

	Sudan LS				*Percentage from each source* [3]			
	1977/78	1978/79	1979/80	1980/81	1977/78	1978/79	1979/80	1980/81
Levied by Central Government:								
Collected by Regional Government								
Personal income tax	700,000	880,000	1,350,000	1,350,000	8.9	7.8	9.5	9.1
Business profits tax	200,000	280,000	280,000	280,000 [1]	2.5	2.5	2.0	1.9
Land and rental income tax	10,500	21,000	21,000	21,000	0.1	0.2	0.1	0.1
Capital gains tax	15,000	18,000	18,000	18,000	0.2	0.2	0.1	0.1
Stamp duty	45,000	120.000	125,000	125,000	0.6	1.1	0.9	0.8
Total	970,500	1,319,000	1,794,000	1,794,000	12.3	11.7	12.7	12.1
Levied by and collected by Central Government;								
Revenues to Regional Government								
Excise duties	1,700,000	1,100,000	1,100,000	1,100,000	21.6	9.7	7.8	7.4
Consumption duties	400,000	580,000	580,000	580,000	5.1	5.1	4.1	3.9
Export duties	6,000	6,000	6,000	6,000	0.1	0.1	neg.	neg.
Surcharge on imported goods [4]	—	—	—	2,300,000	—	—	—	15.6
Expected revenue from revision of presidential Decree No. 39	—	2,500,000	2,500,000	2,500,000	—	22.2	17.7	16.9
Total	2,106,000	4,186,000	4,186,000	6,486,000	26.8	37.1	29.6	43.9
Levied and collected by Regional Government;								
General Regional services and development tax	2,700,200	3,610,000	6,010,500	5,135,500	34.3	32.0	42.4	34.8
Sales tax	240,000	240,000	240,000	240,000	3.1	2.1	1.7	1.6
Purchase tax, used motor vehicles	6,000	6,000	6,000	6,000	0.1	0.1	neg.	neg.
5% tax, profits of public corporations	20,000	20,000	20,000	20,000	0.3	0.2	0.1	0.1
5% tax, initial construction, new Central Government	812,000	812,000	812,000	repealed	10.3	7.2	5.7	—
Miscellaneous	12,000	12,000	12,000	12,000	0.2	0.1	0.1	0.1
Total	3,790,200	4,700,000	7,100,500	5,413,500	48.2	41.6	50.1	36.6
Share, profits on sugar production [2]	1,000,000	1,080,000	1,080,000	1,080,000	12.7	9.6	7.6	7.3
Overall total, tax revenue	7,866,700	11,285,000	14,160,500	14,773,500				
Development charges and fees	5,601,140	5,026,624	6,165,368	6,356,707				
Miscellaneous	560,700	127,000	210,200	280,200				
Total non-grant recurrent revenue	14,028,540	16,438,624	20,536,068	21,410,407				

1. Total LS 700,000; LS 420,000 by provinces.
2. Included with tax revenues in the accounts, though not a tax.
3. Totals of tax revenue shown in the budget messages include items shown as miscellaneous revenue in this table: the figures shown in the budget messages are: 1977/78 — LS 8,427,400; 1978/79 — LS 11,412,000; 1979/80 — LS 14,370,700; 1980/81 — Ls 15,053,700.
4. Currently collected by the SR Regional Government. *

* Source: Democratic Republic of the Sudan, Southern Region, ***Annual Budget Speech*** for respective years; for 1980/81: ***Estimates of Revenues and Expenditures for Current Budget., 1980/81.***

E. Budgeted versus actual receipts

A major deficiency in the statistics is the lack of availability of actual revenue collected by fiscal year from various tax and nontax sources; the figures shown in Table 3 are the budget estimates. In the budget speeches, actual collections are shown up to May 1. Table 4 shows the budget figures for the three years 1977/78 through 1979/80, the actual amounts collected, as of May, and these actual collections projected by the authors of this paper through June 30 by simply adding one-fifth. Data are not available to do this by individual tax. It is obvious that much of the shortfall is due to the failure to obtain additional excise revenue on the basis of revision of Presidential Decree 39. The shortfall in the actual collections of nontax sources (fees, charges, etc.) is about as great as that on taxes.

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F. Tax administration

Tax administration in the SR is in the hands of the Tax Department, in the Ministry of Finance and Economic Planning. There is a junior staff of 98 (1980) secondary school graduates, with the primary task of identifying commodities and making collections. Their training is provided in Juba (the SR capital Elementary accountancy instruction is provided at the Regional Accounting Training Center in Juba, established to provide this type of training for a number of government agencies. The senior tax staff, 20 in 1980, consists of university graduates, many with their degrees from the University of Nairobi. Several have been sent abroad for training, and the Head of the Tax Department has been seeking to find more satisfactory places for training.

Local tax offices are located at Renk, Wau, Malakal, Juba, Rumbek, Aweil, Yambio, Yei, and Kapoeta.

The Tax Department operates under serious difficulties: the lack of communication with the local offices, long distances, poor roads and shortage of motor fuel, inadequate background and training of personnel of the junior staff, and the lack of data processing facilities. Our general reaction is that the top level personnel are competent and have excellent ideas of what should be done but lack the means to implement the administration of the taxes effectively.

TABLE 4

Relationship of regional budget and actual revenues from own sources, Government of the Southern Region of the Sudan, 1977-1980 *

Sudan LS

	Budget estimate	*Collected to May 1*	*Collections projected to July 1*	*Percent of projected to budget figure*
	1977/78			
Taxes	8,727,400	5,219,866	6,263,839	72
Nontax revenue	5,601,140	973,995	1,168,794	21
Total	14,328,540	6,193,861	7,432,633	52
	1978/79			
Taxes	11,412,000	5,691,293	6,829,552	60
Nontax revenue	5,026,624	1,742,952	2,091,542	42
Total	16,438,624	7,434,245	8,921,094	54
	1979/80			
Taxes	14,370,700	4,438,285	5,325,942	37
Nontax revenue	6,165,368	1,888,910	2,266,692	37
Total	20,536,068	6,327,195	7,592,634	37

* *Source:* Democratic Republic of the Sudan, Southern Region, *Annual Budget Speeches* 1977/78, 1979/80, 1980/81.

TABLE 5

Percentage distribution of budgeted provincial revenues, Government of the Southern Region of the Sudan, 1979/80, 1980/81 *

Province	*Year*	*Percentage of own revenue from*				*Percentage of total expenditure covered by*	
		Business profits tax	*Import and export levies*	*Licenses*	*Fees and other*	*Own reveneues*	*Grants*
Bahr el Ghazal	1979/80	12.9	21.5	2.8	62.7	15.3	84.7
	1980/81	12.2	13.5	3.2	69.7	12.0	82.0
Jonglei	1979/80	8.8	–	1.9	89.3	4.6	95.4
	1980/81	7.7	–	3.5	88.8	4.3	95.7
Lakes	1979/80	9.5	–	2.1	87.2	5.8	94.2
	1980/81	9.5	–	1.9	88.6	5.0	95.0
Upper Nile	1979/80	19.3	–	3.8	76.9	12.4	87.6
	1980/81	20.1	–	4.0	75.9	10.1	89.9
Eastern Equatoria	1979/80	20.6	–	11.7	67.7	14.6	85.4
	1980/81	19.2	–	9.2	71.6	11.6	82.4
Western Equatoria	1979/80	13.9	4.5	4.6	77.1	7.4	92.6
	1980/81	13.9	2.3	5.6	78.3	5.1	94.9
Total	1979/80	16.3	6.2	5.6	71.8	11.0	89.0
	1980/81	15.7	3.9	5.3	75.0	8.8	91.2

* *Source:* Data in Table A-2.

G. Provincial revenue sources

Table 5 shows the percentage distribution of the revenues of the six SR provinces by source, and Table A2 the actual figure.

The provinces expected to raise, in 1980/81, approximately LS 525,000 from taxes, LS 140,700 from licenses, and LS 2,004,450 from charges[3] and other own-

3. This includes a "shadow element" of LS 750,750 of charge revenues of the Mechanical Transport Department for other governmental agencies.

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sources. They receive a total of LS 19,293,000 from the SR government, most of which is provided by the Central Government.

Their major own tax source is the business profits tax. Bahr el Ghazal and Western Equatoria impose import and export taxes on farm products, thus compounding still more the emphasis on these levies. Otherwise, the provinces collect only license taxes and miscellaneous charges and fees. They thus have only a very limited degree of financial autonomy, much less even than the local governments. The provinces and the local councils have been unable in recent years to collect more than half of the budget revenues and thus their actual own-collections are much lower than the budgeted figures.[4]

H. Local government taxes

There are two types of local councils, urban and rural, and the tax sources differ somewhat.

1. Social services tax. This is by far the major local tax from a revenue standpoint, yielding 64% of local council revenue. This is a poll tax, levied on all adult males, the rate varying by council area, and even by ethnic group within a council area.

2. Gibana, the tax on the sale of agricultural products in local markets.

3. Rates, used primarily by the town councils, imposed on the value of real property.

In addition revenue is received from licenses on traders, sellers of liquor, bicycles, and health-related activities (e.g., slaughter houses). Serious questions have been raised about the effectiveness of collection of these taxes. The percentage distribution of the revenues is shown in Table 6, the detailed figures in table A-3.

TABLE 6

Relative distribution of expected revenues by source, local councils, Government of the Southern Region of the Sudan, 1980/81 *

Percentage of total revenues from	*Township local councils*	*Rural local councils*	*Total*
Taxes	52	53	53
Licenses	13	4	5
Fees, rents	31	15	17
Province	4	28	25
Total	100	100	100
Percentage of tax revenues from			
Social services tax (Poll)	17	70	64
Gibana (Sale of produce)	20	16	16
Rates	27	9	11
Other	36	5	9
Total	100	100	100

* *Source:* Data in Table A-3.

In addition the local councils receive substantial grant funds, about 25% of total revenues, from the Central and SR governments.

For the provinces and the local councils combined, in 1977/78-1979/80 the total revenue sources were as follows:

	Expenditures LS 000	*Own revenues LS 000*	*Percent from own sources*
1977/78	15,671	7,307	46
1978/79	17,241	7,418	43
1979/80	29,990	7,143	23

Source: Democratic Republic of the Sudan, Southern Region, People's Executive Councils, *Annual Budgets for Fiscal Year 1980/81.*

I. Overall recurrent budget picture in the Southern Region

The overall recurrent budget picture for 1980/81 including SR government, provincial, and local revenues and expenditures, but excluding expenditures from donor financing, is shown in Table 7.

Thus the total recurrent government expenditure by the SR government and its subordinate units was projected to be LS 68.3 million in the 1980/81 fiscal year. Of this, LS 40 million was received in grants from the Central Government, while LS 28.5 million was to be raised locally, by taxes and charges.

The estimated per capita GNP in the SR is $150 or LS 120; thus the total GNP, assuming a population of 4 million, is LS 480,000,000. Thus the total taxes and charges constitute 6% of GNP, or taxes alone about 4%. When it is considered that the heavy Central Government customs duties and other indirect levies are also borne to some degree in the SR, the percentage collected in taxes does not appear to be extremely low by comparison with other LDCs, given the low incomes and undeveloped state of the economy.

TABLE 7

Overall recurrent budget summary, Southern Region of the Sudan, 1980/81 *

Millions of Sudan LS

	Revenue, own sources	*Grants received*	*Total expenditures* [1]
Southern Region Government	21.4	40.0	61.4
Provinces	2.7	29.7	32.4
Local councils	4.4	1.3	5.7
Total	28.5	71.0	99.5
Less duplication	—	31.0	31.0
Net	28.5	40.0	68.3

* *Source:* Data in Tables 1, A-2 and A-3.

1. Including transfers to other units and to development budget.

4. The financing problems of the provinces and local governments were stressed in the *Budget Speech* of the Minister of Administration, Police and Prisons of the Southern Region for 1980/81.

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J. Evaluation of the revenue system

As noted the SR government is highly dependent upon funds provided by the Central Government. In the 1980-81 fiscal year, if all budget funds were received, the grants from the Central Government would have provided 65% of the recurrent budget and 85% of the development budget. Furthermore, nearly half of the SR's tax revenues are collected for it by the Central Government. At times at least, the Central Government has been slow to remit these funds to the SR, creating a liquidity crisis. But the more serious problem is that the taxes involved are indirect taxes, with the intent that the SR's share depend on the destination of the taxed goods in the SR. But at the time of importation or sale by the factory, the ultimate destination is often now known, or even if it is, it may not be reported accurately, especially, in view of the SR's import surcharge. The same problem arises with the profits of the sugar monopoly.

For its own source, the SR government has imposed a large number of separate taxes, many of them with nominal yield, and many related to either import or export transactions. This is a consequence of the difficulties of implementing broad based taxes and the very limited potential tax base that does not involve either import or export activities. But there are several limitations:

a) Without "fiscal frontiers," that is, control points at the borders with the remainder of the country, it is difficult to ensure appropriate collections. Smuggling appears to be relatively widespread, further complicating collections on foreign imports or exports.
b) The use of a large number of separate taxes inevitably complicates application of the taxes and produces arbitrary borderlines between taxable and non-taxable goods.
c) The taxes upon exports can easily discourage domestic production for export. Such production is only nominal at present, but hopefully it will increase. The general objection to export taxes is well known.
d) The surcharge on imports and the other taxes on imports encourage firms importing into the Sudan or producing in the north for shipment to the SR to misstate destination.
e) Taxes on products of basic consumption, such as dura, tend to burden the urban poor – a feature that can be questioned on equity grounds.

Taxes on manufactured goods produced in the SR or sold subject to controls (gasoline, sugar) or on services are much more satisfactory.

K. Potential for additional tax revenue

The potential for additional tax revenue in the SR, to lessen dependence on the Central Government and to finance continuation of various agricultural development projects and other activities now financed by donor groups, is not substantial. The inherent problem is that the SR is a very undeveloped area compared to much of Tropical Africa. Semi-subsistence agriculture dominates, and commercial activity is limited. Any significant increase in tax base, unless significant oil discoveries are made, can occur only with increased production for the market and for export, including processing of agricultural products, production of beer, cigarettes, and other articles of widespread consumption, and increased importation of consumption goods. These changes, in turn, require, more than anything else, improved transportation and communication. It would appear that the primary immediate constraint on development in the SR, and thus increase in tax capacity, is the isolation and inadequate infrastructure. Improvements in these, some beyond the control of the SR government, are the most urgently needed steps toward economic development and greater revenues.

Meanwhile, it should be possible to simplify the tax structure, reducing the number of separate taxes and lessening the heavy reliance on taxes related to imports and exports. At the same time, further strengthening of tax administration is urgently needed – as is well recognized by the SR government.

IV. THE NEW REGIONAL GOVERNMENTS

The basic philosophy of the government of the Sudan for the last decade has been to move toward greater decentralization of government, given the size and diversity of the country. After creating the SR government, the Central Government took the next major step in 1980, when it created five new regional governments and gave Khartoum special provincial status. As of late 1981, the new regional governments are functioning, but with their tax systems not yet fully developed. The Regional Government Act, which created the regions, contains a general statement that the new regions have power to levy direct and indirect taxes, but then prohibits taxes on imports and exports, interregional trade, and capital profits and "commercial dealings." The regions were specifically authorized to impose those taxes now levied by the provinces and the local governments. Thus the taxing powers are more restrictive than those of the SR.

The existing taxes of the new Regional Governments

The existing taxes of the Regions, inherited from the provinces and local governments, are as follows:

1. Primarily in urban areas: two levies on land and buildings, a general rate and a house (buildings) tax, now collected together. They are imposed upon annual rental value, as high as 30% in some areas. Assessment is in the hands of local committees of laymen rather than trained appraisers. The tax burden is typically relatively light.

2. In rural areas, there are four forms of tax, but in general no wealth or activity reached by more than one:

a. Land taxes, imposed on irrigated land, a fixed amount per feddan (approximately an acre) on smaller projects, as a percentage of the gross receipts from the crop, often 12%, on the larger. In the Gezira, in lieu of taxes the Gezira Board, which buys all cotton, pays 2% of its net profit from cotton (not from other crops) to the government.
b. The ushur, or tax on produce, called cess in much of Africa. In non-irrigated mechanized farming areas, a tax, typically 12% of the value of the produce is imposed, in lieu of property taxes. The tax is now usu-

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ally collected in the markets, from the buyers. The tax primarily applies to the crops shipped in bulk for export or to other parts of the country.

c. The tax on date trees, in the North, a fixed amount per tree (of which there are about 3 million). The rate is now 8p.
d. The animal tax, applied per head of livestock, in virtually all rural council areas, but of primary importance in the Blue Nile and Darfur areas. The rate varies with the type of animal (highest on camels), and with the area. The tax is generally not administered well and reaches only a small fraction of the total number of animals.
e. Licenses: on motor vehicles and on traders.
f. Entertainment tax, on sporting events and movies.

These taxes, plus nontax revenues, which in many areas approach the taxes in total yield are expected to provide no more than 20% of the total revenues of the regions and local councils.

The remainder of the Regional revenue currently is made up of grants from the Central Government. These are not based upon a scientific formula, although obviously population plays a part. These are essentially block grants, the amount determined, after bargaining, very largely by the prospective deficit. It is generally recognized that the system is unsatisfactory, to some extent lessening the pressure to attain efficiency and to raise taxes.

V. APPROACHES TO IMPROVED FINANCING OF THE REGIONS

There are several possible approaches to the financing of the regions, including the SR.

First, emphasis can be placed upon maintaining a high degree of integration of the entire economy and effective tax administration. This approach would concentrate taxation in the hands of the Central Government, with uniform tax rates, throughout the country (apart from some local taxes). This would minimize interference with free flow of economic activity and economic distortions. But this approach, of course, does not provide financial autonomy for the Regions, keeping them dependent upon the Central Government.

At the opposite extreme, prime emphasis can be placed upon maximizing financial autonomy of the Regions, allowing them free use of major forms of taxes, with lessened use by the Central Government. But this approach would, unless the system was developed with great care, likely result in serious barriers to free flow of trade and interference with national tariff policy, because of the necessity of relying heavily upon indirect taxes. It is unlikely that the Central Government would be willing to surrender income taxes to the Regional governments, as it did to the SR.

The third alternative is, of course, a compromise: preservation of national uniformity and administration with major tax sources, but with strengthened revenue sources for the regions, and an improved system of grants, which would preserve regional expenditure autonomy, if not revenue autonomy. The experience in the SR does not offer much encouragement for the other regions so far as taxes are concerned, although levies on particular commodity sales and services offer substantially greater revenue potential than they do in the SR. Other taxes that are tolerable in the SR because of its relative isolation, such as those on exports from and imports to the region, would be intolerable in the other areas and are prohibited by the Act establishing the new Regions. But clearly some improvements and strengthening of regional and local tax administration are also possible.

Improvements in the grant system involve in part the issue of whether the Central Government payments should be of a shared revenue or grant nature. The problem with shared revenues is that many levies are not suitable for allocation on an origin basis. For example, importation and most industrial production are concentrated in a few areas, and allocation, on a destination basis, for indirect taxes is difficult administratively. The system has not worked well for the SR. Thus substantial reliance on block grants, but ones allocated on a formula basis, must be the primary basis for financing. But, above all, a workable formula, rather than political bargaining, is imperative.

VI. CONCLUSION

The Sudan provides an interesting case of deliberate decentralization of government and of revenue sources. The first major step was the creation of the SR government, granted substantial autonomy in 1972. The SR, the poorest area of the Sudan, though with great potential agricultural resources, has been able to generate a portion of its own tax revenue, but still depends heavily on the Central Government for grants, and a portion of its tax revenue is collected for it by the Central Government. It does administer the income and business profits tax in the region. In an effort to gain revenue, the SR has introduced a number of taxes, some relating to imports and exports. Some have potentially harmful effects, others provide negligible yield.

The second major step was the creation of five additional regions in 1980, with substantial governmental functions transferred to them. Thus far they have been able to implement only the taxes formerly used by the provinces and local councils: taxes on land and building rents, on the local sales of produce, on animals, and on date trees. While they have greater potential for tax revenue on local sales of various products such as gasoline and sugar and on various services than the SR, it is obvious that they must continue to rely heavily on Central Government grants. Under the circumstances of the Sudan the subordinate units of a decentralized system simply cannot, on their own, finance extensive government activities.

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APPENDIX

TABLE A-1

Budgeted tax revenues, Government of the Southern Region of the Sudan, 1980/81 *

Sudan LS

	Expected revenue Sudan LS	*% of total tax[1] revenue*
Levied by Central Government, collected by Regional Government		
Personal income tax	1,350,000	9.1
Business profits tax	280,000	1.9
Land and rental income tax	21,000	0.1
Capital gains tax	18,000	0.1
Stamp duty	125,000	0.8
Total	1,794,000	12.1
Levied by and collected by Central Government		
Revenue to Regional Government		
Excise duties	1,100,000	7.4
Consumption duties	580,000	3.9
Export duties	6,000	neg.
Surcharge on imported goods	2,300,000	15.6
Expected revenue from Revision of Presidential Decree No. 39	2,500,000	16.9
Total	6,486,000	43.9
Levied and collected by Regional Government		
General regional service and development tax		
Govt. + private employees	560,000	3.8
Devt. tax on license holders	150,000	1.0
Sugar	1,417,000	9.6
Petrol	333,000	2.3
Diesel fuel	292,000	2.0
Telegrams	17,500	0.1
Airport embarkation	36,000	0.2
Hotel bills	90,000	0.6
Dates	100,000	0.7
Mechanized farms	317,000	2.1
Cigarettes	300,000	2.0
Imported vehicles	20,000	0.1
Imported misc. appliances	15,000	0.1
Imported liquor	100,000	0.7
Imported coffee	840,000	5.7
Imported tea	200,000	1.4
Processed crocodile skins-exp.	150,000	1.0
Exported fish	15,000	0.1
Exported salt	5,000	neg.
Exported soap	15,000	0.1
Exported edible oil	2,000	neg.
Exported ready made clothes	2,000	neg.
Exported Demuria + Dabilan	5,000	neg.
Exported utensils	1,000	neg.
Exported onions	1,000	neg.
Road tolls (Border)	100,000	0.7
Exported aspro	2,000	neg.
Bicycles + parts	5,000	neg.
Contracts	45,000	0.1
Total, regional development tax	5,135,500	34.8
Sales tax	240,000	1.6
Purchase tax-2nd hand motor vehicles	6,000	neg.
Medical insurance fee	12,000	0.1
Share, profits on sugar	1,080,000	7.3
5% tax, profits of Government corporations	20,000	0.1
Total tax revenue	14,773,500	
Miscellaneous:		
Interest	70,000	
Sale of government lands	75,000	
Other	135,200	
Total, misc.	280,200	
Department fees and charges	6,356,707	
Total revenue, own sources	21,410,407	

1. As shown in the budget, minus LS 280,200 miscellaneous.

* ***Source:*** Democratic Republic of the Sudan, Southern Region, ***Recurrent Budget,*** 1980/81.

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TABLE A-2

Budgeted provincial recurrent revenues and expenditures, Government of the Southern Region of the Sudan, 1979/80; 1980/81 *

Sudan LS

Province	*Year*	*Est. population 000s*	*Expected revenue*							*Budgeted expenditures*
			Business profits tax	*Export and import surcharge*	*Licenses*	*Fees, charges, other*	*Total own revenues*	*Grant revenue*	*Portion of grant revenue to local councils*	
Bahr el Ghazal	1979/80	1,000	90,000	150,000	19,600	437,185	696,785	4,564,462	78,000	5,182,747
	1980/81		90,000	100,000	24,000	525,000	739,000	6,138,812	100,000	6,757,812
Jonglei	1979/80	350	12,000	–	2,600	122,000	136,600	2,951,047	60,000	3,027,647
	1980/81		12,000	–	5,500	139,000	156,500	3,671,212	100,000	3,702,712
Lakes	1979/80	750	18,000	–	3,500	147,019	168,519	2,925,053	50,000	4,144,113
	1980/81		18,000	–	3,500	167,100	188,600	3,745,000	60,000	3,847,660
Upper Nile	1979/80	700	120,000	–	23,700	478,050	621,750	5,000,714	80,000	5,542,482
	1980/81		120,000	–	23,700	453,250	596,950	5,918,126	120,000	6,375,076
Eastern Equatoria	1979/80	675	150,000	–	85,000	493,650	728,650	4,976,011	110,359	5,477,652
	1980/81		150,000	–	72,000	561,000	783,000	6,740,194	120,000	7,383,194
Western Equatoria	1979/80	300	30,000	9,700 [1]	10,000	166,900	216,600	2,932,713	50,000	3,149,313
	1980/81		30,000	5,000	12,000	169,100	216,100	4,205,068	80,000	4,316,168
Total	1979/80	3,775	420,000	159,700	144,400	1,844,804	2,568,904	23,350,000	428,359	26,523,954
	1980/81	–	420,000	105,000	140,700	2,004,450	2,670,150	30,417,512 [1]	580,000	32,382,622

1. This was the sum requested by the provinces in their budgets. The sum provided in the SR government was LS 20,7000,000.

* *Source:* Democratic Republic of the Sudan, Southern Region, ***Budgets,*** 1980/81, of the respective People's Executive Councils.

TABLE A-3

Expected revenues by source and total expenditures, local councils, Government of the Southern Region of the Sudan, 1980/81 *

Sudan LS

Province		*Social services tax*	*Gibana*	*Rates*	*Other taxes*	*Total taxes*	*Licenses*	*Fees, rents, and misc.*	*Health fees*	*Total fees and and misc.*	*Total own revenues*	*Total expenditures*
Bahr el Ghazal	T	4,500	–	53,500	5,500	63,500	29,000	42,300	17,585	59,885	152,385	103,882
	R	343,000	4,500	108,000	–	455,500	33,500	209,300	7,166	216,466	705,466	1,002,905
Jonglei	T	41,000	32,000	8,000	–	81,000	8,800	23,500	4,100	27,600	117,400	129,541
	R	268,000	22,400	7,030	–	297,430	26,630	147,333	3,665	150,998	475,058	499,154
Lakes	T	20,000	–	13,100	–	33,100	6,600	11,350	4,464	15,814	55,514	46,331
	R	366,995	2,210	7,858	–	377,063	10,658	168,028	7,035	175,063	562,784	621,670
Upper Nile	T	–	–	–	–	–	–	–	–	–	–	–
	R	289,926	327,000	52,000	75,300	744,226	31,304	28,180	47,026	75,206	850,736	1,496,135
Eastern Equatoria	T	–	40,000	25,000	131,100	196,100	30,170	53,000	50,044	103,044	329,314	376,805
	R	336,224	68,625	20,375	42,062	467,286	25,425	162,923	13,424	176,347	669,058	809,607
Western Equatoria	T	–	–	2,500	3,500	6,000	17,000	12,450	4,760	17,210	40,210	61,284
	R	244,000	500	44,150	12,000	300,650	41,380	62,553	15,010	77,563	419,593	435,754
Total	T	65,500	77,200	102,100	140,100	384,900	91,570	142,600	80,953	223,553	700,023	717,843
	R	1,848,145	425,235	239,413	129,362	2,642,155	168,897	778,317	93,326	871,643	3,682,695	4,994,766
Total		1,913,645	492,435	341,513	269,462	3,027,055	260,467	920,917	174,279	1,095,196	4,382,718	5,712,609

T: Township Councils.
R: Rural Councils.

* ***Source:*** Democratic Republic of the Sudan, Southern Region, ***People's Executive Councils, Annual Budgets,*** 1980/81.
Note: Minor errors in the original tables result in some inconsistencies in the totals but do not affect the overall pictures.

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U.S.A.:

Draft Model Income Tax Treaty of 16 June 1981

MODEL OF. . . . . , 1981
CONVENTION BETWEEN THE UNITED STATES OF AMERICA
AND . . . . . .
FOR THE AVOIDANCE OF DOUBLE TAXATION AND
THE PREVENTION OF FISCAL EVASION
WITH RESPECT TO TAXES ON INCOME AND
CAPITAL

The United States of America and . . . . . ., desiring to conclude a convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital, have agreed as follows:

Article 1
General scope

1. This Convention shall apply to persons who are residents of one or both of the Contracting States, except as otherwise provided in the Convention.

2. The Convention shall not restrict in any manner any exclusion, exemption, deduction, credit, or other allowance now or hereafter accorded
a) by the laws of either Contracting State; or
b) by any other agreement between the Contracting States.

3. Notwithstanding any provision of the Convention except paragraph 4, a Contracting State may tax its residents (as determined under Article 4 (Residence)), and by reason of citizenship may tax its citizens, as if the Convention had not come into effect. For this purpose, the term "citizen" shall include a former citizen whose loss of citizenship had as one of its principal purposes the avoidance of income tax, but only for a period of 10 years following such loss.

4. The provisions of paragraph 3 shall not affect
a) the benefits conferred by a Contracting State under paragraph 2 of Article 9 (Associated Enterprises), under paragraphs 1 b) and 4 of Article 18 (Pensions, Annuities, Alimony, and Child Support), and under Articles 23 (Relief From Double Taxation), 24 (Non-discrimination), and 25 (Mutual Agreement Procedure); and
b) the benefits conferred by a Contracting State under Articles 19 (Government Service), 20 (Students and Trainees), and 27 (Diplomatic Agents and Consular Officers), upon individuals who are neither citizens of, nor have immigrant status in, that State.

Article 2
Taxes covered

1. The existing taxes to which this Convention shall apply are
a) in the United States: the Federal income taxes imposed by the Internal Revenue Code (but excluding the accumulated earnings tax, the personal holding company tax, and social security taxes), and the excise taxes imposed on insurance premiums paid to foreign insurers and with respect to private foundations. The Convention shall, however, apply to the excise taxes imposed on insurance premiums paid to foreign insurers only to the extent that the risks covered by such premiums are not reinsured with a person not entitled to the benefits of this or any other convention which applies to these taxes;
b) in . . . . . :
. . . . . .
. . . . . .

2. The Convention shall apply also to any identical or substantially similar taxes which are imposed after the date of signature of the Convention in addition to, or in place of, the existing taxes. The competent authorities of the Contracting States shall notify each other of any significant changes which have been made in their respective taxation laws and of any official published material concerning the application of the Convention, including explanations, regulations, or judicial decisions.

Article 3
General definitions

1. For the purposes of this Convention, unless the context otherwise requires
a) the term "person" includes an individual, an estate, a trust, a partnership, a company, and any other body of persons;
b) the term "company" means any body corporate or any entity which is treated as a body corporate for tax purposes;
c) the terms "enterprise of a Contracting State" and "enterprise of the other Contracting State" mean respectively an enterprise carried on by a resident of a Contracting State and an entrerprise carried on by a resident of the other Contracting State;
d) the term "international traffic" means any transport by a ship or aircraft, except when such transport is solely between places in the other Contracting State;
e) the term "competent authority" means
(i) in the United States: the Secretary of the Treasury or his delegate; and
(ii) in . . . . . :
. . . . . .
. . . . . .
f) the term "United States" means the United States of America, but does not include Puerto Rico, the Virgin Islands, Guam, or any other United States possession or territory;
g) the term . . . . . means
. . . . . .

2. As regards the application of the Convention by a Contracting State any term not defined therein shall, unless the context otherwise requires or the competent authorities agree to a common meaning pursuant to the provisions of Article 25 (Mutual Agreement Procedure), have the meaning which it has under the laws of that State concerning the taxes to which the Convention applies.

Article 4
Residence

1. For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of this domicile, residence, citizenship, place of management, place of incorporation, or any other criterion of a similar nature, provided, however, that
a) this term does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein; and
b) in the case of income derived or paid by a partnership, estate, or trust, this term applies only to the extent that the income derived by such partnership, estate, or trust is subject to tax in that State as the income of a resident, either in its hands or in the hands of its partners or beneficiaries.

2. Where by reason of the provisions of paragraph 1, an individual is a resident of

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both Contracting States, then his status shall be determined as follows:

a) he shall be deemed to be a resident of the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident of the State with which his personal and economic relations are closer (center of vital interest);
b) if the State in which he has his center of vital interests cannot be determined, or if he does not have a permanent home available to him in either State, he shall be deemed to be a resident of the State in which he has an habitual abode;
c) if he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident of the State of which he is a national;
d) if he has a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

3. Where by reason of the provisions of paragraph 1 a company is a resident of both Contracting States, then if it is created under the laws of a Contracting State or a political subdivision thereof, it shall be deemed to be a resident of that State.

4. Where by reason of the provisions of paragraph 1 a person other than an individual or a company is a resident of both Contracting States, the competent authorities of the Contracting States shall settle the question by mutual agreement and determine the mode of application of the Convention to such person.

Article 5
Permanent establishment

1. For the purposes of this Convention, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

2. The term "permanent establishment" includes especially

a) a place of management;
b) a branch;
c) an office;
d) a factory;
e) a workshop; and
f) a mine, an oil or gas well, a quarry, or any other place of extraction of natural resources.

3. A building site or construction or installation project, or an installation or drilling rig or ship used for the exploration or exploitation of natural resources, constitutes a permanent establishment only if it lasts more than twelve months.

4. Nothwitstanding the preceding provisions of this Article, the term "permanent establishment" shall be deemed not to include

a) the use of facilities solely for the purpose of storage, display, or delivery of goods or merchandise belonging to the enterprise;
b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display, or delivery;
c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;
d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or of collecting information, for the enterprise;
e) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character;
f) the maintenance of a fixed place of business solely for any combination of the activities mentioned in subparagraphs a) to e).

5. Notwithstanding the provisions of paragraphs 1 and 2, where a person – other than an agent of an independent status to whom paragraph 6 applies – is acting on behalf of an enterprise and has and habitually exercises in a Contracting State an authority to conclude contracts in the name of the enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph.

6. An enterprise shall not be deemed to have a permanent establishment in a Contracting State merely because it carries on business in that State through a broker, general commission agent, or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business.

7. The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either company a permanent establishment of the other.

Article 6
Income from real property (immovable property)

1. Income derived by a resident of a Contracting State from real property (including income from agriculture or forestry) situated in the other Contracting State may be taxed in that other State.

2. The term "real property" shall have the meaning which it has under the law of the Contracting State in which the property in question is situated.

3. The provisions of paragraph 1 shall apply to income derived from the direct use, letting, or use in any other form of real property.

4. The provisions of paragraphs 1 and 3 shall also apply to the income from real property of an enterprise and to income from real property used for the performance of independent personal services.

5. A resident of a Contracting State who is liable to tax in the other Contracting State on income from real property situated in the other Contracting State may elect for any taxable year to compute the tax on such income on a net basis as if such income were attributable to a permanent establishment in such other State. Any such election shall be binding for the taxable year of the election and all subsequent taxable years unless the competent authorities of the Contracting States, pursuant to a request by the taxpayer made to the competent authority of the Contracting State in which the taxpayer is a resident, agree to terminate the election.

Article 7
Business profits

1. The business profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the business profits of the enterprise may be taxed in the other State but only so much of them as is attributable to that permanent establishment.

2. Subject to the provisions of paragraph 3, where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the business profits which it might be expected to make if it were a distinct and independent enterprise engaged in the same or similar activities under the same or similar conditions.

3. In determining the business profits of a permanent establishment, there shall be allowed as deductions expenses which are incurred for the purposes of the permanent establishment, including a reasonable allocation of executive and general administrative expenses, research and development expenses, interest, and other expenses incurred for the purposes of the enterprise as a whole (or the part therof which includes the permanent establishment), whether incurred in the State in which the permanent establishment is situated or elsewhere.

4. No business profits shall be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods or merchandise for the enterprise.

5. For the purposes of this Convention, the business profits to be attributed to the permanent establishment shall include only the profits derived from the assets or activities of the permanent establishment and shall be determined by the same method year by year unless there is good and sufficient reason to the contrary.

6. Where business profits include items of income which are dealt with separately in other Articles of the Convention, then the provisions of thos Articles shall not be affected by the provisions of this Article.

7. For the purposes of the Convention, the term "business profits" means income derived from any trade or business, including the rental of tangible personal property and the rental or licensing of cinematographic films or films or tapes used for radio or television broadcasting.

Article 8
Shipping and air transport

1. Profits of an enterprise of a Contracting State from the operation of ships or aircraft in

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international traffic shall be taxable only in that State.

2. For the purposes of this Article, profits from the operation of ships or aircraft in international traffic include profits derived from the rental of ships or aircraft if such ships or aircraft are operated in international traffic by the lessee or if such rental profits are incidental to other profits described in paragraph 1.

3. Profits of an enterprise of a Contracting State from the use, maintenance, or rental of containers (including trailers, barges, and related equipment for the transport of containers) used in international traffic shall be taxable only in that State.

4. The provisions of paragraphs 1 and 3 shall also apply to profits from participations in a pool, a joint business, or an international operating agency.

Article 9
Associated enterprises

1. Where
a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State; or
b) the same persons participate directly or indirectly in the management, control, or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State, and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which, but for those conditions would have accrued to one of the enterprises, but by reason of those conditions have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

2. Where a Contracting State includes in the profits of an enterprise of that State, and taxes accordingly, profits on which an enterprise of the other Contracting State has been charged to tax in that other State, and the profits so included are profits which would have accrued to the enterprise of the first-mentioned Stated if the conditions made between the two enterprises had been those which would have been made between independent enterprises, then that other State shall make an appropriate adjustment to the amount of the tax charged therein on those profits. In determining such adjustment, due regard shall be paid to the other provisions of this Convention and the competent authorities of the Contracting States shall if necessary consult each other.

3. The provisions of paragraph 1 shall not limit any provisions of the law of either Contracting State which permit the distribution, apportionment, or allocation of income, deductions, credits, or allowances between persons, whether or nor residents of a Contracting State, owned or controlled directly or indirectly by the same interests when necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such persons.

Article 10
Dividends

1. Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State.

2. However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident, and according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed
a) 5% of the gross amount of the dividends of the beneficial owner is a company which owns at least 10% of the voting stock of the company paying the dividends;
b) 15% of the gross amount of the dividends in all other cases.
This paragraph shall not affect the taxation of the company in respect of the profits out of which the dividends are paid.

3. The term "dividends" as used in this Article means income from shares or other rights, not being debt-claims, participating in profits, as well as income from other corporate rights which is subjected to the same taxation treatment as income from shares by the laws of the State of which the company making the distribution is a resident.

4. The provisions of paragraph 2 shall not apply if the beneficial owner of the dividends, being a resident of a Contracting State, carries on business in the other Contracting State, of which the company paying the dividends is a resident, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the dividends are attributable to such permanent establishment or fixed base. In such case the provisions of Article 7 (Business Profits) or Article 14 (Independent Personal Services), as the case may be, shall apply.

5. A Contracting State may not impose any tax on dividends paid by a company which is not a resident of that State, except insofar as
a) the dividends are paid to a resident of that State,
b) the dividends are attributable to a permanent establishment, or a fixed base situated in that State, or
c) the dividends are paid out of profits attributable to one or more permanent establishments of such company in that State, provided that the gross income of the company attributable to such permanent establishment constiuted at least 50% of the company's gross income from all sources.
Where subparagraphs c) applies and subparagraph a) and b) do not apply, the tax shall be subject to the limitations of paragraph 2.

Article 11
Interest

1. Interest derived and beneficially owned by a resident of a Contracting State shall be taxable only in that State.

2. The term "interest" as used in this Convention means income from debt-claims of every kind, whether or not secured by mortgage, and whether or not carrying a right to participate in the debtor's profits, and in particular, income from government securities, and income from bonds or debentures, including premiums or prizes attaching to such securities, bonds, or debentures. Penalty charges for late payment shall not be regarded as interest for the purposes of the Convention.

3. The provisions of paragraph 1 shall not apply if the beneficial owner of the interest, being a resident of a Contracting State, carries on business in the other Contracting State, in which the interest arises, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the interest is attributable to such permanent establishment or fixed base. In such case the provisions of Article 7 (Business Profits) or Article 14 (Independent Personal Services), as the case may be, shall apply.

4. Interest shall be deemed to arise in a Contracting State when the payer is that State itself or a political subdivision, local authority, or resident of that State. Where, however, the person paying the interest, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment or a fixed base in connection with which the indebtedness on which the interest is paid was incurred, and such interest is borne by such permanent establishment or fixed base, then such interest shall be deemed to arise in the State in which the permanent establishment or fixed base is situated.

5. Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the interest, having regard to the debt-claim for which it is paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of the Convention.

6. A Contracting State may not impose any tax on interest paid by a resident of the other Contracting State, except insofar as
a) the interest is paid to a resident of the first-mentioned State;
b) the interest is attributable to a permanent establishment or a fixed base situated in the first-mentioned State; or
c) the interest arises in the first-mentioned State and is not paid to a resident of the other State.

Article 12
Royalties

1. Royalties derived and beneficially owned by a resident of a Contracting State shall be taxable only in that State.

2. The term "royalties" as used in this Convention means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic, or scientific work (but not including cinematographic films or films or tapes used for radio or television broadcasting), any patent, trademark, design or model, plan, secret formula or process, or other like right or property, or for information concerning industrial, commercial, or scientific experience. The term "royalties" also includes gains de-

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rived from the alienation of any such right or propertry which are contingent on the productivity, use, or disposition thereof.

3. The provisions of paragraph 1 shall not apply if the beneficial owner of the royalties, being a resident of a Contracting State, carries on business in the other Contracting State, in which the royalties arise, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the royalties are attributable to such permanent establishment or fixed base. In such case the provisions of Article 7 (Business Profits) or Article 14 (Independent Personal Services), as the case may be, shall apply.

4. Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the royalties, having regard to the use, right, or information for which they are paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of the Convention.

Article 13
Gains

1. Gains derived by a resident of a Contracting State from the alienation of real property referred to in Article 6 (Income from Real Property (Immovable Property)) and situated in the other Contracting State may be taxed in that other State.

2. Gains from the alienation of
a) shares of the stock of a company (whether or not a resident of a Contracting State) the property of which consists principally of real property situated in a Contracting State; or
b) an interest in a partnership, trust, or estate (whether or not a resident of a Contracting State) to the extent attributable to real property situated in a Contracting State

may be taxed in that State. For the purposes of this paragraph, the term "real property" includes the shares of a company referred to in subparagraph a) or an interest in a partnership, trust, or estate referred to in subparagraph b).

3. Gains from the alienation of personal property which are attributable to a permanent establishment which an enterprise of a Contracting State has in the other Contracting State, or which are attributable to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services, and gains from the alienation of such a permanent establishment (alone or with the whole enterprise) or such a fixed base, may be taxed in that other State.

4. Gains derived by an enterprise of a Contracting State from the alienation of ships, aircraft, or containers operated in international traffic shall be taxable only in that State.

5. Gains described in Article 12 (Royalties) shall be taxable only in accordance with the provisions of Article 12.

6. Gains from the alienation of any property other than property referred to in paragraphs 1 through 5 shall be taxable only in the Contracting State of which the alienator is a resident.

Article 14
Independent personal services

Income derived by an individual who is a resident of a Contracting State from the performance of personal services in an independent capacity shall be taxable only in that State, unless such services are performed in the other Contracting State and the income is attributable to a fixed base regularly available to the individual in that other State for the purpose of performing his activities.

Article 15
Dependent personal services

1. Subject to the provisions of Articles 18 (Pensions, Annuities, Alimony, and Child Support) and 19 (Government Service), salaries, wages, and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State.

2. Notwithstanding the provisions of paragraph 1, remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State if
a) the recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in the taxable year concerned;
b) the remuneration is paid by, or on behalf of, an employer who is not a resident of the other State; and
c) the remuneration is not borne by a permanent establishment or a fixed base which the employer has in the other State.

3. Notwithstanding the preceding provisions of this Article, remuneration derived by a resident of a Contracting State in respect of an employment as a member of the regular complement of a ship or aircraft operated in international traffic may be taxed only in that State.

Article 16
Limitation on benefits

1. A person (other than an individual) which is a resident of a Contracting State shall not be entitled under this Convention to relief from taxation in the other Contracting State unless
a) more than 75% of the beneficial interest in such person is owned, directly or indirectly, by one or more individual residents of the first-mentioned Contracting State; and
b) the income of such person is not used in substantial part, directly or indirectly, to meet liabilities (including liabilities for interest or royalties) to persons who are residents of a State other than a Contracting State and who are not citizens of the United States.

For the purposes of subparagraph a), a company that has substantial trading in its stock on a recognized exchange in a Contracting State is presumed to be owned by individual residents of that Contracting State.

2. Paragraph 1 shall not apply if it is determined that the acquisition or maintenance of such person and the conduct of its operations did not have as a principal purpose obtaining benefits under the convention.

3. Any relief from tax provided by a Contracting State to a resident of the other Contracting State under the Convention shall be inapplicable to the extent that, under the law in force in that other State, the income to which the relief relates bears significantly lower tax than similar income arising within that other State derived by residents of that other State.

Article 17
Artistes and athletes

1. Notwithstanding the provisions of Articles 14 (Independent Personal Services) and 15 (Dependent Personal Services), income derived by a resident of a Contracting State as an entertainer, such as a theatre, motion picture, radio, or television artiste, or a musician, or as an athlete, from his personal activities as such exercised in the other Contracting State, may be taxed in that other State, except where the amount of the gross receipts derived by such entertainer or athlete, including expenses reimbursed to him or borne on his behalf, from such activities does not exceed twenty thousand United States dollars ($ 20,000) or its equivalent in . . . . . for the taxable year concerned.

2. Where income in respect of activities exercised by an entertainer or an athlete in his capacity as such accrues not to the entertainer or athlete but to another person, that income of that other person may, notwithstanding the provisions of Articles 7 (Business Profits) and 14 (Independent Personal Services), be taxed in the Contracting State in which the activities of the entertainer or athlete are axercised, unless it is established that neither the entertainer or athlete nor persons related thereto participate directly or indirectly in the profits of that other person in any manner, including the receipt of deferred remuneration, bonuses, fees, dividends, partnership distributions, or other distributions.

Article 18
Pensions, annuities, alimony, and child support

1. Subject to the provisions of Article 19 (Government Service)
a) pensions and other similar remuneration derived and beneficially owned by a resident of a Contracting State in consideration of past employment shall be taxable only in that State; and
b) social security benefits and other public pensions paid by a Contracting State to a resident of the other Contracting State or a citizen of the United States shall be taxable only in the first-mentioned State.

2. Annuities derived and beneficially owned by a resident of a Contracting State

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shall be taxable only in that State. The term "annuities" as used in this paragraph means a stated sum paid periodically at stated times during a specified number of years, under an obligation to make the payments in return for adequate and full consideration (other than services rendered).

3. Alimony paid to a resident of a Contracting State shall be taxable only in that State. The term "alimony" as used in this paragraph means periodic payments made pursuant to a written separation agreement or a decree of divorce, separate maintenance, or compulsory support, which payments are taxable to the recipient under the laws of the State of which he is a resident.

4. Periodic payments for the support of a minor child made pursuant to a written separation agreement or a decree of divorce, separate maintenance, or compulsory support, paid by a resident of a Contracting State to a resident of the other Contracting State, shall be taxable only in the first-mentioned State.

Article 19
Government service

Remuneration, including a pension, paid from the public funds of a Contracting State or a political subdivision or local authority thereof to a citizen of the State in respect of services rendered in the discharge of functions of a governmental nature shall be taxable only in that State. However, the provisions of Article 14 (Independent Personal Services), Article 15 (Dependent Personal Services) or Article 17 (Artistes and Athletes), as the case may be, shall apply, and the preceding sentence shall not apply, to remuneration paid in respect of services rendered in connection with a business carried on by a Contracting State or a political subdivision or local authority thereof.

Article 20
Students and trainees

Payments received for the purpose of maintenance, education, or training by a student, apprentice, or business trainee who is or was immediately before visiting a Contracting State a resident of the other Contracting State and who is present in the first-mentioned State for the purpose of his full-time education or training shall not be taxed in that State, provided that such payments arise outside that State.

Article 21
Other income

1. Items of income of a resident of a Contracting State, wherever arising, not dealt with in the foregoing Articles of this Convention shall be taxable only in that State.

2. The provisions of paragraph 1 shall not apply to income, other than income from real property as defined in paragraph 2 of Article 6 (Income from Real Property (Immovable Property)), if the beneficial owner of the income, being a resident of a Contracting State, carries on business in the other Contracting State through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the income is attributable to such permanent establishment or fixed base. In such case the provisions of Article 7 (Business Profits) or Article 14 (Independent Personal Services), as the case may be, shall apply.

Article 22
Capital

1. Capital represented by real property referred to in Article 6 (Income from Real Property (Immovable Property)), owned by a resident of a Contracting State and situated in the other Contracting State, may be taxed in that other State.

2. Capital represented by personal property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State, or by personal property pertaining to a fixed base available to a resident of a Contracting State for the purpose of performing independent personal services, may be taxed in that other State.

3. Capital represented by ships, aircraft, and containers owned by a resident of a Contracting State and operated in international traffic, and by personal property pertaining to the operation of such ships, aircraft, and containers shall be taxable only in that State.

4. All other elements of capital of a resident of a Contracting State shall be taxable only in that State.

Article 23
Relief from double taxation

1. In accordance with the provisions and subject to the limitations of the law of the United States (as it may be amended from time to time without changing the general principle hereof), the United States shall allow to a resident or citizen of the United States as a credit against the United States tax on income

a) the income tax paid to. . . . . .by or on behalf of such citizen or resident;

and

b) in the case of a United States company owning at least 10% of the voting stock of a company which is a resident of. . . . . .and from which the United States company receives dividends, the income tax paid to. . . . . .by or on behalf of the distributing company with respect to the profits out of which the dividends are paid.

For the purposes of this paragraph, the taxes referred to in paragraphs 1b) and 2 of Article 2 (Taxes Covered) shall be considered income taxes. Credits allowed solely by reason of the preceding sentence, when added to otherwise allowable credits for taxes referred to in paragraphs 1b) and 2 of Article 2, shall not in any taxable year exceed that proportion of the United States tax on income which taxable income arising in. . . . .bears to total taxable income.

2. In accordance with the provisions and subject to the limitations of the law of. . . . . .(as it may be amended from time to time without amending the general principle hereof). . . . . shall allow to a resident or citizen of . . . . . .as a credit against the. . . . . .tax on income . . . . . .

3. For the purposes of allowing relief from double taxation pursuant to this Article, income shall be deemed to arise exclusively as follows

a) income derived by a resident of a Contracting State which may be taxed in the other Contracting State in accordance with this Convention (other than solely by reason of citizenship in accordance with paragraph 2 of Article 1 (General Scope)) shall be deemed to arise in that other State;

b) income derived by a resident of a Contracting State which may not be taxed in the other Contracting State in accordance with the Convention shall be deemed to arise in the first-mentioned State.

The rules of this paragraph shall not apply in determining credits against United States tax for foreign taxes other than the taxes referred to in paragraphs 1b) and 2 of Article 2 (Taxes Covered).

Article 24
Non-discrimination

1. Nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances are or may be subjected. This provision shall apply to persons who are not residents of one or both of the Contracting States. However, for the purposes of United States tax, a United States national who is not a resident of the United States and a . . . . . national who is not a resident of the United States are not in the same circumstances.

2. For the purposes of this Convention, the term "nationals" means

a) in relation to . . . . . ,
. . . . . .
. . . . . ; and

b) in relation to the United States, United States citizens.

3. The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favorably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities. This provision shall not be construed as obliging a Contracting State to grant to residents of the other Contracting State any personal allowances, reliefs, and reductions for taxation purposes on account of civil status or family responsibilities which it grants to its own residents.

4. Except where the provisions of paragraph 1 of Article 9 (Associated Enterprises), paragraph 5 of Article 11 (Interest), or paragraph 4 of Article 12 (Royalties) apply, interest, royalties, and other disbursements paid by a resident of a Contracting State to a resident of the other Contracting State shall, for the purposes of determining the taxable profits of the first-mentioned resident, be deductible under the same conditions as if they had been paid to a resident of the first-mentioned State. Similarly, any debts of a resident of a Contracting State to a resident of the other Contracting State shall, for the purposes of determining the taxable capital of the

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first-mentioned resident, be deductible under the same conditions as if they had been contracted to a resident of the first-mentioned State.

5. Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which other similar enterprises of the first-mentioned State are or may be subjected.

6. The provisions of this Article shall, notwithstanding the provisions of Article 2 (Taxes Covered), apply to taxes of every kind and description imposed by a Contracting State or a political subdivision or local authority thereof.

Article 25
Mutual agreement procedure

1. Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of the Contracting State of which he is a resident or national.

2. The competent authority shall endeavor, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with the Convention: Any agreement reached shall be implemented notwithstanding any time limits or other procedural limitations in the domestic law of the Contracting States.

3. The competent authorities of the Contracting States shall endeavor to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention. In particular the competent authorities of the Contracting States may agree

a) to the same attribution of income, deductions, credits, or allowances of an enterprise of a Contracting State to its permanent establishment situated in the other Contracting State;
b) to the same allocation of income, deductions, credits, or allowances between persons;
c) to the same characterization of particular items of income;
d) to the same application of source rules with respect to particular items of income;
e) to a common meaning of a term;
f) to increase in any specific amounts referred to in the Convention to reflect economic or monetary developments; and
g) to the application of the provisions of domestic law regarding penalties, fines, and interest in a manner consistent with the purposes of the Convention.

They may also consult together for the elimination of double taxation in cases not provided for in the Convention.

4. The competent authorities of the Contracting States may communicate with each other directly for the purpose of reaching an agreement in the sense of the preceding paragraphs.

Article 26
Exchange of information and administrative assistance

1. The competent authorities of the Contracting States shall exchange such information as is necessary for carrying out the provisions of this Convention or of the domestic laws of the Contracting States concerning taxes covered by the Convention insofar as the taxation thereunder is not contrary to the Convention. The exchange of information is not restricted by Article 1 (General Scope). Any information received by a Contracting State shall be treated as secret in the same manner as information obtained under the domestic laws of that State and shall be disclosed only to persons or authorities (including courts and administrative bodies) involved in the assessment, collection, or administration of, the enforcement or prosecution in respect of, or the determination of appeals in relation to, the taxes covered by the Convention. Such persons or authorities shall use the information only for such purposes. They may disclose the information in public court proceedings or in judicial decisions.

2. In no case shall the provisions of paragraph 1 be construed so as to impose on a Contracting State the obligation

a) to carry out administrative measures at variance with the laws and administrative practice of that or of the other Contracting State;
b) to supply information which is not obtainable under the laws or in the normal course of the administration of that or of the other Contracting State;
c) to supply information which would disclose any trade, business, industrial, commercial, or professional secret or trade process, or information the disclosure of which would be contrary to public policy (ordre public).

3. If information is requested by a Contracting State in accordance with this Article, the other Contracting State shall obtain the information to which the request relates in the same manner and to the same extent as if the tax of the first-mentioned State were the tax of that other State and were being imposed by that other State. If specifically requested by the competent authority of a Contracting State, the competent authority of the other Contracting State shall provide information under this Article in the form of depositions of witnesses and authenticated copies of unedited original documents (including books, papers, statements, records, accounts, and writings), to the same extent such depositions and documents can be obtained under the laws and administrative practices of that other State with respect to its own taxes.

4. Each of the Contracting States shall endeavor to collect on behalf of the other Contracting State such amounts as may be necessary to ensure that relief granted by the Convention from taxation imposed by that other State does not enure to the beneit of persons not entitled thereto.

5. Paragraph 4 of this Article shall not impose upon either of the Contracting States the obligation to carry out administrative measures which are of a different nature from those used in the collection of its own taxes, or wich would be contrary to its sovereignty, security, or public policy.

6. For the purposes of this Article, the Convention shall apply, notwithstanding the provisions of Article 2 (Taxes Covered), to taxes of every kind imposed by a Contracting State.

Article 27
Diplomatic agents and consular officers

Nothing in this Convention shall affect the fiscal privileges of diplomatic agents or consular officers under the general rules of international law or under the provisions of special agreements.

Article 28
Entry into force

1. This Convention shall be subject to ratification in accordance with the applicable procedures of each Contracting State and instruments of ratification shall be exchanged at . . . . . as soon as possible.

2. The Convention shall enter into force upon the exchange of instruments of ratification and its provisions shall have effect

a) in respect of taxes withheld at source, for amounts paid or credited on or after the first day of the second month next following the date on which the Convention enters into force;
b) in respect of other taxes, for taxable periods, beginning on or after the first day of January next following the date on which the Convention enters into force.

Article 29
Termination

1. This Convention shall remain in force until terminated by a Contracting State. Either Contracting State may terminate the Convention at any time after 5 years from the date on which the Convention enters into force, provided that at least 6 months prior notice of termination has been given through diplomatic channels. In such event, the Convention shall cease to have effect

a) in respect of taxes withheld at source, for amounts paid or credited on or after the first day of January next following the expiration of the 6 months period;
b) in respect of other taxes, for taxable periods beginning on or after the first day of January next following the expiration of the 6 months period.

DONE at . . . . . in duplicate, in the English and . . . . . languages, the two texts having equal authenticity, this . . . . . day of . . . . . 19...

For the United States of America:

For . . . . . .

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GHANA:

The Investment Code, 1981

by Elizabeth de Brauw-Hay *

I. INTRODUCTION

Ghana has a new investment code – Act 437 of 1981 – which received assent on 11 August 1981. It had quickly been discovered that the provisions of existing investment legislation – the Investment Policy Decree of 1975 [1] – were acting as a severe deterrent to foreign investors; hence the introduction of a new investment code within such a relatively short time from the passing of the previous one.

Views of potential investors were sought at a special conference on Ghana's gold reserves held in Accra in January 1981 and were taken into account in the preparation of the new code. The government is particularly keen to encourage overseas investment in mining and gold mining in particular; gold, along with cocoa and timber, account for around 75% of Ghana's total export receipts and in recent years production of this mineral has been falling heavily, mainly due to lack of investment.

These and other reasons behind the new legislation, which repeals the Investment Policy Decree and amending legislation, are clearly set out in the preamble to the Code, viz.:

it is considered vital to attract foreign investments in Ghana and also to encourage investments in Ghana by Ghanaian entrepreneurs to contribute to an increase in fixed capital formation for the exploitation of the resources of Ghana and for an increased production and creation of wealth, employment and improvement in skills and the social conditions of the citizens of Ghana;

having regard to the experience obtained in the operation of previous laws in Ghana relating to investment it has been recognised that one of the most important steps necessary to be taken in order to achieve the foregoing is to operate a policy of liberalization and an open economy and assure to the foreign and Ghanaian investor protection of his investment and a fair return therefrom;

it is the policy of Ghana to operate a mixed economy;

it is considered necessary to redefine the areas of investment in which non-Ghanaians are encouraged to invest, to indicate the areas in which the State and Ghanaians are required to participate in enterprises in which such foreign investments are made and to set out the incentives available to investors in the various fields of investment considered to fall within the priority areas of investment;

it is deemed to be in the best interests of Ghana to promote large-scale investments aimed at the exploration, exploitation, and processing of the mineral resources of Ghana;

it is considered desirable to provide for the registration of technology transfer contracts.

II. ADMINISTRATION OF THE INVESTMENT CODE

The Code provides for certain benefits to investors. In order to qualify for these benefits a potential investor must have his investment approved by a body set up under the Code known as the Ghana Investments Centre. The functions of the Centre, as well as approving investments, include advising on the priority sectors into which investment should be attracted, liaising between investors and ministries and government departments, agencies, etc., ensuring compliance with investment laws in force, approving and registering technology transfer contracts relating to investments in Ghana, recommending legislation to encourage investment, monitoring the results of benefits granted to investors and advising on how the investment climate could be improved. [2]

III. APPLICATIONS FOR APPROVAL

Prospective investors should submit to the Centre an application containing a detailed description of the enterprise intended to be carried on. This application should indicate, inter alia, the product to be produced, a production scheme, the time scale for commencement of production, an investment and financial plan, the locality where it is proposed to carry on the industry, the effects of the investment on the environment, the anticipated volume of imports and exports, an employment training scheme for Ghanaians.

An approval decision will be taken within 3 months from receipt of the application and the applicant will be notified of the Centre's decision. [3]

IV. CRITERIA FOR APPROVAL

Potential investments will be examined in the light of to what extent they contribute to the development of the economy and an efficient use of its resources and economic potential, full and efficient use and expansion of the capacity of existing enterprises, savings on imports, an increase in exports and the strengthening of Ghana's balance of payments situation, a fair country-wide distribution of investments, a high level of employment, importation at reasonable cost and transfer of technology and technical skills to citizens of Ghana. The effect which any investment might have on the environment will also be looked at. [4]

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* Former senior associate of the International Bureau of Fiscal Documentation.

1. See 29 *Bulletin for International Fiscal Documentation* (December 1975) at 495 ff.
2. Investment Code, 1981, Art. 10.
3. Id., Art. 23.
4. Id., Art. 11.

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V. RESERVED AREAS OF INVESTMENT

Only Ghanaians may participate in a variety of types of enterprise and in other a certain percentage of the capital of the enterprise must be owned by Ghanaians (see Appendix). In the case of mineral enterprises and enterprises engaged in the production of mineral oil or natural gas, the State will participate in accordance with the terms agreed between the Centre and the foreign investor. [5]

The Code also lays down which areas of investment will be regarded as priority areas. Broadly these are agriculture, mining (including boring for water), manufacturing, export-oriented industries, tourism, the construction and building industries and non-metropolitan industies. [6]

VI. SPECIAL PROVISIONS RELATING TO MINERALS AND OIL [7]

In cases where the State owns part of the capital of a mineral enterprise or an enterprise engaged in the production of mineral oil, an investor wishing to dispose of any part of the capital of such enterprise must first offer it for sale to the State.

Furthermore, all gold, diamonds and uranium produced in Ghana must be sold to the State.

VII. BENEFITS AVAILABLE UNDER THE CODE [8]

Benefits available under the Code fall into 2 categories – general benefits and special benefits.

A. General benefits

General benefits will be available to all enterprises approved under the Code and comprise the following:
- exemption for the first 5 years from payment of customs duties on machinery, equipment and accessories imported exclusively for the establishment of an approved enterprise;
- exemption for the 3 years after the establishment of an approved enterprise from customs duties on spare parts and other imports (other than raw materials) imported specially and exclusively for the enterprise;
- guaranteed manufacturing and establishment licence;
- exemption from selective employment tax [9] for the first 5 years;
- guaranteed personal remittance quota for expatriate personnel and the exemption of such personnel from taxes on the transfer of external currency out of Ghana.

B. Special benefits

Special benefits are also laid down in the Code for the priority areas of investment mentioned above, viz.:

1. Benefits available to agricultural enterprises

(a) Complete exemption from company income tax for the first 5 years; no dividends may be declared or paid, however, until after this benefit has terminated.

(b) Foreign companies investing blocked funds of repatriable status held in Ghana in an approved agricultural enterprise will be entitled:
- to a special import licence for machinery and equipment essential to the enterprise;
- to transfer 35 pesewas for every cedi invested (1 cedi = 100 pesewas) out of blocked funds;
- to transfer out of blocked funds 50 pesewas for every cedi of profit which could have been repatriated but which is reinvested:
- where the gestation period of an investment is more than one year, permission will be given to transfer for each year out of blocked funds 15 pesewas per cedi invested. This also applies to an additional investment made for the expansion of the enterprise. The rate of transfer will be 20 pesewas per cedi in respect of cattle rearing, oil palm, rubber, citrus, and cashew nut plantations.

The term "blocked funds of repatriable status" is defined as meaning accumulated dividends or profits or pre-1972 import credits or proceeds of foreign-owned capital sold to Ghanaians held by the Bank of Ghana awaiting transfer as well as any other certified funds.

The Investments Centre may also grant the following benefits:
- exemption from company income tax and customs duties for up to 10 years for the case of livestock and tree crops with a gestation period over 4 years;
- exemption of management staff from income tax with respect to furnished accommodation on the farm site;
- guaranteed management control for foreign investors in the case of agricultural enterprises in which there is foreign participation for such period as the Centre may determine.

2. Benefits available to the mining industry

(a) All mining enterprises will be entitled to:
- exemption from company income tax for as long as the company has not recovered the whole of its initial development expenditure; the same restriction as to declaring dividends as above operates here;
- guaranteed management control as above for the foreign investor so long as the whole initial development expenditure has not been recovered.

(b) Enterprises engaged in mineral exploitation and exploration may also benefit from the following:
- exemption from turnover tax;
- royalty on gold produced to be based on millhead grade of ore mined on a sliding scale between 2 and 6% of gross value of minerals won;
- company income tax not to exceed 45%;
- exemption of management staff from income tax with respect to furnished accommodation on mine camp.

5. Id., Arts. 12 and 13 and First and Second Schedules.
6. Id., Third Schedule, Part 1.
7. Id., Art. 13.
8. Id., Third Schedule, Part. 2.
9. See *African Tax Systems* (Bureau of International Fiscal Documentation, Amsterdam), Section B, Ghana, I.1.2.5.

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3. Benefits available to manufacturing industries

(a) All manufacturing industries will be entitled to exemption from company income tax for up to 5 years; the restriction as to declaring dividends during this period operates here, too.

(b) In areas outside Accra and Tema the following benefits may be granted on the expiry of the general benefits available:

- reduction of 25% in the company income tax payable;
- remission of 25% for customs duties on machinery, equipment and spare parts imported specificially and exclusively for the enterprise.

4. Benefits available to export-oriented enterprises

Export-oriented enterprises may be granted:

(a) exemption from company income tax for such period as the Centre may determine. The restriction on declaring dividends operates here, too;

(b) a special duty drawback of 25% on raw materials imported and used exclusively for export orders and on which customs duties have been paid;

(c) holding a certain percentage of sales proceeds in a foreign exchange account to meet repayment of initial suppliers.

5. Benefits available to tourist enterprises

Tourist enterprises may be granted:

(a) exemption from company income tax for a period not exceeding 5 years; the restriction on the declaring of dividends operates here, too;

(b) exemption from customs duties on items not immediately available in Ghana required for the establishment, construction and efficient operation of the enterprise;

(c) capital allowances at rates additional to the rates provided under the Income Tax Decree, 1975 as determined by the Centre.

6. Benefits available to construction and building enterprises

Benefits available to approved enterprises operating in the construction and building sector are as follows:

(a) exemption from company income tax for a period not exceeding 5 years. The restriction relating to declaring of dividends also operates here. It should, however, be noted that this benefit does not apply to specific construction and building contracts;

(b) exemption of management staff from income tax on furnished accommodation on the construction site.

7. Benefits available to enterprises operating in non-metropolitan areas

Approved enterprises in this category will be eligible for the following benefits:

(a) exemption from company income tax for a period not exceeding 5 years; the restriction regarding declaring of dividends operates, too;

(b) a reduction of 30% in company income tax payable and a remission of 30% of customs duties on machinery, equipment and spare parts imported specifically and exclusively for enterprises situated within the area of authority of a District Council responsible for any Regional capital. In the case of enterprises situated outside the authority of such District Councils the percentage is 40.

VIII. OTHER TAX-RELATED INCENTIVES AVAILABLE

The Code also provides for capital allowances being granted in respect of buildings, plant, machinery, structures, roads, furniture and fittings and fixtures used for the purposes of an approved enterprise at rates additional to those provided under the Income Tax Decree, 1975. [10]

A deduction for capital expenditure incurred in respect of scientific research for the purpose of the development or advancement of an approved enterprise is also available under the Code. [11] Such expenditure may be deducted from income over a 4-period beginning with the year in which the expenditure is incurred, at the rate of 25% per year.

IX. NON-TAX-RELATED INCENTIVES [12]

Of great importance to foreign investors is the guarantee that there will be no restrictions on the remittance of capital to the country of origin in the event of the sale or liquidation of an enterprise. The transfer of profits to the country of origin of an investment is also guaranteed after payment of taxes and maintenance and replacement of assets. Likewise, there will be no restrictions on the transfer of loan repayments or licence fees.

A guarantee is also given that there will be no restrictions on the entry into Ghana of foreign management and technical personnel required for an approved enterprise.

X. PROTECTION OF INVESTMENTS [13]

Central to the new Code is the guarantee that no approved enterprise may be expropriated by the government. Neither can an investor be compelled to cede his interest in the capital of an approved enterprise to a third party.

A guarantee is also given that benefits granted to an approved enterprise may not subsequently be altered to the disadvantage of the investor.

Fair, adequate and, not least, prompt compensation is, however, provided for in the exceptional cases where an enterprise is taken over or its capital ceded to a third party in the public interest.

XI. SETTLEMENT OF DISPUTES [14]

Where disputes arise between a foreign investor and the Ghanaian government over an approved investment it is provided that the government will *take all necessary steps to ensure amicable settlement of the dispute.*

10. Investment Code, Art. 19.
11. Id., Art. 20.
12. Id., Art. 16.
13. Id., Art. 14.
14. Id., Art. 17.

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Should, however, it prove impossible to achieve an amicable settlement, then resort may be had to the conciliation or arbitration procedure laid down in investment protection agreements between Ghana and the country of the investor or in the International Convention for the Settlement of Investment Disputes or in accordance with any other international machinery for the settlement of investment disputes agreed to by the parties involved.

Appendix

ENTERPRISES WHOLLY RESERVED FOR GHANAIANS

Part A – Commercial enterprises

1. Any enterprise concerned with retail or wholesale trade, unless such business is carried on by or within a department store or a supermarket which has an employed capital of not less than ₵ 2,000,000.00.
2. The sale of anything whatsover in any market, petty trading, hawking or selling from a kiosk at any place.
3. Overseas business representation unless the enterprise has an employed capital of not less than ₵ 2,000,000.00.
4. Operation of taxi service and car hire service.
5. The sale under hire-purchase contract of motor vehicles including taxis or vehicles intended to be used in the operation of taxi service or a car hire service.
6. Produce brokerage.
7. Advertising agencies and public relations business.
8. All aspects of pool betting business and lotteries.
9. Estate agency.
10. Travel agency.
11. Lighterage services unless the enterprise has an employed capital of not less than ₵ 2,000,000.00.
12. Commercial transportation of passengers by land.

Part B – Industrial enterprises (including service industries)

1. Bakery;
2. Manufacture of foam materials;
3. Operation of beauty salons and barbers' shops;
4. Manufacture of cement blocks for sale;
5. Ordinary manufacture or tailoring or both of garments such as joromi, shorts, blouses, ladies' dresses, children's wear;
6. Textile screen hand printing (including tie and dye);
7. Tyre retreading;
8. Manufacture of suitcases, briefcases, portfolios, handbags, shopping bags, purses, wallets.

ENTERPRISES PART OF WHOSE CAPITAL IS REQUIRED TO BE OWNED BY GHANAIANS

1. Enterprises not less than 60% of whose capital must be owned by Ghanaians:
enterprises carrying on insurance business.

2. Enterprises not less than 40% of whose capital must be owned by Ghanaians:
enterprises carrying on banking business.

3. Enterprises in which Ghanaians must participate in accordance with terms agreed between the Ghanaian and foreign investor and approved by the Centre:

Commercial enterprises

(i) Department stores and supermarkets being enterprises exempted administratively or by executive instrument from the provisions of section 11 of the Ghanaian Business (Promotion) Act, 1970 (Act 334) or exempted under section 38 of this Code from the minimum requirements of capital prescribed or the minimum Ghanaian ownership of its capital required by this Code;
(ii) Distribution and servicing of motor vehicles and tractors, and spare parts thereof or other similar objects;
(iii) Distribution agencies for machines and technical equipment;
(iv) Operation of industrial laundry and dry cleaning;
(v) Shipping;
(vi) Distribution of petroleum products and lubricants;
(vii) Commercial transportation of goods including the operation of tankers;
(viii) Casinos;
(ix) Clearing and forwarding agencies;
(x) Operation of cold stores and ice making;
(xi) Any enterprise engaged in retail or wholesale trade where the business is carried on within a department store or a supermarket the employed capital of which enterprise is not less than ₵ 2,000,000.00;
(xii) Overseas business representation where the employed capital of the enterprise is not less than ₵ 2,000,000.00;
(xiii) Lighterage services where the employed capital of the enterprise is not less than ₵ 2,000,000.00.

Industrial enterprises (including service industries)

(i) Laundry and dry cleaning;
(ii) Manufacture of charcoal;
(iii) Manufacture of furniture (including knock-down furniture for export);
(iv) Terrazzo work;
(v) Manufacture of confectionery;
(vi) Slaughtering of animals for human consumption and storage, processing and distribution of meat;
(vii) Operation of cinemas;
(viii) Motor workshops;
(ix) Manufacture of pharmaceuticals, cosmetics and perfumery;
(x) Sawmilling;
(xi) Manufacture of insecticides, pesticides and fungicides;
(xii) Assembly of motor vehicles and cycles;
(xiii) Manufacture of plastic, metal and paper containers;
(xiv) Manufacture of paints, varnishes or other similar products;
(xv) Manufacture of packaging materials;
(xvi) Manufacture of wire, nails, washers, bolts, nuts, rivets and other similar articles;
(xvii) Printing of books and stationery (including publishing);
(xviii) Manufacture of mosquito coil;
(xix) Manufacture of metal products;
(xx) Paper conversion;
(xxi) Assembly of household electrical equipment and appliances;
(xxii) Manufacture of jewellery and related articles;
(xxiii) Manufacture of candles;
(xxiv) Fish processing;
(xxv) Manufacture of footwear;
(xxvi) Blending and bottling of alcoholic drinks;
(xxvii) Manufacture of plastic products;
(xxviii) Estate development (including building contracting work);
(xxix) Manufacture of ball-point pens, lead pencils and coloured pencils;
(xxx) Manufacture of glass, mirrors and optical equipment;
(xxxi) Manufacture of gramophone records;
(xxxii) Manufacture of chalk and writing ink;
(xxxiii) Manufacture of biscuits;
(xxxiv) Ceramics;
(xxxv) Any enterprise which is engaged in the production of the following:
  (a) Sugar, salt, soap, detergents;
  (b) Fertilizers, petroleum products, lubricants;
  (c) Matchets, hoes and all agricultural implements;
  (d) Animal feed, milk and baby food;
  (e) Textiles (by all forms of processes other than textiles screen hand printing tie and dye);
  (f) Matches, cement, rubber and products and flour;
(xxxvi) Any enterprise engaged in the brewing of beer;
(xxxvii) Any enterprise engaged in the production or preparation of tobacco or the manufacture of tobacco products;
(xxxviii) Any timber enterprise.

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Pakistan's Budget for 1981-1982:

Fiscal Measures for Economic Development*

by Ahmad Khan **

The balanced economic development of a country requires the pursuit of coherent, consistent and coordinated economic policies. The policy planning itself should define the overall strategy and long term goals in unambiguous terms, especially in the historical, economic and social contexts. The policy plan also requires a constant quantitative analysis of the impact of various monetary and fiscal measures to ensure whether the desired goals have been achieved or not, so that, in the light of such analyses, necessary changes in the strategy can be made. Nevertheless, less developed countries like Pakistan, consistently faced with a resource constraint on the one hand and the desire to have an economic breakthrough on the other, find it quite difficult to work out a coordinated economic policy appropriately supplemented by necessary economic inputs. Consequently, despite the need for realization of a balanced economic growth, consistent with the hopes and aspirations of its people, the desired results of the fiscal measures adopted over a period of time may not come true.

Pakistan has historically attempted to formulate appropriate monetary and fiscal measures with a view to achieving balanced economic growth by broadening its industrial base, diverting resources to priority areas in the economy, increasing agricultural production, maximising exports, maintaining price stability, redistributing income, and improving its balance of payments. The fiscal measures employed include both direct and indirect taxes. They were further supplemented by non-tax measures such as providing the necessary infrastructure, skilled manpower, and monetary policies aimed at maintaining stable prices. In order to supplement domestic resources, liberal incentives in the form of tax concessions and investment guarantees were offered to attract foreign capital, goods and technology.

Although the present study does not intend to encompass a quantitative analysis of the impact of various fiscal and non-fiscal measures taken in the past, it might be appropriate to throw some light on the economic scenario of the country. It appears that, in spite of a satisfactory rate of growth in GDP during the past few years, "Pakistan is still in the throes of some acute problems such as low level of investment, widening trade dificit, a sick industrial sector, high rate of inflation and rising debt servicing burden". The only redeeming features in the scenario are "self-sufficiency in food production, improvement in output of other crops, a satisfactory increase in exports both in value and absolute terms, a rise in the level of home remittances, and a change in the outlook of the donor countries affecting the level of foreign economic assistance in the year to come". There is, however, a need to reinforce such gains with sound economic policies and decisive economic gains in all sectors of the economy.

The budgetary measures adopted during the current year reflect the government's desire to push the economic process ahead by providing sufficient incentives to both the industrial and agricultural sectors. The Finance Minister in his budget speech unfolded the economic policy package which the government will pursue in years to come. The fiscal measures adopted through this budget emphasize making the taxation system responsive to growth in the national economy, stricter financial management, controlling inflation, encouraging private sector investment, and improving public sector efficiency. The short term goals include raising of productivity and efficiency in agriculture and industry. The policy to restore private investment and public sector efficiency is backed by a reduction of the Annual Development Program for the industrial sector from 16 to 10 percent, and a clear policy advice to public sector enterprises to generate funds out of their own savings.

Apart from the philosophical consideration cited above, the fiscal measures adopted through the 1981-82 budget especially aim at providing incentives for private individual savings, increasing the surplus in the corporate sector for reinvestment in existing industries, encouraging investment in new industrial units, exploration for natural resources, increasing export of carpets and engineering products, developing agriculture, and construction of residential houses. Necessary changes have also been made in the tax laws to rationalize and streamline the procedures, remove fiscal anomalies and plug the loopholes.

In precise terms, the fiscal measures adopted through the 1981-82 budget are discussed below:

I. ENCOURAGEMENT OF PRIVATE SAVINGS

With a view to meeting the resource gap and encouraging the common man's association with the industrial development in the country, the government has, in the past, come out with various investment schemes like the National Investment Trust, the National Defence Savings Certificates, portfolio investment schemes of the Investment Corporation of Pakistan, postal savings schemes, etc. The investments made in such schemes and the shares and debentures of the public companies registered on the stock exchange have been historically

* This paper is essentially descriptive in nature and discusses the various fiscal measures adopted in the 1982-82 budget. Although reference has been made to the inadequacy of the fiscal measures in achieving the desired economic results, no attempt has been made to quantify the impact and interaction of monetary, fiscal and other non-tax measures to boost the economy.

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considered for rebate purposes while computing the tax liability of a person. In order to further induce private savings, the existing maximum monetary limit of 40,000 Rs. has been increased to 45,000 Rs. Similarly, the existing tax exemption for dividends and capital gains on disposal of shares of capital stocks of companies has been continued. The scope of investment channels has further been widened to include "Modaraba" certificates and Participation Term Certificates. Exemption from income tax in respect of income from approved debentures has been widened to include income from Participation Term Certificates. Similarly, income from newly introduced "Profit and loss sharing accounts", along with dividend income, if any, has been exempted up to the limit of 15,000 Rs. in the case of an individual.

II. INCENTIVES FOR THE INDUSTRIAL SECTOR

The Fiscal policy incentives for the industrial sector aim at broadening the industrial base, increasing output, channelling the investment to import-substituting industries and dispersing industrial units to the less-developed areas of the country. Whereas the existing tax concessions — e.g. the tax credit for installation of machinery (for balancing, [1] modernization and replacement), the tax credit to companies for investment in shares and debentures (of the Equity Participation Fund), the concessional rate of tax on intercorporate dividends, the tax holiday for industries set up in industrial estates and less-developed areas of the country and the setting off of losses of wholly owned subsidiary companies against the profits of parent companies (if the latter are registered on the stock exchange and have prepared plans for revitalizing sick subsidiaries which are approved by specified financial institutions, etc) — have been continued, the following new measures have been adopted to encourage investment in the industrial sector in general and some priority sectors in particular:

(i) In view of the high investment cost and the large cash flow needs of new enterprises, the rate of initial depreciation has been increased from 25 percent of the cost of plant and machinery.

(ii) On account of the heavy capital outlays involved in the organised exploitation of minerals, and the lack of adequate incentives for the purpose, the rich mineral endowment of the country has remained largely unexploited. Accordingly, Pakistani companies set up between July 1, 1981 and June 30, 1985, engaged in the exploration for and extraction of selected minerals, as to be notified by the government from time to time, have been extended a full tax holiday for a period of 5 years from the date of commencement of commercial production, and a tax concession of 50 percent of the normal rate for 5 years thereafter.

(iii) In order to encourage investment in oil exploration, the existing policy of recouping the entire depreciation allowed on plant and machinery at the stage of export out of Pakistan and charging it to tax at the normal rates has been revised, and it has been decided that such machinery and plant when exported out of Pakistan shall in future be charged to tax only in respect of initial depreciation.

(iv) Under the existing rules, the cost of road transport vehicles for purposes of depreciation is deemed to be no more than 100,000 Rs. This provision was primarily meant to discourage the use of big cars. However, in view of the substantial rise in the price of cars and the fact that in many businesses, vehicles other than cars are also an operational necessity, the provision has been adding undue harship. The limit for the purposes of depreciation has accordingly been relaxed as follows:
(a) for motorcars — 150,000 Rs.;
(b) for other types of transport vehicles — actual cost.

(v) With a view to reducing the tax burden on companies and creating a better climate for investment, the corporate tax rates have also been reviewed. Consequently, the corporate surcharge of 10 percent of the income tax and supertax on companies has been reduced to 5 percent.

(vi) Companies were allowed a rebate on the surcharge on retained profits provided the free reserve did not exceed 15 percent of the paid-up capital. Since banks and financial institutions have of necessity to keep their free reserve higher than this level it was seldom that they availed themselves of the rebate facility. In recognition of this genuine problem, the limit of free reserves in such cases has been raised to 300 percent of paid-up capital.

The direct tax measures have been further supplemented by concessions in the area of indirect taxes. The general rate of sales tax on domestically produced goods has been reduced from 20 to 12.5 percent. Some of the items such as sanitary ware, washing machines, radio sets, TV sets, and other electrical applicances, etc. which were chargeable at higher rates varying between 25 and 30 percent would consequently be taxable at the standard rate of 12.5 percent. Other items such as paper and paper products, artificial leather and rexine, motor vehicle tubes, automobile parts, calcium carbide and asbestos waste which were previously liable to a tax at rates lower than 12.5 percent will continue to be levied at lower rates. On the customs side, in order to provide encouragement ot the leather goods industry, the import duty of 85 percent otherwise chargeable on wet blue goat and sheep leather has been withdrawn. Similarly, the duty on dies and moulds has been reduced from 40 to 20 percent and the sales tax leviable at 10 percent has been withdrawn to encourage the manufacture of machinery and consumer durables. Single filament bulbs for use in miners' safety lamps have also been exempted from customs duties. As a measure of protection to domestic industry, import duties have been enhanced on some goods such as natural yeast, acetic acid, carbon black, sulfur black, white and colored cement, plastic moulding compound and resins, man-made fibres, sanitary ware, kitchen ware, tiles, etc.

1. *Editor's note:* The term "balancing" (of machinery) means installation of additional machines in an industrial unit for the purpose of achieving optimum efficiency of the various interrelated components of that unit.

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Similar concessions have been offered in the area of excise duties. These include:

(a) exemption from excise duty and sales tax to locally manufactured tyres and tubes for use in motorcycles, scooters and motor rickshaws;
(b) replacing the present 15 percent ad valorem rate of duty on woolen fabrics, other than carpets, rugs, blankets and shawls, by 13 percent of the retail price.

III. CONCESSIONS TO AGRICULTURE

The agricultural sector is of predominant importance to Pakistan and all possible efforts are being made to increase agricultural production. With this end in view, tax incentives, as well as other measures, are being widely used to achieve the desired objectives. The 1981-82 budget continues the existing exemption to agricultural income, and also income from poultry farming, dairy farming, cattle and sheep breeding, and fish catching. Similarly, the income from domestic manufacture of farm implements and machinery and income from renting of agricultural machinery or from providing pest control services continues up to June 1983. No additional concession on the direct taxes side has been granted through the current budget. However, in the area of indirect taxes, further incentives have been offered to encourage mechanization of agriculture, i.e.:

(a) Imported tractors imported in CKD condition for local assembly which were previously liable to an import duty of 10 percent, subsequently refunded after assembly, have been totally exempted from customs duties.
(b) Spare parts for tractors, previously charged to import duty ranging from 10 to 115 percent, have been made liable to a concessionary duty of 10 percent provided these are imported by authorised assemblers and do not exceed 20 percent of the value of imported tractors.
(c) Bulldozers, angle-dozers and levellers, previously charged to import duty and sales tax at 40 and 10 percent respectively, have been exempted from sales tax and the import duty reduced from 40 to 20 percent.

In addition to the fiscal measures referred to above, certain non-tax measures such as partial withdrawal of subsidy on wheat and increased support price of agriculture products, increased capital investment in the fertilizer industry with a fixed low price for the fertilizer (through Government subsidy) are expected to show positive results in the years to come.

IV. EXPORT PROMOTION MEASURES

Pakistan is essentially a primary goods exporting country. In recent years, the emphasis has, however, shifted towards export of finished goods, technical know-how and services, etc. With a view to encouraging exports, liberal concessions in the form of either a total tax exemption or a reduction of tax rates have been offered in the past. During recent years, it was felt that there was yet the need to further supplement the existing incentive programs to boost the export of certain items and services. Consequently, the following further tax concessions have been given through the current year's budget:

(i) The export of carpets and engineering goods is facing tough competition in the ineternational market. Similarly, the export of leather goods has been effected by the recession and depreciation of the currencies of major European countries which constitute the main export market. To protect the position of these important exchange earners in the export market, in computing the taxable income of domestic companies engaged in the export of carpets and engineering goods, an income tax concession in the form of allowing the deduction of expenditure in connection with advertisement abroad and supply of free samples shall be allowed at $1\frac{1}{3}$ times the amount of actual expenditure Simultaneously, a compensatory rebate of 12.5 percent on the export of carpets and leather goods will also be allowed.
(ii) A tax concession in the form of exemption of income of Pakistan companies rendering technical services abroad to foreign enterprises has been available since 1977 if the money is repatriated to Pakistan. This concession was only partially available to non-company taxpayers. In order to bring the company and non-company taxpayers rendering technical services abroad at par, income derived by non-company taxpayers has also been exempted. This concession is also available to shared income of persons who are partners of registered firms.

V. INCENTIVES TO ATTRACT FOREIGN INVESTMENT

Whereas all possible efforts are being made to utilize domestic resources, including capital and technology, to develop Pakistan's industrial base, the need for import of foreign capital and sophisticated technology is being met through very liberal incentive programs. Tax concessions to industries in priority areas of the economy or geographical areas are equally available to foreign investors. The exemption of income of expatriate technicians engaged in industrial projects for a specified period of time and of interest on foreign loans (whether from foreign governments and their financial institutions or from private lenders) has long been in vogue.

In order to attract sophisticated foreign technology, the percentage of deductible expenditure incurred abroad (while computing the income of a foreign enterprise rendering technical services in Pakistan) has been raised from nil to 10 percent of the gross amount of such fees. The entire expenditure incurred in Pakistan, nevertheless, remains a deductible expense. Appropriate measures are also being taken to streamline the deduction of head office expenses incurred by multinational corporations on behalf of their Pakistan subsidiaries and branches. Draft Income-tax Rules, in this behalf, have been framed and circulated for public opinion.

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Realising the necessity of providing a definite set of rules for the computation of income of foreign enterprises engaged in transnational business transactions and to supplement the tax incentives otherwise available under the domestic statutes, Pakistan has endeavoured to broaden its tax treaty net. Whereas conventions for the avoidance of double taxation and prevention of fiscal evasion with respect to taxes on income with most of the developed countries had been concluded by 1970, a number of similar conventions with countries like Canada, Malta, Libya, Romania, the Netherlands, Belgium, Italy, Bangladesh, Thailand, the Philippines, Malaysia, etc. have been concluded during the past few years. These conventions provide for concessional tax rates on dividends, interest, royalties, etc. It is expected that these treaties will serve as a favourable vehicle for the flow of capital, goods and technology from abroad.

An important area for foreign investment has been or is exploration and drilling for oil in Pakistan. Keeping in view the huge capital outlays in this area (and in order to reduce its oil import bill), Pakistan has entered into a number of petroleum concession agreements with foreign enterprises from Western Europe and North America. The existing tax concessions in the form of depletion allowances, reduced rate of tax, deduction of expenditure on drilling of dry holes and its carry forward to the subsequent years (where it can not be adjusted in the relevant year) have been continued.

To sum up, it can be safely stated that the fiscal measures adopted through the Budget for 1981-82 are oriented towards accelerating the place of economic development through the participation of both the public and private sectors, and to reach a stage of self-sufficiency in industrial and agricultural products.

Pakistan:

SUMMARY OF NEW TAX CONCESSIONS IN BUDGET 1981-1982

by Abdul Waheed *

The new tax measures are summarised as follows:

Tax relief has been provided to non-salaried persons falling in low income brackets:

where the total income –

(i) exceeds 12,000 but not 15,000 Rs., the amount of tax payable by an assessee shall be reduced by a sum equal to 20% of the tax payable;
(ii) exceeds 15,000 but not 25,000 Rs., the amount of tax payable shall be reduced by a sum equal to 15% of the tax payable; and
(iii) exceeds 25,000 Rs., the amount of income tax payable shall be reduced by a sum of 315 Rs.

Tax monetary limit of investment for the purposes of tax rebate has been raised from 40,000 to 45,000 Rs.

The rate of surcharge on companies has been reduced from 10 to 5%.

Exemption from tax has been granted to new residential houses constructed between 1 July 1981 and 30 June 1983 and having an annual value op to 18,000 Rs.

The rate of initial depreciation on plant and machinery of a new industrial enterprise has been raised from 25 to 40%.

In case of assets used in the exploration and extraction of petroleum, when exported out of the country, only initial depreciation shall be recaptured and charged to tax.

Pakistani companies engaged in the exploration of selected minerals have been given a tax holiday for 5 years; on the expiry of the 5 years, tax on such income shall be charged at 50% of the normal rate for the next 5 years.

Domestic companies exporting carpets and engineering goods shall be allowed expenditure on account of publicity and free sampling abroad at 1⅓ times the actual expenditure.

Exemption of income derived from rendering of technical services abroad to a foreign enterprise has been extended to non-company taxpayers.

Profits paid or credited to profit and loss sharing accounts shall be allowed as business expense to the banks.

Income tax rebate shall be allowed on investments made in purchase of Modaraba Certificates.

Investment in Participation Term Certificates shall be eligible for purposes of investment allowance, subject to the monetary and holding period limit.

Income derived from Modaraba has been exempted singly or in aggregate with other dividend income up to 15,000 Rs.

Income from PLS accounts along with dividend income, if any, shall be exempt up to 15,000 Rs.

Income from Participation Term Certificates shall be exempted along with debenture income up to 5,000 Rs.

Return on advance tax payments has been raised from 4 to 6%.

Income of a non-professional writer has been exempted up to 25,000 Rs.

A professional sportsman has been allowed exemption in respect of income from one benefit match.

In case of private limited companies with paid-up capital of 3,000,000 Rs. or more, audit by chartered accountants or cost management accountants has been made compulsory.

The Central Board of Revenue, with prior approval of the Federal Government, has been empowered to disclose any particulars of a taxpayer to the public.

The self-assessment scheme has been extended to all taxpayers filing returns for assessment year 1981-1982.

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* Member (Income Tax and Joint Secretary) Central Board of Revenue, Islamabad.

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PAKISTAN:

Budget 1981-82

Extract from the Budget Speech pronounced on 26 June 1981 by Mr. Ghulam Ishaq Khan, Finance Minister.

A detailed discussion of Pakistan's tax system appears in the International Bureau of Fiscal Documentation's publication: TAXES AND INVESTMENT IN ASIA AND THE PACIFIC

I. PRELIMINARY REMARKS

86. *Additional tax measures.* – Before coming to the tax proposals, I would like to briefly mention the considerations which have guided them. Although the demands on resources arising from the pressing needs of development, defence, administration, social and other services are enormous, the increase in expenditure of the government has been kept well within the rate of growth of GNP at current prices and, as I have just mentioned, it has been cut further. Even so, as tax receipts do not rise at the rate of GNP, additional resource mobilisation effort including the levy of new taxes becomes inevitable. This is a phenomenon that we have witnessed year after year and stems from the poor elasticity of taxes with respect to the tax base – be it the response of income taxes to incomes, import duties to imports or excise duties to industrial output. Furthermore, numerous exemptions and deductions make for a narrow tax base and a complex tax structure, which by facilitating evasion results in gross horizontal inequities as well as loss of revenue specific taxes lose their real value with inflation.

Poor elasticity of taxes

87. The Government has been concerned with this deficiency and has embarked upon a process of reform with a view to obviating in course of time the need for additional tax levies each year. The most encouraging reponse has been obtained in income tax where a combination of a self-assessment scheme under the new income tax law with tighter, selective enforcement has led to an extraordinary increase in revenue collections and the number of assessees.

88. *Indirect tax structures.* – A similar need exists to reform the indirect tax structures in order to make it more simple, control evasion and reduce areas of discretion and to enable the system to serve the needs of efficient resource allocations. One of the major deficiencies in the system is the heavy taxes, on raw materials which tend to be levied for revenue reasons because taxes on capital goods and consumer goods have a direct and visible impact which is generally resisted. Indeed, if taxes on raw materials are high and prevent development of uses by industries then the whole nation suffers.

89. *Tax reform.* – The flaws in the taxation structure, accumulated over many decades, cannot be removed overnight. But I hope that the measures that I will announce will mark a further significant step in the direction of tax reform. If these measures succeed in achieving the objectives in mind, the base would have been laid for a stable taxation system which will not only serve the needs of revenues but would also generate confidence by eliminating the annual uncertainty about taxation policies.

II. INCOME TAX

90. *Returns under self-assessment scheme.* – This brings me to the tax measures for the coming year. I am glad to say that the self-assessment scheme has now completed two years of its operation. During 1980-81, the campaign to educate the taxpayer about the full implications of the Scheme was stepped up and it has brought about encouraging results. Over 400,000 returns were received from the existing taxpayers as against 370,000 odd received during the preceding year. The number of taxpayers declaring increase in income over the preceding year by 10% or more was 52,718 as against 42,853 during 1979-80. This year 22,128 returns showed an increase in income of more than 20% over that of the last year. About 95% of the returns filed this year were accepted as was the case last year and the rest were subjected to detailed scrutiny.

91. *New taxpayers.* – During 1980-81, the efforts to locate new taxpayers continued unabated and over 200,000 new taxpayers were brought on to the tax register. The total number of taxpayers after deleting dead cases now stands at 844,645 which is more than double the number of taxpayers on income tax record only three years back.

92. *Collection of income-tax.* – The collection of income tax has also more than doubled in two years' time. Collections during 1980-81 are expected to exceed Rs. 670 crores as against Rs. 526 crores during 1979-80 and Rs. 334 crores during 1978-79. As a consequence the contribution of income tax to the federal revenues has increased to 19% in 1980-81 as against 17% in 1979-80 and 14.6% in 1978-79. the significant increase in collections without any increase in the tax rates bears eloquent testimony to the taxpayer's positive response of self-assessment, as well as to the commendable efforts made by the tax collectors to maximize tax revenues.

Success of self-assessment scheme

93. *Simplification of laws, forms and returns.* – Taxpayer's convenience is a matter of paramount concern to the Government. It is our constant endeavour to simplify the relevant laws, and forms and returns. The Income Tax Rules have been revised and published in a draft form for eliciting public opinion. We hope to finalise these rules in the light of the comments and reactions received by August, 1981. A new set of simplified income tax returns has also been prepared for use by different classes of taxpayers from the assessment year 1981-82. For the facility of non-English knowing taxpayers returns will be made available in Urdo also.

94. *Scope of self-assessment scheme.* – Coming to specific budget measures, it has been decided to extend the scope of the self-assessment scheme and to liberalize it further along the following lines:

(i) The scheme presently covers only such taxpayers who fulfil certain prescribed conditions. In view of the positive response from the tax paying public if has been decided to treat all returns for the assessment year 1981-82 showing taxable income as self assessment returns.

(ii) For the assessment year 1980-81, new taxpayers could show in their returns unexplained capital upto Rs. 50,000 provided the income on such capital was declared at not less than 50%. For the assessment year 1981-82, new taxpayers will be allowed to show unexplained capital upto Rs. 100,000 provided they declare an income of 50% on the first Rs. 50,000 and 40% on the balance.

(iii) For the assessment year 1980-81, immunity was given to such persons who declared income higher by 20% or more as compared with the highest assessed income in any of the three preceding years. This concession will continue to be available. However, those assessees who enjoyed immunity for the assessment year 1980-81 by declaring higher income are being given a further incentive. Such assessees will be entitled to immunity if their declared income exceeds the average (instead of the highest) assessed income of the three preceding years by 20% or more.

(iv) Under the present provisions, all self-assessment returns are first processed by accepting the declared income. Subsequently the cases selected for detailed scrutiny are re-opened. As this practice caused inconvenience to the tax payers, it has been decided that only one assessment shall be framed in all cases, whether for accepting them under self assessment or subjecting them to detailed scrutiny.

95. It is hoped that taxpayers will take full advantage of these concessions and declare their true and correct incomes in order to avail of the immunity.

96. *Personal tax rates.* – Personal tax rates have also been reviewed. It is felt that relief on the lines already available to the salaried class is called for in respect of non-salaried assessees falling in lower income brackets. It has, therefore, been decided to provide the following relief to this class of taxpayers:

(i) where the total income is upto Rs. 15,000 the income tax liability before rebate for investment will be reduced by 20%;

(ii) where the total income exceeds Rs. 15,000 but does not exceed Rs. 25,000, the income tax liability before rebate for investment will be reduced by 15%; and

(iii) where the total income exceeds Rs. 25,000 the extent of tax relief will be the same as available to persons having income of Rs. 25,000.

Reduction of rates

97. *Corporate tax rates.* – The corporate tax rates have also been reviewed. Corporate surcharge is presently 10% of the income tax and super tax on Companies. In order to reduce the burden of this tax on companies with a view to creating a better climate for investment, it has been decided to reduce it to 5%.

98. *Rebate of surcharge admissible to companies.* – At present rebate on surcharge is admissible to companies on retained profits provided the free reserves do not exceed 150% of the paid up capital. Since banks and financial institutions have of necessity to keep free reserves higher than this level, it is seldom that they avail of the rebate facility. In recognition of this genuine problem, it has been decided to raise the limit of free reserves in such cases to 300% of paid up capital.

99. *Rebate on investments.* – In order to promote savings, rebate is given on investments made by taxpayers in certain types of securities and savings schemes. The present monetary ceiling for such investments is Rs. 40,000. This limit is being raised to Rs. 45,000. The other conditions will remain unchanged.

100. *Tax treatment of certain financial instruments.* – In pursuance of Government's objective to Islamise the economy, certain financial instruments were introduced and other measures taken during the course of the year. The Income Tax Law is being amended to provide for the tax treatment of these instruments and measures on the following lines:

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(i) Investment made by the first holder of a Modarba certificate issued by a specific value Modarba will not be entitled to Income tax rebate subject to the statutory limit of investment.
(ii) Income tax rebate on investment in open end Modarba will be allowed to the holder of such certificate subject to the monetary and holding period limits already provided in the law.
(iii) Income tax rebate on investment in Participation Terms Certificate (other than such Certificate acquired by purchase or otherwise from previous holder thereof) will be allowed subject to the monetary and holding period limits already provided in the law.

Islamisation of the economy

(iv) Dividend income derived from Modarba will be exempted singly or in aggregate with dividend income from NIT, ICP, PLS Account and listed companies upto Rs. 15,000.
(v) Income from Participation Term Certificates will be exempted singly or in aggregate with income from approved debentures upto Rs. 5,000.
(vi) Profits distributed among profit and loss sharing account holders shall be allowed as business expense while computing profits of banks for tax purposes.
(vii) Income from profit and loss accounts, alongwith dividend income, if any, will be exempted upto the limit of Rs. 15,000 in the case of an individual.

101. *Tax concessions in industrial sector.* – To encourage investment in industrial sector in general and some priority sectors in particular, the following tax concessions are being given:
(i) At present initial depreciation is admissible on new plant and machinery at the rate of 25%. In view of the high initial investment cosdt and the larger cash flow needs of new enterprises, it has been decided to increase the rate of initial depreciation to 40%.

Investment incentives

(ii) Because of the heavy capital outlays involved in the organised exploitation of minerals, and the lack of adequate incentives for the purpose, the rich mineral endowment of the country has remained largely unexploited. It has, therefore, been decided that Pakistani companies set up between 1-7-1981 and 30-6-1985 and engaged in the exploration and extraction of selected minerals as notified by the government from time to time shall enjoy full tax holiday for the first 5 years from the date of commencement of commercial production, and a tax concession of 50% of the normal rate for the 5 years thereafter.
(iii) Oil exploration is one of our priority areas. In order to encourage investment in this sector, it has been decided that the machinery used in oil exploration when exported out of Pakistan shall be charged to tax only in respect of initial depreciation instead of full depreciation as is the case at present.
(iv) Under the existing rules, the cost of road transport vehicles for purposes of depreciation is deemed to be not more than Rs. 100,000. This provision was primarily meant to discourage the use of big cars. However, in view of the substantial rise in the price of cars and the fact that in many a business, vehicles other than cars are also an operational necessity, the provision is acting unduly harshly. It has, accordingly, been decided to relax the limit for purposes of depreciation as under:
  (a) for motor cars the new limit will be Rs. 150,000 and
  (b) for other types of transport vehicles, the actual cost.

102. *Exemption in housing sector.* – At present houses constructed between 1st July, 1974 and 30 June 1983 enjoy tax exemption for a period of five years as under:
(a) where annual value does not exceed Rs. 12,000 – Full exemption.
(b) where annual value exceeds Rs. 12,000 – Exemption limited to Rs. 6,000.

103. In order to further encourage investment in housing sector, it has been decided that income from houses completed between 1st July, 1981 and 30th June, 1983 and having an annual value of not more than Rs. 18,000 (in the case of Islamabad Rs. 24,000) shall be exempted for 5 years. Where annual value exceeds these limits the exemption shall be restricted to Rs. 9,000 only.

104. *Concession on export of goods and technical services.* – At present a number of tax concessions are available on exports of goods and technical services from Pakistan. In the interest of exports, the following further tax concessions are being given:

Export incentives

(i) Export of carpets and engineering goods is facing tough competition from other countries. To create markets for these exports there is need for sale promotion. It has, therefore, been decided that for working out taxable income of domestic companies engaged in export of carpets and engineering goods and such other goods as are notified by the Government from time to time, expenditure in connection with advertisement abroad and on supply of freee samples shall be allowed @ 1⅓ times the amount of actual expenditure;
(ii) At present income of Pakistani Companies rendering technical services abroad to foreign enterprises is exempt from tax, if the money is repatriated to Pakistan. This concession is only partially available to non-company taxpayers. In order to bring the company and non-company taxpayers rendering technical services abroad at par, it has been decided to exempt such income derived by non-company assessees also and on case, such tax payers are firms, the share income will be exempt in the hands of partners as well.

105. *Limit of return paid by Government raised on advance tax deposited by taxpayers.* – Currently, return @ 4% is paid by Government on advance tax deposited by the taxpayers. This rate is low. It has, therefore, been decided to raise it to 6% which will bring it at par with return on treasury bills.

106. *Exemption of income of professional sportsman.* – Presently, income of a professional sportsman from the exercise of his profession including income from a benefit match is taxable. It has been decided that income of a professional sportsman from one benefit match shall be exempted.

107. *Exemption limit raised in respect of artistic and literary work.* – In order to promote literary and artistic work by non-professional writers, poets or artists, it has been decided that the exemption limit on income from this source be raised from Rs. 15,000 to Rs. 25,000.

108. *Date for filing return of income.* – Now I come to some rationalisation measures:
(i) The last date for filing of income tax returns in case of non-company tax payers whose income year ends on any day between 1st January and 30th of June is 1st of November. This date is being brought forward to 1st of October.
(ii) There is no requirement of law at present for the private companies to have their accounts audited by qualified auditors. In order to ensure that accounts of bigger private companies are properly maintained and audited it has been decided that private companies with a paid up capital of Rs. 3,000,000 or more should get their accounts audited by Chartered or Cost and Management Accountants.

Residency

109. *Resident in Pakistan.* – At present a person becomes a resident in Pakistan if his stay in Pakistan during any year exceeds 60 days and during the four preceding years exceeds 365 days. By virtue of acquiring resident status the world income of such person becomes taxable in Pakistan. It has been observed that the condition of 60 days stay in Pakistan creates hardship for Pakistanis working abroad. While, on leave in this country for a period of more than 60 days they have to face taxation on world income basis. To obviate this hardship, the condition of stay of 60 days is being changed to 90 days.

110. *Minimisation of leakage of revenue.* – To minimize the chances for leakage of revenue, the following changes are being made in the area of withholding tax at various stages:
(i) In respect of assessees liable to pay advance tax, the tax rate at import stage is being reduced from 2% to 1.5%. Such taxpayers shall pay tax at this rate on all imports and shall be entitled to adjust the payment at import stage against their advance tax liability.
(ii) Tax @ 3% of the auction price of goods auc tioned by or on behalf of the Government, Local authorities, Public companies, Foreign associations, Contractors or Consultants or Consortium shall be collected by the auctioning authorities.
(iii) At present fees paid to professionals are subjected to withholding tax if total payments in the year exceed Rs. 50,000. This limit is high and is causing leakage of revenue. It is, therefore, being lowered to Rs. 10,000 in any financial year.

111. *Disclosure of particulars of income of taxpayers.* – The law prohibits disclosure of particulars of income of a taxpayer by the tax autorities. It has been observed that this provision gives undue protection to unscrupulous taxpayers whose particulars if made known to public may lead to detection of sources of income not shown to the Department. It has, accordingly, been decided to withdraw this protection and to empower Central Board of Revenue to disclose, with the prior approval of the Government, particulars of any assessee in respect of his income, assets, liabilities etc. to the general public.

112. *Notifications issued in 1980-81 incorporated in formal law.* – During 1980-81, a number of notifications were issued under Section 167 of the Income Tax Ordinance, 1979 in order to tide over difficulties experienced in the course of administering the Law. These notifications are now being incorporated in the formal law.

113. *Prospective enforcement of tax proposals.* – In the last year's budget, the principle of prospective enforcement of tax proposals being convenient to the taxpayers, was adopted. The same pattern has been generally followed this year also. Accordingly amendments relating to tax relief for small income groups, exemption of income from profit and loss sharing accounts, exemption of income from benefit matches and income of non-professional writers will be effective from the assessment year 1981-82. The rest of the amendments relating to relief measures will be effective from the assessment year 1982-83.

114. *Economic activities.* – Before coming to the field of indirect taxation I would like to state as had hinted earlier that we are in the process of restructuring the system in order to make it more responsive to increase in the level of economic activities so that the need for frequent changes in the tax rates is minimised. We intend to pursue this goal more vigorously during 1981-82 and hope to bring about substantial reform during the next couple of years. In this connection a major exercise was undertaken last year to bring the Pakistan Customs Tariff Clas-

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sification in line with the latest International Customs Nomenclature for Classification of goods. While doing so, a uniform classification for the purposes of customs duty and Import Trade Control was developed which, on becoming operative from the next financial year will go a long way in minimising discretion and assessment disputes.

III. CUSTOM DUTIES

115. *Range of duties.* – As was the case with the classification, the rate structure which is another important component of the total system also needed to be simplified. Starting with 11 rates in 1967-68, the number of ad valorem rates has proliferated to 42, which provide numerous opportunities for misdeclaration and malpractices. There are a number of rates involving fractional calculations like 12½%, 47½%, 72½%, 102½% and 197½%. Whatever rationale these rates might have had at the relevant time, it is not valid any more. There are other rates against which either no duty is being collected or which make insignificant contribution to the revenue. Again there are a number of composite rates which do not serve the purpose or the philosophy of their ad valorem or specific levies. It has, therefore, been decided to convert the existing composite rates into specific rates and to reduce the number of ad valorem rates from 42 to 16 only. Staying within the existing range of duties from 10% to 350%, these sixteen new slabs are 10%, 20%, 30%, 40%, 50%, 60%, 70%, 85%, 100%, 120%, 150%, 160%, 175%, 200%, 250% and 350%.

116. *Headings in the Tariff.* – Out of 1100 headings in the Tariff, some 950 headings already carry one or the other of these sixteen rates and they remain unaffected by the change. Adjustment is required to be made only in the remaining 150 headings. It has been decided to adjust the duty on these headings in the next lower or higher slab. The general principle followed in this regard is that the duty on essential items has been adjusted by and large in the lower slab and on less essential and luxury items in the next higher slab.

Improvements of the system

117. *Duty in lower slabs.* – Items on which duty has been adjusted in lower slabs include coke and semi-coke, coaltar, petroleum products like liquid paraffin, white oil, greases and brake fluid, worked mica, glassware for laboratory use, cutting blades for machine, motor parts, motor cycles, cars upto 1,000 cc and optical elements.

118. Among items on which duty has been adjusted in the next higher slab, some items of general interest are woven fabric of silk and plywood where duty will now be chargeable @ 250% instead of 235%, and 200% instead of 195% respectively. Likewise, duties in case of cocoa paste and butter, tooth brushes and tooth pastes, motor cars with an engine capacity of 1000 cc to 1300 cc will now be chargeable @ 120% instead of 115%, 150% instead of 135% and 120% instead of 115% respectively.

119. *Specific rates on betel leaves, unmanufactured tobacco, matches etc.* – Of the composite rates on items of general interest which have been converted into specific rates, betel leaf, is presently chargeable to @ Rs. 50 per kg plus 10% ad valorem. It has now been converted to a single specific rate of 60 per kg. Similarly duty on unmanufactured tobacco has been converted from Rs. 40 per kg + 10% ad valorem to Rs. 50 per kg, unexposed cinematographic films, from 20 paisas per metre + 10% ad valorem to 30 paisas per metre, fish and whale oil, from 70 paisas per kg + 10% ad valorem to Rs. 1.60 per kg, and on safety matches from Rs. 1.92 per 1440 matches + 10% ad valorem to Rs. 288 per 1440 matches.

120. *Improvement in Pakistan customs tariff.* – In addition to rationalization of rate structure, an effort has also been made to improve the Pakistan Customs Tariff from another angle. It has been observed that identical items with minor variation become chargeable to different duties. Such a situation gives birth to assessment disputes and malpractices. A number of such items have been identified and they have been subjected to a uniform rate of duty to minimize discretion and malpractices. These changes are:

(i) Manganese dioxide with slight change in description, is chargeable under three different tariff headings and attract rates of duty and sales tax ranging from 25% duty and nil sales tax to 40% duty plus 10% sales tax. It has, therefore, been decided to charge manganese dioxide to a uniform rate of duty @ 40% plus 10% sales tax.

(ii) Cigarette paper is classifiable under three different tariff headings attracting duty rates ranging from 40% to 50%. It has been decided to charge all kinds of cigarette paper to a uniform rate of duty @ 50%.

(iii) Duty on imported man-made yarns varies from Rs. 35 to Rs. 40 per kg, the bulk of the import being in the Rs. 40 per kg category. The difference in rate of duty provides opportunities for misdeclaration and consequential loss to the Government revenues. It has been decided to subject all such types of yarn to a uniform rate of duty of Rs. 40 per kg.

(iv) Switches and fuses not exceeding 500 volts are chargeable to 85% duty; and other fuses and switches to 40% rate of duty. Importers many times declare switches and fuses of 500 volts as switches of 550 and 560 volts to evade customs duty, although there is no voltage range between 500 to 1000 in the country. In order to remove this technical flaw the description of 500 volts is being substituted by 999 volts.

(v) Clocks of C&F value upto Rs. 100 are chargeable to 100% duty whereas clocks of higher value are chargeable at the rate of 150%. At present there are very few clocks whose value is less than Rs. 100. This distinction provides scope for misdeclaration and under-invoicing. It has been decided to remove the distortion by charging all the clocks regardless of value to a uniform rate of 120%.

121. *Rationalization measures in case of products which are substitute for each other.* – Similar rationalization measures have been taken in case of products which are substitutable for each other but suffer different incidence of duty. Details of these measures are:

(i) Most of the items falling under chapter relating to plastics are chargeable to specific rate of duty. This was done to check under-invoicing in the import of these items. Acrylic sheet is another item of this chapter which is being underinvoiced. To check its under-invoicing and bring it in line with other items of this chapter it has been decided to subject it to specific rate of duty of Rs. 25 per kg instead of 120% ad valorem.

(ii) Toilet paper cut to size or shape is chargeable @ 85% duty plus 10% sales tax. On the other hand, toilet paper in rolls, imported for the manufacture of toilet paper, cut to size or shape is chargeable @ 100%. It has, therefore, been decided to enhance the duty on toilet paper cut to size or shape from 85% to 120%.

(iii) Imported chemicals which are not manufactured in the country are chargeable @ 40%. Hydrogen peroxide, which is an important raw material for textile industry, although presently not being manufactured in the country is chargeable to duty @ 85%. It has been decided to reduce its rate to 40%.

122. *Enhancement of import duties.* – As a measure of protection to domestic industry, import duties have been enhanced on the following eight items:

(i) Natural yeast will now be chargeable to 120% duty instead of 70%;

(ii) & (iii) Acetic acid and carbon black to 85% instead of 70%;

(iv) Sulphur black to 85% plus 10% sales tax, instead of 70%;

(v) Cement coloured and white to 20% and cement grey to 10% from nil rate of duty;

(vi) Plastic moulding compounds and resins to Rs. 13 per kg instead of Rs. 11 per kg;

(vii) Man-made fibres to Rs. 20 per kg instead of Rs. 15 per kg; and

(viii) Sanitary ware, kitchenware and tiles to 150% instead of 120%.

123. *Withdrawal of concession in respect of imported tickets and tags.* – Now that the facilities to print airline tickets and baggage tags have become available in the country it has been decided to withdraw the concession given to imported tickets and tags.

124. *Duty on imported wood veneer.* – Wood veneer is an intermediary product between wood log which is its raw material and plywood, the finished product. Whereas plywood is chargeable to 195% duty both wood veneer and wood log are chargeable to 100% duty. the local units which convert log into wood veneer are, therefore, at a disadvantage because high percentage wastage is involved in converting wood log into wood veneer. It has, therefore, been decided to subject the imported wood veneer to a rate of 150% which is intermediate between the rates on wood log and plywood.

125. *Mechanisation of agriculture.* – To encourage mechanisation of agriculture, the following measures have been taken:

(i) Imported tractors are chargeable to 10% rate of duty. In case of CKD import for local assembly, duty is charged at import stage and is subsequently refunded when tractor is assembled. In order to ensure that the benefit of this concession is made available to farmers immediately, it has been decided to outrightly exempt customs duty on tractors imported in CKD form.

(ii) Spare parts for tractors which are chargeable to various rates of duty ranging from 10% to 115%, will be subject to a uniform rate of 10%, in case these are imported by the authorized assemblers and do not exceed 20% of the value of imported tractors. Tractor parts imported by the commercial importers will, however, be subjected to duty at the rates applicable to general auto-parts which has been reduced from 72½% to 70%.

(iii) Bull-dozers, angle-dozers and levellers are presently chargeable to customs duty and sales tax @ 40% and 10% respectively. In view of their extensive use in agriculture, road-building as well as construction, it has been decided to withdraw sales tax altogether and to reduce the rate of customs duty from 40% to 20%.

126. *Leather goods industry.* – In the field of industry, in order to provide encouragement to leather goods industry, it has been decided to withdraw the import duty of 85% presently chargeable on the wet blue goat and sheep leather.

127. *Duty on dies and moulds.* – Dies and moulds are presently charged to 40% duty and 10% sales tax. To encourage the manufacture of machinery and consumer durables, the duty on dies and moulds is being reduced from 40% to 20%, and sales tax is being entirely withdrawn.

128. *Exemption of single filament bulb.* – Miner's safety lamps and the two-filament bulbs used therein are already exempt from customs duty. Now that single filament bulbs are also being imported for use in the miner's safety lamps, it has been decided to extend the exemption to these bulbs also.

129. *Containers.* – Containers are increasingly being used for the transportation of trade goods. The equipment for handling the containers in the port area such as fork-lift, cranes, tractor tug masters, trawlers etc. is presently chargeable to customs duties ranging from 40% to 85%. These are also chargeable to sales tax at the rates of 10% to 20%. In order to encourage the present trend to-

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wards containerisation it has been decided to reduce the customs duty on the equipment used for handling the containers within port area to 20% whereas sales tax is being withdrawn altogether.

130. *Relief in respect of dental material, etc.* – The following further relief is being provided to the health sector:

(i) Dental materials and preparations which are at present chargeable to duty at rates ranging from 35% to 85% have been exempted from duty.

(ii) Oral diagonostic re-agents are exempt from customs duty but non-oral diagonostic re-agents are chargeable to duty at 40% ad valorem and 10% sales tax. It has been decided to exempt non oral diagonostic re-agents, imported in kit form from both customs duty and sales tax.

(iii) Presently the entire range of X-ray equipment except X-ray film processor is exempt from duty. It has now been decided to exempt the aforementioned processor also.

131. *Duty on watches.* – Considering the high value of watches these days it has been decided to provide relief on this item by reducing the duty from 85% to 60%.

132. *Export rebate on art-silk fabrics and garments.* – Export rebate on art silk fabrics and garments is presently being paid @ 42% of the f.o.b. value and on dyed and printed fabrics it is 45% of the f.o.b. value. A study undertaken revealed that the export values have been more than doubled whereas cost of inputs in terms of C & F price and duty per metre has increased by only 20%. This has obviously distorted the relationship between the f.o.b. export price and the actual duty paid on raw materials. It has, therefore, been decided to correct this distortion by refixing the rates of export rebates. Now the rebate on art silk fabrics and garments will be 32% of the f.o.b. value whereas in the case of dyed and printed fabrics it will be 35%.

133. *Hand knitted woollen carpets and leather goods.* – As stated earlier, export of hand knitted woollen carpets and leather goods has been affected by the recession and depreciation of the currencies of major European countries which constitute their main export markets. These items are important exchange earners for the country and in order to protect their position in the export market it has been decided to allow 12.5% compensatory rebate on their exports.

134. *Mining industry and export of gem stones.* – The Government believes that there is sufficient potential for development of mining industry and export of gem stones. It is accordingly proposed to allow concession of duty free import machinery for balancing and modernisation to marble industry and to the Gem stone Corporation for machinery required for cutting and polishing of gem stones.

135. *Changes in baggage rules.* – The following changes are being made in the Baggage Rules:

(i) Radio-cum-tape recorder is presently chargeable to import duty under the Baggage Rules. It has now been decided to exempt the same from levy of import duty.

(ii) Washing machines and gas appliances are presently allowed to be imported free of duty. Now that these are being manufactured within the country on a large scale, it has been decided to disallow their duty free import. However they would be chargeable to a concessionary rate of 125%.

136. *Warehoused goods in excess of specified period.* – Under the Customs law, imported goods can be warehoused without payment of duty normally for a period of one year. The importers, however, tend to delay the clearance of goods beyond one year. In order tocurb this tendency it has been decided that the rate of penal charge on the warehoused goods for the period in excess of one year be increased from 8% per annum to 2% per month.

IV. CENTRAL EXCISE DUTIES

137. *New measures in respect of central excise.* – In the field of central excise the following new measures have been taken:

(i) Raw materials imported for manufacture of tyres and tubes for use in motor cycles, scooters and motor rickshaws suffer customs duty ranging from 40% to 12%. The tyres and tubes are also chargable to central excise duty @ 10% and sales tax @ 10%. Consequently, the domestically produced tyres and tubes are at a serious dis-advantage vis-a-vis the imported tyres and tubes. It has, therefore, been decided to exempt this category of domestically produced tyres and tubes from both central excise duty and sales tax.

(ii) Knitting yarn is presently exempt from central excise duty. It is usually spun on the same spindles which are used for the manufacture of other yarns chargeable to duty @ Rs. 1 per kg. Cases come to notice where taking advantage of this position dutiable yarn has been cleared as knitting yarn to avoid payment of duty. To plug this loophole, it has been decided to withdraw the exemption on knitting yarn and make it chargeable to duty at the rate applicable to other dutiable yarns.

(iii) Woollen fabrics, other than carpets, rugs, blankets, lohis and shawls are presently chargeable to duty @ 15% ad valorem. Instances of valuation disputes on the basis of over charging of consumers have been reported. In order to protect both the manufacturers as well as consumers, it has been decided to link the rate of duty with the retail price fixed by the manufacturer. However, to prevent any price rise, it has been decided to replace the present 15% ad valorem rate of duty by 13% of the retail price.

(iv) (a) Metal containers which are manufactured in a factory which is not equipped with any plant or machinery capable of being operated with the aid of power, steam or natural gas are presently exempt from duty. It has been noticed that this exemption is being misused and certain large scale manufacturers get the tin sheet printed from regular tin manufacturers and convert the same into tin containers manually. To end this misuse, it has been decided to restrict the said exemption to cottage industries only as was the original intention.

(b) Metal containers manufactured by a manufacturer of vegetable ghee and kerosene oil for packing these products exclusively are exempt from central excise duty. In case, he also manufactures metal containers for packing products other than vegetable ghee and kerosene oil, he becomes dis-entitled to exemption even on metal containers manufactured for vegetable ghee and kerosene oil as well. In order to remove this anomaly, it has been decided to rationalise the exemption so as to ensure that metal containers manufactured for the packing of vegetable ghee and kerosene oil do not become dis-entitled to exemption under any circumstances.

V. SALES TAX

138. *Self clearance procedure in respect of goods manufactured or produced in Pakistan.* – It may be recalled that since 25th April, 1981, sales tax on all goods produced or manufactured within the country is being collected under the excise mode of collection. For the convenience of the manufacturers, however, the self-clearance procedure of the excise mode of collection has been applied. Consequently, no resident staff is posted to the factories and the manufacturers have complete freedom in the conduct of their day-to-day business.

139. *Collection of sales-tax.* – In order to make the excise mode of collection more effective, it has been decided to amend the Sales Tax Act so as to:

(i) redefine the term "sale price" in order to make it applicable to all taxable goods, whether excisable or not;

(ii) merge the two provisos to Section 3 of the Sales Tax Act (which provide for the excise mode of collection for excisable and non-excisable goods separately) into one; and

(iii) apply the provisions of the Central Excises and Salt Act, 1944 to the exclusion of the normal provisions of the Sales Tax Act. It has also been decided to make the provisions of the Customs Act, 1969 similarly applicable to the collection of sales tax on the imported goods. However, the self-clearance procedure of excise mode of collection, to which I have referred earlier, will be applied and no resident staff will be posted at the factories.

140. *Standard rate of sales tax.* – At present, the standard rate of sales tax is 20%. As in the case of customs duty, over a period of time, the rates have multiplied with the result that domestically produced goods have become chargeable to rates ranging from 5% to 30%. The multiplicity of rates has given rise to innumerable difficulties and avoidable disputes. It has, therefore, been decided to reduce the standard rate on all domestically produced goods to 12.5% and to abolish all rates above 12.5%. This will mean that items currently liable to rates of 15%, 20%, 25% and 30% will now be charged to the new standard rate of 12.5%. However, six commodities namely asbestos waste, paper and paperboard, tyres and tubes, calcium carbide, automobile parts and artificial leather and rexine will continue to be charged at the existing rates which are lower than the new standard rate of 12.5%.

141. The reduction in tax rates will bring relief to a majority of manufacturers of taxable goods, like sanitaryware, which was chargeable to 30%, tarpulines which was chargeable to 15%, and bakery products, sweet meats, sodium silicate, tents, plastic products and T.V. sets which were all liable to 20% rate and a number of other products.

142. In addition to general relief in the form of substantial reduction in the standard rate of sales tax applicable to the domestically produced goods, certain other relief and rationalization measures have also been taken:

(a) At present nuts, bolts and screws which are component parts of machinery are exempt from sales tax. Similarly, nuts, bolts and screws produced by cottage industry are also exempt. Besides, the majority of units are quite small which have to compete with cheaper imports. It has, therefore, been decided to exempt locally manufactured nuts, bolts and screws, including wood screws.

(b) The local sodium sulphide manufacturers are also facing disadvantage viz-a-viz imported product. In order to protect the local industry, sodium sulphide manufactured in the country, is being exempted.

(c) Domestically manufactured chip board and particle board of thickness of more than 7 mm, which is the substitute of timber, will be exempt from sales tax whereas other varieties of chip board and particle board will be chargeable at the new standard rate.

(d) Presently asbestos tiles, asbestos cement tiles, vinyl tiles and brick tiles are liable to sales tax @ 20% whereas glazed ceramic tiles and marble tiles are exempt. As all these commodities are close substitutes of each other, it has been decided that tiles of all description will be uniformly charged to tax at the new standard rate of 12.5%.

(e) Leather footwear is presently exempt from sales tax. Rubber footwear in which the value of rubber is at least 75% of the total value of raw material; and non-leather footwear the price of which does not exceed Rs. 25 per pair, are also exempt. Polyurethane footwear is, however, chargeable at 20%. It has been decided that footwear of whatever material

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will be exempt from sales tax if the retail price does not exceed Rs. 125 per pair. All footwear the price of which exceeds Rs. 125 per pair will now be chargeable to the new standard rate of 12.5%. This measure will treat different types of footwear in a like manner and will also shift incidence of tax from low priced to high priced footwear.

143. *Sales tax on paraformaldehyde abolished.* – Sales tax on imported paraformaldehyde, a raw material for manufacturing urea formaldehyde, is being abolished.

144. *Exemption to small manufacturing units.* – Exemption from sales tax was granted to small manufacturing units functioning on cottage industry basis, provided certain prescribed conditions were fulfilled. One of the conditions relates to the amount of capital employed in business.

145. *Capital employed.* – However, "capital employed" was not properly defined. Taking advantage of this loose definition, quite a few large manufacturers split their units to avail of the exemption. To plug this loophole a similar definition of the term "capital employed" is being provided in both, the Sales Tax and the Central Excise Laws. It is proposed to define "capital employed" as to mean every type of capital including borrowed capital. It has also been provided that if a person obtains machinery and fixtures on rent the value of such assets will be included in the amount of capital employed. Investment in business premises will not be considered while computing the amount of capital. In addition to these changes, all other existing conditions relating to cottage industry will remain in force.

VI. WEALTH TAX

146. *Return of Wealth tax.* – A fairly large number of property owners have failed to comply with the statutory requirement of filing their returns under the Wealth Tax Act. We could have easily invoked the penal provisions of law but we have decided not to do so in order to afford another opportunity to the defaulters to comply with the statutory requirements. It has accordingly been decided that the property owners who file the returns for the earlier years by 1st September, 1981 and pay at least 50% of their tax liability simultaneously shall not be subjected to the penal action under the law. the returns for 1981-82 may be filed by 1st October, 1981. The last date for furnishing wealth tax returns has been changed from 15th September to 1st October to synchronise with income tax returns of non-company assessees.

147. *Wealth tax on individual having more than one property, etc.* – In the case of a firm, an association of persons or body of individuals, whether incorporated or not immovable property held for the purpose of the business of construction and sale or letting out is liable to incidence of wealth tax on the portion of its value which exceeds rupees five lakhs. Some persons have started fragmenting their total investment in units of less than rupees five lakhs to avoid payment of wealth tax. In order to check such tendencies, it is being provided that wealth tax will be payable by an individual if he owns more than one such properties and his shares in different properties exceed rupees five lakhs.

VII. GIFT TAX

148. *Rate of gift tax.* – The present gift tax rates are effective since 1963. As prices have risen over the years it has been decided to reduce gift tax rates as under:

On the first Rs.	50,000 of taxable gifts.	From 5% to 2.5%.
On the next Rs.	100,000 of taxable gifts.	From 10% to 5 %.
On the next Rs.	150,000 of taxable gifts.	From 15% to 7.5%.
On the next Rs.	500,000 of taxable gifts.	From 20% to 10 %.
On the next Rs.	1,000,000 of taxable gifts.	From 25% to 20 %.
On the balance of taxable gifts.		From 30% to 25 %.

Malaysia: British company having no permanent establishment not subject to tax on management fees

– Euromedical Industries Ltd. (EIL) *v.* Director-General of Inland Revenue –

In January 1981 the Malaysian High Court decided that EIL, a company resident in the United Kingdom, was not subject to Malaysian income tax on certain management fees because EIL did not possess a permanent establishment in Malaysia. The facts in this case were as follows. In 1973 Euromedical Industries Sdn. Bhd. (EISB) was created in Malaysia for the purpose of manufacturing catheters. EIL and EISB concluded a contract under which EISB paid EIL managerial fees for the provision of three directors and staff supplying managerial, planning, training, technical, operational, marketing and development services. The Malaysian Inland Revenue found that these management fees were subject to income tax.

EIL appealed to the High Court and it was established that:

(1) The management fees were royalties as defined in Section 2 of the Malaysian Income Tax Act, which reads (as far as is relevant):
"royalty" includes –
   (a) any sums paid as consideration for the use of, or the right to use –
      (i) copyright, artistic or scientific works, patents, designs or models, plans, secret processes or formulae, trademarks or tapes for radio or television broadcasting or other like property or rights;
      (ii) know-how or information concerning technical industrial, commercial or scientific knowledge, experience or skill;
   (b) income derived from the alienation of any property, know-how or information mentioned in paragraph (a) of this definition;
   (c) amounts paid in consideration of services rendered by a non-resident person or his employee in connection with the use of property or rights belonging to, or the installation or operation of any plant, machinery or other apparatus purchased from, such non-resident person; and
   (d) any other amounts paid in consideration of technical advice, assistance or services rendered in connection with technical management or administration of any scientific, industrial or commercial undertaking, venture, project or scheme.

(2) The management fees did *not* fall within the royalty definition of Article I(3) of the Malaysia–United Kingdom tax treaty of 30 March 1973 which reads (as far as is relevant):

(3) The term "royalties" as used in this Article means a repayment of any kind received as consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work, any patent, trademark design or model, plan, secret formula or process or for the use of, or the right to use, industrial, commercial or scientific equipment or for information concerning industrial, commercial or scientific experience. The term, however, does not include any royalty or other amount paid in respect of motion picture films or of tapes for radio or television broadcasting, or of the operation of a mine, oil well, quarry or any other place of extraction of natural resources or of timber or forest produce.

(3) However, since the management fees are not covered by the royalty article they must fall under Article VI of the Treaty dealing with business income. This article provides (in part):

1. The income or profits of an enterprise of one of the Contracting States shall be taxable only in that Contracting State, unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, tax may be imposed in that other Contracting State on the income or profits of the enterprise but only so much thereof as is attributable to that permanent establishment.

. . .

5. Where income or profits include any items or profits which is dealt with separately in another Article of this Agreement, the provisions of that other Article shall not be affected by the provisions of this Article.

The High Court, therefore, held that EIL was not subject to Malaysian income tax with respect to the management fees it received. However, the Inland Revenue has appealed to the Federal Court.

Of course, the principles of this decision are also applicable under other tax treaties concluded by Malaysia, i.e. with Australia, Belgium, Canada, Denmark, France, German Fed. Rep., India, Japan, New Zealand, Norway, Poland, Singapore, Sri Lanka, Sweden and Switzerland. For the texts of the treaties, see *Taxes and Investment in Asia and the Pacific*, Part Treaties, under Malaysia.

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BANGLADESH:

1981 INCOME TAX AMENDMENTS

by K.A. Gofran*

A detailed discussion of the Bangladesh tax system appears in the Bureau's publication TAXES AND INVESTMENT IN ASIA AND THE PACIFIC

Income tax is an annual charge levied by the Parliament at the rate fixed each year by the Finance Act on the taxpayer's total income of the previous year (accounting year immediately preceding the assessment year).

Several amendments have been made in the Income-tax Act, Sales-tax Act, Gift-tax Act, Wealth-tax Act and Urban Immovable Property Tax Act by the Finance Act, 1981.

This article deals briefly with the amendments of the Income-tax Act which are important for international investors in Bangladesh.

INCOME-TAX ACT, 1922

1. *Section 4(3)(via)*

The limit of exemption has been raised to 2,500 Tk. from 2,000 Tk. on account of any receipts of a casual and non-recurring nature other than receipts (i) from winning lotteries, (ii) capital gains, (iii) receipts arising from business, profession, vocation or occupation and (iv) receipts by way of addition to the remuneration of an employee.

2. *Section 4(3)(xvi)*

Previously, interest to the extent of 500 Tk. on any deposit in a savings account with a scheduled bank, co-operative bank or co-operative society was exempt from income tax. This provision has been widened. The exemption of interest is now up to 3,000 Tk. on any kind of deposit but such exemption is available only to an assessee who is an individual.

3. *Section 4(3)(xviii)*

The exemption available on account of interest from a scheduled bank, co-operative bank or co-operative society together with interest on securities and approved debentures will be limited to 5,000 Tk.

4. *Section 7(1)*

An assessee chargeable under the head "Salaries" used to enjoy an exemption of 3,600 Tk. if he owned and maintained at his own expense a car registered in his name and did not receive any conveyance allowance or any other benefit or perquisite in lieu of such allowance from the employer. Similarly, the exemption available was 1,800 Tk. if the conveyance was any other power driven vehicle and 1,500 Tk. if no vehicle was maintained by him. The above exemptions have been respectively raised to 4,200 Tk., 2,400 Tk. and 1,800 Tk. this year.

It may, however, be remembered that the exemption is not available if the assessee, in addition to his income chargeable under the head "Salaries", derives income from business, profession or vocation.

5. *Section 9(1)(i) and 9(1)(ii)*

One sixth of the bona fide annual value of property was until now allowed as a deduction on account of cost of repairs irrespective of whether any expenditure was incurred or not. Henceforth one fifth of such value will be allowed as a deduction from the bona fide annual value.

6. *Section 9A (6)*

Agricultural income up to 3,600 Tk. was exempt from payment of tax under sub-section (6) of section 9A. The provision of such exemption has been withdrawn.

7. *Section 10(4)(d)*

An employer used to be allowed to deduct the lesser of 50,000 Tk. or 50% of the salary, perquisites or other benefits granted to any employee. This limit has been raised to 60,000 Tk. or 50% of the salary, whichever is less.

8. *Section 10(4)(g)*

A new clause (g) has been added to sub-section (4) of section 10. This provision puts a restriction on the admissibility of expenses incurred by an assessee on account of entertainment or services rendered in cases of sales and services liable to excise duty. Such expenses will not be allowed unless supported by an excise stamp or seal.

9. *Section 14A(2BB)*

A new sub-section (2BB) has been inserted providing for a "tax holiday" for expansion of an existing industrial undertaking if such expansion constitutes an identifiable industrial unit or a similar unit for the carrying out of an identifiable industrial process subject to fulfilment of conditions as laid down in section 14A(2B).

The tax holiday will not, however, be available to an industrial undertaking which is formed by the splitting up or the reconstruction or reconstitution of any business already in existence or by the transfer to a new business of any machinery or plant used in a business carried on in Bangladesh.

10. *Section 15(3)*

Previously the limit of exemption, i.e. investment allowance, was 30% of total income or 30,000 Tk., whichever was less. This limit has now been raised to 30% of total income or 35,000 Tk., whichever is less.

11. *Section 15(3A)*

A new sub-section (3A) of section 15 has been inserted. It puts a restriction on calculation of the investment allowance under section 15(3). Subject to limitation as provided in section 15(3), the aggregate sum of exemption, other than the sums exempted for premiums paid for life insurance, deduction for deferred annuity and

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contribution to a Government or Recognised Provident Fund, shall be up to 5,000 Tk. if the investment does not exceed 5,000 Tk. The amount of allowance available is 5,000 Tk. plus 60% of the amount exceeding 5,000 Tk. The full amount of insurance premium, deferred annuity and contribution to Provident Fund will be taken into account for the purpose of exemption subject to the overall limits.

12. *Section 15AA(1)*

By amending sub-section (i) of section 15, Unit Certificates issued by the Investment Corporation of Bangladesh have also now been made an item for which exemption under section 15AA(1) is available. In other words, purchase of such certificates will also be considered for the purpose of investment allowance.

13. *Section 18(3BB)*

Previously there was provision for deduction of tax at such rate or rates as may be prescribed by a person responsible for making any payment to another on account of supply of goods, execution of a contract or for services rendered, and by the Collector of Customs in the case of an importer or exporter. Now the scope of this provision has been widened by the inclusion of "indenting commission" in section 18(3BB) for the purpose of deduction of tax. It may be mentioned that a rule prescribing rates of deduction has so far been made in the case of supply of goods, execution of a contract or for services rendered. It is gathered that rates are being prescribed for deduction of tax in respect of import and export and indenting commission.

14. *Section 18(1)*

The liability to pay advance tax under section 18A (1) used to be attracted if the total income of an assessee as per the latest completed assessment (either normal or provisional) exceeded 20,000 Tk. This limit has now been raised to 25,000 Tk.

15. *Section 22(1)*

An individual was required to furnish along with the return or certificate, as the case may be, a statement of total assets and liabilities of himself, his wife or wives and his minor children if his/her total income exceeded 20,000 Tk. for any assessment year. This limit has been raised to 25,000 Tk.

16. *Section 23(3A)*

The limit of total income for presumptive assessment under section 23(3A) was 15,000 Tk. The limit has been raised to 20,000 Tk.

17. *Section 24(3)*

A new proviso has been added to sub-section (3) of section 24. Any amount received in cash as subsidy from the Government will henceforth be deducted in computing any loss for the purpose of set off and carry forward of loss under section 24.

18. *Section 28(1)*

An amendment has been made to sub-section (1A) of section 18 empowering the Deputy Commissioner of Taxes to impose a penalty also for understatement of the value of any immovable property in connection with sale or transfer with a view to evading tax.

19. *Section 34(2)(iv)(b)*

Sub-clause (b) of clause (iv) of the proviso to sub-section (2) of section 34 has been amended providing for a time limit to make assessment or re-assessment, as the case may be, in consequence of, or to give effect to any finding or direction in, an order under sections 31, 33, 33A, 34A, 66 or 66A or, in the case of a firm, an assessment to be made on a partner of a firm in consequence of an assessment made on the firm.

The previous legal position in this regard was that an assessment or re-assessment could be made (a) in the case of any such order made before 1 July 1975 within 4 years from that date, and (b) in any other case, within 2 years from the end of the year in which such order was made. An amendment regarding the time limit in respect of other cases has been made this year giving retrospective effect from 1 July 1980 authorising asn assessment or reassessment (a) in the case of any such order made on or after 1 July 1976 and before 1 July 1978 up to 30 June 1982, and (b) in any other case, within 2 years from the end of the year in which such order was made. The amendment does not appear to cover the cases of assessment or reassessment in consequence of such orders made during the financial years 1975-76 and 1978-79.

20. *Section 46(5A)*

A new paragraph has been added to sub-section (5A) of section 46. It provides that if any person to whom a notice under sub-section (5A) is sent fails to make payment in compliance therewith he shall be deemed to be an assessee in default for the amount specified in the notice and further proceedings may be taken against him for the recovery of the amount.

21. *The Third Schedule (Rates of income tax)*

The limit of total income liable to tax has been raised to 15,000 Tk. in the case of every individual, Hindu undivided family, unregistered firm, association of persons and every artificial juridical person (excluding a company and local authority). The number of slabs of taxable income has been reduced to 7 with lower rates of income tax compared to the previous rates. The rates now range from 10 to 60% of taxable income in the case of the above-mentioned kinds of assessees. The rate of 60% is applicable on the amount of taxable income exceeding 150,000 Tk.

A provision has been made this year to charge income tax at a concessional rate in the case of a resident and ordinarily resident assessee other than a company if he brings into Bangladesh through official channels his income accruing and arising outside Bangladesh. The rate of tax is 30% of such income or at the rate applicable to his total income including such income, whichever is more beneficial to him.

The rate of income tax is 50% of total income (excluding dividend income from a Bangladeshi company) in the case of every industrial company and 60% in the case of

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other companies including banks and financial institutions and local authorities. The income from dividends declared and paid by a Bangladeshi company or a body corporate in respect of the share capital issued, subscribed and paid after 14 August 1947 is liable to tax at the rate of 15% of such dividend.

The rate of income tax has been reduced to 30% from the previous rate of 60% in the case of a non-resident assessee.
Every registered firm is liable to income tax at rates ranging from 10% of total income exceeding 15,000 Tk. to 30% of total income exceeding 150,000 Tk.

U.S.A.: Return of tax treaties
(British Virgin Islands and Cyprus)

Mr. Percy, from the Committee on Foreign Relations, submitted the following

REPORT
(To accompany S. Ex. Res. 4)

The Committee on Foreign Relations, having had under consideration an original executive resolution (S. Ex. Res. 4) providing for the return to the President of pending income tax treaties with Cyprus (Ex. I, 96-2) and the British Virgin Islands (Treaty Doc. 97-6), reports favorably thereon and recommends that the Executive Resolution do pass.

Purpose

By this resolution the Senate would return to the President for renegotiation two bilateral income tax treaties, with Cyprus and the British Virgin Islands, which are pending before the Committee on Foreign Relations.

Committee action

On September 15, 1981, the Committee received the following letter concerning these tax treaties from Assistant Secretary of the Treasury for Tax Policy John E. Chapoton:

Department of the Treasury
Washington, D.C., September 15, 1981

Hon. Charles H. Percy,
Chairman, Senate Committee on Foreign Relations,
U.S. Senate, Washington, D.C.

Dear Mr. Chairman: I am writing with reference to the hearings scheduled by the Foreign Relations Committee on September 24, 1981, to consider fourteen pending tax treaties. For reasons which I will explain, I am hereby requesting that the Committee's consideration of the treaties with Denmark, Cyprus and the British Virgin Islands be delayed to give the Treasury Department time to negotiate certain modifications in those treaties.

Because of a recent amendment to Denmark's tax law, modifying the manner in which Danish corporations and their shareholders are taxed, Danish tax officials have requested that we renegotiate one provision of the pending treaty before it enters into force. We would like to accommodate Denmark's request. We intend to negotiate a Protocol to the Danish treaty. That Protocol, when signed, will be transmitted to the Senate for consideration along with the treaty which is now pending.

With respect to Cyprus and the British Virgin Islands, our desire to amend the treaties has come about as a result of our review of these treaties in preparation for hearings. Both of these jurisdictions are tax havens. The pending treaties with both were designed to prevent, or at least limit, the extent to which residents of third countries can use these treaties, in conjunction with favorable internal law provisions in those jurisdictions, to receive U.S. treaty benefits. We have concluded, on the basis of our review of these treaties, that the opportunities which potentially remain for such use are too great for us to tolerate. We intend to raise our concerns with the Governments of both jurisdictions, and seek modifications in these treaties consistent with our present policy. Although we are confident that the proposed British Virgin Islands treaty can be satisfactorily renegotiated, the existing British Virgin Islands treaty has been, and will continue to be as long as it is in force, subject to greater abuse than is likely to occur under the proposed treaty. Thus, in light of our concerns as expressed above, if satisfactory negotiations are not concluded by early 1982, the Administration intends to serve notice of termination of the existing treaty in accordance with its terms. In such event, termination would be effective January 1, 1983.

It should be noted that this procedure is not necessary with respect to Cyprus, since there is no existing treaty in force.

I hope that you will agree to delay consideration of these three treaties.

With best wishes.

Sincerely,

John E. Chapoton
Assistant Secretary (Tax Policy)

Assistant Secretary Chapoton reiterated the position of the Reagan administration with respect to these treaties at a hearing of the Committee on Foreign Relations held on September 24, 1981. On the basis of this request the Committee deferred taking any action on either of these treaties until its regular business meeting on December 8, 1981, when the Committee voted unanimously by voice vote to report out an original executive resolution returning both treaties to the President for renegotiation.

Committee comments

In view of the position of the executive branch on these treaties, as well as the serious reservation expressed by the chairman of both the House Ways and Means and Senate Finance Committee because of their potential for abuse by the residents of third countries, the Committee believes it desirable to return them to the President for renegotiation rather than to maintain them indefinitely on its calendar.

The Committee supports the objective of meaningful anti-treaty shopping provisions and therefore supports the effort to renegotiate the proposed treaties. The Committee may also support termination of the existing treaty with the British Virgin Islands if a more satisfactory agreement cannot be achieved. However, the Committee would expect to have further consultations with the executive branch prior to any decision on the termination of an existing treaty in accordance with the procedures appropriate to such a decision.

Taxes and Investment in the Middle East

- Company Law: — Forms of doing business
  — Establishing a business
- Investment Law
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– by *I.W. Harris*

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China: Recent tax experiments to revive the industrial and commercial tax system of State enterprises
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Tax incentives of industrialized countries for private undertakings in developing countries
– by *Eugen Jehle*

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BOLZ, Klaus; REYMANN, Sybille; PLOTZ, Peter; GABRISCH, Hubert; PISSULLA, Petra; BOHM, Edward; ALTMANN, Franz-Lothar; WASS VON CZEGE, Andreas.
Die wirtschaftliche Entwicklung in den sozialistischen Ländern Osteuropas zur Jahreswende 1980/81.
Hamburg, Verlag Weltarchiv, 1981. 355 pp., 29 DM.
Compilation of reports drawn by various experts on the economic development of the socialist countries of Eastern Europe as per January 1, 1981. The authors discuss the purposes and results of the last plan period of the various countries as well as purposes set in the five-year plan for 1981/1985.
(B. 103.392)

European Communities

A TWO-TIER COMMUNITY?
Reports of a TEPSA-conference, June 1979 on prospects for a two-tier system for the European Communities.
Amsterdam, Interdisciplinary Studygroup European Integration, 1981. 96 pp.
This report discusses harmonization of tax legislation.
(B. 103.466)

France

ANNALES DE L'UNIVERSITE DES sciences sociales de Toulouse. Tome XXVIII.
Toulouse, Université des sciences sociales, 1980. 493 pp.
The 28th Yearbook of the Social Science University of Toulouse, including the law faculty, contains the papers of a seminar held on November 29-30, 1979 with respect to the Sixth Value Added Tax Directive of the European Communities. M. Sergio Incecchi traces the history and implementation of the VAT directives; Prof. Guy Isaac discusses the implementation of the Sixth directive in French legislation; Prof. J.J. Philippe examines the general mechanism of the VAT after implementation of the Sixth directive; M.A. Viala discusses the extension of VAT to the "liberal professions" and M. Raffray the place of taxable transactions.
The implementation of the Sixth directive in the West German, British and Belgian legislation is discussed by, respectively, Prof. G. Haas, P. Wilmott and Prof. J. Malherbe.
(B. 103.401)

GOLDSMITH, Jean-Claude.
Business operations in France.
Foreign income portfolios.
Washington, Tax Management, 1981. 206 pp.
Portfolio containing information on conducting business or making investments in France. It includes descriptions of business organizations and taxation in France. The text of the income tax treaty between France and the U.S.A. and tax return forms are appended.
(B. 103.460)

BARRERA, J. Nicasio.
La organización judicial y la formación de los jueces. (La experiencia francesa).
Tucuman, Universidad Nacional de Tucuman, 1981. 222 pp.
Study of the French experience in training and appointing magistrates and of the judicial system and court procedures in force as from 1958.
(B. 103.474)

URI, Pierre.
Changer l'impôt (pour changer la France).
Paris, Editions Ramsay, 1981. 223 pp.
"Change taxes in order to change France". The author criticizes the present tax system in France and suggests a better tax system to encourage savings and productive investments.
(B. 103.400)

GUIDE FISCALO-COMPTABLE 1981.
Edited by Thierry Lamorlette.
Paris, Lamy, 1981. 1100 pp., 210 Fr.Frs.
Study designed to explain bookkeeping and tax aspects of enterprises from their establishment to their dissolution. International tax aspects arising from investments abroad by French enterprises are also dealt with.
(B. 103.369)

German Federal Republic

DEUTSCHER STEUERBERATERTAG 1980.
Protokoll.
Berlin, Erich Schmidt Verlag, 1981. 117 pp., 24.60 DM.
Compilation of the various speeches made on the occasion of the German Tax Consultant Congress 1980.
(B. 103.289)

RÖSSLER, Rudolf; TROLL, Max; LANGNER, Johannes.
Bewertungsgesetz und Vermögensteuergestz.
12., völlig neubearbeitete und erweiterte Auflage.
Munich, Verlag Vahlen, 1981. 2029 pp., 142.80 DM.
Twelfth edition of very detailed commentary on the German Valuation Law and the net wealth tax law.
(B. 103.256)

MITTELBACH, Rolf.
Grundstücke, Gebäude und Gebäudeteile im Betriebsvermögen.
3., erweiterte Auflage.
Cologne, Peter Deubner Verlag, 1981. 120 pp., 24.80 DM.
Third edition of a work that explains in detail the tax treatment of real estate belonging to the business property.
(B. 103.375)

PAULICK, Heinz.
Handbuch der stillen Gesellschaft. 3., völlig überarbeitete Auflage.
Cologne, Verlag Dr. Otto Schmidt, 1981. 524 pp., 128 DM.
3rd revised and updated edition of a handbook dealing with the civil law and tax law aspects of the concept "silent partnership"; recent legislative action, such as the effects of the 1977 corporate income tax reform and the new provisions concerning the negative capital account, are considered.
(B. 103.423)

BACONNIER, Robert; DIEHL, Wolfram; ELLIS, Maarten J.; FLICK, Hans; GORL, Maximilian; KOCH, Karl; LANGER, Marshall J.; MOORE, Raymond E.; RITTER, Wolfgang; VOGEL, Klaus.
Steueroasen und Aussensteuergesetze.
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Description of the significance of tax havens and legislative measures to combat them.
(B. 103.381)

HAAS, Gerhard.
Haftungsbegrenzte deutsche Betriebstätten in der EG – Elemente und Modelle steuergünstiger Bündelunternehmen.
Unternehmensformen ohne steuerliche Doppelbelastung, Teil II.
Bielefeld, Erich Schmidt Verlag, 1981. 158 pp., 34 DM.
Monograph explaining the various legal forms for permanent establishments of German enterprises in other EEC countries with emphasis on permanent establishments with limited liability which operate under favorable tax conditions.
(B. 103.376)

SCHULZE ZUR WIESCHE, Dieter.
Vereinbarungen unter Familienangehörigen und ihre steuerlichen Folgen.
Mit Formularanhang. 2., erweiterte Auflage.
Cologne, Peter Deubner Verlag, 1981. 195 pp., 38 DM
Second edition of a handbook that deals with all kinds of questions that exist concerning arrangements of family members and their tax consequences. Model contracts form the appendix to this work.
(B. 103.280)

SCHAUB, Günter; SCHUSINSKI, Ewald; STROER, Heinz.
Erfolgreiche Altersvorsorge.
Bech-Rechtsberater im dtv.
2. neubearbeitete Auflage. Stand 1. Februar 1981.
Munich, Verlag C.H. Beck, 1981. 228 pp., 10.80 DM.
Second edition of a guide that deals with aspects of old age pensions of any kind.
(B. 103.377)

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BUNJES, Johann, GEIST, Reinhold.
UStG. Umsatzsteuergesetz.
Munich, Verlag C.H. Beck, 1981. 694 pp.
Pocket-size comentary on the new German Value Added Tax and related statutes, including the turnover tax provisions in the Berlin Promotion Law.
(B. 103.390)

PAUSCH, Alfons.
Herzog Eberhard, Zehntabgaben-Ordnung aus dem Jahre 1669.
Cologne, Dr. Peter Deubner Verlag, 1981. 32 pp., 14.80 Dm.
Booklet providing a reprint of a tax ordinance dating from 1669, issued by Duke Eberhard of Baden-Württemberg; the booklet also contains a short historical explanation of this tax.
(B. 103.456)

SCHMOLDERS, Günter.
Allgemeine Steuerlehre.
Fünfte Auflage, neu bearbeitet von Karl-Heinrich Hansmeyer.
Berlin, Duncker & Humblot, 1980. 312 pp., 38 DM.
5th updated edition of a sourcebook providing a theoretical analysis of the various aspects of taxation, such as the tasks of taxation, the effects and systems thereof as well as the historical development of taxation.
(B. 103.317)

BETRIEBLICHE ALTERSVERSORGUNG im Umbruch.
Herausgeber Beratungs-GmbH für Altersversorgung Steuerberatungsgesellschaft Dr. Ernst Heissman und Deutsches Institut für Betriebswirtschaft e.V.
Bielefeld, Erich Schmidt Verlag, 1980. 511 pp., 118 DM.
Source book providing an extensive commentary on the various legal and economic aspects of private pension plans as compared with social security, e.g. from the point of view of personnel policy, labor law, insolvency law, life insurance aspects, audit aspects.
(B. 103.255)

TROLL, Max.
Erbschaftsteuer- und Schenkungsteuergesetz.
Loseblatt-Kommentar. 3. neubearbeitete Auflage.
Munich, Verlag Franz Vahlen, 1981. 1072 pp., 168 DM.
3rd revised edition of a thorough commentary on the German Inheritance and Gift Tax Law. The present edition is published as a loose-leaf service. Updating supplements will be released annually.
(B. 103.257)

WESSEL, Hanns Heinz.
Die Firmengründung.
4., neubearbeitete und erweiterte Auflage 1981.
Heidelberg, Verlagsgesellschaft Recht und Wirtschaft, 1981. 335 pp., 76 DM.
4th updated edition of a handbook discussing the importance of the concepts "business", "firm" and "trader" and the conditions for and the course of the foundation of various legal forms of enterprises, as well as the legal provisions for business names.
(B. 103.209)

ZIEMER, Herbert; KALBHENN, Heinz; FELIX, Günther.
Fundheft für Steuerrecht.
Leitsätze der Entscheidungen – Literaturübersicht, Nachweiss der Verwaltungsvorschriften.
Band 27: 1979.
Munich, Verlag C.H. Beck, 1980. 424 pp., 172 DM.
Annual source book for tax law for the year 1979 referring to articles and other publications, case law, administrative regulations, theses, etc., dealing with nearly all aspects of taxation in Germany, as well as an overview of articles on tax law in foreign countries published in the German language.
(B. 103.415)

RUPPE, Hans Georg.
Gewinnrealisierung im Steuerrecht.
Cologne, Verlag Dr. Otto Schmidt, 1981. 320 pp., 58 DM.
Book containing the text of lectures held at a seminar discussing the provisions in various German tax laws (Individual and Corporate Income Tax Law, Foreign Tax Law, Developing Countries Tax Law and Foreign Investment Law) with respect to the realisation of profits and the computation of taxable profits.
(B. 103.416)

HANDBUCH DER STEUERveranlagungen 1980.
Einkommensteuer, Körperschaftsteuer, Gewerbesteuer, Umsatzsteuer.
Munich, Verlag C.H. Beck, 1981. 2692 pp.
Annual guide for filing 1980 returns for individual income tax, corporate income tax, business and turnover tax.
(B. 103.391)

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Booklet explaining the most important company law and tax law aspects of foreign investment in West Germany.
(B. 103.338)

SCHAD, Hans-Joachim; EVERSBERG, Horst; WAGNER, Jürgen.
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Anleitungen und Erläuterungen zur Ausfüllung der verschiedenen Erklärungsvordrucke, einschl. der Vordrucke zur Gliederung des verwendbaren Eigenkapitals.
Düsseldorf, IdW-Verlag, 1981. 368 pp., 43 DM.
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Steuertabellen, Jahressteuer für Pkw und kleinere Nutzfahrzeuge, Steuerbefreiungen, Umfassende Erläuterungen, Berechnungsbeispiele.
Stollfuss Tabellen.
Bonn, Stollfuss Verlag, 1981. 32 pp., 14.80 DM.
Tax tables, exemptions, explanations, examples of the computation of the tax due, etc. regarding the German motor vehicles tax.
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Band 6.
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Greece

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Berichte und Dokumente zum ausländischen Wirtschafts- und Steuerrecht, No. 140 a/b, März 1981.
Cologne, BFAI, 1981. 42 pp., 8 DM.
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Ireland

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International Tax and Business Service.
New York, Deloitte Haskins & Sells, 1980. 90 pp.
General introduction to the tax system in Ireland in the series "International Tax and Business Service" prepared by Deloitte Haskins & Sells.
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Roma, Editoriale Tributaria Italiana, 1981. 338 pp.
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Paris, Organisation for Economic Co-operation and Development, 1981. 67 pp.
(B. 103.384)

TRANSFER PRICING. THE ITALIAN Experience.
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Liechtenstein

GUBSER, Anton.
Grundriss der Liechtensteinischen Gesellschaftsrechtsreform 1980. 167 pp.
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Netherlands

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Introduction to corporate income tax in the Netherlands.
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ADVIES INZAKE DE ZELFSTANDIGEN-aftrek in de Wet op de Inkomstenbelasting.
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Fiscale en juridische documentatie voor internationaal zakendoen. No. 11
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(B. 103.254)

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The Hague, Raad voor het Midden- en Kleinbedrijf, 1981. 194 pp.
Compilation of unpublished recommendations on tax matters prepared by the Tax Commission to the Council for Medium and Small Enterprises from 1970 to 1980 which might be of interest to self-employed persons.
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Sociaal- en arbeidsrechtelijke reeks No. 9.
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Monograph dealing with the social security law aspects of frontier workers in connection with the Netherlands, Belgium and the German Federal Republic. Labour law and taxation aspects are also considered, including the treatment under the income tax treaties. Relevant texts of statutes are appended.
(B. 103.434)

INVESTMENT IN THE NETHERLANDS.
The Hague, Peat, Marwick & Mitchell Belastingadviseurs, 1981. 61 pp.
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Annual guide providing all information on the current VAT law for business operations in the Netherlands, including reference to refund of foreign turnover tax. Model forms are appended.
(B. 103.481)

PARLEMENTAIRE GESCHIEDENIS VAN HET Nieuw Burgerlijk Wetboek. Boek 3, Vermogensrecht in het algemeen. Boek 5, Zakelijke rechten. Boek 6, Algemeen gedeelte van het verbintenissenrecht.
Deventer, Kluwer, 1981. 969, 442, 1108 pp.
Bound volumes containing the historic parliamentary written explanatory memoranda sectionwise arranged to the new Netherlands Civil Code. Book 3 of the Civil Code deals with the law on property in general. Book 5 of the Civil Code dals with the rights in rem (zakelijke rechten). Book 6 of the Civil Code deals with the contract law in general.
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(B. 103.405)

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De Wet investeringsrekening.
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Commercial edition in the series "Fiscal Monographs" of a thesis dealing with the Law on Investment Incentives (WIR) from the economic and taxation points of view. Also dealt with are the levies under the Industrial Deconcentration Act (SIR).
(B. 103.406)

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Een wettelijke regeling van het beroep van belastingconsulent?
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Text of a lecture and ensuing debate at the 28th Tax Consultant Day convened by the Netherlands Federation of Tax Consultants on April 3, 1981 in The Hague on the subject whether the profession of tax consultant in the Netherlands must be organized under a national law.
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Trends in Scandinavian Taxation.
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(B. 103.408)

Switzerland

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Explanation of the tax changes arising from the Finance Act 1981 with respect to customs and excise duties, value added tax, car tax, income tax, corporation tax, stock relief, industrial buildings, capital gains tax, capital transfer tax, stamp duty, oil taxation, development land tax, etc.
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L'impôt facteur de développement économique: le cas des pays en voie de développement.
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LINDENCRONA, Gustaf; MATTSSON, Nils.
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AUSTRIA

KOMMENTAR ZUR MEHRWERTSTEUER

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Tome VII, release 42
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CANADA

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DENMARK

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The Fiscal Structure of Jamaica

by H.W.T. Pepper

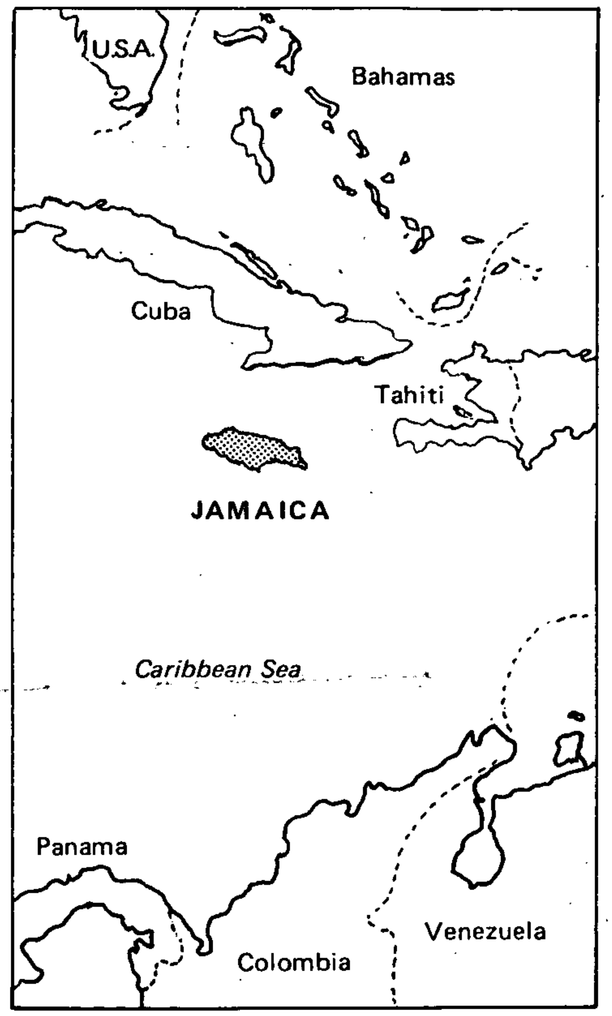
I. INTRODUCTION

Jamaica is a fairly large Caribbean island, approximately 150 miles long by 50 miles wide, at latitude 18 degrees North situated strategically between Florida and Latin America. The population is about 2,200,000.

The official, and spoken, language is English. A New Government was elected in October 1980, on a platform of encouraging free enterprise and foreign investment, for a 5-year term. The government is bi-cameral, having a House of Representatives and a Senate under the titular headship of a Governor-General.

The Jamaican dollar is linked to the U.S. dollar at a fixed rate of US$1 = J$1.778 and tourists coming to the island are permitted to pay taxi fares and hotel bills in U.S. dollars if they wish.

Of total tax revenue raised in the fiscal year 1979-80, 49% came from indirect taxes, 29% from direct taxes, and 22% from levies on bauxite and alumina of which Jamaica is a major producer. There is a wide spectrum of tax and other incentives to encourage industrial investment, tourist facilities, and exports, including, of course, the protected markets provided under the CARICOM, Lomé II, Commonwealth Preference, and other arrangements.



II. COMMUNICATIONS

Jamaica has good air links with the United States (1 hour to Florida, 3½ hours to New York) and Europe (9 hours to London), and also to other parts of the Caribbean and Central and South America. There are 6 or more flights per day to Miami and daily flights also to New York and Toronto.

There are several good harbours, Kingston – the capital – having one of the best in the world which is equipped for container ships and roll-on, roll-off ships which ply on regular service between Jamaica and the United States, and Jamaica and Europe.

There are excellent telephone, telex, and cable links with the rest of the world and there are direct dialling systems operating between Jamaica and North America.

Internally there is an air network – one can fly from Kingston to Montego Bay in 20 minutes – and also bus and rail services. Most of railway revenue comes from haulage for the bauxite companies, but passengers services are also provided and there are good roads between all the main towns and villages for bus, coach and other vehicular traffic.

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III. INTERNATIONAL LINKS

Jamaica is a member of the United Nations, the World Bank, the IMF, CARICOM (The Caribbean Common Market), ACP (the African-Caribbean-Pacific Group of Nations which has important links with the EEC through the Lomé II Agreement), and is a founder-member of the International Bauxite Association which negotiates minimum prices for alumina exports.

Jamaica is a member of the British Commonwealth of Nations, and of the OAS (Organisation of American States). Jamaica is also a beneficiary of GSP (Generalised System of Preferences) accords made by Canada and the United States with Jamaica in 1974 and 1976 respectively, and has a Bilateral Textile Agreement with the United States as well as trade agreements with Mexico and Venezuela which, inter alia, provide favourable terms on which oil may be imported.

Double taxation treaties with the United Kingdom, United States, Canada, Denmark, Federal Germany, Norway, New Zealand, and Sweden facilitate investment by those countries in Jamaica.

Law of the Sea

The decision was taken in August 1981 to site the International Seabed Authority (ISA) in Jamaica. The ISA is one of the many organisations of the United Nations and the fact that Jamaica has been thus honoured should further enhance its status as a suitable place to hold international conferences, as well as having some useful economic and touristic spin-offs.

IV. TRADE

As a member of CARICOM, Jamaica has access to the markets of its fellow members on a duty-free basis, the members being Barbados, Guyana, Jamaica, and Trinidad and the smaller countries Antigua-Barbuda, Belize, Dominica, Grenada, Montserrat, St.Kitts-Nevis, St.Lucia, and St.Vincent and the Grenadines.

Outside CARICOM, the Lomé II Convention gives duty-free access for Jamaica, as one of the 58 ACP countries, into the EEC in respect of over 99% of the items produced in Jamaica (and, of course, in the other ACP countries as well).

Jamaica also benefits from the Commonwealth Preference provisions available to members of the British Commonwealth of Nations of which Jamaica itself is a member, and from GSP (Generalised Schemes of Preferences) agreements with the United States and Canada. The latter, together with the Textile Agreement with the United States, make it possible for a U.S. firm to set up an industry in Jamaica whereby garment cut-outs can be sent to Jamaica for finishing and putting together for re-import into the United States duty-free for sale to customers there.

Jamaica enjoys quotas for traditional exports to the United Kingdom of bananas and sugar, the latter at fixed prices which are usually more favourable than the going world price.

Tourism, which counts as an "invisible export", draws customers from North America during the Northern winter months and from Europe in the summer months although in practice tourists from many countries arrive at all times of the year. Business conferences by U.S. organisations qualify for tax deductions in the United States – if held abroad – only if they take place in approved countries, e.g. Canada, Mexico, Puerto Rico, and the U.S. Virgin Islands. Jamaica's name has now been added to this select list which should help to expand both touristic and trade links between the two countries.

The flow of trade is assisted by the Jamaica Export Credit Insurance Company (JECIC), run by the (Central) Bank of Jamaica, which provides insurance for Jamaican exports. Various countries which export to Jamaica provide parallel cover for exports to Jamaica, e.g. Britain through its Export Credit Guaranteed Department (ECGD), the Netherlands through the Nederlandse Crediet Verzekering Maatschappij (NCM), and the United States through the Overseas Private Investment Corporation (OPIC).

V. INCOME TAX

Taxpayers resident in Jamaica, who are also domiciled there, are taxable on world income, on the basis of the amount arising. Tax is payable on the gross amount of the foreign income, whether it is remitted or not to Jamaica. Individuals who reside in Jamaica, but are domiciled in some other country, or being Commonwealth citizens are not ordinarily resident in Jamaica, are taxable in Jamaica on their Jamaican income; their foreign income, however, is taxed in Jamaica only to the extent that it is remitted to Jamaica.

Assessment

The income tax year runs from 1 January to 31 December, and self-employed individuals, partnerships, and corporate bodies are required to render self-assessment forms each year by 15 March, estimating the income likely to arise in the current year, and computing the relevant tax thereon. Normally the estimate is based on the previous year's income, but the taxpayer may amend his estimate at any time during the year if he finds that his current income is likely to be more or less than estimated. Tax is payable in quarterly instalments, the first on 15 March when the form is rendered, the rest on 15 June, 15 September, and 15 December.

The final accounting for tax for that year comes when the declaration of income for the year is made on 15 March in the following year. At that date a final self-assessment declaration of the actual income and tax liability for the preceding year is required and the balance of the tax is to be paid (or refunded if there was an overestimate).

If the taxpayer does not render his form, the Commissioner may make an estimated assessment – the taxpayer may object to this within 30 days. Under new provisions

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being introduced, the objection will not be valid unless it is accompanied by the necessary statement of income and tax. The Commissioner, in the absence of the statement, may order it to be submitted within 90 days, failing which the assessment may be confirmed. The Commissioner may extend the 90 days in appropriate cases, such extension being subject to a payment of tax on account. The taxpayer may appeal the confirmation of the assessment to the new Board of Revenue.

A. Corporate taxation

All corporate bodies, including associations (but not partnerships) are liable either to Company Profits Tax (CPT) and Additional Company Profits Tax (ACPT) or to Income Tax (IT), at the following rates:

	CPT	ACPT	Total
Agricultural companies	25 %	10 %	45 %
Other companies	35 %	10 %	45 %
	IT		
Life assurance companies	37.5%		37.5%
Estates and trusts	37.5%		37.5%
Building societies	30 %		30 %

Exemption is given from CPT and ACPT (and IT) for approved pension and superannuation funds, and for charities.

Dividends paid by companies are subject to withholding of tax at source at the rate of 37.5%, the tax deducted being accounted for by the company in the manner indicated below.

Where the shareholder receiving the dividend is a company, no further tax is payable by the recipient since the rate of tax payable by the company is 37.5% and relief of the same amount is due in respect of the 37.5% withheld by the distributing company.

Preference dividends paid by a company are deductible from profits in the same manner as debenture interest, but there is no deduction for ordinary dividends.

Dividends paid by a company out of capital are not charged to income tax on the recipient, but are subject to the 5% Transfer Tax.

The Additional Company Profits Tax is available to a company in its accounting for tax withheld from dividends paid out of its profits, as demonstrated in the following examples.

An individual taxpayer receiving dividends is chargeable on the gross amount at his marginal rate of tax, but is credited with the tax withheld at source.

Life assurance companies and *building societies,* besides being taxed at a rate lower than the ordinary corporation tax rate, benefit from the fact that tax relief is given to policy-holders and depositors in respect of premiums and deposits, respectively, which are paid to those institutions. In addition, the interest paid out by building societies on deposits left for a year or more are free of tax to the investor.

Life assurance companies, however, are also subject to a small levy on premium income excluding premiums relating to approved superannuation funds. The levy is 0.5% for Jamaican companies and 2% for others.

Banks are taxable at the ordinary corporate tax rate of 45%, but also benefit from the exemption from tax of interest paid to customers who place money on deposit for a year or more, a relief provided by the 1981-82 Budget.

Example A

Company tax on profit and dividends

	Company profit	CPT	ACPT
	$100	35	10
Total tax	45		
Profits available for distribution	55		
Gross dividend	40		
less tax withheld @ 37.5%	15		
Net cash dividend	25		
Tax to be accounted for by company		= $15	
less ACPT		10	
Net tax due		5	
Plus CPT		35	
ACPT		10	
Total tax payable by company		$50	

Tax payble by shareholder

Assume shareholder's marginal rate	= 50%
Gross dividend $40 @ 50%	= 20 tax
Less tax withheld @ 37.5%	= 15
Net tax payable on dividend by shareholder	$ 5

Example B

	Company profit	CPT	ACPT
	$100	35	10
Total tax	45		
Profits available for distribution	55		
Gross dividend	25		
less tax withheld @ 37.5%	9.37		
Net cash dividend	$15.63		
Tax to be accounted for by company		= $9.37	
Covered by ACPT		10	
Net liability		Nil	
Plus CPT		35	
ACPT		10	
Total tax payable by company		$45	

Tax payble by shareholder

Assume shareholder's marginal rate	= 30%
Gross dividend $25 @ 30%	= 7.50
Less tax withheld @ 37.5%	= 9.37
Tax credit available to taxpayer for refund or offset against other tax	$1.87

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Employment income is subjected to PAYE deductions at source according to the individual's code number, based on his entitlement to reliefs. To obtain a code number the individual must complete an "application for code number" form (P.1). If his domestic circumstances change during the year he may apply for a revised code number. If at the end of the year he finds he had additional tax reliefs to claim he completes a full return form and this is also necessary where he has received income not taxed by PAYE deductions.

The self-employed and those whose income is not, or not fully, subjected to PAYE are required to make by 15 March each year declarations indicating their probable income for the year, and tax thereon, as the basis for making quarterly payments of tax.

Tax reliefs for personal savings, referred to above under "shares subscription", have been extended by the 1981-82 Budget.

B. Personal income tax

Income tax in Jamaica is charged on personal income accruing in the calendar year at the following rates.

First	$ 7,000	30 %
Next	$ 3,000	40 %
Next	$ 2,000	45 %
Next	$ 2,000	50 %
Remainder	(over $14,000)	57.5%

There are no deductions from statutory income – instead reliefs are accorded in terms of tax as follows (tax credits).

Type of relief	*Relief in terms of tax*
Personal allowance	$600
Wife allowance	$140
Alimony or maintenance payments	40% of amount paid, or $160 tax if less
Wife's earned income	40% of earned income up to maximum of $320 tax
Child allowance	$10 per child
Child at university	$120 per child
Dependent relative	$40
Household helper	$4 p.w. max $208
Pensioner's allowance	$400
Special credit	$156 – allowable if income below $12,000

In addition there are various tax credits to encourage saving and investment, viz.:

Life assurance premiums (on life of taxpayer or wife)	60% of premiums paid (max. tax $360) + similar relief for an equity-linked life policy ("capital growth investment") so that maximum relief = $720
Donations	40% of eligible donations (not exceeding 1/20th of statutory income)
Mortgage interest	40% of interest paid – max. $60
Medical expenses	40% of expenses, or $40 tax if less
Shares subscription (regarding payments on 5-year contract to Building Society or Credit Union)	60% of sums paid, max. $360

C. Depreciation

1. *General*

Depreciation allowances on qualifying assets are calculated in the first year on cost and subsequently on the declining balance or written-down value of the asset, except in the case of motor vehicles. Commercial motor vehicles other than motor cars qualify for initial allowances (see below) and all types of qualifying vehicle are depreciated at the rate of 12.5% on a straight-line basis.

2. *Qualifying assets*

Industrial buildings, including factories, mills, warehouses, and buildings housing machinery and plant, but not office buildings (which, however, qualify for a 2.5% straight line depreciation allowance), qualify for straight-line allowances at rates from 2.25% to 5% according to the nature of the building. Plant and machinery generally qualify for an initial allowance of 20% and annual allowances (see below); expenditure on mines, oil wells, etc., patents and scientific research also qualifies.

3. *Investment allowances*

Investment allowances are granted at the rate of 40% of qualifying capital expenditure by sugar cane farmers and sugar manufacturers, and other farmers, on ships and on docks in respect of passenger facilities. For "basic industries" 20% is allowed which includes canning and preserving, textiles, and many other types of manufactures. These allowances are given in the first year, are not deducted in arriving at written-down value, and are not taken into account in computing balancing allowances and charges (see below).

4. *Initial allowances*

Initial allowances are granted at the rate of 20% on the cost of industrial buildings and plant and machinery. The rate for commercial vehicles is 12.5%. The allowances are in addition to the annual allowances and are deducted in arriving at the written-down value.

5. *Annual allowances*

The rates of depreciation allowance on the various types of qualifying assets vary broadly according to the estimated working life of the asset.

6. *"Multi-shift" etc. allowance*

If machinery is used on the basis of 2 or more 8-hour shifts per day, the annual allowance due on the machinery is doubled. Where a qualifying motor vehicle is used to such an extent that it will have a less than normal life, depreciation thereon may be increased.

7. *Balancing allowances and charges*

When qualifying assets are sold, scrapped, or destroyed and the disposal proceeds, including insurance and recoveries, exceed the written-down value, a balancing charge representing the excess (not exceeding the depreciation allowed) is taxed as income of the taxpayer.

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Where the proceeds fall short of the written-down value the difference is deductible as a balancing allowance in computing profits.

8. *Depletion*

Depletion allowances are granted regarding the working of minerals (including oil) at the rate of 20% initial, plus an annual allowance proportionate to the rate of exhaustion of the mineral deposits (output of taxable period divided by that output plus remaining reserves), subject to a minimum deduction of 5%.

D. Relief for losses

1. *General*

Losses incurred in business activities, which if profitable would be taxable, may be carried forward for 5 years. A loss for tax purposes may be created where depreciation allowances (see above) exceed taxable profit and the same 5-year carry-forward limit applies. In the case of that part of a loss created by investment allowances, however, the carry-forward period is extended to 11 years.

2. *Hobby-farming*

In the case of hobby-farmers, with effect from 1 January 1982, losses will not be available to offset against other income, but may be carried forward to set against future profits from the farm.

E. Double taxation relief

Foreign income, taxable in Jamaica, which qualifies for double taxation relief is taxable on the gross amount before deduction of foreign tax, the relief for foreign tax being then offset against the Jamaican tax on the foreign income.

Relief is available on income derived from other countries in the British Commonwealth, and also on income from countries which have double taxation treaties with Jamaica (the United Kingdom, United States, Canada, Denmark, West Germany, Norway, and Sweden – negotiations are also in progress for such treaties with certain other countries).

Under double tax treaties relief for doubly-taxed income is given in the country of residence at the rate to which the income has been subjected in the other country, or at the rate applicable in the residence country, whichever is less.

Some types of income, however, may be exempted by one of the countries, allowing the other the sole right to tax. This may apply to the income of shipping and airline companies which are usually taxable only in the country of residence, and some types of pension may be taxed in one country only. Favourable treatment, i.e., exemption in one country or restriction of the amount of tax to be withheld in the paying country, is also generally accorded to interest, dividends, and royalties.

Double tax relief in respect of Commonwealth income is granted at the rate of tax charged in the other Commonwealth country where that rate does not exceed one half the Jamaican rate of tax on the same income. Where the Commonwealth tax rate exceeds one half the Jamaican rate, the relief is given at half the Jamaican rate.

VI. INDIRECT TAXATION

Customs duties in Jamaica are fixed at the level prescribed by CARICOM.

Imported goods may be subjected, in addition to consumption duties, to a 10% stamp duty, and there is also a retail sales tax of 10% levied on certain consumer durables such as refrigerators, television sets, and air-conditioners. Motor vehicles are subjected to much higher rates of sales tax, but substantial abatements have recently been granted in respect of vehicles used for haulage or for agricultural purposes generally.

Locally manufactured goods are subject to excise duties and/or consumption duties as well as to retail sales tax where applicable, but the manufacturers are entitled to duty-free imports of raw materials, etc.

Exports are usually free of all local indirect taxation, and a Free Zone (Export Processing Zone) has been established in Kingston for export-oriented industries which amounts to a "tax haven" since apart from freedom from indirect taxation, income tax holidays for an indefinite period are also granted. A Free Zone is also to be provided at the country's second largest port, Montego Bay.

Although indirect taxation is high there are numerous abatements and exemptions, and certain foodstuffs are actually subsidised.

VII. PROPERTY TAX

Property tax has been charged since 1974-75 on a site (capital) value or unimproved value basis on land only and on the basis of 1973 values. There is no tax on buildings, and the system provides the maximum incentive for site development.

Land being used for agriculture is taxed at 25% of the normal tax rates, and there are provisions for abatement of the tax in case of hardship. Land used for hotels is taxed at 75% of the normal tax rates.

The tax rates are:

Value	*Tax*
not exceeding $2,000	$5 (minimum)
$2,000 to $4,000	$5 + 1% of excess over $2,000
$4,000 to $10,000	$25 + 1.75% of excess over $4,000
$10,000 to $16,000	$130 + 2.5% of excess over $10,000
$16,000 to $25,000	$280 + 3.25% of excess over $16,000
$25,000 to $50,000	$572.50 + 4% of excess over $25,000
Over $50,000	$1572.50 + 4.5% of excess over $50,000

There are approximately 520,000 taxable properties and the annual yield of the tax is around $25,000,000 so that its incidence is by no means oppressive. The tax may be paid in one sum, or in two, or four instalments. In the case of some mortgagors of private property there are schemes whereby the property tax may be paid in monthly instalments along with the mortgage payments.

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VIII. OTHER TAXES

A. Payroll tax

There are two types of payroll taxation, the social security or "National Insurance" levy and the National Housing Trust levy, both of which involve contributions from both employer and employee.

(a) *National insurance contributions*

Contributions are payable by employers in respect of employees at fixed rates up to a maximum of $3.75 per week. The employee also contributes, his maximum payment being $3.65 per week. The funds are used to provide old age pensions and other social security benefits. At the lower end of the contribution scale, a domestic helper contributes 10 cents per week and her employer 20 cents.

(b) *National Housing Trust (NHT)*

3% is charged on payroll, payable by the employer, and 2% of his emoluments is paid by the employee to provide funds for the National Housing Trust which builds low cost housing for sale on mortgage. Mortgages are let out at sub-economic interest rates varying from 4 to 8%. The employee is entitled to a refund of his contributions plus interest after 7 years but he continues to subscribe at the same 2% rate, so that a fund of 7 years' contributions from employees will remain in being. The 7-year refund system does not apply to the employers' contributions.

Contributions by employers to both schemes are tax-deductible. The employee receives a deduction for his NIS contribution but not for the (refundable) NHT contribution.

B. Hotel room tax

A tax ranging from US$4 to $6 per room is charged on occupancy in hotels in the main tourist season (15 December to 30 April). The tax is reduced to a range of US$2 to $4 during the rest of the year. The tax is related to the classification of the hotel which in turn is related to the level of the charges made for rooms.

C. Stamp duties

There are stamp duties on various documents ranging from a few cents on waybills and bills of lading to moderate ad valorem charges on life policies, mortgage deeds, etc. The highest rate is charged on conveyances of property, rising to approximately 2.66% on transfers over $2,000.

D. Transfer tax

On transfers of real property and leases thereof 5% of value is charged after exemption of the first $4,000 of value. Where real estate is disposed of at a price less than, or not much greater than, the acquisition price, the taxpayer may claim that the tax shall not exceed 25% of the excess of disposal price or value over acquisition price or value. If there is no excess, there is no 5% transfer tax payable.

E. "Death duty"

Transfers of property at death are exempted up to $10,000, the rate schedule being:

First	$ 10,000	exempt
Next	$ 10,000	7.5%
Next	$ 40,000	10 %
Next	$ 50,000	12.5%
Over	$110,000	15 %

IX. INCENTIVES

The incentives for manufacturing, agricultural, and tourism enterprises in Jamaica are generous, reaching their peak in the Free Zone referred to below.

Approved manufacturing enterprises may receive tax holidays of 5, 7, or 9 years according to the amount of local added value embodied in their output. Manufacturing goods for export outside the CARICOM area may rank for a 10-year tax holiday, and builders of factories for a tax holiday enterprise may qualify for a 15-year tax holiday. In all these cases there is also broad exemption from customs duties on raw materials for export industries, and from customs and other indirect taxes on imported equipment and machinery.

For new hotel enterprises the tax holiday may extend to 10 or 15 years, and resort cottages may qualify for 7 years of tax holiday. In both cases there is also initial exemption from customs duty on imports of construction materials and equipment.

For approved agricultural enterprises the tax holiday has increased by the 1981-82 Budget from a maximum of 5 to a maximum of 9 years, again in accordance with the amount of local added value embodied in the products. Another 1981-82 innovation is a provision allowing duty-free importation of trucks or lorries used in agricultural enterprises.

Motion picture producers may also obtain tax holidays on a similar basis to the above industries.

Farmers who make losses in their tax holiday period may carry them forward for a further period of 6 years after the end of the holiday. As mentioned under V. Income tax above, farmers also benefit by a lower rate (35%) of tax.

Dividends paid in the tax holiday period out of exempted profits are themselves also exempted from tax for the benefit of the shareholder.

The "Free Trade" or import duty exemption privileges available overseas to exporters of products grown, manufactured, processed, or assembled in Jamaica are quoted above under IV. Trade.

There are other favourable factors for those investing in enterprises in Jamaica, such as the provision of trading estates, factories for rent, and training grants to industries employing Jamaican labour.

There is a Free (Export Processing) Zone in Kingston

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and another is projected for the second largest port, Montego Bay. The main fiscal features are:

(a) indefinite tax holidays;
(b) exemption from indirect taxation on imports, and freedom from import licensing restrictions;
(c) freedom from exchange control; and
(d) no restriction on repatriation of profits.

In addition, factory and warehouse space may be rented in the Free Zone, and there is no restriction on the issue of work permits for expatriate executive and technical personnel.

Products from foreign companies operating in the Kingston Free Zone are granted preferential status in the import markets of the United States, Canada, Japan, the EEC, Switzerland, Denmark, Australia, New Zealand, and COMECON.

Export rebates in the form of a percentage reduction in the rate of corporate profits tax charged are available after the end of the tax holiday period. The rebate varies from 25% where between 10% and 21% of the profits of the enterprise are derived from exports, to 50% where the export profits are 61% or more of total profits.

Offshore companies are charged only 2.5% on their profits if certain conditions are fulfilled under the International Finance Companies (Income Tax Relief) Act 1971. The company must be at least 95% foreign-owned both as regards voting capital and loan stock, and its trading must be wholly off-shore. The company may, however, have a local office and use the services of local professionals.

Property tax is not chargeable on Government properties, so that manufacturers who rent industrial sites or factories from Government have no liability to Property tax.

JAMAICA:

BUDGET 1981-82

On 28 May 1981, the Right Hon. Mr. Edward Seaga, P.C., Prime Minister and Minister of Finance and Planning in Jamaica, introduced his Government's first Budget after its election in 1980. The Government was elected on a platform, inter alia, of encouraging foreign investment, private enterprise, and divesting a number of industries which had been nationalised by the previous Government. Extracts from the Budget Speech concerning tax changes and incentives are reproduced below. See the preceding article by H.W.T. Pepper for a general review of the fiscal system in Jamaica.

I now turn to the question of investment.

. . .

The development of an investment policy must seek to re-establish harmony of local and foreign investment in collaboration, working in the national interest to achieve significant growth and better standards of living. We have in the past defined our national interests and safeguarded them against violation. We did this by carefully selecting only investment interests which would operate in harmony with our national interests to our mutual satisfaction.

No one can point a finger at any of those who are here; if they can, let them do so. Let them do so.

That successful record of the 60s is the same sort of successful record that we propose to carry on in the 1980s.

. . .

Dealing with the taxation measures which we propose to offer in this year's Budget; we first of all face the position that there is a need to stimulate savings. To create a pool of investment to generate growth. As I said earlier, investment does not exist by itself. Savings are what constitute investment, providing the decision is taken to convert savings into investment. And growth is not possible without investment. If we are, therefore, intent upon achieving growth, we must be intent upon achieving investment and likewise we must be intent upon achieving savings.

I would like, therefore, to set out what measures the government proposes to adopt in terms of inducement to personal savings.

The first concerns income tax exemption of interest income from shares in Building Societies. At present, there is a limit of $600 on the exemption which an individual can claim in respect of exemptions from interest income from shares in Building Societies. It is proposed to move that $600 limit and replace it by a limitless amount.

That means you can invest as much as you wish in the shares of a Buiilding Society, the investment income from that will not attract any income tax providing the investor is an individual. This does not apply to corporations. Secondly, there are persons who invest in other areas in certificates of deposits, in banking institutions and in deposits in Credit Unions.

It has been decided to allow complete exemption of all interest earned from certificates of deposits in commercial banks and in credit unions and in any co-operative society which is approved, providing it is by an individual and not by a Corporation and providing the deposit is for a minimum of one year.

There are certain measures in addition to improve tax collection. The present situation is that companies and self-employed individuals are required each year before 15 March to estimate the amount of tax due by self-assessment and to pay this to the Commissioner of Income Tax in quarterly amounts. Where the taxpayer fails to do this, the Commissioner is empowered to make an assessment. The taxpayer can object to the assessment if it is disputed within 30 days.

What follows thereafter is a long, drawn out battle concerning the settlement of the objection, as a result of which millions of dollars are tied up on objections which are not settled.

It is proposed that a Notice of Objection by taxpayers to the assessment by the Commissioner will not be valid if not accompanied by a financial statement of Return Income Tax by the taxpayer within 90 days of the Commissioner requiring the taxpayer to enter such a return.

If the return is not made to the Commissioner within the 90 days, the Commissioner is empowered to confirm the assessment as final. But, we have to be practical. There is a limited number of accountants and auditors, most of them are very badly overworked and, therefore, for good and just reasons it might not be possible to meet the timetable. Hence, the Commissioner is also empowered to grant an extension in the event that the taxpayer says to him he is not able to render the account within 90 days.

He is empowered to grant an extension for a period which he will decide and, if he thinks fit, to make as a condition of the extension the payment of a small amount in the meantime.

Taxpayers may feel that because they are in the hands of a single individual, they may not be getting a proper decision and since this decision is vital to them, we have made a provision that the taxpayer may appeal the decision of the Commissioner in respect of granting the extension or in respect of the amount required as a condition of granting the extension and this appeal would be to the Revenue Board.

Now, the Revenue Board is a new concept, a new administrative unit which is about to be established in the tax structure of the country. It provides for 3 Revenue Board members, one of whom is the Chairman, and they will have under them the various tax departments. They, in turn, will have certain responsibilities whereas the departments will have others and by virtue of having a trio, or, as my friends on that side may say, "troika", it will be a much more acceptable position to taxpayers in so far as they are expecting and appearing to get justice in their complaints and in their objections.

. . .

Another area in terms of saving foreign exchange is to deal with the question of hobby farmers. Presently, some persons engage in hobby farming and set off losses incurred against other income for the purpose of avoiding tax. Provision is to be made that losses arising from agricultural activity may be set off only against future incomes from that source.

Now, for the sake of accuracy and full information,

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I should indicate that the personal savings provision will come into operation on 1 July 1981 and it is for a trial period of one year to test how the flow of funds will materialize.

The measures designed to improve tax collection on the basis of a new assessment arrangement will come into effect on 1 October 1981 and the measures concerning hobby farming will come into effect on 1 January 1982.

. . .

Agricultural incentives as I indicated earlier in my presentation are to be provided and on the basis that these incentives will be now on the same level as industrial incentives.

. . .

But there is another area of incentives which we consider very important for agriculture, and that is the transport section. Right now, people who have trucks can't look forward to ever replacing them. The duties and the taxes that were piled upon vehicles of all sorts, including trucks, by the last government have rendered it impossible for any but the very rich to replace that kind of vehicle and especially when that vehicle is serving the commercial purpose of agriculture.

We have decided, therefore, to exempt from customs duty, retail sales tax and stamp duty, indeed, all tax and all duty, all trucks used for agriculture.

In keeping with our policy to make the rural areas more dynamic, and to bring them more into the mainstream of development, we recognize that there are trucks that ply the routes with passengers, that there are trucks that take goods to deliver to the small shops. One of the reasons why the shops on the top of the hills of the country could not get various items was because there were no trucks to distribute them.

We have decided, therefore, that all other trucks will be relieved of Stamp Duty and Retail Sales Tax. They will still pay Customs Duty.

What does this mean in costs? It means that a truck that costs $45,000 c.i.f., with the present duties and tax would sell for $97,930, and will now cost $54,000, a savings of $43,370.

A lesser truck that cost $36,000 and used to sell for $78,000 will now sell for $43,000.

For the non-agricultural truck that used to be imported at $45,000 to sell for $97,000, with the exemptions granted will now cost $65,000.

. . .

And now I turn to the Budget.

. . .

In so far as the Budget for 1981-82 is concerned, the deficit on recurrent account is $279 million as compared with $357 million in the last Budget and we are committed to progressively reducing this until we show a surplus.

On the basis of that deficit on recurrent account there is an overall gap in the financing of the Budget of $86.7 million. And normally, at this point, I would be saying to you that that gap has to be financed by taxation.

. . .

That $86.7 million will not be financed by taxation; it will be financed by Treasury Bills. There will be no new taxation imposed this year.

But, I lodge a caveat. The revenues are over-stated by $35–$37.5 million. I didn't have to tell the House this. We expect to collect that by improvement in the collection of arrears. And it is entirely possible to do so but I give warning now that if there is any failure to collect it or any part of it, I will be coming back in the middle of the year for the balance.

There will be no printing of money unbacked by the Bank of Jamaica to finance this Budget.

The Budget financing has been designed in this manner to give the taxpayers of the country a rest after years of crippling taxation.

To give the country a chance to pull itself together and to produce growth again. But let us not forget that there are certain ceilings that we have to observe in the financing of the budget by agreement between ourselves and the Fund. The recurrent deficit must not exceed 3.5% of GDP. The overall deficit must not exceed 13.5% of GDP. And the total Budget outlay must not exceed 33% of GDP. This Budget has been financed within all those limits.

. . .

The Budget has been financed without a financial gap. There is no printing of money by the Bank of Jamaica to finance this Budget except in the interim period for cash flow purposes as is the normal course during the year. No new taxation will be levied this year if the $35 million put in for the collection of arrears is collected as we expect it to be.

Agricultural incentives increasing tax holidays on par with industry have been provided; full relief of taxes and duties on agricultural trucks reducing the cost by 80% has been provided; relief on Stamp Duty and Sales Tax for other trucks has also been provided; tax exemption on all interest earned by individuals on shares or deposits in Building Societies, Credit Unions and other approved Co-operatives has been provided.

Tax exemption on all interest earned by individuals on deposits of more than one year in commercial banks and other approved financial institutions under the Protection of Depositors Act has been provided.

Tax collection is to be improved by requiring taxpayers who object to assessment by Commissioner to file accounts within 90 days to substantiate their objection, or the assessment of the Commissioner will be binding. The taxpayer can seek extension of time from the Commissioner and can appeal against the decision of the Commissioner regarding extension.

The investment required to met the growth target for three years is four billion, six hundred million dollars. At this point, the only gap that remains in finding that sum is $820 million or 18%, a creditable amount at this time in terms of unidentifiable projects.

The growth targets are 3.7% for Year One; 4% for Year Two; 5% for Year Three . . . .

In next issues:

Taxation for development: corporate taxation in Japan
– by *Dharmendra Bhandari*

Tax incentives of industrialized countries for private undertakings in developing countries
– by *Eugen Jehle*

Safe harbor leasing - a controversial means for distribution of investment incentives
– by *Frank Schuchat*

The development of double taxation conventions with particular reference to taxation of international air transport
– by *D. Hund*

The welfare cost of taxation: its meaning and measurement
– by *Nizar Jetha*

The Peruvian tax reform (1981)
– by *Pedro Massone*

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HONG KONG:

Tax Aspects of Foreign Currency Gains

by I.W. Harris*

I. INTRODUCTION

In researching for this talk I was surprised to find, or, perhaps I should say, not to find, how little has been published on the topic and how few decided cases exist. However, on reflection, this is perhaps not surprising as it is only comparatively recently that exchange differences have actually emerged as an accounting problem, let alone a tax problem. Although I do not intend to clutter up this talk with a learned discourse on international exchange rates, it may help in order to put the problem in its correct perspective to spend a few minutes on the history of exchange rates.

In the so-called good old days, trade was financed by one of two principal means – by barter or by payment in a precious commodity, generally gold, perhaps silver and, in this part of the world, opium. On the whole, until the outbreak of World War II, the currencies of the world's major trading nations remained on a par with each other, with the U.S. dollar and the pound sterling being exchanged on a 1 to 4 basis and it being true to say, therefore, the old 2/6d coin was really "half a dollar". The first major upset to this pleasant state of equilibrium occurred in the late 1940s when Britain, which at the time was undergoing a severe financial crisis, devalued the pound against the U.S. dollar from \$4 = £1 to \$2.80 = £1. This was followed in 1967 by a further devaluation which brought the rate down to \$2.40. This event seemed to open the floodgates of change and spawned such features of current monetary policy as Special Drawing Rights, the European Monetary System's "Snake" and of course the move of gold away from the fixed parity with the U.S. dollar.

So where has all this left the businessman and his tax adviser? First and foremost it has meant that any transaction entered into by the businessman involving a foreign currency has an exchange risk attached to it – no longer can he assume that if he purchases a machine for, say, US\$10,000 when the rate is HK\$5 = US\$1 that therefore on delivery he will need to shell out, say, HK\$50,000 – it may cost him HK\$55,000 or, if he is lucky, HK\$45,000. He may have sold some goods to a dealer in the United Kingdom for £1,000 which at the exchange rate then prevailing would have yielded HK\$10,000, but when he cashes the draft he only receives HK\$9,500 or again, if he is lucky, perhaps HK\$10,500. The businessman may have invested some of his profits into Australian real estate or German shares or Japanese bonds – what does he do at the end of the year when translating the value of his investment? He finds it is worth less than he paid for it – or, if he has guessed correctly, it is worth more.

Fortunately for me it is no part of this paper to delve into the complexities of currency hedging, swap transactions and the like, nor indeed is it any part of this paper to discuss the various highly technical reasons that cause exchange fluctuations, nor even the theoretical side of the pronouncements of the various accounting bodies on the treatment of this subject, although some brief consideration is necessary in respect of all 3 topics in order to cover this particular subject in the required depth.

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VIII. CONCLUSION

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II. WHAT IS A CURRENCY GAIN OR LOSS?

I am not going to attempt to define what is an exchange gain or loss as this is a field more appropriate for our accountant or lawyer friends who can expound no doubt at great length on the situations in which a businessman can find himself when involved in foreign currency. However, for the purposes of this paper it is probably sufficient to define a currency gain or loss in 2 parts:

(a) where an obligation has to be met or an item of income is taken into account which produces less or more in the local currency than when the transaction was originally entered into;
(b) where at a particular date the value of a foreign currency denominated asset or liability reveals a surplus or a shortfall when translated into local currency.

III. ACCOUNTING TREATMENT

A. Normal exchange fluctuations distinguished from major changes in currency parities

For Hong Kong companies engaged in substantial overseas trade, or owning substantial overseas trading branches or subsidiaries, the normal fluctuations of exchange rates, whether the rates are pegged or floating, may give rise to differences on exchange whenever one currency has to be converted for accounting purposes into another. Such gains and losses on exchange are a normal feature of overseas operations and do not in themselves usually present any special problems. In general, where there has been no substantial shift in parities, exchange differences on direct trading with foreign customers or suppliers are dealt with in the profit and loss account in arriving at the profit or loss for the period. Where the accounts of overseas branches or subsidiaries have to be converted into Hong Kong dollars for inclusion in the parent's or group accounts, the normal accounting conventions for conversion are straightforward and are used consistently from year to year.

Where, however, exchange rates are subjected to a sudden significant and evidently permanent adjustment outside the run of normal exchange fluctuations, companies may encounter special accounting problems. In these circumstances exceptional exchange gains or losses attributable to the abnormal change in parities may arise as regards both direct trading transactions and the accounts of overseas branches and subsidiaries. It then becomes necessary to determine the amount of exceptional loss or gain involved, and how it should be dealt with in the accounts.

In broad theory, the loss or gain attributable to a change in parities could be most directly arrived at by converting overseas assets and liabilities at the date the rate changes into local currency first at the old rate and then at the new: the difference between the local currency equivalents, after taking account of any forward transaction in overseas currencies, including any forward purchases and sales of goods, is the exceptional gain or loss attributable to the shift in parities. In the case of overseas branches and subsidiaries the exceptional gain or loss is in practice generally computed by means of adjustments applied to their assets less liabilities at the balance sheet date. The gain or loss computed, if material, should be segregated from "normal" exchange gains or losses (which, as noted, are generally dealt with in the profit and loss account in arriving at the profit or loss for the period), and separately disclosed whether (a) as an exceptional item entering into the computation of the profit or loss for the period, or (b) as an exceptional item shown separately after "profit after taxation". When the latter treatment is adopted, account has to be taken of any consequential effect on the tax charge and disclosure made of such adjustments as are necessary. Where a company or group has extensive interests overseas and fluctuations in local currency equivalents or overseas assets and liabilities are a recurrent feature, the treatment in (a) above may be preferable unless the amount involved is exceptionally large; in other instances the treatment in (b) may be more appropriate. An alternative to the treatment in (b) is for the exceptional gain or loss (so far as it may be regarded as being of other than a revenue nature – for instance, as arising on the re-statement of currency fixed assets at the new rates) to be dealt with by a direct transfer to or from reserve, if this would facilitate the presentation of a true and fair view.

The identification and treatment of exceptional gains and losses attributable to major changes in exchange parities are dealt with below in 2 parts: first in the context of overseas transactions or locally based companies not involving overseas branches or subsidiaries; and second, in the context of the conversion into dollars of the accounts of overseas branches and subsidiaries.

B. Overseas transactions of locally based companies not involving branches or subsidiaries

For companies with overseas assets and liabilities other than those attributable to overseas branches and subsidiaries, a major change in currency parities will give rise to a local currency gain or loss on exchange in respect of those of their overseas assets or liabilities affected at the date currency rates change.

In these circumstances the general rule is that overseas assets and liabilities, both current and long term, at the date the parities change should be converted into local currency and the new rate of exchange and the resultant exceptional losses or gains on exchange, if material, presented in the accounts so as to show a fair view of the effects of the alteration in exchange parities.

Exceptional gains or losses on exchange attributable to changes in parities and relating to overseas assets and liabilities of a normal trading nature are normally dealt with in the profit and loss account, and separately disclosed as an exceptional item, if material. Due account is taken of any consequential effect on liability to tax.

There may be exceptions to the general rule to the extent that any part of the gain or loss may properly be taken into account in arriving at the amount at which items to which it relates are to be stated in the balance sheet. For instance, that part of an exceptional loss on exchange attributable to goods unsold on the balance sheet date may be treated as an increment in cost provided net realisable

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value in local currency is estimated to be in excess of cost so computed; this treatment is preferable if local currency prices of the items on hand have been increased to compensate for the change in parities.

Similarly, exceptional losses or gains attributable to liabilities outstanding at the relevant date for purchases of fixed assets from overseas are normally dealt with by adjustment of the cost in local currency of the relevant asset account.

The amount attributed in the balance sheet to work in progress on long term contracts involving overseas customers or suppliers will require review in the light of altered exchange parities so that provision can be made in the normal way for any foreseeable loss arising therefrom.

Exceptional gains or losses which may be regarded as not of a revenue nature, such as those relating to long term loans granted or received, may be shown in the profit and loss account or dealt with by direct transfer to or from reserve according to which method will better present a true and fair view, as suggested above. Where there are both gains and losses of other than a revenue nature, they are set off in the first instance.

C. Locally based companies with overseas branches or subsidiaries

The object of converting the accounts of locally based companies' overseas branches or subsidiaries into local currency is to enable them to be incorporated into the home company's or group accounts at a local currency equivalent which fairly expresses their state of affairs and results. Normally the 2 main methods of converting other currencies for this purpose are the "closing rate" and "historic rate" methods.

Where a major revision of exchange parities has taken place during the financial period it is necessary to determine whether the effect on the local currency equivalent of overseas branches' or subsidiaries' accounts gives rise to an exceptional difference on exchange. In theory, as noted above, the gain or loss attributable to a change in parities could be directly arrived at by converting the accounts of the overseas branches or subsidiaries at the dates the rates changed into local currency at the old and new rates and measuring the difference.

In practice the exceptional gain or loss attributable to the change in parities is normally calculated by adjustment of net assets in the opening or closing balance sheets; for instance, by taking net assets at the last accounting date before the change and adjusting them by reference to the profit earned or loss incurred in the period up to the date of change, the difference between the resultant amount converted at the old and new rates of exchange is the exceptional gain or loss. This achieves the same result as converting net assets at the date the rates changed. Since the "historic rate" method of conversion uses the average rate of exchange for the year to convert profits or losses (before charging depreciation), it automatically takes account of the effect of any change in parities; the "closing rate" method does not, and in that case to determine the exceptional difference on exchange it is normally appropriate to apportion profits or losses to the date the parities changed and to convert results up to that date at the old rate and after that date at the closing rate. In making this calculation, results should be apportioned as nearly as possible on an actual basis so as to take due account of seasonal or other fluctuations in trade. Turnover should be apportioned and converted in the same way so as not to present a misleading view of trading and results.

Under the "closing rate" method, assets and liabilities at the balance sheet date are converted at the rate of exchange then ruling, so that the effect on them of any major change of parities is automatically recognised. Under the "historic rate" method, however, fixed assets and long term loans and liabilities are normally stated at their original local currency equivalents. A major change in parities calls in question these amounts. Bearing in mind that proper provision must be made for depreciation of fixed assets and repayment of long term liabilities, it would be unrealistic not to recognise that a change in parities implies an adjustment in the local currency equivalents of fixed assets and long term loans. In these circumstances it may be desirable either to adjust their local currency amounts by reference to the balance sheet rate of exchange, or to carry out a valuation of fixed assets; if the "historic rate" method of conversion is to be followed, the latter amounts would continue to be used for future conversion purposes in place of original local currency equivalents. Whichever basis of conversion is used, fixed assets appearing "at cost" in terms of overseas currencies may normally continue to be so described after conversion into local currency, since the position will be made sufficiently clear by disclosure of the basis on which foreign currencies have been converted into local currency.

IV. WHEN DO GAINS AND LOSSES OCCUR?

As can be seen from the introduction to this paper, an exchange gain or loss can be said to arise at a number of different points in time. For instance, on a sale of goods contracted at a particular price the gain or loss could arise when the price for the sale of the goods is paid, or when they are actually received or, if deposited in an overseas bank account, when the proceeds are eventually remitted. However, as a general principle it is probably safe to say that the Revenue would normally follow generally accepted accounting principles such as those that I have mentioned earlier. I will revert in more detail later, but it should be noted that although accounting principles would generally apply as to when a gain or loss arises, it does not follow that this follows for a determination as to whether it is of a revenue or capital nature.

V. TAX TREATMENT OF GAINS AND LOSSES

As I have just mentioned, despite the accounting treatment of a gain or loss, the Revenue will apply their own rules to determine whether it is of a revenue or capital nature. What are these rules? The same general principles apply to currency gains and losses as apply to other items of income and expenditure, but because of the very special nature thereof there exist certain peculiarities which are worth examining in some detail.

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A. Capital transactions

If a taxpayer purchases fixed assets from abroad and before he makes payment for them a loss or profit results due to the intervention of a change in exchange rates, such a loss or profit would be on capital account. An incidental result of this would be that the asset could have 3 different cost prices, i.e. the cost at the time of incurring the obligation to pay for it, the cost of acquiring the foreign currency to pay for it and the cost which would be relevant to the computation of capital allowances. For example, a local ship owner contracts to buy a ship from the U.K. for HK$5M. The ship is delivered in the same year but payment is not made until the following year. During the intervening period the Hong Kong dollar is revalued by 10% and therefore in the following year the shipowner will gain HK$500,000 as he will only need to pay HK$4.5M to settle the debt. The ship in his books will continue to show the figure of HK$5M although the real cost to him will only be HK$4.5M. The gain here will be on capital account and this may be taken up in his profit and loss account, but below the line.

For tax purposes the Revenue will adjust the cost to HK$4.5M for the purposes of calculating initial and annual allowances. Of course the converse would apply if an exchange loss had been made on the transaction. It will be seen from this example that for tax purposes the actual outlay of currency by the taxpayer is taken as the cost for the purposes of capital allowances and the corresponding gain or loss is excluded from the profit for tax purposes.

Similarly, the discharge of a foreign loan can result in exchange losses or profits should there be fluctuations in the exchange rates by the time the loan is repaid. It should be noted, however, that loans in this context do not include outstanding balances on trading accounts; exchange gains or losses resulting from this transaction are of a revenue nature.

B. Revenue transactions

Any exchange differences which relate to a taxpayer's income earning operations or form part of his business or are directly or sufficiently related to his business operations will be taxable or deductible as the case may be. For example, if a local importer purchases goods from Japan and prior to the settlement of the purchase price the Japanese yen is devalued he will require fewer Hong Kong dollars to discharge the yen debt. The acquisition of yen to discharge the debt is closely connected with his income earning operations and consequently the gain he makes will be subject to tax.

C. Onshore or offshore

In most jurisdictions it is irrelevant whether the gain or loss was made onshore or offshore as both will come within the tax net. However, in a source jurisdiction such as Hong Kong, the matter is very relevant. The Hong Kong Inland Revenue Department have not, as far as I am aware, issued any guidelines other than a circular issued after the 1967 devaluation of sterling which admitted that the problem was complex and that each case would have to be examined separately. However, as we are only concerned with gains and losses of a revenue nature it is difficult to imagine many circumstances where a normal trading concern in Hong Kong would be able to incur an offshore exchange profit of a revenue nature as it is the underlying transaction, i.e. the sale of goods, which has to be looked at. This matter will, however, be discussed later when we come to minimisation.

VI. TAX CASES

Perhaps there is no clearer way of illustrating the complexities of this subject than by a review of the various judicial decisions that are available.

The only Hong Kong case that has come to the attention of the Courts is that of the Commissioner of Inland Revenue v. Li and Fung Limited which is reported in the 10th Supplement to the Hong Kong Tax Cases. The facts were as follows:

The Company carried on business as exporters and general merchants; its business included exporting Hong Kong manufactured goods to the United States. Such goods were paid for in U.S. currency and the proceeds were deposited in banks in the United States on 7-day call. At various times, when better rates of exchange between the U.S. and the Hong Kong dollar could be obtained, the accumulated funds with interest thereon were remitted back to Hong Kong. When preparing accounts for the year ended 31 December 1972 the Company was aware of the impending devaluation of the U.S. dollar and accordingly revalued the amounts of its cash and bank balances, trade debts and credits expressed in U.S. dollars, resulting in a net loss of HK$333,296.76.

On 12 February 1973 the U.S. dollar was in fact devalued and the Company claimed a deduction for the loss shown in the 1972 accounts against its assessable profits for 1974/75. The Assessor disallowed the amount of HK$327,750 relating to revaluation of the cash and bank balances on the grounds that this was a loss of capital.

On Appeal the majority of the Board of Review found that the U.S. dollar balances, being the proceeds of sale of goods and therefore income from trading, did not lose their identity as trading income by being retained in the U.S.A. and the loss was therefore allowable. The minority view held by one member was that the retention of the money in U.S. dollars placed on deposit altered the nature of the funds from trading income to investment. The Commissioner appealed.

Mr. Justice Garcia held that although the sums in question originated as trading income, their nature was altered to that of capital investment when accumulated and placed on deposit in U.S. banks with the intention of obtaining more favourable exchange rates. The Commissioner's appeal was allowed.

Two Australian cases are of interest and are useful guides. The first is Federal Commissioner of Taxation v. Cadbury-Fry Pascall (Australia) Limited (79ATC4346) which was heard in the Supreme Court of Victoria. The facts were as follows:

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Cadbury-Fry Pascall (Australia) Limited was a subsidiary of an English company which manufactured confectionery for sale in Australia. Two of the materials required for the manufacturing process were cocoa beans and cocoa butter which were purchased from West Africa. Under a long-standing arrangement the English parent placed orders for these items on behalf of the taxpayer with the supplier in West Africa and paid for these goods on the Australian company's behalf. Regular statements of the amounts due to the parent company were sent to the subsidiary and this debt was included in the subsidiary's loan account. Interest was charged by the parent on this account and settlement was made by the subsidiary generally some 6 months after the debt was incurred. It was part of the arrangement between the 2 companies that the debt should be paid in sterling. The loan account also reflected transactions relating to purchases of material made directly by the subsidiary from the parent and also purchases of plant and equipment made through the parent. In addition, service charges made by the parent were passed through this account. As a result of the sterling devaluation in November 1967, the taxpayer was required to pay fewer Australian dollars than had earlier been estimated. The taxpayer claimed that the part of the exchange gain thus made which related to the purchases of raw materials made by the parent on the subsidiary's behalf was not assessable. The taxpayer argued that the arrangement between it and its parent was to provide an advance of funds and that therefore payments in reduction thereof were of a capital nature. The case went to the Board of Review who upheld the taxpayer's claim and thereafter the Commissioner appealed to the Victoria Supreme Court. It was held by the Judge that the arrangement between the subsidiary and its parent was not for the purpose of providing the subsidiary with an advance of funds but that the payment in reduction of the loan account was in substance part of the regular outlay of the taxpayer for raw materials regularly required by it for manufacturing purposes. The mere substitution of the parent for the supplier was an incident of the commercial operation and did not affect the true nature of the transaction. It was held, therefore, that the gains made on that part of the loan account which related to the purchases of raw material and the service charges were subject to tax but the Commissioner agreed that the gain made on purchases of the plant and equipment was not taxable.

A more complex case was that of Lombard Australia Limited v. Federal Commissioner of Taxation (80ATC4151) which was heard in the Supreme Court of New South Wales. The facts in this case were that Lombard Australia Limited, which was a wholly owned subsidiary of the U.K. based National Westminster Bank, borrowed money from several overseas sources, including its parent. These funds were used for the general purposes of its business and were generally for a period of 5 years. At the same time, Lombard Australia Limited also raised funds in the Australian market. After 1975, the company conducted a policy of gradually reducing its foreign currency borrowings and relied more extensively on local fund raising. During the year ended 31 December 1975 Lombard Australia Limited repaid certain overseas loans and sustained exchange losses of $3.2M and claimed this as a deduction in its tax return for that year. Mr. Justice Powell held that the losses were deductible and that they were properly treated as losses or outgoings necessarily incurred in the income earning process. The Judge said that the evidence showed that at all relevant times borrowing overseas was an integral part of the process by which not only the taxpayer but most, if not all, major financiers in Australia funded their lending activities. The evidence also showed that at all relevant times fluctuations in the value of currencies were an established feature of the worldwide monetary scene. This being so, the losses in question represented a kind of casualty, mischance or misfortune which is a natural or recognised incident with the particular trade or business. In his summary the Judge referred to the Cadbury-Fry case referred to above and said that the facts were similar in both cases as the transactions with the overseas parent related to transactions which related to trading stock.

The 2 Australian cases illustrate the rule that it is not the actual transaction that must be looked at to determine whether an exchange gain or loss comes within the tax net, but the underlying transaction to which it relates.

In the U.S., where surprisingly enough there are no detailed regulations covering currency gains and losses, much reliance is placed on decided cases to establish the rules.

One of the leading cases was heard in April 1979, the Hoover Company case (72TC206), where the tax court held that gains and losses from a taxpayer's transactions in foreign exchange contracts were capital gains or losses and not ordinary gains or losses. The Court concluded that the transactions related to taxpayer's ownership or stock in its foreign subsidiaries rather than the taxpayer's everyday operations. This was despite the fact that the Hoover Company entered into a considerable number of foreign exchange contracts, most of which resulted in losses. This was contrasted with the Corn Products case (350US46/1955) where similar transactions were entered into but related to the taxpayer's everyday operations.

A useful case was heard in Malaysia in 1973 (L Sdn Berhad v. Comptroller General of Inland Revenue 1973 1MLJ56). The facts in this particular case were that the company was carrying on the business of buying and selling land and part of the proceeds from these transactions were deposited in the U.K. When sterling was devalued the company incurred a loss of M$595,840. The taxpayer claimed this as an allowable deduction but the claim was dismissed and the Judge said that one of the major questions which arose before the special Commissioners was whether the taxpayer's money in London was fixed capital or circulating capital. He agreed that in the light of decided cases if the money in London was circulating capital then the loss would be an allowable deduction. It would be otherwise if it was fixed capital. It is implicit that the manner in which the capital is employed is a material factor in determining whether it is fixed or circulating capital. The Judge went on to say that it did not seem to be part of the taxpayer's case that the money in London had been employed in any manner for the company's business which of course was buying and selling land in Sabah.

Judge Ali concluded by saying, "The assertion by the

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taxcpayer that the money could be used any time if needed for the company's business is neither here nor there. I venture to think that the taxpayer has not suffered any loss known to law."

Finally, we must have a look at the various U.K. tax cases on this topic. Not unnaturally, the U.K., having certainly in the past one of the world's major trading currencies and relying to a great extent on case law to decide matters of principle, have produced a number of interesting cases over the years. One of the earliest cases was that of Bennett v. Underground Electric Railway Company of London Limited (1923ATC4275) where the taxpayer claimed as management expenses a deduction for the additional costs incurred in purchasing U.S. dollars with which to pay interest in New York. The judgement was that the management of the company did not alter whether or not the interest was paid in dollars and therefore at a greater sterling cost and accordingly gave judgement in favour of the Revenue. The next case was McKinlay v. H T Jenkins and Son Limited (10TC372) where a U.K. company imported marble from Italy and remitted to a bank in Italy sufficient funds to meet advanced payments for the quantity of marble. Before the supplier needed to be paid, the sterling/lira rate moved and as a result a large profit accrued to the U.K. company on sale of the lira. The exchange rate then moved in the opposite direction and the U.K. company was able to acquire the lira cheaper to pay off the Italian exporter. Mr. Justice Rowlatt held that the profit was no more in effect than a bare exchange transaction in the nature of a speculation and that the profit from such transactions could not be a trading profit of the company since it was no part of the company's business to deal in exchange. Another pre-war case was that of Imperial Tobacco Company of Great Britain and Ireland Limited v. Kelly (25TC292) where the company acquired U.S. dollars each year to finance its purchases of tobacco leaf. On the outbreak of war the company had certain funds in U.S. dollars for this purpose which it was required to sell to the U.K. Government. A profit was made and it was held that such a profit was subject to tax because the dollars were acquired for the purposes of a trading transaction. A case a little nearer to this part of the world was Davies v. The Shell Company of China Limited (32TC133) where the company had a large number of agents in China who were required to place deposits with the company. These deposits at the outbreak of the Sino-Japanese war amounted to some 7 million Chinese dollars and were placed on long term deposits with banks. It was agreed that interest was payable to agents on the deposits and at the outbreak of the war the company converted these deposits to sterling and repatriated the funds to the U.K. As each agency became renewable the company terminated the agency and repaid the agent his deposit. On account of the depreciation of the Chinese dollar these payments gave rise to substantial sterling deposits. The U.K. Court of Appeal decided the company's deposits were fixed capital and the profits in question were not trading receipts.

A post-war case which in fact is still going through the U.K. courts is that of Pattison v. Marine Midland Bank Limited, and in May of this year the Chancery Division found in favour of the Crown, but it is understood that the bank are considering appealing against the decision. The facts in this particular case were that Marine Midland Bank Limited is a subsidiary of an American bank who borrowed dollar funds by issuing loan stock to 2 subsidiaries of its parent company resident in the U.S. These funds were lent on to dollar and other foreign currency clients. The loan stock was cancelled by repayment of the loan on 15 June 1976. The company did not speculate in foreign exchange transactions but looked for its profits to the interest differential between amounts lent and amounts received on deposit and for the most part the borrowings were matched by loans. As a result of the fall in the value of sterling an exchange loss was shown on repayment of the loan stock and gains were shown on the assets matching the loan stock translated into sterling on the relevant balance sheet dates. At no time was there any actual conversion into sterling. The taxpayer company was assessed to corporation tax on the basis of exchange loss arising on the payment of the loan stock as a capital loss and the exchange profits shown on the matching assets were revenue gains. The taxpayer company appealed to the City Commissioners contending that the loan stock did not represent capital employed in the trade and any exchange loss was a revenue loss deductible from trading profits. The Commissioners determined that neither the exchange loss nor the exchange profits were to be taken into account in computing the taxpaying company's liability to tax. The Crown appealed to the Chancery Division where it was held that since the loan stock formed part of the capital structure of the company and the liability to pay it was a capital liability, the deduction of the exchange loss sustained on repayment from trading profits was prohibited. The exchange profits shown in the balance sheet in respect of the matching assets however were revenue profits to be taken into account in computing liability to tax.

VII. MINIMISATION TECHNIQUES

The wide variety of cases referred to just now indicates that there are numerous ways in which currency gains and losses can arise and it is clear that careful consideration needs to be given to the tax effects of exchange related transactions. However, it should be borne in mind that the first priority should in all probability be to reduce the risk of the exposure itself of a currency change. This of course is necessary unless the tax planner can ensure that all exchange losses will be deductible in high tax areas and all exchange profits are taken in low tax or nil tax countries, or, alternatively, all losses are of a revenue nature and all profits are of a capital nature.

A. What is currency exposure?

Currency exposure is the net amount of a firm's assets and liabilities in a foreign currency. A net asset position is also called a "long" position, a net liability position a "short" position. The exposure risk is consequently the risk of a monetary loss due to exchange rate fluctuations. It depends both on the size of the exposure and the extent of the expected re- or devaluation of a currency in terms of the base currency.

Currency exposure can be calculated basically in 3 ways:

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1. *Transaction exposure* covers those assets and liabilities which, in the short or medium term, will result in an actual currency conversion. Any change in the value of the respective currency between the date on which an asset or liability is created and the actual conversion date will result in an immediate, actual gain or loss on exchange. This exposure consequently covers all transactions involving foreign currencies such as imports and exports of goods and services, payments of royalties, etc.

2. *Translation exposure* is the exposure calculated on the basis of the balance sheet of the foreign operation. It includes both the amounts of the transaction exposure and all other items which will cause a profit and loss effect on consolidation if the currency in which they are denominated changes in value. It therefore also comprises assets and liabilities which will not give rise to an actual gain or loss on exchange as these items will not be liquidated in the short or medium term. Nevertheless, the translation of these items will result in an accounting (i.e. unrealised) gain or loss, if the currency in which they are expressed changes in value as compared to the base currency.

3. *Economic exposure.* As gains/losses resulting from the economic exposure are not reflected in the financial statement as realised or unrealised exchange gains/losses but a sordinary trading income with no special tax implications, currency exposure, in what follows, will refer only to transaction and translation exposure.

B. How to minimise exposure

The 2 basic methods are:

(a) *Forward exchange contracts/swaps*

By way of forward exchange contracts the firm can shift its exposure to another party, usually to a bank, for a cost which will be based on the interest differential between the local currency and the foreign currency. If an exposure is the result of a temporary loan, the firm can make a swap, i.e. it sells the local currency at the present (spot) exchange rate and, at the same time, re-purchases the local currency at the applicable forward exchange rate.

(b) *Invoicing in the base currency*

This is the hedging method for firms which export directly to third party customers. As the exposure risk is passed on to the customer, it requires a certain bargaining strength and may not be possible in highly competitive markets unless the hedging costs are reflected in the price.

Re-invoicing can be the solution to this dilemma. The exporting company invoices in the local currency to a re-invoicing centre which is to carry and manage the exchange risk. Re-invoicing for a group of companies has the additional advantage that payables/receivables in the different currencies can be netted thus reducing transfer charges and exchange costs.

C. The tax effects of exposure management

As in all business decisions care must be taken to ensure that the tax effect of any transaction is known in advance so that at least the possible liability is known and at best so that the transaction can so be structured to the best possible advantage. Foreign exchange transactions of necessity require that the tax planner is aware of the law and practice relating to such activities not only in his home jurisdiction but also in other countries where the taxpayer operates. This is because of the varying tax rates involved, but more importantly the differing tax treatment accorded to foreign exchange. Thus in the Netherlands the Revenue do not distinguish between capital and revenue, whereas in Germany unrealised gains are not taxable until recognised wherever unrealised losses are deductible when incurred.

VIII. CONCLUSION

In concluding this short talk I hope that I have been able to shed some light on this complex problem. In the days of sailing ships and fixed parities of currencies, currency gains and losses rarely arose, and, if they did, were readily identifiable as to nature and source. However, with the vast sums neeed for international finance these days and with the speed that not only currencies can fluctuate, but also funds can be transferred, it is important for the tax planner to be fully aware of the consequences of international transactions.

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CHINA:

China's Recent Tax Experiments to Revive the Industrial and Commercial Tax System of State enterprises

By Jap Kim Siong *

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I. INTRODUCTION

Important changes in economic development policy are taking place in the People's Republic of China since the Government's announcement that it intends to achieve the declared goals of the Four Modernizations – in agriculture, industry, defense, and science and technology – by the end of this century. This modernization program is the start of a new venture in China's economic development strategy since the establishment of the People's Republic of China on 1 October 1949 and naturally not without consequences to taxation matters.[1]

The tax system of each country, in order to be an effective part of its economic development policy, must be tailored carefully to the peculiar circumstances and objectives of that country. China has chosen the road to socialism. The crucial point which emanates therefrom is the collectivization of ownership of the important means of production, such as land, capital and labor.[2] Socialization of the means of production connotes the transfer of private ownership of the means of production into public and collective ownership.[3] In China, even private ownership of dwellings has been eliminated by the socialization of the means of production. Only recently have flats been for sale for private ownership.[4] By and large, the means of production (land, capital and labor) are allocated by the State according to the national economic production plan. Consequently, the decisive role of production and consumption under a free market economy or where the price mechanism rules has been replaced by State planning. The price fixing system of commodities in the planned economy in China has caused a deterioration in the balance between prices set by the State and the actual market value. Consequently, it is generally conceived that the economic set-up at present no longer suits the goal of achieving high sustained economic growth after 30 years of socialist economic planning.[5]

China introduced its own tax system in 1950 and adopted "the policy of utilization, restriction and transformation", which translates into plain terms as the transformation from private ownership into public ownership of the means of production during the transition period of the early 1950s. The basic 1950 tax system was followed by tax reforms in which the tax system of State enterprises was more finally attuned to the socialist economic system by turning the advantages of the advances of production to the benefit of the people instead of private entrepreneurs.[6]

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1. See: Y.C. Jao, "Recent developments in China's tax system", *Bulletin for International Fiscal Documentation* 35:1 (1981), 16 ff; Guo Hongde, Wang Wending and Han Shaochu, "The reform of the industrial and commercial tax system will serve the 'Four Modernizations'", *Jingji Guanli* (Economic Management) 1980:3, 18 ff.
2. E.L. Wheelwright and Bruce MacFarlane, *The Chinese road to socialism* (Harmondsworth: Pelican, 1973).
3. "Two types of ownership", *Beijing Review*, 11 February 1980, 14.
4. "Flats for private ownership", *Ta Kung Pao* (Hong Kong), 3 July 1980.
5. Gao Zhihua, "What is the best economic set-up for China?", *Social Sciences in China* 1980:1, 7 ff.
6. Liu Zhicheng, "On the reform of the industrial and commercial tax system in our country", *Jingji Guanli* (Economic Management) 1980:9, 23 ff.

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In the wake of the Cultural Revolution (1966-1976), the benefits of taxation were not accepted and it was not until recently that the idea of taxation has been revived as a means of providing incentives for greater efficiency and productivity in the use of scarce means of production in State enterprises.

State enterprises are subject to the profit allotment system in which enterprises have to transfer all their profits to the State and, by the same reasoning, all losses are automatically covered by State subsidies. In addition, workers are hired but not fired, promoted but not demoted: a phenomenon known as the "iron rice bowl". This was considered for a long time a sign of "the advantages of socialism". This system of overall State responsibility in production, distribution of goods, social welfare and in other social and economic fields is known as "everybody eats from the same rice bowl". One may compare it with a national social security system for the entire country.

From a functional point of view, however, the profit allotment system replaced the price mechanism to equalize supply and demand of goods in the planned economy. It is obvious that the system of the "iron rice bowl" provides hardly any material incentive for greater efficiency and productivity in the production of capital and consumer goods. The crucial point is that efficient or inefficient functioning of the economy does not depend on who owns the means of production but on the efficient or inefficient operation of the means of production, irrespective of whether it is in a centrally planned economy or in a free market economy.[7]

If the means of production owned by the people are left idle or are badly operated, their economic value is not used. To introduce more vitality in the economic structure, limited competition in a planned economy with State ownership of the means of production and taxation as an instrument to achieve equilibrium between supply and demand may play a role. Higher taxes can be levied on goods whose production needs to be curtailed, and reduction or exemption from taxes can be granted for goods whose production must be encouraged. Besides tax policy, other measures (e.g. price policy, the supply of materials, investment policy, credit and loan policy) may also be applied.[8] The new policy should emphasize the use of "tax instead of profit, independent accounting and self-responsibility for profit and loss."[9]

Since China has nearly 400,000 State enterprises operating in the fields of industry, commerce, communication and transportation, accounting for 64.7% of State revenue in 1960, as against 13.4% in 1950 (see Appendix A), the introduction of taxes to play a role in Government policy to reform the national economic set-up will be implemented gradually during a transitional period of several years, and not overnight by one law as was the case with the introduction of the income tax on joint ventures and the individual income tax effective as of 10 September 1980.[10]

At present, foreigners residing or operating a business in China can be subject to the following taxes:
- the individual income tax;
- the income tax on joint ventures;
- the industrial and commercial income tax;
- the industrial and commercial consolidated tax;
- the urban real estate tax;
- the tax on vehicles and ships;
- foreign enterprise income tax (see Appendix B).[11]

However, the purpose of this article is to explore and focus on the almost imponderable tax aspects of the gradual expansion of self-responsibility of State enterprises for their respective profits and losses. The term State enterprises may include factories, department stores and retail shops run by the State. It should also be noted that the tax experiments undertaken in chosen pilot enterprises are so various in number that attempting to obtain a complete concept of the prospective tax changes can be little more than crystal-gazing.[12]

II. PROBLEMS ARISING FROM THE RESTORATION OF SELF-RESPONSIBILITY OF STATE ENTERPRISES FOR THEIR OWN PROFIT AND LOSS

By and large the profit allotment system will be phased out in 2 stages. The first stage is that enterprises will be allowed to retain a portion of their acquired profits after turning in their planned profits to the State. The State assigns them a basic production schedule to be fulfilled, but each enterprise can increase its own production using its own initiative . The retained profits can be used by the enterprises for expansion of production or for the safety and welfare of the workers. The portion of retained profits differs from location to location in the country and depends on the kind of activity of the enterprise, such as manufacturing, transportation or commerce.[13] For example, in the Municipality of Shanghai, 2 profit retention systems were put into force for trial implementation. In 1978, spinning and weaving enterprises were allowed to retain 9.5% of the profits for allocation to special funds while 90.5% went to the State; they were allowed to retain their total profits for 5 years beginning in 1979. For metallurgical enterprises, the profit retention ratio in 1978 was set at 40% with 60% allotted to the State.

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7. See: George N. Halm, *Economic systems. A comparative analysis,* third edition (New York, 1968), 32 ff.
8. Xue Muqiao, "A study in the planned management of socialist economy,,, *Beijing Review,* 26 October 1979, 14.
9. "Make a good job to substitute tax for profit, promote increased production for increased income. Shanghai Light Industry Machinery Corporation", *Jingji Guanli* (Economic Management) 1981:6, 44 ff.
10. "Law of the People's Republic of China concerning income tax on joint ventures between Chinese and foreign investments", *Official Gazette of the State Council of the People's Republic of China,* 15 November 1980, 397 ff; "Individual income tax law of the People's Republic of China", *Official Gazette...,* 15 November 1980, 397 ff.
11. Zhao Suzheng, "What taxes should foreigners pay in China?", *Beijing Review,* 26 October 1981, 20-21.
12. See: "Eighty examples of the system of economic responsibility in industrial production. Compiled by the Investigation and Research Department of the State Economic Commission", *Jingji Guanli* (Economic Management), 1981:10, 17-35.
13. "Circular of the Ministry of Finance concerning measures for State owned industrial enterprises to retain profits for trial experiment approved by the State Council on January 22, 1980", *Official Gazette...,* 8 March 1980, 6-10.

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They were allowed to retain their total profit for 5 years beginning 1979.[14]

However, the most important development affecting the taxation of State enterprises in China is the last stage, the experiment with financial self-responsibility for one's own profit and loss. Instead of handing over a portion of their profits to the State, the enterprises pay *taxes* to the State. Any profits remaining after paying taxes are at the disposal of the enterprise. On the other hand, the State will no longer provide subsidies to those enterprises that "produce" losses with independent accounting systems outside the national budget.[15]

Where taxes are not levied upon State enterprises, the introduction of a financial self-responsibility system creates complicated problems which must be solved first. In a planned economy the profit or loss of an enterprise is determined by 2 factors. Those making a higher profit because of subjective or internal factors, such as good economic management, should be rewarded, while those making more profit on account of objective or external factors not influenced by, say, enterprise management, should, in principle, turn over the profits to the State.

Those objective factors are the outcome of the following prevailing circumstances in China's planned economy:
- the price fixing system;
- the nature of the country's natural resources;
- the productivity of fixed assets and of laborers.[16]

1. The price fixing system

As indicated above, the socialization of the means of production in China and the use of economic planning have replaced the price mechanism and the profit motive as instruments to equalize supply and demand on both consumer goods and capital goods. Where a price mechanism does not exist, prices of products have to be fixed by the planning authorities. It is generally accepted that, with respect to the relationship between tax and price in a planned economy, taxes are not price-determining. Consequently, in general, prices of individual items or commodities are independently set by the State to achieve equilibrium in commodity market. The turnover tax, for example, is only one of many factors making up the final price in the price fixing system. Although the tax affects the final price, it plays at most a secondary role in fixing the price of a particular commodity, and in many cases the tax is clearly price-determined. The tax serves as a buffer between cost price and sales price and is an important element in creating equilibrium between the general price level and the cost price for individual commodities.[17]

Price fixing of goods as a substitute for the price mechanism is conducive to making profit and taxes an accounting item set out *ex-ante* in the process of the centrally planned economy.

Because of price fixing, the prices of many products in China are not commensurate with their real economic value, an important factor in determining profit margin. Products urgently needed by the people (raw and processed materials) are too cheap, while those not in urgent need (manufactured goods) are too expensive. The present profit margins of some enterprises are not determined by good economic management but by fixed prices. Without a readjustment of prices, it will be difficult to work out a rational profit retention system.

For example, a watch costs approximately 6 to 12 yuan to make, but sells for 50 yuan, so that watch companies make a big profit. Meanwhile, 1 ton of coal costs about 14.75 yuan to produce, but sells for only 11 yuan, since coal is an essential consumer good and watches are a luxury. To go from a price fixing system to a market price system is a difficult task. There is no way to institute an overall price reform; raising just a few prices will spark inflation.

It is believed that the first step in reducing the gap between various enterprises' income is to use taxes to absorb the windfall profits arising from the irrational price fixing system of goods prevailing in China. If the profit margins on some goods are too wide and yet it is impossible to lower their prices, the extra profits should be turned over to the State in the form of an income regulating tax, so that all industries and trades will attain reasonable post-taxation profits under good management of the enterprise.[18]

Thus, in brief, economic change has been stifled by the Government price fixing system. Some enterprises earn more profits and other less, not because of how well they are managed and how much their workers produce, but merely because of the prices fixed for their product.[19]

2. The nature of China's natural resources

The second objective factor is natural resources. Enterprises in mining industries bring in different profits because of different natural conditions. For example, there are large differences between the resources and consequently between the profits of the Daqing and Yumen oil fields. In such case, different rates of tax (including those on resources) should be introduced to make the profit retention system effective. In fact, some oil wells produce a few tons a day while others produce hundreds or even thousands of tons a day. Since oil is scarce, the maximum production must be achieved at all costs. On the basis of such differences in productivity, the State should either levy different taxes on resources or introduce a system whereby the mining enterprises retain varying portions of the profits they earn over and above the

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14. Chen Lingshu, "Take the advantages and disadvantages of the profit retention regulations put into force as the responsibility for the organizational unit", *Jingji Guanli* (Economic Management) 1981:1, 14.
15. Jin Qi, "More on economic readjustment", *Beijing Review,* 11 May 1981, 3.
16. Xue Muqiao, *A study on the problems of Chinas's socialist economy* (Beijing, December 1979), 185 ff.
17. George N. Ecklund, *Finance the Chinese Government Budget. Mainland China, 1950-1959* (Chicago, no date), 28.
18. Luo Jingfen, "The reform of price and taxation system is the important link of the reform of the economic system", *Jingji Guanli* (Economic Management) 1980:9, 27-30, particularly 29.
19. Frank Ching, "Some of Sichuan's economic experiments are spreading to other Chinese provinces", *Asian Wall Street Journal,* 2 June 1981.

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assigned profit norms.[20] China is in fact contemplating introduction of a national resources tax.[21]

The different productivity of natural resources can be illustrated in the following example:[22]

Assume that there are 3 oil wells, A, B and C, having a different productivity of respectively 50, 100 and 200 metric tons of oil at a cost of 10,000 yuan. To achieve a 20% profit rate the selling price per metric ton will be respectively as follows:

Oil well A:

$\frac{10{,}000 \text{ yuan}}{50 \text{ ton}}$ plus 20% profit rate = 240 yuan

Oil well B:

$\frac{10{,}000 \text{ yuan}}{100 \text{ ton}}$ plus 20% profit rate = 120 yuan

Oil well C:

$\frac{10{,}000 \text{ yuan}}{200 \text{ ton}}$ plus 20% profit rate = 60 yuan

If the country's selling price is fixed at 240 yuan per ton, the gross receipt per well will be 12,000 yuan per year and the total gross receipt of the 3 wells, 36,000 yuan. The difference between the selling price ands the cost price for well B is 120 yuan and is turned in as land (mining) tax to the State. For well C the land (mining) tax is 180 yuan, while well A does not turn in tax due to its poorer oil endowment.

The picture which emerges from the above illustration indicates that marginal oil well A (or even oil wells making losses) can still operate at the expense of profit making enterprises if total production is considered by the authorities as necessary for the centrally planned economic development of the country. Since price fixing of many products deviates from their real economic value, it has become a major reason for the irrational amounts of profits made and amounts of tax turned in to the State.

In the economic planning structure of China, the rates of profits and taxes are fixed *ex-ante* by the planning authorities and used as a means to measure the economic achievements of an enterprise through the economic accounting system.[23] The importance of the economic accounting system in the control of enterprise operations is recognized by Chinese writers, although the effectiveness of such control depends on the availability of accurate and prompt reporting of enterprise activities.[24] In addition, since the price of the product is set by the central government, the profit is predetermined and the manufacturer of the product cannot influence profit margins, but only can estimate production.[25]

3. The productivity of fixed assets and of laborers

The third objective factor is the differences in productivity of fixed assets resulting from the use of different kinds of equipment. Such differences are created by unequal sums of State investment and not by unequal degrees of effort on the part of the workes. To solve this problem, the State may introduce a system whereby the enterprise pays a compensation for the appropriation of fixed assets. The enterprise may pay taxes or interest on those fixed assets at different rates to offset the differences in profit margins arising from the productivity of the fixed assets used. Some Chinese tax authorities consider the fixed assets tax the "selling out" of fixed assets owned by the State to financially independent enterprises. It is asserted that fixed capital assets were redeemed ("bought out") in 1956 from their former private owners during the period of socialization of the ownership of the means of production whereas at present the tax policy would be directed to the opposite, namely, the "selling out" of fixed assets or means of production to independent account units in a planned economy of which the means of production remain in the ownership of the people, i.e. the State.[26]

The fixed assets and working capital of State enterprises have been given at no cost by the financial authorities. The enterprises have to turn over all their profits, if any, to the State and its products are purchased and marketed by the State commercial departments. Given no power or responsibility over either material supply or funds, the enterprise does not concern itself with the question of waste. Mere supervision from the higher authorities cannot be ensured by control through the economic accounting system if the persons running the enterprises are not interested. To change all this, it is necessary to make an enterprise economically responsible for the use of state funds and give it more financial power to handle its profits. It should be provided with a business fund for developing technical innovation. Part of the extra profit earned through improved personal management may be used for the worker's collective welfare or distributed as bonuses among workers who have made greater contributions to earning more profit.[27]

The rate of the fixed assets tax in 5 State-owned enterprises in Sichuan Province, applying the self-sustained profit and loss system in a trial experiment, was differentiated and may vary from either 0.2%, or from 0.3 to 0.5% or from 0.5 to 0.8% of the fixed assets value payable monthly.[28]

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20. See note 16, p. 187.
21. See note 1, Hongde et al.
22. Xiao Shuoji, "The role of average rate of profit in the socialist economy", *Jingji Yanjiu* (Economic Research) 1979:11, 74.
23. For a technical treatise on economic planning in China, see: *Chinese economic planning, translations from* Jihua Jingli *(Economic Planning)*, edited and with an introduction by Nicholas R. Lardy. Translation by K.K. Fung (1978).
24. Kwang Chingwen, "The economic accounting system of State enterprises in mainland China", *International Journal of Accounting* 2 (Spring 1976).
25. Cf. Frank Ching, "Troubled steel complex in China now operates relatively normally", *Asian Wall Street Journal*, 27 December 1980.
26. Zhang Biwei, "The problems on the levy of fixed assets tax from State-run industrial enterprises. Hunan Province Metallurgic Bureau", *Jingji Guanli* (Economic Management) 1980:5, 15-17.
27. Liu Zhicheng, "A view how to cope with the expansion of financial responsibility of State enterprises", *Jingji Guanli* (Economic Management) 1980:4, 16-90, 30.
28. Gu Zongcheng, "Problems concerning the self-sustained profit and loss system of the State-owned enterprise – Tentative study on the experimental self-sustained profit and loss system of the five enterprises in Sichuan Province", *Jingji Guanli* (Economic Management), 1980:12, 26.

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Objections were raised by enterprises to basing the tax on fixed assets on the original value. Certain factories have old and obsolete fixed assets which should have been written off long ago; the authorities concerned do not agree to this and the assets are still listed in the account books at their original value. In many factories most of the fixed assets were acquired in the 1950s. After 20 years or more, practically all the depreciation costs have been written off, yet their value remains intact according to the books. It is obvious that taxation on such a nominal value would be unjustifiable.

The depreciation of fixed assets in China must be changed. Experiments undertaken in Sichuan province in enterprises acquiring greater independence in their economic management suggested a gradual shortening of the depreciation period of fixed assets and a steady increase in the funds for their replacement and for technical improvement. Under the present system the depreciation period ranges from 25 to 40 years. In the next 5 years, it should be shortened to 10 to 15 years and the annual rate of depreciation should gradually be raised from 6.5 to 10%, while 80% of the basic depreciation fund should be placed in the hands of the enterprise.[29] Thus, as some enterprises get more fixed assets, and more modern ones, from the State, they achieve higher productivity and profit. If the tax on fixed assets is not used, the profit retention system cannot be implemented on a fair and equitable basis. To introduce a tax on fixed assets, China has to conduct a nation-wide appraisal of the fixed assets of State-owned enterprises.

This is an enormous job which cannot be accomplished in a short period. Thus a reform in the economic set-up requires the readjustment in a wide field of issues in such areas as production, pricing, supply marketing and taxation. It is necessary to establish a system to transfer surplus fixed assets of one enterprise to another which is in need of such fixed asset. The enterprise having a surplus of fixed assets may transfer those assets to the higher authorities on a lease, or sell those assets to other enterprises and use the proceeds to buy whatever fixed assets it needs. Fixed assets from State investments may be placed at the disposal of banks, which will rent them to the enterprises which need to use the fixed asset. On the other hand, these fixed assets represent an enterprise liability to the State, for which the enterprise should pay an interest or fixed assets tax at regular intervals according to State regulations. At present, the State has allocated fixed assets to enterprises for use without any compensation, as "everybody eats from the same rice bowl".

It is also necessary to make changes in the labor force now operating under the "iron rice bowl" principle. At present, the State allocates manpower to enterprises without much regard for the ability of the person assigned. The State should introduce a system of vocational assessment and promotion in order to transfer to suitable jobs those who cannot fully use their abilities. An enterprise must have the power to fire those employees who prove to be incompetent in the course of employment. The discharged workers may be referred back to the labor departments for new assignments or they may also be allowed to find jobs by themselves.[30]

III. THE TAX EXPERIMENT

The State Council approved on 2 September 1980 the Report of the Economic Commission concerning the gradual expansion of the self-responsibility of State-owned industrial enterprises dated 9 August 1980.[31] As far as taxation is concerned, this Report revealed that beginning with 1981 the principle of retained profit of enterprises must be further developed and extended to provinces and prefectures on a trial basis. The experiment of self-responsibility for profit or loss of State-owned enterprises must be further developed and evolve into a tax system for China. It has been revealed that in Sichuan province 3 kinds of taxes are levied on enterprises to wit, the industrial and commercial tax, the tax on fixed assets and the income tax. In Shanghai, 5 kinds of taxes and 2 kinds of duties are levied on enterprises, viz., the industrial and commercial tax, the income regulating taxes, the tax on houses and land, the boats and vehicle license tax, the income tax and the duty on fixed assets and the duty on the use of circulating funds (working capital). The Head of the General Tax Office of the Ministry of Finance must further replace the profit retention system of enterprises by implementing tax laws concerning the taxation of enterprises in China, such as the value-added tax, the natural resources tax, the differential levies of income regulating taxes, the income tax and the duties on fixed assets and on the use of circulating funds.

The experiment "Take Tax Instead of Profit and Self-Responsibility for One's Own Profit and Loss" was applied in pilot enterprises situated in Beijing municipality, Sichuan province and Shanxi province.[32]

The Report on the Arrangement for the National Economic Plans for 1980 and 1981 revealed that a value-added tax will be introduced for machinery and farm machinery industries to solve the problem of double taxation levied on some industrial products. The income tax on urban collectively-owned enterprises will be revised so as to reduce their tax burden to facilitate the development of the collective economy in China. On an experimental basis more State-owned enterprises will have to pay income tax instead of turning their profits over to the State under the profit retention system.

Beginning in 1981, duties on fixed assets shall be levied on a trial basis on State-owned enterprises so as to promote the rational use of State capital assets allocated by the State. State-owned enterprises that use circulating funds allocated by the State will be subject to the duty on the use of circulating funds.

With respect to the capital construction sector, investment by the State will be replaced by bank loans whever repayment is possible.[33]

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29. Ren Tao, Sun Huaiyang and Liu Jinglin, "Investigation report: Enterprises in Sichuan Province acquire greater independence", *Social Science in China* 1980:1, 201, 214.
30. See note 16, pp. 188, 190.
31. Published in the *Official Gazette* of 20 November 1980.
32. See note 12, particularly pages 22-23.
33. See: *Official Gazette*... of 28 October 1980, pp. 332, 344; Wang Bingqian, "Minister of Finance at the Fifth National People's Congress on August 30, 1980. Report of financial work", *Beijing Review*, 29 September 1980, 11-

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1. Tax experiments on State-run industrial enterprises in Shanghai

a. The industrial and commercial tax

The tax regulations of pilot enterprises are promulgated on a case-by-case basis. For example, one of the Shanghai diesel engine factory plants[34] is taxed in conformity with the "five taxes and two duties" approved by the State Council concerning the gradual expansion of the self-responsibility of State-owned industrial enterprises (see above). The Shanghai diesel engine factory plant comprises 32 factories employing about 9,000 laborers.

The industrial and commercial tax experiment envisages the levying of a kind of value-added tax. For China a sophisticated value-added tax system was considered necessary, which implied that for each pilot enterprise the regulation is used on a case-by-case basis. Because of the different circumstances of each enterprise, a uniform value-added tax system is not fair for socialist competition in a period of change in the set-up of the national economy.[35]

In the Shanghai experiment the consumption type of value-added tax was applied. From the total sales proceeds, the enterprise deducts a specific number of materials purchased from other enterprises and processed or used in the manufacture of the product. The difference is the value added by the entrprise by its own activity, which is the tax base for the value-added tax.

With respect to the computation of the value-added tax, the amount payable under the Shanghai consumption type of value-added tax is obtained by the subtraction method rather than the tax credit method.[36]

The deduction of purchases by the enterprise from sales proceeds consists of 7 specified materials obtained from other enterprises and processed in its product. The processed materials comprise raw materials, auxiliary materials, fuels, purchased spare parts, repaired spare parts, low cost materials and package materials. The formula used to calculate the value added tax is the following:

The amount of the industrial and commercial tax is the sales proceeds multiplied by the value-added ratio multiplied by the applicable rate of the industrial and commercial tax.

The formula of the value-added ratio is:

$$\text{Value-added ratio} = 1 - \frac{\text{Production cost} \times \frac{\text{processed purchased materials}}{\text{purchased production expenses}}}{\text{Sales proceeds}}$$

The value-added ratio is calculated for each year per enterprise. The average value-added ratio for the year 1979 which applied to the Shanghai diesel engine factory was 54.2%. For the Shanghai factory the applicable rate of the industrial and commercial tax was 5%. The existing rates of tax were: for agricultural diesel engines, 6%, and for non-agricultural diesel engines, 10%.

The industrial and commercial tax is levied twice a month. Late payment of the tax is penalized by a fine amounting to 0.1% per day levied on the tax not paid.[37]

b. The income regulating tax

The income regulating tax levied in 1979 on the pilot Shanghai diesel engine factory was imposed at the rate of 7.5% on the "determined" profit. The rate of the income regulating tax will not be changed for 5 years if no changes take place in the fixed prices of goods, the tax rates, the costs and utilization of the factory's capacity.

If in those factors a change of 1% occurs in a certain year, the following first half year the income regulating tax rate may be adjusted by 0.4% for each 1% change. The income regulating tax is levied twice a month. Late payments of the tax are penalized by a fine amounting to 0.1% per day levied on the tax not paid. Income regulating tax is paid together with the industrial and commercial tax.

c. The income tax

At present, 270 State-run enterprises pay income tax in Shanghai, Liuzhou (Guangzi province), Sichuan and Hubei provinces.

Hubei province levies progressive income tax at rates divided into 5 income tax brackets ranging from a low of 50% to a high of 75%.

Sichuan province levies progressive income tax rates divided into 6 income tax brackets ranging from a low of 40% to a high of 78%.

Shanghai and Liuzhou both levy a proportional income tax at 50%.[38] The income tax levied on the Shanghai diesel engine factory plant was 50% on the total annual sales proceeds after deduction of the industrial and commercial tax, the income regulating tax and the production cost. The allocation to the workers welfare fund is 11% of the total annual wages paid.

The income tax is levied twice a month. Late payment of the tax is penalized by a fine amounting to 0.5% per day levied on the tax not paid.

d. Special funds

The retained profits shall be divided and transferred to the following special funds of the Shanghai factory plant:
- Production development fund: 41%;
- Staff and workers' welfare fund: 32%;
- Staff and workers' reward fund: 27%.

23, particularly 20 ("Reform of the taxation system"). See also: Yao Yilin, "Vice-Premier of the State Council delivered report at the Third Session of the Fifth National People's Congress on August 30, 1980. Report on the arrangements for the National Economic Plans for 1980 and 1981", *Beijing Review*, 22 September 1980, 30-43, particularly 42.

34. See Tao Youzhi and Huang Laiji, "The experimental conditions of self-sustained profit and loss system of the Shanghai diesel engine factory plant", *Jingji Guanli* (Economic Management) 1981:1, 16-19.

35. Han Shaochu, "Theoretical discussion on the value-added tax to be put in force. Ministry of Finance. General Tax Affairs Bureau", *Jingji Guanli* (Economic Management) 1980:1, 15-18.

36. For other types and methods of computation of value added tax, see: Carl Shoup, *Public Finance* (Chicago, 1979), 250 ff.

37. See note 34.

38. Wang Wending and Han Shaozhu, "Discussion of the problems arising from the imposition of income tax on State-run enterprises", *Jingji Guanli* (Economic Management) 1981:5, 42 ff.

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Under the original profit retention system adopted, the ratios were 38, 36 and 26% respectively.

e. Tax on land and buildings

With respect to the experiment of the Shanghai diesel engine factory plant, the tax on buildings was levied at 1.2% on the annual rental value. The land tax amounts to 0.72 yuan per square metre per year with respect to land located in the city and 0.36 yuan per square metre per year for land located in the suburbs.

The tax on buildings is levied twice a year, on 20 April and 20 October. Late payment of the tax is penalized by a fine amounting to 0.5% per day levied on the tax not paid. The Shanghai diesel engine factory paid an annual tax on buildings amounting to 1,070,000 yuan. The license tax for the use of vehicles and boats paid by the Shanghai diesel engine factory amounted to 22,000 yuan per year.

f. Duties for the use of fixed assets and of circulating capital

In the experiment of the Shanghai diesel engine factory plant, 2 kinds of duties were levied.

The duty for the use of fixed assets at 0.8% per month was levied on the value of fixed assets supplied by the State at the disposal of the factory. The duty for the use of circulating capital (working capital or loan) was levied at the rate of 0.42% per month on the amount of the loan. Both duties must be paid on the 25th of each month. Late payments of duties are penalized by a fine amounting to 0.1% per day levied on the duty not paid. The Shanghai factory paid each month 586,000 yuan with respect to the duty for the use of fixed assets and 136,000 yuan with respect to the duty for the use of circulating capital.

2. Tax experiments on State-run retail trade enterprises in Tianjin

In 1979 experiments were undertaken in Tianjin by State-tun retail trade enterprises with respect to self-responsibility for one's own profit or loss. There were 20 pilot enterprises involved utilizing 3 different measures of economc self-responsibility. Ten enterprises experimented with taxation under self-responsibility for one's own profit or loss and 6 enterprises experimented with the profit retention system, whereas the remaining 4 were "responsible for a task until its completion".[39]

Self-responsibility for one's own profits or loss was subdivided in two kinds of methods, to wit, the "Five Taxes, One Duty" and the "Proportional Income Tax".

Under the "Five Taxes, One duty" method, general trade stores and groceries had to pay the following taxes: the industrial and commercial tax levied at the rate of 3% on the sales proceeds, the tax on buildings levied at the rate of 1.2% on the annual rental value, and the land tax amounting to 0.72 yuan per square metre per year. The income tax was levied at 4% of the profits, increased by a local surcharge of 15%, thus totalling 4.6%.

The duty on the use of working capital was 0.21% per month of the working capital amount. The ratio between retained profit and State share was 30 and 70% respectively. The 4 taxes and one duty are levied on the State share. The balance, if any is available, is taxed by an income regulating tax which is levied at the rate of 0.6% of sales proceeds with respect to groceries, and 2.3% with respect to department stores.

Under the "Proportional Income Tax" method, the district street general trade stores may retain 42% of the profit and transfer 58% of the profit to the State. This ratio is fixed for 3 years. From the retained profit under both methods mentioned above, different amounts were allocated to the special funds, to wit, the development funds, the welfare funds and the reward funds respectively. The ratio to the special funds differs depending on the trade branch.

For trade stores the ratio of the funds were 50, 30 and 20 respectively. For groceries 35, 25 and 40 respectively and for district street trade stores 40, 20 and 40 respectively.[40]

IV. CONCLUSION AND SUMMARY

The tax system of China, in order to be effective as part of its new economic development policy, must be tailored carefully to the path that China has chosen, the road to socialism.

It is generally conceived that the economic set-up at present no longer suits the goal of achieving high sustained economic growth after 30 years of socialist economic planning. In addition, it is strongly asserted that the present economic set-up in China must be adjusted, restructured and consolidated in order to serve better the Four Modernizations and to foster cooperation with foreign investors from countries having an economic system different than that prevailing in China. State enterprises are subject to the profit allotment system in which enterprises have to transfer all their profits to the State and, by the same token, all losses are automatically covered by State subsidies, a phenomenon which is known as "everybody eats from the same rice bowl". This was considered for a long time one of "the advantages of socialism".

The system of overall State responsibility in production and distribution of goods provides little material incentive for greater efficiency and productivity in the production and distribution of goods. To put more vitality therein, China will phase out the profit allotment system and replace it by one of self-responsibility of State enterprises for their respective profits and losses. Instead of handing over their profits to the State, the enterprises pay taxes to the State. Any profits remaining after paying taxes are at the disposal of the enterprises. On the other hand, the State will no longer provide subsidies to those enterprises which have losses.

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39. "Enterprises responsible for a task until its completion and with limited profits should enlarge its right too – The Economic Commission of Mianyang Prefecture of Sichuan Province", *Jingji Guanli* (Economic Management) 1981:6, 27 ff.

40. Zheng Ning and Wang Shiquan, "The experiments effecting sole responsibility for one's own profits or losses in Tianjin's State-run retail trade enterprises", *Jingji Yangjiu* (Economic Research) 1981:6, 27 ff.

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Where taxes are not levied, their introduction creates complicated problems which must first be solved. This can be accomplished by gradually expanding trial experiments in taxation of enterprises to acquaint people with the "virtues" of financial self-responsibility in doing business and paying taxes to the State instead of by one reform law promulgated overnight designed to break the "iron rice bowl" in a predominantly planned economy.

Appendix A:

CHINA'S TAX REVENUE STATISTICS

The classification of tax revenue in China has been simplified and unified to concur with the unification of the national economy in the form of public ownership of the means of production. This is reflectd in the fact that China did not provide a breakdown in tax revenue figures; consequently there seemed to be no need to follow a classification by types of taxes.

In 1959 China had disclosed some information on its economic performance in the first 10 years of its existence in the publication *Ten Great Years of Financial Accomplishments in the People's Republic of China.* This is up to now the only statistical book published by the People's Republic of China. *Ten Great Years* also contained some national tax revenue statistics. Those tax statistics do not provide a detailed breakdown of the kinds of taxes collected. Only the ratios of taxes, profits from state-owned enterprises and other items of revenue to total national revenue are given.

The purpose of China's tax statistics is to reflect the progress of the accomplishment of the national centrally planned economy. See for the developments of revenue receipts between taxes and revenue from state-owned enterprises: Tables I, II and III. The revenue structure is set out in Table IV.

The statistics on state revenue in Tables I and II are from *Ten Great Years.* The statistics in Tables III and IV on revenue development and revenue structure are from the Chinese-source publication *New China's Research Tax Department,* published in the Japanese article "Chugokuno Sozeiseido" (China's Tax System) in *Kakkokuno Sozeiseido* (Every Country's Tax System) (Tokyo, Zaikei Shohosha, 1976).

Tables III and IV supplement the figures given in Tables I and II. The revenue development statistics reveal that China from 1950 to 1960 relied more on revenue from state-owned enterprises as profit allotments rather than on taxes and much less on loans. Whereas taxes amounted to 75.1% of total revenue receipt in 1950, they amounted to only 34.8% in 1960. On the other hand, revenue from state-owned enterprises increased from 13.4% in 1950 to 64.7% in 1960. Other revenue items dropped from 11.5% in 1950 to 0.5% in 1960.

The relatively heavy reliance on revenue from state-owned enterprises may be explained by the fact that much of the peasants' income in China was in kind and the monetary tax base was, therefore, limited.[1]

In the budget statement by the Minister of Finance submitted to the plenary session of the National People's Congress held in June 1979, some revenue figures were disclosed for the first time since the publication of *Ten Great Years.* The total national revenue for 1979 was estimated at 112,000 million Yuan (112,111 million Yuan for 1978 and 87,450 million Yuan for 1977).[2] The drastically reduced state revenue estimated for 1979 in comparison to 1978 was the result of special measures taken in the new economic programm to raise the living standard in rural areas in comparison to that of urban areas. Among the measures were reduction and exemption from taxes in rural areas.[3]

No detailed breakdown of revenue receipts was given in the 1979 budget statement. The only breakdown for 1978 given was the following: taxes from industrial and commercial enterprises – 45,100 million Yuan (12.6% higher than 1977); and profit from state-owned enterprises – 44,000 million Yuan (an increase of 35%).[4]

TABLE I
State revenue
(in million Yuan)

	Total	*Taxes*	*Revenue from state-owned enterprises*	*Credit and insurance*	*Others*
1950	6,520	4,900	870	330	420
1951	12,960	8,110	3,050	570	1,230
1952	17,560	9,770	5,730	190	1,870
1953	21,760	11,970	7,670	490	1,630
1954	26,230	12,220	9,960	1,790	1,260
1955	27,200	12,750	11,190	2,360	900
1956	28,740	14,090	13,430	720	500
1957	31,020	15,490	14,420	700	410
1958	41,860	18,730	22,020	800	310

TABLE II
State revenue
(in percentage of total)

	Taxes	*Revenue from state-owned enterprises*	*Credit and insurance*	*Others*
1950	75.1	13.4	5.0	6.5
1971	62.6	23.5	4.4	9.5
1952	55.6	32.6	1.1	10.7
1953	55.0	35.2	2.3	7.5
1954	50.4	38.0	6.8	4.8
1955	46.9	41.1	8.7	3.3
1956	49.0	47.7	2.5	1.8
1957	49.9	46.5	2.3	1.3
1958	44.8	52.6	1.9	0.7

Source: Ten Great Years, Statistics of the Economic and Cultural Achievements of the People's Republic of China. Compiled by the State Statistical Bureau (Peking, 1959) (English edition).

1. Jan S. Prybyla, *The political economy of Communist China* (Scranton 1970), 204.
2. "Report on the Final State Accounts for 1978 and the Draft State Budget for 1979 by the Minister of Finance, Zhang Jingfu", *Beijing Review,* 20 July 1979, 17-24.
3. "Tax reduction in rural areas", *Beijing Review,* 16 March 1979, 12.
4. "Report on the Final State Accounts for 1978 and the Draft State Budget for 1979", *Beijing Review,* 20 July 1979, 18.

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TABLE III
Revenue development
(in million Yuan)

	Taxes	*Revenue from state-owned enterprises*	*Others*
1950	4,900 (75.1%)	870 (13.4%)	750 (11.5%)
1953	11,970 (55.0%)	7,670 (35.2%)	2,120 (9.8%)
1956	14,090 (49.0%)	13,430 (46.7%)	1,220 (4.3%)
1959	20,470 (37.8%)	33,360 (61.6%)	330 (0.6%)
1960	24,360 (34.8%)	45,300 (64.7%)	360 (0.5%)

TABLE IV
Revenue structure
(in million Yuan)

	Industrial and commercial taxes	*Agricultural tax*	*Customs duties and salt tax*
1950	2,360 (48.3%)	1,910 (38.9%)	630 (12.8%)
1953	8,250 (68.9%)	2,710 (22.6%)	1,010 (8.5%)
1956	10,100 (71.7%)	2,970 (21.0%)	1,030 (7.3%)
1959	15,700 (76.7%)	3,300 (16.1%)	1,470 (7.2%)
1960	19,450 (79.9%)	3,300 (13.5%)	1,610 (6.6%)

Source: New China's Research Tax Department, published in a Japanese article "Chugokuno Sozeiseido" (China's Tax System). In: *Kakkokuno Sozeiseido* (Every Country's Tax System) (Tokyo, Zaikei Shohosha, 1976).

Appendix B:

FOREIGN ENTERPRISE INCOME TAX LAW

(Adopted at the fourth session of the 5th National People's Congress on 13 December, promulgated by an order of Ye Jianying, Chairman of the NPC standing committee, the same day, entered into force on 1 January 1982)

The Income Tax Law of the People's Republic of China Concerning Foreign Enterprises

Article 1. Income tax shall be levied in accordance with this law on the income derived from production, business and other sources by any foreign enterprise operating in the People's Republic of China.

"Foreign enterprises" mentioned in this law refer, with the exception of those for whom separate provisions are stipulated in Article 11, to foreign companies, enterprises and other economic organizations which have establishments in the People's Republic of China engaged in independent business operation or cooperative production or joint business operation with Chinese enterprises.

Article 2. The taxable income of a foreign enterprise shall be the net income in a tax year after deduction of costs, expenses and losses in that year.

Article 3. Income tax on foreign enterprises shall be assessed at progressive rates for the parts in excess of a specific amount of taxable income. The tax rates are as follows:

Range of income	*Tax rate (%)*
Annual income below 250,000 yuan	20
That part of annual income from 250,000 to 500,000 yuan	25
That part of annual income from 500,000 to 750,000 yuan	30
That part of annual income from 750,000 to 1,000,000 yuan	35
That part of annual income above 1,000,000 yuan	40

Article 4. In addition to the income tax levied on foreign enterprises in accordance with the provisions of the preceding article, a local income tax of 10% of the same taxable income shall be levied.

Where a foreign enterprise needs reduction in or exemption from local income tax on account of its small-scaled production or business, or low-profit rate, this shall be decided by the people's government of the province, municipality or autonomous region in which that enterprise is located.

Article 5. A foreign enterprise scheduled to operate for a period of 10 years or more in farming, forestry, animal husbandry or other low-profit occupations may, upon approval by the tax authorities of an application filed by the enterprise, be exempted from income tax in the first profit-making year and allowed a 50% reduction in the second and third years.

With the approval of the Ministry of Finance, a 15-30% reduction in income tax may be allowed for a period of 10 years following the expiration of the term for exemptions and reductions mentioned in the preceding paragraph.

Article 6. Losses incurred by a foreign enterprise in a tax year may be carried over to the next year and made up with a matching amount drawn from that year's income. Should the income in the subsequent tax year be insufficient to make up for the said losses, the balance may be made up with further deductions against income year by year over a period not exceeding five years.

Article 7. Income tax on foreign enterprises shall be levied on an annual basis and paid in quarterly instalments. Such provisional payments shall be made within 15 days after the end of each quarter. The final settlement shall be made within 5 months after the end of a tax year. Excess payments shall be refunded by the tax authorities or deficiencies made good by the taxpayer.

Article 8. Foreign enterprises shall file their provisional income tax returns with the local tax authorities within the period prescribed for provisional payments. The taxpayer shall file its final annual income tax return together with its final accounts within 4 months after the end of the tax year.

Article 9. The method of financial management and the system of accounting of foreign enterprises shall be submitted to local tax authorities for reference.

Where the method of financial management and the system of accounting of foreign enterprises is in contradiction

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with the provisions of the tax law, tax payments shall be assessed according to the provisions of the tax law.

Article 10. Foreign enterprises shall present relevant certificates to the local tax authorities for tax registration when they go into operation or close down in accordance with law.

Article 11. A 20% income tax shall be levied on the income obtained from dividends, interest, rentals, royalties and other sources in China by foreign companies, enterprises and other economic organizations which have no establishments in China. Such tax shall be withheld by the paying unit in each of its payments.

For the payment of income tax according to the provisions in the preceding paragraph, the foreign companies, enterprises and other economic organizations which earn the income shall be the taxpayer, and the paying unit shall be the withholding agent. Taxes withheld on each payment by a withholding agent shall, within 5 days, be turned over to the state treasury and the income tax return submitted to the tax authorities.

Income from interest on loans given to the Chinese government or China's state banks by international finance organizations shall be exempted from income tax. Income from interest on loans given at a preferential interest rate by foreign banks to China's state banks shall also be exempted from income tax.

Income derived from interest on deposits of foreign banks in China's state banks and on loans given at a normal interest rate by foreign banks to China's state banks shall be taxed. However, exemption from income tax shall be granted to those foreign banks accordingly in whose countries income from interest on deposits and loans of China's state banks is exempted from income tax.

Article 12. The tax authorities have the right to investigate the financial affairs, account books and tax situation of any foreign enterprise, and have the right to investigate the withholding situation of any withholding agent. Such foreign enterprise and withholding agent must make reports on facts and provide all relevant information and shall not refuse to co-operate or conceal any facts.

Article 13. Income tax levied on foreign enterprises shall be computed in terms of renminbi (RMB). Income in foreign currency shall be assessed according to the exchange rate quoted by the State General Administration of Exchange Control of the People's Republic of China and taxed in renminbi.

Article 14. Foreign enterprises and withholding agents must pay their tax within the prescribed time limit. In case of failure to pay within the prescribed time limit, the appropriate tax authorities, in addition to setting a new time limit for tax payment, shall surcharge overdue payments at one half of 1% of the overdue tax for every day in arrears, starting from the first day of default.

Article 15. The tax authorities may, acting at their discretion, impose a penalty on any foreign enterprise which has violated the provisions of Articles 8, 9, 10 and 12 of this law.

In dealing with those withholding agents who have violated the provisions of Article 11 of this law, the tax authorities may, in addition to setting a new time limit for the payment of the part of tax that should have been withheld and, at their discretion, impose a penalty of not more than the amount that should have been withheld.

In dealing with foreign enterprises which have evaded or refused to pay income tax, the tax authorities may, in addition to pursuing the tax, impose a fine of not more than five times the amount of tax underpaid or not paid, according to how serious the offence is. Cases of gross violation shall be handled by the local people's courts according to law.

Article 16. In case of disputes with tax authorities about tax payment, foreign enterprises must pay tax according to the relevant regulations first before applying to higher tax authorities for reconsideration. If they do not accept the decisions made after such reconsideration, they can bring the matter before the local people's courts.

Article 17. Where agreements on tax payment have been concluded between the government of the People's Republic of China and the government of another country, matters concerning tax payment shall be handled in accordance with the provisions of these agreements.

Article 18. Detailed rules and regulations for the implementation of this law shall be formulated by the Ministry of Finance of the People's Republic of China.

Article 19. This law shall come into force as of 1 January 1982.

IFA NEWS

GREEK BRANCH

The following review written by Mr. Alun G. Davies, honorary president of IFA, has been submitted by the General Secretariat of IFA.

A Greek Economist's Journal,
by Professor Athanase John Sbarounis

Professor Athanase Sbarounis was the President of the XVIth Congress of the International Fiscal Association at Athens in September 1962, and continues to this day to be Chairman of the Greek Branch of IFA, which he has ably led for many years. It was during the Athens Congress that he introduced Dr. Mitchell Carroll, then President of IFA, for the presentation to Dr. Carroll of the Silver medal of the City of Athens. In the course of his address to the participants in the Athens Congress, the mayor of the City of Athens, Dr. Angelos Tsoukalas, recalled that Dr. Carroll's father had been a professor of Greek, and his mother a professor of Greek archaeol-

[Continued on page 83]

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MALAYSIA:

1982 PROPOSALS

This survey was prepared by *SGV Taxation Services SDN. BHD.*, Kuala Lumpur, Malaysia.

I. INTRODUCTION

The Minister of Finance in his 1982 Budget Speech presented to Parliament on 23 October 1981 made several amendments and additions to the country's tax legislation. The proposals will become law when they receive the Royal Assent or when the relevant Orders/Rules are gazetted. Points 1 to 18 hereinafter are therefore subject to the aforesaid events.

II. 1982 BUDGET – SUMMARY OF DIRECT TAX AMENDMENTS

Income Tax Act, 1967

Banks – Special loan scheme

2% income tax rebate to banks amended with the intention of including over-drafts.

Shipping companies

- New 12-year exemption period introduced.
- Tax-exempt dividend limit increased to 15%.
- Relevant periods of 4 years each concept introduced re tax exemption consequent upon compliance with conditions.
- 50% abatement of chargeable income for the 12 years after the tax holiday period.

Insurance companies

Income tax rate on profits from insurance of offshore risks lowered to 5%.

Late payment of tax

Penalty of 1% per month for 5 months replaced by a 5% penalty upon expiration of 60 days from date of first penalty of 10%.

Interest to non-residents

Interest paid by banks licensed under the Banking Act, 1973 are exempted from withholding tax.

Accelerated depreciation allowanee

Qualifying period extended to 31 December 1985 and to all industries.

Tax-exempt interest income

- Savings account interest:
  - Bank Simpanan Nasional – no limit.
  - Bank Pertanian, Tabung Haji and Malaysia Building Society – interest on deposits up to $10,000 only.
  - Licenced banks and finance companies – interest on deposits up to $1,000 only.
- Time deposits – no limit on amount if deposits are for more than 12 months.

Tax-exempt dividend

Dividends from investment in Amanah Saham Nasional and other approved unit trusts up to $5,000 per annum.

Insurance premiums on imports

Double deduction allowed if insurance is taken out with an insurance company which is incorporated in Malaysia.

Wages of the handicapped

Employer who employs a disabled person is entitled for double deduction of the wages paid.

Real Property Gains Tax Act, 1976

Compulsory acquisition of land

Gains derived from compulsory acquisition will with effect from 23 October 1981 be exempt.

Inter-spouse land transfers

Tax-free transfers permitted between husbands and wives.

Deemed market value transactions

Extended to include those transactions between unconnected persons.

Transfers on reorganisation, reconstruction or in compliance with NEP amalgamation

- Condition on type of consideration removed.
- When assets are distributed by liquidator, no tax arises.

Sale of assets in the seventh years

Gains on assets sold in seventh year of ownership and thereafter, NIL tax rate.

Investment Incentives Act, 1968

Hotel incentives

- Abatement of chargeable income extended to 31 December 1986 for hotels of approved standard built and opened for business in Kuala Lumpur and Penang.
- Pioneer status and hotel accelerated depreciation allowance for hotels of approved standard built and opened for business in Kuala Lumpur and Penang extended to 31 December 1986.
- New incentive for all hotels of approved standard called Hotel Tax Credit (similar to investment tax credit) introduced.

General

Road transportation fees

Revised as follows:

		Rate	
		Current	*Proposed*
1.	the first registration fee for a motor vehicle other than an invalid carriage, a motor bicycle or a motor tricycle	$30	$60
2.	fee on the transfer of a motor vehicle other than an invalid carriage, a motor bicycle or motor tricycle	$20	$40
3.	fee for international driving licence	$30	$60
4.	fee for the issue of a duplicate license	$ 5	$20

Travellers and overseas visitors

New exemptions as follows:

1. Travellers to be exempted from import duty, surtax and sales tax on the following items:
(a) tobacco not exceeding 225 grams (equivalent to 200 cigarettes);
(b) matches not exceeding 100 sticks;
(c) cosmetics, perfumery, soap and dentifrices, in open containers to a total value not exceeding $200;
(d) wearing apparel not exceeding 3 pieces;
(e) footwear not exceeding 1 pair;
(f) electrically and battery operated portable appliances for personal care and hygiene not exceeding 1 unit each;
(g) dutiable foot preparations to a total value not exceeding $75;
(h) souvenirs and gifts to a value not exceeding $200.

For a visitor to enjoy the exemption, he must be in Malaysia for at least 72 hours while for a Malaysian returning from abroad he must be away for the same period. In addition, the articles must be the property of the visitor or the Malaysian and for his personal use.

2. A flat duty of 60% to be imposed on all dutiable items except motor vehicles, liquor and cigarettes brought in by travellers.

Abolition of excise duty and reduction of import duty

Categories of goods:
1. Electric lamps;
2. Electric rice-cookers;
3. Gas stoves;
4. Electric iron;
5. Electric kettle;
6. Oven;
7. Toothpaste;
8. Soap, washing preparations and scouring powder;
9. Cement;
10. Gramophone records;
11. Fans;
12. Mattresses.

III. AMENDMENTS TO THE INCOME TAX ACT, 1967

1. Tax rebate on loans to small business (Section 61B)

With effect from the year of assessment 1981, income tax chargeable on a lender who grants a qualifying loan to a small business is rebated by 2% per annum on the outstanding balance of the loan "calculated on a term loan basis".

It is proposed that the words "calculated on a term loan basis" be deleted from the year of assessment 1982 with the intention that the rebate would also be granted in respect of qualifying overdrafts.

(With effect from year of assessment 1982).

2. Shipping companies – tax exemption (Section 54A)

A 12-year exemption from tax for shipping companies was introduced from the year of assessment 1979.

The Bill proposes to create a replacement tax exemption period in that income tax relief will be given for all Malaysian shipping companies for a period of 24 years commencing from the year of assessment 1982 or date of incorporation, whichever is the later. The companies are required to meet two conditions:

(a) they cannot declare more than 15% dividend which will be tax exempt in the hands of shareholders;
(b) they must use at least 75% of the fleet acquisition reserve for the purchase of ships on the following basis:
  (i) for the first 12 years under this scheme, full exemption will be given if the 75% utilisation condition is fulfilled as at the end of every 4 years of operation, failing which they are then allowed to satisfy the 75% condition at the end of the 12th year.
  (ii) for the next 12 years, companies will be examined every 4 years for compliance of the 75% fleet acquisition reserve condition and the limitation of dividend to 15% tax exempt. If such conditions are fulfilled, the companies will be allowed an abatement of 50% of their chargeable income from tax.

Briefly the above changes mean that whereas a shipping company has previously to incur, by the end of its last basis period for the tax exempt period, capital expenditure to the extent of 75% of

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fleet acquisition reserve account balance on the acquisition of ships or vessels in order to qualify for tax exemption, it is proposed that with effect from the year of assessment 1982 the 12-year tax-exempt period be divided into "relevant periods", each comprising 4 consecutive basis periods. Under the proposal the 75% requirement would be applied at the end of each relevant period. If a company fails to meet the 75% investment requirement at the end of any relevant period, tax exemption would not apply to that period unless at the end of the 12th year the 75% requirement is met with overall.

For the purposes of this incentive, the Bill provides that capital expenditure is deemed to have been incurred:

- when expenditure is made;
- on the signing of a contract for the purchase of a ship or vessel;
- when a similar commitment is undertaken and it is proved to the satisfaction of the Director Gefneral that such commitment is for the actual purchase of a ship or vessel.

(With effect from year of assessment 1982).

3. Shipping companies – abatement of chargeable income (new Section 54B)

It is proposed that from the year of assessment 1982, a Malaysian resident shipping company should have its chargeable income in respect of transporting passengers or cargo by sea abated by 50% for 12 years commencing from the year of assessment immediately following its tax exemption period described above under Section 54A.

Any chargeable income thus abated should be credited to an exempt account. Dividends paid out of the balance on this account would be tax exempt in the hands of shareholders. If a corporate shareholder is involved, dividends paid by that shareholder out of the exempt dividends received would be tax free to the shareholders of said company.

Similar restrictions as to the payment of dividends (15% limit) apply as described above.

As in the case of tax-exempt shipping companies, any excess of the audited net profit less actual tax payable and dividend paid should be credited to a fleet acquisition reserve which may only be reduced by capital expenditure incurred on the acquisition of ships and vessels.

The 75% investment requirement, relevant period concept, withdrawal of the tax exemption for any relevant period and definition of "incur" apply to the abatement provisions as they do to the exemption provisions.

(With effect from year of assessment 1982).

4. Insurance companies (Section 60)

The proposed new Section 60(2) provides that life, inward reinsurance, offshore insurance and general insurance business would all be treated as separate businesses.

Offshore insurance is defined as insurance of a risk under a general policy where the risk is outside Malaysia and the policy of insurance is issued by an insurer resident in Malaysia or a branch in Malaysia of a non-resident insurer. Where any risk is in transit in Malaysia, it shall be deemed to be outside Malaysia.

It is proposed that the adjusted income of the newly created class of separate business, the offshore insurance business, should be computed in the same way as the adjusted income of the general insurance business is computed both for resident as well as non-resident insurers, as the case may be.

(With effect from year of assessment 1982).

5. Offshore insurance – incentives (New Section 60B)

The new proposed Section 60B is a replica of the provisions of Section 60A except that it provides an incentive for the offshore insurance business and not the inward reinsurance business.

The Bill seeks to reduce the income tax rate on the chargeable income from inward reinsurance from 40% to 5% from the year of assessment 1982. As in the case of the inward reinsurance business the chargeable income less tax is available for franking tax-free dividends.

The existing Section 60B should, it is proposed, be renumbered Section 60C.

(With effect from year of assessment 1982).

6. Penalties on late payment of tax (Section 103(5A))

Under existing legislation, a 10% penalty may be imposed if tax is not paid by the due date(s). Further this percentage may be increased to 15% by additions of 1% for each subsequent period of 30 days during which tax charged under a notice of assessment remains outstanding.

The Bill seeks to replace the 1% per month penalty with a 5% penalty chargeable upon the expiration of 60 days from the date of the first penalty of 10%.

The proposed amendment would assist the Inland Revenue in its administrative functions.

(With effect from year of assessment 1982).

7. Tax-exempt interest (Schedule 6 Paragraph 33)

The anticipated revisions to the above paragraph would from the year of assessment 1982 enable licensed banks to pay or credit interest to any non-resident, including the overseas branch of a non-resident bank, without deduction of withholding tax. Such interest would not be subject to Malaysian tax unless it accrues to a place of business of that non-resident in Malaysia.

(With effect from year of assessment 1982).

IV. AMENDMENTS TO THE REAL PROPERTY GAINS TAX ACT, 1976

8. Compulsory acquisition of land under law (New Paragraph 3(f) Schedule 2)

The Bill seeks to provide that gains on disposals on or after 23 October 1981 arising from compulsory acquisitions of land under the Land Acquisition Act, 1960 are not subject to tax under the Act as the disposal price would be deemed to be equal to acquisition price.

(With effect from 23 October 1981).

9. Transfer of chargeable assets between spouses (paragraph 3(b) Schedule 2)

Under the proposed amendment, any transfer of chargeable assets between husbands and wives from 23 October 1981 would be tax free as the disposal price would be deemed to be equal to the acquisition price. (Nevertheless, for the purpose of the private residence exemption, only one life-time exemption will continue to be available to both husbands and wives as any private residence owned by the wife would, for the purposes of this exemption, be deemed to be owned by her husband.)

(With effect from 23 October 1981).

10. Transactions deemed to be at market value (New Paragraph 9(e) Schedule 2)

The Bill seeks to specifically provide that from 23 October 1981, in cases where the anti-tax avoidance provisions of Section 25(2) apply, e.g. where there is evasion or avoidance of tax, the acquisition and disposal of the chargeable assets in question shall be deemed to be at market value.

(With effect from 23 October 1981).

11. Intra-group transfers and transfers upon reorganisations, etc. (Paragraph 17(1)(b) Schedule 2)

Sub-paragraph 17(1)(b), which was subjected to a major alteration in 1977, would, if the proposed amendment is passed, be again changed.

At present, in order that exemption from tax could be claimed, where a chargeable asset is transferred under a scheme of reorganisation, reconstruction or amalgamation, consideration receivable should be in the form of shares or substantially in the form of shares and the balance in cash. The amendment does not place any restrictions on the form of consideration receivable and a wholly cash consideration is now possible.

Further, the amendment provides that where a chargeable asset is distributed in specie by a liquidator under a scheme of reorganisation, reconstruction or amalgamation, no taxable gain or loss arises.

The usual conditions that the transferee company must be a Malaysian resident company and the scheme must be in accordance with the New Economic Policy on capital participation in industry must be met in order to qualify for exemption.

It should be noted that the condition that the consideration should be in the form of shares, or substantially in the form of shares and the balance a money payment, would continue to apply to intra-group transfers for the promotion of greater efficiency in operation under Paragraph 17(1)(a).

(With effect from 23 October 1981).

12. Rate of tax (Schedule 5)

A new tax band has been created under the Bill. Assets sold after the 6th anniversary of the date of acquisition will no longer be subject to tax as the relevant rate of tax would be reduced from 5% to 0% in respect of disposals made on or after 23 October 1981.

Non-citizens and non-permanent residents of Malaysia would however continue to be taxed at 40% on assets acquired after 17 October 1980 irrespective of the period of ownership. However, if the assets were acquired by the non-citizens or non-permanent residents prior to 17 October 1980, then gains on such disposals would be entitled to the graduated rates of tax or the exemption depending on the holding period.

V. OTHER AMENDMENTS BASED ON THE 1982 BUDGET SPEECH

13. Accelerated depreciation allowance (ADA)

Under the existing 1980 Rules, qualifying plant expenditure incurred from 1 January 1978 to 31 December 1982 on the provision of machinery or plant used directly in the manufacture of any product or subjection of goods to any process would qualify for capital allowances of 100% in the year in which the expenditure was incurred.

The Minister of Finance has proposed that ADA should be granted to all industries (apparently in its widest possible sense), including the leasing industry, on qualifying plant expenditure incurred in the period to 31 December 1985.

An Order to this effect should be made in due course and it is expected that companies enjoying pioneer status, etc. would continue to be excluded from claiming ADA.

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14. Tax exemption on interest income

The current exemption available on interest on savings accounts with the Bank Simpanan Nasional is that on a deposit of $30,000 for a calendar year. It is proposed that this limit be removed from the year of assessment 1982 such that all savings account interest from the Bank Simpanan Nasional would be tax exempt.

Interest on savings deposits of up to $10,000 placed by individuals with registered cooperatives, Bank Pertanian, Tabung Haji, or the Malaysia Building Society would remain exempted from tax as at present.

However, in the case of interest from licensed banks and finance companies, interest on savings deposits of up to $1,000 only would be tax exempt from the year of assessment 1982. The current exemption level is interest on $10,000.

It is proposed that the limit placed on interest on fixed deposits exceeding 12 months currently stated at deposits of $10,000 be removed from the year of assessment 1982 such that all interest on deposits exceeding 12 months with approved institutions, e.g. licensed banks and finance companies, would be tax free. Although there are no fixed deposits of 12 months plus one day, it appears possible to claim tax exemption in respect of interest on 15-month fixed deposits prematurely terminated after 12 months.

Whilst for the year of assessment 1981 the exemption applied to individuals as well as companies, it would appear from the Minister's speech that the new exemption Order when issued would restrict the exemption to individuals only from the year of assessment 1982.

15. Double deduction on insurance premiums

With a view to encouraging the insurance of imported goods with locally incorporated companies, it is proposed that any importer who incurs premiums in respect of the insurance of goods imported into this country would from the year of assessment 1982 qualify for a double deduction on the expense if the insurance is taken out with a Malaysian incorporated insurer.

Clients may therefore consider changing the basis of purchasing goods to exclude the CIF basis, where relevant.

16. Double deduction for wages of handicapped employees

As an incentive for the employment of the handicapped, it is proposed that from the year of assessment 1982, the wage expense of employing the disabled should qualify for a double deduction.

17. Incentives to hotels

The abatement of chargeable income provision is an incentive offered to the hotel industry. Under this incentive, chargeable income is abated by between 15% to 30%, depending on the location of the hotel, for 12 years of assessment. In respect of Kuala Lumpur and Penang, this incentive expired on 31 December 1973. In view of an anticipated shortage of hotels in these areas, it is proposed that the incentive be extended to hotels completed or modernised by 31 December 1986.

Further, it is proposed that pioneer status and accelerated hotel depreciation allowance be extended to all hotels of an approved standard in Kuala Lumpur and Penang which are completed/modernised and opened for business from 1 January 1974 to 31 December 1986.

A new incentive hotel tax credit which is similar to investment tax credit is to be introduced for all areas. In respect of Kuala Lumpur and Penang, this incentive will be available up to 31 December 1986. It is expected that under hotel tax credit, companies will be able to claim a minimum credit of 25% calculated by reference to capital expenditure incurred on the hotel building and plant, machinery and apparatus used in the hotel business in the period of 5 years from the beginning of the financial year in which the hotel project was approved for hotel tax credit purposes. The actual credit percentage granted could be much higher than 25%. Relief is claimed through a reduction of the adjusted income of the company by utilising the credit granted. As the credit may be utilised at any time, this incentive would be expecially beneficial if the company does not expect to realise profits within the first few years of operation.

18. Exempt dividends from approved unit trusts

It is proposed that with effect from the year of assessment 1982, the amount of exempt dividends receivable from the Amanah Saham Nasional and other approved unit trusts be increased from $4,000 to $5,000.

VI. CHANGES IN INLAND REVENUE PRACTICES

19. Progressive profits basis of assessing housing developers

The Inland Revenue has previously accepted the completed contract basis of assessing developers. However, since 1981 there has been a move to assess developers on a progressive profits basis. The text of an individual directive by the Inland Revenue is reproduced below:

"As the definition of stock-in-trade in Section 2 of the Income Tax Act, 1967 includes work-in-progress, a company's development projects qualify for a direction under Section 36 of the Act.

Accordingly, the Director-General has directed that under Section 36 of the Act, the gross income and adjusted income from each project for the basis period for each year of assessment in the period within which each project is carried on and completed by the company shall be computed in the following manner:

$$\frac{\text{Total amounts of payment received in the basis period for the year of assessment}}{\text{Full sale consideration}} \times \text{Adjusted income finally ascertained on completion of the project}$$

Pending completion of each project for the purpose of provisional assessment, the company is required to estimate the net profit in respect of the project and the same should be allocated to the basis period for the particular year of assessment in the proportion of the total amount of payments received in that basis period to the full value of the project (consideration). The statutory income can then be arrived at after deducting therefrom the capital allowance due for the year."

"Payment received" includes booking fees and advances. A review of the position would arise following the completion of the project when any tax adjustments necessary would be made restrospectively.

MALAYSIA:

BUDGET 1982

Extracts from the Budget Speech 1982 pronounced on 23 October 1982 by Mr. Mulia Tengku Razaleigh Hamzah, Minister of Finance.

A detailed discussion of the Malaysian tax system appears in the Publication: Taxes and Investment in Asia and the Pacific

Export duty exemption for processed palm oil

It is very encouraging to note the rapid growth which has taken place in the palm oil refining industry in the last few years as a result of the tax incentive provided by the Government in the form of exemption from the export duty on processed palm oil products. While this incentive has been effective in promoting downstream processing of palm oil, it is necessary to make some changes to the duty exemption structure in order to take account of higher costs of refining and to encourage a wider variety of export products. It is therefore proposed that:

(i) the basic level of exemption will be increased from about $75 to $95 to take account of higher cost of refining;

(ii) processed palm oil products will now be classified into 5 categories instead of 4 categories as at present. There will be a new category III to take account of a product which has undergone three stages of processing and which should therefore be given more duty exemption;

(iii) the rates of exemption will be adjusted, so that there is a difference of 5 percentage points between each of the categories. In effect, this will mean that the exemption rates for category II in the present structure will be reduced by 5 percentage points, with no change in the other categories. Thus, the present policy which emphasises the export of a variety of refined palm oil products will be maintained.

To be consistent with this policy, the export duty on stearin which is now at a flat rate of 5% will also be changed. Thus, from now on, fully refined stearin will not be subject to the export duty. The 5% export duty will only apply to crude and semi-refined stearin.

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The new changes will give, on the average, an additional gain of about $20 per ton to the manufacturers of palm oil products.

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Hotel Incentives

To further encourage tourism, the hotel incentives for Kuala Lumpur and Penang island, which expired at the end of 1973, will be further extended up to 31st December, 1986 for hotels of approved standard.

In addition to the existing incentives, namely full tax relief under pioneer status conditions and abatement of chargeable income, the Government will also introduce a new incentive in the form of Hotel Tax Credit to be provided in all areas.

In the case of Kuala Lumpur and Penang island, this incentive is available only up to 31st December, 1986. This tax incentive will be similar to the Investment Tax Credit which is being provided for the manufacturing sector i.e. a minimum tax credit of 25% of the total capiutal expenditure incurred on the project.

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Real Property Gains Tax Act

The Real Property Gains Tax Act will be amended to exclude gains arising from the transfer of a house between a husband and a wife from the tax. A transfer between a husband and a wife is an internal dealing within the same household, and therefore should not attract tax under the Act.

The provision under the Real Property Gains Tax Act to exempt gains arising from restructuring of companies to conform with the New Economic Policy is found to be restrictive. The Act requires that the companies carry out the transactions in shares or substantially in shares and the balance in cash.

This requirement may deter foreign companies to restructure as they may not want to hold shares in the locally incorporated companies and minority shareholders may prefer cash.

Therefore, the Act should be amended to allow exemption even if the transaction consists of money payment rather than in shares provided that the transfer is made under an approved scheme of reconstruction. Distribution of assets by the liquidation of a company will also not be taxed if it is done under an approved scheme of reconstruction.

Another change is to exclude from tax the gains arising from the disposal of an asset which is compulsorily acquired by the Government.

Finally, it is also proposed that from to-day any gain derived from the sale of assets in the 7th year onwards after their acquisition and thereafter will not be subject to tax. At present, tax is imposed at 5% on the gain from the disposal of an asset in the 7th year of acquisition onwards.

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Double deduction

We remember our Ex-Servicemen, especially those who have been incapacitated in the line of duty. It is also important to maximise the utilisation of our manpower resources. Thus, to encourage the employment of the handicapped, and in keeping with the compassionate spirit of the Year of the Handicapped, I propose that double deduction will be provided for wages incurred in employing handicapped persons. All equipment and appliances for the specific use of the handicapped will also be exempted from customs duty. The surtax and sales tax will be abolished for wheelchairs, artificial arms, artificial legs, calippers, hearing aids, buggy invalid chairs and dialysis machines.

Apart from expanding public expenditure, the private sector, will also be encouraged to maintain a high rate of growth in investment and production. At present, Accelerated Depreciation Allowance (ADA) is provided up to basis year 1982.

However, because it has proved beneficial to industries, and has helped to promote industrialisation and modernisation, the period for the ADA will be extended up to basis year 1985. Its scope will now be widened to include not only the manufacturing sector, but to all industries including leasing.

It is expected that this new extension will contribute significantly to greater investment and economic growth as the ADA allows 100% of the capital expenditure to be written off in one year.

The granting of Investment Tax Credit will be geared to provide more tax benefits in order to expedite the development of heavy and ancillary industries.

Thus, while the minimum rate of tax credit granted under this incentive is 25% of total capital expenditure incurred in the project, priority industries will be granted higher rates in order to give them greater relief from tax.

An important incentive available to industries in the manufacturing sector is the exemption from import duties, surtax and sales tax on their imports of raw materials and machinery.

I propose to streamline the administration of duty exemptions so as to make it expeditious and more widely available to the manufacturing sector. Thus:

(a) The surtax on imports of a wide range of raw materials which are not available locally and for which there is only a surtax of 5% will be abolished. Instead, the reduced rate of surtax at 2% or 3% as the case may be, which is payable under the existing exemption system, will be integrated into the import duty. The advantage of this proposal to manufacturers is that they can now obtain the reduced duty of 2% or 3% for importing their raw materials without having to apply for it;

(b) As a further incentive, those industries which import the raw materials bearing the 2% or 3% rate of import duty, can apply for exemption from this duty if such industries comply with the New Economic Policy in terms of equity participation, management and employment structure upon certification by the Foreign Investment Committee;

(c) Furthermore, the surtax and sales tax on imports of machinery and equipment which are not produced locally and which are directly used in manufacturing, will now be totally abolished.

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Shipping

In order to help expand our shipping industry and reduce the foreign exchange paid to foreign shipping, the 1979 tax incentive for the shipping industry will be replaced by a new incentive scheme to make it more attractive for Malaysian ship-owners.

It is proposed now that income tax relief be given to all Malaysian companies for a period of 24 years commencing from the year of assessment 1982 or date of incorporation, whichever is the later. The companies are required to meet two conditions namely:

(a) they cannot declare more than 15% dividend which will be tax exempt in the hands of the shareholders; and

(b) they must use at least 75% of the fleet acquisition reserve for the purchase of ships.

For the first 12 years such companies will be eligible for full tax relief. In the next 12 years, these companies are eligible for a 50% abatement of chargeable income.

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Insurance

Another important area where foreign exchange can be conserved is in insurance. As Malaysia develops, the service sector of the economy and the Balance of Payments must also expand.

Thus the preferential tax treatment provided in the 1980 Budget for inward reinsurance will be extended to insurance companies covering offshore risks as a further encouragement for them to break into the international insurance market.

Therefore, the tax rate applicable to profits earned by Malaysian incorporated companies on the coverage of offshore risks will be reduced from the normal company rate of 40% to 5%.

Malaysian importers will also be further encouraged to insure with Malaysian insurance companies. For this purpose, it is proposed to provide an incentive in the form of double deduction from income tax on the insurance expenses for the cargo.

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SRI LANKA:

BUDGET 1982

Extracts from the Budget Speech for 1982 pronounced on 23 October 1981 by Mr. Ronnie de Mel, the Minister of Finance and Planning.

See for a detailed discussion of Sri Lanka's tax system the Bureau's publication: Taxes and Investment in Asia and the Pacific

A. Direct taxes

1. Surcharge on Income tax and Wealth tax

Mr. Speaker, in the country's present difficult financial situation, at a time when the ordinary man is called upon to bear considerable burdens due to the rise in the cost of living, I feel that the more affluent sections of the population should make a greater contribution to government revenue. We must remember that we cannot continue to balance the budget on the backs of the poor. I therefore, propose to impose a surcharge both on income tax and on wealth tax. The surcharge on income tax will be different from the surcharges which have been levied in the past. The surcharge will be on a progressive rate schedule and only the more affluent taxpayers will be called upon to pay it. The surcharge will not be levied on companies and individuals whose taxable income does not exceed Rs.25,000. The surcharge will be levied on income tax and wealth tax payable for the year of assessment 1981-82 as follows:

(a) Income tax:

(i) Companies, bodies of persons, etc. –
Where the taxable income exceeds Rs.25,000 and does not exceed Rs.50,000 – 5% of the income tax payable;
Where the taxable income exceeds Rs.50,000 – 10% of the income tax payable.

(ii) Individuals –
Where the taxable income exceeds Rs.25,000 and does not exceed Rs.50,000 – 5% of the income tax payable;
Where the taxable income exceeds Rs.50,000 and does not exceed Rs.200,000 – 10% of the income tax payable;
Where the taxable income exceeds Rs.200,000 – 15% of the income tax payable.

(b) Wealth tax:

A surcharge of 10% on the Wealth Tax payable.

These surcharges will bring in additional revenue of Rs.200 million.

2. Tax incentives

Mr. Speaker, there has been a drop in the revenue collected from direct taxes in recent years. One of the main reasons for this drop is the provision of numerous tax holidays as incentives for investment. While there was justification for those incentives in the early stages of our new economic policies, I am of the view that tax holidays should not be a permanent feature of our tax system because of their revenue and equity implications. I, therefore, propose to have a cut-off date for approvals for tax holidays and to fix this date as 31st March 1983. Approvals granted up to this date will hold good only if meaningful steps are taken within one year from the date of approval. Mr. Speaker, this proposal would have the effect of inducing entrepreneurs to take positive steps, within the next year or two, to embark on new ventures. This would further accelerate the development programme of the country. The removal of the tax holiday would not apply to export-oriented enterprises licensed by the GCEC.

3. Exemption of profits arising to foreign contractors

There is provision under Section 22 of the Inland Revenue Act for the exemption from income tax of the profits accruing to foreign contractors, under certain specified circumstances. Mr. Speaker, there is no justification for continuing to exempt such profits. This provision was introduced at a time when Sri Lanka did not provide an attractive climate for investment and when there were only a few Double Tax Relief Agreements.

Exemption under this section is now not granted to a contractor who is a resident of a country with which there is a Double Tax Relief Agreement. The reason is that, where there is such an agreement, Sri Lanka tax paid is allowed as a credit against the tax payable in the contractor's home country. If exemption is granted to the foreign contractor he would not get such a tax credit and would have to pay the full tax in his home country. Sri Lanka would thus unnecessarily forgo revenue for the benefit of a foreign government.

I, therefore, propose to repeal Section 22 of the Inland Revenue Act.

4. Small company relief

Mr. Speaker, in order to encourage the small entrepreneurs to organize their businesses as limited liability companies, concessionary rates of tax have been granted to small companies. The existing provisions define a small company as one whose issued capital does not exceed Rs.500,000.

Resident companies other than quoted public companies pay tax at 50% of their taxable income, while quoted public companies pay tax at 40%.

Instances have come to light of companies earning high incomes which maintain their issued share capital at a figure of less than Rs.500,000 in order to benefit from the concessionary rates of tax. I, therefore, propose to subject small companies to the normal rate of tax of 50% on the excess of their taxable income over Rs.250,000 per annum.

A small company which is a quoted public company would, however, continue to pay tax on the present rate-schedule applicable to small companies even if its taxable income is over Rs.250,000.

5. Foreign entertainers and artistes

At present there is no provision in the Inland Revenue Act to compel an employer or a sponsor to withhold a percentage of the payments made to foreign entertainers, artistes, etc., for tax purposes. In order to prevent any loss of revenue by the non-payment of tax by these persons, I propose to make suitable amendments to the Inland Revenue Act so as to empower an employer or sponsor to withhold 33⅓% of the payments due to these categories of persons against their tax liabilities.

6. Minors' extended deposit schemes

Mr. Speaker, several banks have started deposit schemes whereby the deposits made on behalf of minors are payable with interest to the beneficiary after a period of 20 years or more. Under the present law, tax on interest has to be calculated on an accrual basis for each year of assessment. In view of the long period of maturity of these deposits, it will not be practicable for taxpayers to ascertain the interest each year and to pay tax on such interest. I, therefore, propose that –

(a) the banks should be required to deduct tax at 15% on the interest element from the amount payable on maturity or at the time of withdrawal;
(b) the tax so deducted should be deemed to be a final levy.

This mode of payment of tax would be convenient both to the taxpayer and to the banks.

7. Interest payable under the Land Reforms Act

Mr. Speaker, under the Land Reform (Amendment) Act, No. 39 of 1981, interest at 10% is payable on compensation due to the previous owners of lands taken over by the Land Reform Commission. Interest income is liable to income tax on an accrual basis. It will not be practicable, however, to make assessments from 1972-73 onwards on the additional tax payable by these owners as a result of these interest payments. I, therefore, propose that –

(a) the interest payable at the rate of 10% under the Land Reform Law should be treated as income arising in the year in which the interest is actually paid;
(b) the Land Reform Commission should be required to deduct tax at 10% from the interest payable;
(c) the tax so deducted should be deemed to be a final levy.

This will yield a net interest rate of 9% on the recipients.

8. Non-Resident Foreign Currency Accounts

Mr. Speaker, at present the interest arising on deposits in Non-Resident Foreign Currency Accounts is exempt from income tax only during the period in which the holder of the account is not resident in Sri Lanka. These deposits are, however, exempt from wealth tax both during the period in which he is non-resident and for a further period of three years after he becomes resident.

With a view to making Non-Resident Foreign Currency Accounts more attractive, I propose that, as in the case of wealth tax, the interest on these deposits should be exempt from income tax both during the period in which the holder of the account is non-resident and for a further period of three years after he becomes resident.

9. Exemption of earnings abroad

There is provision under the Inland Revenue Act to exempt the emoluments earned in foreign currency by an individual in respect of services rendered abroad if such emoluments (less reasonable personal expenses) are remitted to Sri Lanka. This provision was enacted to encourage Sri Lankans who are engaged in short-term assignments abroad to bring back their foreign exchange savings to Sri Lanka. In recent years, several resident consultancy firms have also been engaged in rendering services abroad for payment in foreign currency. Mr. Speaker, I am of the view that these resident companies and partnerships too should be granted a tax exemption similar to what is available to individuals, which would act as an incentive for them to bring back their foreign exchange earnings to Sri Lanka. I propose to make the necessary changes to the Inland Revenue Act.

B. Turnover tax and import duty

1. Turnover Tax on Imports on Manufacturing businesses

Mr. Speaker, under the existing law, Business Turnover Tax at rates ranging from 1% to 35% is levied on locally manufactured goods, whilst import duties at rates ranging from 5% to 500% are

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levied on imported goods. In addition, there is a turnover tax on services and a general turnover tax of 2% on non-manufacturing businesses.

The present import duty has two functions. It is partly a revenue measure and partly a protective measure to assist local industries.

It is desirable that the two elements of import duty, namely, the revenue element and the protection element, be separated. This would ensure that the revenue component of import duty at the point of import would be identical to that of the turnover tax on a locally manufactured article when sold. The balance payable at the point of import will represent the level of protection afforded to the locally produced article. The new Turnover Tax Act will enable tax to be levied on this basis.

Under the existing provision, turnover tax in respect of manufacturing businesses is levied at rates ranging from 1% to 35%.

Mr. Speaker, under the new scheme which will take effect immediately, a turnover tax will be imposed on most of the imports. This will be in addition to the present customs duty. However, where an imported item is used in the manufacture of goods or commodities in Sri Lanka, the turnover tax paid on the imported item will be deducted from the turnover tax payable by the manufacturer. Similarly, where a locally manufactured component is used in the manufacture of another item, the turnover tax paid on the component will be deducted from the tax payable by the final manufacturer. In other words, the tax levied on the manufacturer will only be on the value added. The new system will, therefore, be more equitable and will provide a certain degree of relief to the local manufacturer. To provide further relief to the local manufacturer, I propose, with the introduction of the new turnover tax on imports, to reduce the Customs duty on machinery and essential raw materials used in industry from the present level of 12.5% to 5%.

There will be only 3 basic rates of turnover tax, namely, 2%, 5% and 10%. A three-tier rate structure simplifies the administration of the tax.

The 2% rate will apply to:
Agricultural inputs;
Building materials;
Food items (other than infant milk foods which would be free of tax);
Fishing boats and fishing nets;
Handloom and pure cotton textiles;
Petroleum and petroleum products;
Pharmaceuticals (including ayurvedic preparations);
Other manufactured items which are now subject to turnover tax at 1%.

Mr. Speaker, some of these items are items of mass consumption, but I feel that there is no alternative to taxing goods which are articles of mass consumption if additional resources of the magnitude required have to be mobilized. This is the price we have to pay for development and employment.

The increase in the prices of these commodities as a result of the tax will be only marginal. For example, a 2% tax will have no real impact on the price as rice is no longer a controlled commodity. The seasonal fluctuations in the price on the free market will greatly exceed the 2% tax which will amount to only about 10 cents a measure of rice.

The 5% rate will apply to practically all the other items. However, a very few items which are at present taxed at over 5% will fall into the 10% band.

In the case of liquor and beedies, the existing rate of 15% will continue, whilst in the case of tobacco and cigarettes, the existing rate of 35% will continue.

Mr.Speaker, the existing business turnover tax law contains a host of exemptions. There is no justification for these exemptions, and I propose to remove most of them. However, undertakings for the manufacture of desiccated coconut, copra, coconut fibre, coconut oil, crepe rubber, sheet rubber, block rubber, scrap rubber or tea, as well as undertakings for the cultivation of tea, rubber and coconut, will be gazetted as exempted business.

Mr. Speaker, I also proposed to exempt the following items from turnover tax:
(a) Infant milk foods;
(b) Fertilizer;
(c) Crude oil;
(d) Articles manufactured in Sri Lanka and exported by the manufacturer (excluding jewellery and gems);
(e) Goods or materials which are imported and proved to the satisfaction of the Principal Collector of Customs to be goods or materials which would be used in the production in Sri Lanka of goods or commodities for export.

These items will be classified as "excepted articles".

The additional revenue expected from the new scheme of turnover tax is estimated at Rs.1,290 million.

2. Banks, Finance Companies and Pawnbrokers

Mr. Speaker, banks are now liable to a turnover tax of 2% on their income receipts. The banking sector has recorded a high rate of growth of 10% in 1979 and 15% in 1980. This sector has been enjoying substantial profits over the past 2-3 years which are mainly a reflection of the greater economic activity and their increased external transactions. I propose to increase the rate of turnover tax on banks from 2% to 5%.

Finance companies are now liable to BTT at 5% on their total receipts, which include capital sums as well. There is no rationale for adopting a different basis for levying turnover tax on finance companies as compared to banks, particularly as banks also engage in hire purchase business, which was earlier the preserve of finance companies. Also, finance companies, like banks, are now subject to supervision and control by the Central Bank. Accordingly, in the new Turnover Tax Act the definition of turnover as applicable to finance companies has been amended to bring it in line with that applicable to banks. However, I propose to increase the rate applicable to finance companies from 5% to 10%.

Pawnbrokers are also liable to turnover tax on their total receipts which include capital sums. I propose to adopt the same definition of turnover so that pawnbrokers will hereafter be liable to turnover tax, as in the case of banks and finance companies, only on their income receipts. I propose, however, to increase the rate of turnover tax from 2% to 5%.

The additional revenue from this proposal relating to banks, finance companies and pawnbrokers will be about Rs. 50 million.

3. Advertising

Mr. Speaker, during the past few years there has been a significant increase in advertising expenditure, and the newspapers have benefited from this increase. I, therefore, purpose to increase the rate of turnover tax on the advertising receipts of newspapers and periodicals from 5% to 10%.

The additional revenue from this source is estimated to be around Rs. 10 million.

4. Construction

Mr. Speaker, there are a number of businesses in which there has been a phenomenal increase in activity over the last two or three years as a result of the policies adopted by the present Government.

Two sectors have enjoyed particularly large increase both in their total turnover and in their profits. One such sector is the construction industry.

Mr. Speaker, it is my view that the contractors engaged in construction activities, as well as architects and consultants engaged in these activities, can well afford to pay higher rates of turnover tax.

In the case of contractors in the construction industry, the rate of turnover tax is, therefore, being increased from 2% to 3% of the total value of the contract. In the case of architects and consultants, the rate of turnover tax is being increased from the present level of 5% to 10%. The rate for the other professions will remain at 5%.

5. Hotel Sector

Mr. Speaker, the other sector which has enjoyed particularly large increases both in its total turnover and in its profits is the hotel industry. Tourist arrivals have increased rapidly in the last 3 years and hotel owners have increased their room rates sharply because of the increased demand. Room charge increases are far in excess of the amounts warranted by increased costs. The hotel owners have also been given very liberal income tax concessions so that the large profits made by them are not subject to tax periods ranging from five to ten years.

I am confident that hotels can easily pay an increased rate of turnover tax. I, therefore, propose to increase the rate of turnover tax on hotels from the present level of 15% to 20%. The new rate will be made effective from 1st April 1982 in order to give hotels sufficient notice of the change.

Representations have been made that if the higher rate of turnover tax is levied not only on hotel room charges but also on hotel restaurant charges, hotel restaurants would not be able to compete with outside restaurants. I am, therefore, increasing the turnover tax payable by restaurants which are patronized by tourists. Such restaurants are registered with the Ceylon Tourist Board and are given liquor licences on the basis of such registration.

The rate of turnover tax applicable to luxury restaurants will be increased from the present rate of 2% to 10%.

The additional revenue expected from these proposals would be approximately Rs. 25 million.

6. Import duty exemption – Government Departments

Mr. Speaker, I am of the view that the duty exemption which is at present available to government departments and to some corporations on imports made by them should be removed. The removal of the exemption would not, of course, provide the Government with any additional funds, as the duty would appear both on the receipts and expenditure sides of the Budget, but, if government departments and corporations paid normal duties, we would have a more realistic picture of government expenditure and costs of various projects. In addition, potential domestic suppliers of intermediate inputs or of final products would be given a fair chance to compete. At present, contractors for Government who import finished goods for use on contracts can import them duty free, while local suppliers who fabricate products from imported components pay duty. The reduction of duty exemptions will also simplify the administration of customs to a great extent. Finally it will prevent any leakage or avoidance of duty.

Preparations for this change will be made in 1982 and it will be brought into force from 1st January 1983.

C. Excise duties

Mr. Speaker, excise duties on liquor and the tobacco tax have been revised upwards with almost monotonous regularity with every Budget. In spite of the resulting price increases, revenue from liquor and tobacco taxes has continued to grow. After an initial dip in demand immediately following the price increase, demand once again picks up to maintain an upward trend. In view of this, I am proposing the following increases in respect of liquor, cigarettes and beedies.

1. Liquor

The increase in excise duty on liquor with effect from midnight today, will result in the following price increases:

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Molasses arrack	Rs. 3 per bottle
Coconut arrack	Rs. 5 per bottle
Processed arrack	Rs. 10 per bottle
Country-made foreign liquor	Rs. 10 per bottle

In the case of imported liquor, the new turnover tax will increase the price of a bottle of whisky by approximately Rs. 30 and the price of a bottle of brandy by approximately Rs. 35 to Rs. 40.

The additional revenue expected from this proposal is around Rs. 175 million.

2. Cigarettes

Mr. Speaker, I propose to increase the tobacco tax by Rs. 41 per kilogramme, from Rs. 241 per kilogramme to Rs. 282 per kilogramme with effect from midnight today. This increase in tobacco tax will have the effect of putting up the retail prices of all brands of cigarettes by 5 cents per cigarette.

The import duty on raw tobacco will be increased by the same amount so as to equalize the duty incidence.

The additional revenue from this proposal is about Rs. 255 million.

3. Beedies

Mr. Speaker, the price differential between beedies and cigarettes has continued to widen with every Budget, when invariably the price of cigarettes was increased by an increase in the tobacco tax or in the BTT rate, with no corresponding increase in the tax on beedies.

I am, therefore, considering the imposition of an excise duty on beedies, which will bring in additional revenue of around Rs. 70 million. The necessary amendments to the Excise Ordinance to give effect to this proposal will be introduced in Parliament before the end of this year.

4. Beer

Mr. Speaker, the current excise duty on beer amounts to Rs. 12.50 per litre or approximately Rs. 9.40 per bottle of beer. The duty on beer in 1978 was Rs. 4 per litre and was increased to Rs. 6.33 per litre in January 1979 and to Rs. 8.50 per litre in February 1980. Thus, within a space of three years the duty has been pushed up by more than 300%. There is definite evidence that there has been consumer resistance to the high price of beer, which at present is retailed at around Rs. 19 per bottle exforeign liquor shops. The demand for beer, which is not a hard liquor like arrack, has been on the downward trend, mostly due to the sharp increase in prices. I propose therefore, to reduce the duty on beer. The resulting reduction in the price of beer coupled with the proposed increase in the price of arrack would help in weaning people away from the consumption of hard liquor. The excise duty reduction will also encourage the sale of local beer as against imported beer, as no corresponding reduction is being made in the import duty on imported beer.

I propose to reduce the excise duty on beer from its present level of Rs. 12.50 to Rs. 8.50 per litre, which was the level at which it stood before the last increase in November 1980. This should enable the retail price of beer to be reduced by about Rs. 3 per bottle. I expect the increase in consumption to more than offset the effect of the decrease in the rate of duty.

D. Licence tax fees

Mr. Speaker, licence fees and charges for services rendered by various government departments bring in about Rs. 300 million annually to the Government. Most of these fees and charges have not been revised for a long time. I feel that these fees and charges should be revised so as to bring them in line with current costs and prices.

1. Liquor Licence Fees

Mr. Speaker, licence fees on liquor shops and beema salawas are at present collected by the Government Agents and passed on to the local authorities.

I propose that the issue of a licence should, in addition to a licence fee, be subject to a stamp fee as well. The stamp fee will vary, depending on the type of activity for which the licence is issued. Higher stamp fees will be payable in respect of licences within the municipal areas.

The additional revenue from this proposal will be about Rs. 10 million.

2. Stamp duty on cheques

I propose to increase the stamp duty on a cheque from 10 cents to 25 cents. This proposal will yield an additional revenue of Rs. 3 million.

3. Licence fees on Government Vehicles

Mr. Speaker at present there is no licence fee payable on vehicles owned by government departments. I propose that these vehicles should also be liable to licence fees. This would be in keeping with my proposal that government imports be subject to import duties.

4. Fees for Registration of Nursing Homes

Most of the nursing homes in the city as well as in provincial towns are doing well and there is no reason why they should not be called upon to contribute to government revenue. I, therefore, propose that the fee for first registration be increased from Rs. 100 to Rs. 10,000 and that the annual licence fee be increased from Rs. 50 to Rs. 2,000.

5. Other fees and charges

Mr. Speaker, there are a number of services for which fees are charged by the respective government departments under various laws and ordinances which govern the levy of such fees. I propose that the fees charged under the following heads be doubled so as to bring these fees in line with the increased costs of providing these services:

(i) Court fees;
(ii) Audit fees;
(iii) Fees of the Survey Department;
(iv) Fees under the Weights and Measures Ordinance;
(v) Fees under Merchant Shipping Act;
(vi) Fees of the Valuation Department;
(vii) Fees charged for Registration of Companies.

It is expected that the increase in these fees would bring in Rs. 15 million in additional revenue.

6. Revenue licence fees on Motor Vehicles

Mr. Speaker, a new scheme for the licensing, registration and transfer of motor vehicles – to be effective from the licensing year 1982 – will be implemented by the Registrar of Motor Vehicles shortly.

The licence fees as presently levied are based on the age and the tare of the vehicles. There are at present six categories based on the age of the vehicle and ten categories based on the tare. This complicated structure is being simplified by reducing the age categories from 6 to 2 and the tare categories from 10 to 5 for motor cars. In the case of vehicles other than motor cars there will be only 8 categories based on tare and none based on age.

Revenue proposals 1981
Additional revenue

	Rs.Million
Surcharge on income tax and wealth tax	200
Restriction of small company relief	2
Turnover tax on imports and increase in manufacturers' tax	1,290
Increase in turnover tax on banks, finance companies and pawnbrokers	50
Increase in turnover tax on hotels, approved restaurants, contractors, architects and consultants	25
Increase in turnover tax on advertising receipts of newspayers and periodicals	10
Increase in excise duty and turnover tax on liquor	175
Increase in taxes on tobacco	255
Imposition of excise duty on beedies	70
Stamp fees on liquor licences	10
Increase in stamp duty on cheques	3
Revision of fees levied by government departments	15
Increase in licence, registration and transfer fees on motor vehicles	65
	2,170
Less:	
Reduction of import duty on machinery and essential raw materials	200
	1,970

Estimate of expenditure and revenue 1982

		(Rs. Million)	
(i)	Recurrent Expenditure	− 21,114	
	Less: Provision for under-expenditure	+ 450	
			− 20,664
(ii)	Advance Account Receipts		+ 100
			− 20,564
(iii)	Revenue		+ 19,319
(iv)	Current Account Deficit		− 1,245
(v)	Capital Expenditure	− 20,817	
	Less: Provisions for under-expenditure	+ 902	
			− 19,915
	Overall Deficit		− 21,160

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The new scheme has been drawn up with the following objectives in mind:

(a) to increase the total licence fees derived from motor vehicles;
(b) to keep licence fees on very small cars below 15 cwts. in weight low, irrespective of the date of registration, to encourage the use of light cars which are fuel efficient;
(c) to substantially increase the licence fees on cars where the tare exceeds 25 cwts. so as to discourage the use of heavy cars consuming large quantities of fuel;
(d) to reduce the advantage which diesel car owners now enjoy because diesel is sold at a much lower price then petrol.

The new licence, registration and transfer fees will bring in additional revenue of about Rs. 65 million. In anticipation of this additonal revenue, a sum of Rs. 50 million has already been provided in the 1982 Estimate as additional grant to the local bodies for maintenance of roads.

IFA NEWS

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ogy, and that an ancestor of Dr. Carroll, Charles Carroll, had been a signatory of the Declaration of Independence of the U.S.A. (He did not mention the interesting fact that Dr. Mitchell Carroll had been conceived on Greek soil!)

Professor Sbarounis was Director of Direct Taxation at the Greek Ministry of Finance from 1925 to 1935, when he was appointed Director of Studies and Inspection at the Ministry. In 1936 he was appointed Director-General of Taxation (including Customs) when that post was first created. During the German Occupation of Greece he was removed from his post (in 1942) and became Economic Counsellor to the Ministry of Finance. In 1943 he escaped from Occupied Greece and was dismissed from government service by the collaborationist Greek government of Occupied Greece for abandonment of his post. On his arrival in Cairo he was again appointed Director-General of the Ministry of Finance by the Greek Government in exile, led by Tsouderos. After the liberation of Greece in 1944, Professor Sbarounis resumed his post at the Ministry of Finance. In 1944, he was also elected Professor of Public Finance at the Athens School of Economic and Commercial Sciences, which chair he held till 1962, when he was elected Emeritus Professor. During his career after World War II Professor Sbarounis was deputy-governor of the National Bank of Greece, Head of a Greek mission to the U.S.A., a Governor of the World Bank, and represented Greece on many international bodies.

While a considerable part of Professor Sbarounis's career was spent in the stormy years of World War II and the difficult reconstruction period that followed it, he carried out considerable research on taxation in the period between the two world wars. In 1934 he wrote "L'Impôt sur le revenu en Grèce", being an analysis of the three basic laws passed in 1919, on income, on real property, and on successions, as amended thereafter by more than fifty modifications. The period between 1918 and 1934 was not a particularly stable one for Greece. The World War I aftermath included the Asia Minor debacle of the Greek armies and the refugee problems which followed the abandonment of the Greek settlements in Asia Minor. The process of reconstruction in Greece, accompanied by a new law on net wealth and increasing rates of tax, led to considerable discontent amongst taxpayers, baffled by high taxes and retrospective assessments, and by continual tax reforms passed by government after government anxious to change the tax base. Professor Sbarounis analysed this turbulent development, helped by his researches into the various tax systems employed in Western Europe. He concluded that the level of taxation in Greece was excessive, both by reference to the pre-1914 rates and by reference to other tax systems in the Balkans and certain western European systems.

In 1953, before the EEC treaties had come into being, Professor Sbarounis wrote a tract on a "Project for a Turkish-Hellenic customs and economic union". It was a technical study by an economist who saw the dynamic possibilities inherent in an economic union of Greece and Turkey, neither of which had even achieved the benefits of the Industrial Revolution which had invigorated the rest of Europe, and both of which were comparatively undeveloped economies. Writing in 1966 in the "Journal de Genève", Professor Sbarounis wrote despairingly about the failure of Turkey to join with Greece in an association which would enable both countries to harness their converging interests into a profitable union, to bring them both into a prosperous and dynamic future.

One cannot help a final remark: that Professor Sbarounis has been a brave and lonely voice, crying in the wilderness for reason and logic to prevail over turgid emotions and divisive politics.

SWISS BRANCH

On 5 February 1982 a special meeting was held in Basel in which a number of subjects regarding tax harmonization in Switzerland were discussed. These subjects included:

- taxation of families;
- period of assessment;
- capital gains taxation of personal property;
- special problems connected with the taxation of legal entities (including holding and domiciliary companies).

The next regular meeting will be held on 25 June 1982 in Zurich.

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NEPAL:

Budget 1981-82

Extracts from the Budget Speech pronounced on 7 July 1981 by Dr. Y.P. Pant, Minister for Finance

4.1 Honourable Chairman, now I would like to submit additional tax proposals to meet the above deficit. I have taken due care to make the present tax system more effective and efficient. Besides, special emphasis has been laid on the process of making the tax assessment procedure simple, just and practical. I have adopted the policy of increasing revenue to meet the development expenditures not so much by increasing tax rates but mainly by strengthening and improving the tax administration.

4.2 While proposing new taxes for the coming fiscal year, I have paid due attention to the principle of social justice by providing maximum relief to the low income group and small farmers. Similarly, a measure of relief has been provided for the middle income group which has faced hardship due to the rising prices. Efforts have been made to raise more taxes from the higher income group on the basis of the principle of ability to pay. The objective of any tax system is not only to collect maximum revenue but also to create a conducive environment for the production of essential commodities in the country and promote import substituting industries. It is also expected that the tax system should not adversely affect the prices of essential commodities and should facilitate expansion and diversification of international trade. On the basis of these considerations, I have designed the tax proposal for the next fiscal year.

4.3 The new Industrial Policy[1] has been promulgated with a view to accelerate industrial development in the country and also to encourage small entrepreneurs. In order to implement the policy successfully, appropriate rules and regulations will be brought out very soon. The fiscal measures, which I have proposed, aim at creating a sound, healthy and stable industrial atmosphere.

4.4 As I have already mentioned, total expenditure for the next year is higher in comparison to last year. This is necessary to meet the targets of the Sixth Plan. I have adopted the policy of generating maximum revenue from existing taxes and meeting shortfalls by the introduction of new taxes. At present, there is a very limited scope for increasing tax rates.

No significant increase of tax rates

4.5 In fact, further increases in tax rates may, at this stage, lead to evasion only. Therefore, I have specifically emphasized raising the revenue by strengthening and streamlining revenue administration as well as by bringing the potential taxpayers within the tax net. An additional amount of Rs 183.2 million is estimated to be collected from such a policy. I have submitted additional tax proposals only to cover the gap not covered by the extra proceeds resulting from the improvement in tax administration.

Indirect taxation

4.6 Now, allow me to submit indirect tax proposals.

4.7 With a view to ensure the flow of essential goods for the consumption of the common people and to check the price rise of these goods, I propose to reduce import duties on coarse cotton textile, kerosene oil and canvas shoes. Keeping in view the general health of the common people, import duty on all kinds of medicine has been reduced to 1%.

4.8 I want to assure the Honourable Members that His Majesty's Government will ever remain vigilant to ensure regular supply of such commodities and to check the rise in their prices. In this context, the price of kerosene oil has been reduced from Rs. 5.15 to Rs. 4.90 per litre by reducing its import duty, and this, I hope, will provide direct benefits to the consumers.

4.9 I have also tried to establish uniformity and consistency and narrowed the gap in the existing rates of customs duty on various commodities imported from the foreign countries.

4.10 As the Honouable Members are well aware, the year 1981 has been observed as the international year of the disabled ones. Various activities are also being organized for their welfare in Nepal. So, I have exempted fully the duties on all aids and equipment to be used by disabled persons with a view to provide necessary support to them.

4.11 Regarding the facilities provided to the newspapers and magazines, there has been duty exemption in newsprint, and 1% duty on press machines, spare parts and printing. The duty on the film used in block making has also been reduced to only 1%.

4.12 From these arrangements, revenue will decrease by Rs. 9.0 million in the next year.

4.13 However, I have proposed to increase the import duty on some luxurious items such as refrigerators, air conditioners, deepfreezes, motorcars, televisions, video-sets, cosmetic goods etc. Similarly, I have also proposed to raise import duty on woolen yarns, leather shoes as well as synthetic materials and soaps in order to protect the domestic industries.

4.14 Keeping in view the deterioration in ecological balance caused by deforestation and to meet the future domestic demand for fuel, I have raised the duty on the export of wood and allied products. Similarly, the export duty on boulder, gravels and sands has been raised with an objective of discouraging exports and precluding soil-erosion, flood and landslides.

4.15 The above mentioned adjustments in custom duties are given in Schedule No. 1, 2, 3 and 4. The revised rates will be effective from today. An additional revenue of Rs. 95.0 million is estimated to accrue from this adjustment. All other custom duties will be retained as before.

4.16 Concerning excise duties, I have proposed to change the existing duty on some of the commodities, while for some other coomodities, I have introduced new excise duty which will be effective from today.

1.	Sawn timber	Rs. 3 per cubic ft.
2.	Bidi manufactured from all types of tobacco	Rs. 6 per thousand sticks
3.	Cutlery manufactured from stainless steel scraps	Rs. 10 per kg
4.	Bricks	
	a. Made by using electric machines	Rs. 5 per thousand
	b. Made without using electric machines	Rs. 4,500 per annum per kiln
	However, the ordinary bricks made by other local methods are exempted from excise duty	
5.	Iron-rod, strips and sheets	Rs. 0.20 per kg
6.	Assembling industries which use imported spare parts	
	a. Radio and transistor sets up to the value of Rs. 600	3%
	b. Radio and transistor sets valued more than Rs. 600	5%
	c. Two or three-in-one which can be used as tape-recorders, transistors, tape-players, cassette-recorders and any set with two or more functions	15%
	d. Simple tape-recorders and cassette-players	10%
	e. Cassette-tape	
	i. playing up to 60 minutes	Rs. 0.50 per unit
	ii. playing for more than 60 minutes and continuing up to 90 minutes	Rs. 0.60 per unit
	f. All types of watches	3%
	g. Electrically operated heaters, hair-dryers, toasters, cookers, calculators run by power	2%
7.	Beer	Rs. 8.50 per litre

4.17 With a view to provide special incentives to the industries established in remote and hilly areas and to remove the existing regional disparities, I have proposed to introduce 10% rebate on prevailing excise duty to industries established in hilly areas. The mills and factories that pay excise duty on the basis of that rebate will be granted rebate of 2% for timely payment of such duty.

4.18 No excise duty will be levied on products of rural and cottage industries except soft drinks, cigarettes, bidi, catecheu, katha, alcoholic drinks, rice, oil, khandsari, sugar, sawn timber, bricks, stainless steel utensils, machine made furniture, assembling of radio transistors, watches, cassette tape recorders and players, calculators, electric heaters, hair-dryers, toasters, cookers, mixtures, juice-extractors, cassette tapes, zippers and diamond cutting.

4.19 Other adjustments made in excise duty are given in Schedule No. 5. The rest of the excise duties remain unchanged. The proposed changes will bring in Rs. 37.2 million.

4.20 As regards sales tax, three categories of sales tax rates introduced during the current fiscal year have not been changed. However, some minor changes have been made for some commodities on the basis of their use and importance. For example, rates of sales tax on cotton thread, cotton-vest, vehicle spare parts, betel-leaf, betel spices, etc. have been reduced whereas sales tax on timber, lubricating oil, motor cycles, scooters and auto-rickshaws has been increased. No sales tax is levied on products of cottage and rural industries except on those mentioned in the Schedule, This, I believe, will help encourage the rural and cottage industries resulting in increased production and employment. Such changes in rates will generate an additional revenue of Rs. 35.8 million.

4.21 The existing rate of contract tax at 2.5% on all contracts exceeding Rs. 10,000 has remained unchanged since 1965. Now, I propose to increase it to 5% of the contract amount. Such increase may be justified by changing economic conditions, growing investment and the margin of profit in contract business. This will generate an additional revenue of Rs. 26.5 million.

1. Editor's note: See for extracts of the Government's Industrial Policy Plan hereafter.

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Direct taxation

4.22 Now, allow me to switch over to proposals of direct taxes. I do not have to reiterate here the economic hardship which people are facing due to inflation. Espacially, the low and fixed income groups are finding it difficult to maintain their living standard. Hence, I have proposed to raise the tax exemption limit for the next fiscal year up to Rs. 10,000 for individuals and Rs. 15,000 for couples and families. Income tax rates after the exemption limit will, however, remain intact. This will reduce revenue by Rs. 1.6 million.

4.23 On the theoretical level, it is generally agreed that individuals and commercial firms are required to keep proper accounts of their transactions. But failure on their part to maintain or submit proper accounts had led to practical difficulties in assessing taxes. Lack of proper and reliable accounts makes correct tax assessment difficult. Such a situation may give rise to the complaint among taxpayers that they have been unjustifiably overtaxed. This very situation can also lead to tax evasion. In order to encourage the habit of maintaining proper account of the transactions, from the coming year, a 2% rebate will be given to those taxpayers who get their tax assessed on the basis of accounts of their transactions. This is, however, expected to reduce revenue by Rs. 0.4 million.

4.24 That the value of urban land is increasing rapidly due to population pressure is an undisputed fact. Similarly, nobody can deny that people should at least get minimum shelter in the context of rising prices of construction materials. Keeping this in mind, I have proposed the following changes in house and land taxes from the next fiscal year. This, I believe, will give some relief to the owner cum occupier of the house while those who use their house for other purposes will have to bear additional tax burden.

Value of land & building	*Percentage of tax*
First Rs. 100,000	No tax
Next Rs. 100,000	1.0
Next Rs. 100,000	1.5
Next Rs. 100,000	2.5
Next Any Amount	3.5

4.25 But in the case of land and building occupied by the owner himself the tax on additional Rs. 100,000 will be exempted. This proposed change will generate an additional revenue of Rs. 2.1 million.

4.26 Hon'ble members are aware of the fact that the small farmers have been given a rebate of 75% on the payment of land tax. His Majesty's Government has considered to exempt fully those landowners who own up to 1.5 bighas in Terai, 20 ropanis in hilly areas and landowners who own land in those hilly areas where the cadastral survey has not been completed. Under the existing law, land revenue receipt is recognized as the legal document in case of dispute of ownership. Further, the landowners have the traditional habit of regarding revenue receipt as an evidence of ownership of land. Keeping these facts in mind and also to update land records, we have to continue to collect even a nominal amount of land revenue. From the coming fiscal year, I have, therefore, proposed a minimum rate of land revenue with 99% rebate charging only 1% of current rate, as per Schedule. This exemption limit applies to all landowners of the hilly areas where the cadastral survey has not been completed and also to those landowners who hold 1.5 bighas and 20 ropanis in Terai and hilly areas, respectively. While proposing this special rate of land tax for small farmers, due attention has also been paid to the existing denomination of small coins; and, therefore, the lowest rate of 5 paisa has been proposed for the smallest unit of land holding. This measure will definitely benefit the majority of small farmers. The loss in revenue will amount to Rs. 5.0 million.

4.27 In our country, the rate of land revenue is fixed on the basis of the type of cultivated land. The same rate of revenue is being applied to lands which are used for purposes other than agriculture. There can be no differences of opinion that the land revenue rate of residential and commercial lands should be different from that of agricultural land. In view of this, I have proposed a different rate of land tax which will be applicable in the land under town panchayat areas where the cadastral survey has been completed and the land classified under urban areas according to the provision of the Land (Survey and Measurement) Act as per Schedule from the coming fiscal year.

4.28 As the value of land of various town panchayat areas is assessed differently according to Land Survey Act, I have proposed seperate rates of land tax, as specified in the Schedule, for urban areas of Kathmandu Valley, Terai and Hills. Moreover, in these areas of town panchayats where the classification of land has not been completed, the land tax shall be collected at the lowest rate as proposed for sixth grade of land. The effect of this new proposal will yield an additional revenue of Rs. 5.0 million.

4.29 In order to keep updated land records and to discourage the practices of registering land and property in a different district other than where the land and properties exist, an additional 1% registration fee used to be charged. However, this provision could not achieve the desired objective. Therefore, I have decided to raise the above fee from 1% to 5%. This, I think, will assist greatly in maintaining updated records of land and generate an additional revenue of Rs. 3.0 million. Other rates of land revenue and registration fees will be maintained.

4.30 Hon'ble members are aware that in order to mobilise the additional resources for local development, the whole proceeds from local development tax used to be made available to the same district through Local Development Ministry. As the enthusiasm shown by the people in the current year is encouraging, I have proposed to increase local development tax to 10% of land tax. Likewise, in those districts where the cadastral survey has not been completed, a fee of Rs. 1.00 per landowner will continue to be collected. Provision has been made to deposit such proceeds in a separate account of the land revenue office. The district panchayat will directly receive such proceeds from the land revenue offices for development purposes.

4.31 Keeping in view the importance of the tourist industry as an important source of earning foreign exchange, it is necessary to encourage the tourists to prolong their stay. I propose to reduce visa fee to Rs. 75.00 for every week of the first month and to Rs. 150.00 for every week of the second month.

4.32 Besides this, all other fees and taxes remain unchanged. This proposal would yield an additional revenue of Rs. 197.5 million. Likewise, the strengthening of revenue administration and its reforms is expected to increase revenue by Rs. 183.2 milion. The net deficit would thus be Rs. 825.1 million, out of which Rs. 500,0 million and Rs. 325.1 million will be met from internal loans and cash balance respectively.

4.33 In my view the deficit financing will have no adverse impact on the economy. Because of the favourable monsoon, and our firm commitment to launch development programmes in the form of campaigns, I am fully confident that the agricultural and industrial production will increase substantially. In addition to this, all financial functions from disbursement to internal audit will be decentralized at the district level in order to strengthen financial management. Similarly, I have made special provision of funds for capital and operating capital for smooth implementation of projects. Special attempts have been made to curtail the expenditure for unproductive activities. Particular attention has also been paid to maintain strict financial discipline. Some monetary measures will be undertaken to control unproductive loans advanced by commercial banks.

4.34 While presenting the budget for the current year, I had proposed for some facilities to the Government employees to maintain their living standard and overcome difficulties arising from rising prices. Under a similar note I have made provisions for the following facilities to be provided from the coming year.

4.35 I would like to propose a pay increase of Rs. 100/- to all non-gazetted employees (including peons), Rs. 150/- to gazetted class III and II and Rs. 200/- to all those who are above them in rank. All the government employees, including civil, military and police personnel, will benefit from this provision. This arrangement will increase the basic salary of peons, section officers and the special class officers by 66.6%, 25% and 12.3%, respectively. This will incur an additional expense of Rs. 150.0 million. I would like to inform the House that this increase in pay scale is in consideration of the difficulties faced by the fixed and low income groups.

4.36 In addition, the following facilities are also provided to the employees.

4.37 Pension, which has been paid as a fixed amount so far, will henceforth match with the increase in the level of salary. As a result of this provision, after their retirement, civil servants will derive additional benefit on the basis of the salary which they will have been drawing at the time of their retirement. Gratuity has also been increased.

4.38 The maximum amount of pension has been increased to Rs. 912.50 from the existing level of Rs. 750.00. The minimum amount of pension has also been increased from Rs. 42.00 to Rs. 55.00 per month. On the demise of a pensioner, half of the pension drawn by him will be provided for his wife up to a period of ten years. It is also essential that there should be appropriate change in the rates of travel allowances. Accordingly, the daily allowances have been increased from 36% to 60% for internal travel. Daily allowance in respect of foreign travel has also been increased.

4.39 Medical facilities of the employee have been changed. Gazetted employees will henceforward get medical benefits equivalent to 12 months. Thus, the benefit of 3 extra months' salary will be available to them. Similarly, non-gazetted class I employees will get the equivalent of 18 months' salary instead of 15 months and the rest of the non-gazetted staff will get medical benefits equivalent to 21 months' salary instead of 18 months as at present.

4.40 Taking into consideration the price increase all over the world and difficulties faced by the members of our foreign missions including mission heads, foreign allowance has been increased. The allowance of low level employees of this category has been increased up to 121.73%. Similarly, the salary of the local level employee has also been increased up to 68%. Additional financial liability of about Rs. 20 million has to be incurred becuse of such provisions.

4.41 Taking into consideration the problems and difficulties faced by the government employees, arrangement has been made to constitute a pay commission to study and submit report to His Majesty's Government with respect to pay, allowances, pensions, gratuity and foreign allowances.

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NEPAL:

Industrial Policy Plan 1981

Extracts of the most significant parts of the Industrial Policy Plan 1981 presented by the Nepalese Government

OUTLINES OF THE POLICY

Objectives

– To encourage private sector industrial investment as an element in the growth of gross national product.
– To open up gainful employment opportunities in the industrial sector for a labour force excessively dependent on agriculture.
– To attain self-reliance in the production and supply of essential consumer goods and most construction materials.
– To maintain regional economic balance.
– To increase the output of and attain quality improvements in currently manufactured articles.
– To improve the balance-of-payment position through increased exports and more import substitution.
– To enhance entrepreneurial, managerial and technical capabilities as a means of assisting the development of industrial organizations.
– To develop indigenous technologies and to import such appropriate technologies as will contribute to industrial productivity.

Major policies of interest to foreign investors

– All industries, except those which are defence-oriented, will be open for private sector ownership and investment.
– Existing industrial enterprises will be given incentives to improve their operational efficiency, to consolidate their position and to embark upon expansion programmes.
– The private sector will be given the first opportunity of promoting the development of industry through investment. Only if the private sector does not respond to meet the investment programme, will HMG/Nepal and agencies of government intervene by way of public investment. Even under these circumstances, HMG will pursue a policy of disinvestment in favour of the private sector as and when the climate for this appears to be appropriate.
– As a principle, HMG/N will not establish industrial enterprises under its ownership except when large scale investment is involved and private sector investment is inadequate. HMG/N will, however, take the initiative itself by financing cottage, small and medium scale pilot projects in order to stimulate private sector investment.
– Foreign investment will be encouraged in order to promote capital inflow, generate technical expertise and improve productivity. It may take the form of totally foreign owned enterprise or joint Nepalese-foreign investment. HMG/N will establish the priority areas for such foreign investment.
– Relevent technology will be imported taking account of the soci-economic situation of the country and the rate at which new methods and concepts can be absorbed. When appropriate, new techniques and processes will be identified and developed, and will not be limited to improvements on the traditionnal arts and crafts.
– Adminstrative procedures concerned with the establishment of industrial enterprises wil be simplified and made more efficient.
– Tax and other incentives will be clearly defined and specified to avoid any administrative ambiguities.
– Ownership of and investment in cottage and small industries will be reserved for Nepalese nationals only.
– Foreign investors will be permitted to have majority shareholding in medium scale enterprises. In the case of large scale enterprises, only, the foreign investment may amount to one hunderd percent.
– The principle of engaging Nepalese nationals will be followed when employing unskilled, semi-skilled and skilled labour and most other categories of employee. If circumstances demand, foreigners may be employed for a period of seven years, at the most, with the approval of HMG. The Nepalese nationals should be given appropriate training so that they can replace the foreigners within this period. If, however, specialists are not readily available within Nepal, an enterprise may continue to employ the foreigners for an additional period of five years.
– Enterprises will continue to enjoy such incentives and facilities for the period specified as are provided in the current Act without let or hindrance, notwithstanding the amendments incorporated in the present Act.
– While setting up new industrial enterprises and/or expanding, modernising and diversifying the existing ones, effective ways and means will be adopted to preventing or minimising environmental pollution.
– Industrial enterprises will not be nationalised except in special circumstances, in which case the owners will receive compensation based on a just evaluation of the net worth of the enterprises.
– Steps will be taken to establish an Export Promotion Zone with a view to the effective mobilisation of resources needed to develop and promote specified export industries.
– The mechanism relating to official guarantees for foreign loans will be institutionalised and streamlined.
– Import duty and sales tax paid against the importation of raw materials, auxiliary materials and chemicals will be reimbursed to the HMG-recognised export industries. Such reimbursement will be in proportion to the value of imported materials used in the manufacture of such exports.
– HMG will frame and enforce rules and regulations pertaining to patents, trade marks and designs.

FACILITIES AND INCENTIVES

Income tax concessions

(a) Cottage industrial enterprises, except those mentioned in Schedule 1 will be granted 100% tax exemption for a period of six years.

(b) Manufacturing industrial enterprises, smal, medium or large, will be granted income tax exemption as follows:
   1. 100% exemption for 5 years if the value added is between 20% and 50%.
   2. An additional one year's exemption for every 10% increase in the value added above 50%.

Value added: is defined as the ratio of net domestic annual operating costs and expenses (left after deducting all foreign costs such as imported raw materials, expatriates' salary, wages, fees, etc., depreciation of the imported assets) to the total annual operating costs and expenses.

(c) An additional 2 years' income tax exemption will be given to enterprises which produce essential consumer goods.

(d) If an enterprise exports more than 25% of its total annual production, 15% rebate will be granted on the income tax levied for that year. Similarly 25% rebate will be applicable if any enterprise exports more than 50% of its total production in one year.

(e) Energy-based and mining and mineral processing enterprises will be entitled to six years' tax holiday from the date of operation. Such industrial enterprises having more than 25% value added in each year will enjoy an additional six years' tax holiday.

(f) Five to seven years' tax holiday will be granted to new tourism enterprises, depending on the locations designated for the purpose.

(g) Service enterprises will not generally be granted tax exemption, but the following will be entitled to three years' tax holiday:
   - workshops producing spare parts, tools and other end-use articles with the help of automatic or semi-automatic machinery (lathe, shaping and milling machinery);
   - large warehouses;
   - cold storage;
   - hospitals, x-ray clinics equipped to render specialized services;
   - large rental apartments;
   - printing presses;
   - trolley-bus and water transport services.

(h) Industrial enterprises established in the Export Promotion Zone will be granted an initial ten years' tax holiday followed by 50% rebate on income tax for the next five years.

(i) Agro-based special industrial enterprises will be exempted from income tax for a period of 10 years.

(j) Enterprises located in the areas designated as backward by HMG shall be entitled to 3 years' tax holiday in addition to those enjoyed by similar enterprises established elsewhere.

(k) The start-up date of production or providing service will be used for the purpose of computing the period of income tax exemption.

SCHEDULE 1

Industries not entitled to income tax exemption

1. Traditional rice, oil, dal (pulse), and flour mills.
2. Saw-mills
3. Bidi, cigarettes, cigars and other tobacco-based industries.
4. Distilleries and breweries producing alcoholic beverages including chhang.
5. Catechu extraction.
6. Furniture manufacture.
7. Zip fastener manufacture.
8. Enterprises producing stainless steel utensils and other articles.
9. Laundries.
10. Ice and ice cream producers.
11. Photographic services.
12. Other industrial enterprises designated, from time to time, by HMG as not entitled to income tax exemption.

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(l) If an operating enterprise expands its originally licensed capacity by more than 50%, an investment allowance to an extent of 15% of the new investment will be granted and can be claimed within a maximum period of 7 years.

(m) Expenses incurred on training (recognised by the Department of Labour, HMG) with a view to providing employment for and upgrading the skills of Nepalese workers will be regarded as an item of operating expense, and such an expense will rank as a tax credit. The tax credit allowed for this purpose will be subject to a maximum of 1% of the total annual sales revenue.

Customs facilities

(a) Import duty at the rate of 1% only will be levied on (a) machinery used directly in the construction and operation of an enterprise (b) mining and related conveying equipment and (c) spare parts and tools. The entitlement of an enterprise to total exemption or a rate reduced below 1% is not affected by this clause.

(b) Import duty of 1% only will be levied on raw materials, auxiliary raw materials and chemicals to be used in the production, mixing, blending and processing. But if the duty applicable to such materials is below 1% or the enterprise is totally exempted, it will retain the preferential rights.

Notwithstanding anything mentioned in subclause (b) above, the raw materials, auxiliary materials and chemicals will be subject to duties currently in force if the enterprises which import them fall under the schedule designated by HMG.

(c) If these raw materials, auxiliary materials and chemicals of suitable quality are readily available within the country, an enterprise importing supplies of the same materials will pay an additional 15% customs duty.

(d) imports by industrial enterprises for their own use, by HMG, semi-government agencies, cooperatives or by the designated public limited companies will be subject to customs duties as specified in (a), (b) and (c) above. The appropriate agency of HMG will monitor the quanity of such imports and their use.

(e) Assembly enterprises which are established outside the Export Promotion Zone and whose products have more than 20% value added, will pay 25% less than the rate of duty normally applicable on the parts and components imported, provided that the imports are for their own manufacturing operations.

(f) Enterprises established in the Export Promotion Zone will be liable for only 1% import duty (a) on the machinery to be used in construction and operation (b) on spare parts and tools and (c) on raw materials, auxiliary materials, and chemicals to be used in the production, processing, mixing and blending operations. Duty paid on these items in excess of 1% will be refunded.

(g) Products manufactured in Nepal, except those designated by HMG under the relevant provisions of the current law, will not be subject to any export duty. Designated products of the kind referred to above will be promulgated after consultation with the appropriate Ministry of HMG.

(h) If manufacturers who export their products have previously paid more than 1% import duty on raw materials, auxiliary materials and chemicals, such duty paid in excess of 1% on the quantity of these materials used in the manufacture of the goods exported will be refunded.

SCHEDULE 2

Customs duties at rates currently in force, shall be levied on raw materials, auxiliary materials and chemicals imported by industrial enterprises to manufacture the following products:

1. Precious stones and jewels.
2. Stainless steel utensils.
3. Synthetic yarn and synthetic textiles.
4. Zip fasteners.
5. Acrylic yarn.
6. Photographic articles.
7. Other items notified by HMG from time to time.

(i) If the machinery, spare parts, raw materials, auxiliary materials and chemicals are supplied by domestic manufacturing enterprises to those established in the Export Promotion Zone, such supplies will be treated as exports from the viewpoint of duty concessions.

(j) In relation to tourism industry/enterprises, customs duty will be levied at 1% only, on imported items used directly, except those notified from time to time by HMG in its Gazette.

Excise duty concessions

(a) Cottage industrial enterprises will be exempt from excise duty for 5 years from the date of commencement of operations.

(b) Small, medium and large industrial enterprises will be exempt from excise duty for 3 years from the date of commencement of operations. However, no exemption will be granted to those industry categories listed under Schedule 3.

(c) Industrial enterprises established in the backward regions will be entitled to 5 years' exemption in addition to that applicable for similar enterprises located elsewhere.

(d) Manufactured goods supplied to the enterprises established in the Export Promotion Zone or exported abroad will be exempted from excise duty.

SCHEDULE 3

Industrial products not entitled to excise and sales tax exemption

1. Traditional rice mills, oil mills, flour mills, dal (pulses) mills.
2. Stainless steel products
3. Zip fasteners.
4. Precious stones and jewellery.
5. Catechu and tanin.
6. Cigarettes, bidis, cigars, chewing tobacco, snuff and other tobacco products.
7. Alcoholic beverages produced by distilleries except those distilled from fruits in the backward region.
8. Cosmetics.
9. Liquid petroleum gas.
10. Crowns, corks, etc.
11. Saw-mills.
12. Assembly industries (watch, radio, tape-recorder, cassette and calculator).
13. Acrylic yarn.
14. Other industrial products designated from time to time by HMG through notification.

(e) Excise duty will be waived totally on products manufactured in the Export Promotion Zone.

Sales tax concessions

(a) Sales tax will not be levied on the products of cottage industry.

(b) Sales tax will not be levied on imports of (a) machinery used directly in the construction and operation of an enterprise, (b) mining and related conveying equipment, (c) spare parts and tools, and (d) raw materials, auxiliary materials and chemicals.

(c) Where sales tax is already paid on the raw materials, auxiliary materials and semi-processed materials purchased, manufacturers using such materials will be exempt from sales tax on the proportion of the taxed materials used in manufacturing.

(d) Domestic products exported abroad or supplied to the enterprises within the Export Promotion Zone will have sales tax exemption to the extent of such export or supply. Sales tax exemption will not apply, however, to products listed in Schedule 3.

Concessions on electricity charges

(a) Royalties will not be charged on power generated by industrial enterprises for their own use.

(b) Royalties will be imposed on the basis of actual public sale of electric power by generating industrial enterprise.

(c) In distributing electric power from public supply mains, first priority will be given to industrial enterprises.

Concessions on interest rates

Industrial enterprises established in the backward regions shall pay interest at a rate 2% lower than others of similar status located elsewhere.

Concessions on urban property tax

Land and buildings which are essential for the operation of manufacturing and energy-based enterprises and are owned by such enterprises themselves will be exempt from urban property tax for a period of 10 years. Such exemption will be applic-

REVENUE RECEIPTS*
In millions of rupees

	During the first nine months of FY		
	1978/79	1979/80	1980/81
Tax revenue	955.4	934.6	1317.0
Customs duties	416.1	370.3	562.2
Exports	(36.8)	(40.8)	(35.3)
Imports	(351.1)	(305.3)	(485.3)
Indian excise refund	(24.9)	(23.6)	(39.9)
Miscellaneous	(3.3)	(0.6)	(1.7)
Excise	132.9	149.4	163.9
Sales tax	241.3	261.2	381.8
Income tax	51.3	38.0	51.2
Other taxes	56.2	46.9	62.9
Land revenue	21.8	27.3	44.4
Registration	35.8	41.5	50.6
Non-tax revenue	207.2	224.0	226.0
Forest	25.3	47.1	57.3
Interest and dividend	72.6	78.9	48.1
Miscellaneous	109.3	98.0	120.6
Total	1162.6	1158.6	1543.0

* *Source:* Main Economic Indicators, Nepal Rastra Bank, Research Department, Kathmandu, Nepal. Monthly Report, May 1981.

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able to the following types of premises: factory building, labour and staff quarters, godowns, administrative buildings, clinics, recreation halls and canteens.

Convertible foreign exchange facility

Subject to the prior approval of HMG, convertible foreign exchange shall be provided to industrial enterprises on the basis of economic merit, for the following:

(a) The import of machinery, spare parts, tools and implements, other capital goods, raw materials, auxiliary materials and chemicals which are directly used in the industrial enterprise.

(b) Technical consultancy, technical assistance, service charges, management fees, patent fees, investment promotion, market studies, sales promotion, etc.

Protection

HMG may provide protection to industrial enterprises for a definite period, by means of quantitative restrictions on imports or by higher import tariffs if such a policy is justified on economic grounds, financial conditions, or a time requirement to improve quality and price competitiveness.

PROVISIONS RELATING TO FOREIGN INVESTMENT

– Foreign investment in industrial enterprises will be welcomed on the grounds of obtaining access to desirable technology, expansion of export markets, higher management standards and an increase in employment opportunities.
– Foreign investment will be limited to medium and large industrial enterprises. The investor may be a government, firm, individual, company or an international institution.
– An industrial enterprise financed by foreign investment must be incorporated as a limited liability company in Nepal. Foreign investment is allowed up to majority holding in the medium and 100% in the large industrial enterprises.
– If a foreign investor makes an equity investment in a Nepalese industrial enterprise, in convertible foreign currency, 100% of the dividend may be remitted in convertible currency, whether the enterprise is jointly or severally owned.
– If a foreign investor invests in shares in terms of convertible foreign currency, such shares may be sold only after an enterprise has commenced operation. Repatriation of capital will be at the rate of 20% of the sales proceeds of the shares each year up to the limit of the total investment made in convertible currency.
– If a foreign investor has invested in a Nepalese public limited company and has sold shares through the Nepalese Security Marketing Centre, the sales proceeds may be remitted in convertible currency at the maximum annual rate of 25% of the original total investment made in convertible currency.
– Managerial and technical experts who have been engaged, with the prior approval of HMG and who belong to countries where convertible currency is freely exchanged, can remit, in convertible currency, up to 75% of earnings generated by way of salary and allowances.
– Industrial enterprises with foreign equity participation will not be nationalised except in special circumstances, in which case compensation will be paid to investors on the basis of a just valuation of the net worth of the enterprise.
– If an industrial enterprise, having foreign investment, goes into liquidation, a foreign investor can repatriate his share of proceeds of sale of assets in convertible currency under the Nepal Company Act. No taxes will be levied on such amounts.
– HMG or its designated agency will stand guarantee on long-term loans under prescribed terms and conditions.
– Provision will be made through institutionalised procedures to facilitate a simple, smooth and integrated approach to foreign investment, joint ventures and arrangements for the guarantee of long-term loans. The Department of Industry will be the focal point and will be responsible as such for liaison in all these matters.

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(B. 103.557)

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Dharmendra Bhandari:

Die Besteuerung als ein Element des Fortschritts: Die Körperschaftsteuer in Japan 99
Der Verfasser untersucht das japanische Körperschaftsteuersystem, wobei er das hauptsächliche Augenmerk auf die Anreize richtet, die den Unternehmen zur Verfügung stehen. Er kommt zu dem Schluss, dass das japanische Steuersystem Bestimmungen enthält, die auch in anderen Ländern mit Gewinn zur Anwendung kommen könnten.

D. Hund:

Die Entwicklung der Doppelbesteuerungsabkommen unter besonderer Berücksichtigung der Besteuerung der internationalen Luftfahrtgesellschaften 111
(Ansprache, die am 15. und 16. Februar 1982 in Salzburg anlässlich des IATA – Steuerseminars gehalten wurde)
Die Besteuerung der Gewinne aus dem Betrieb von Luftfahrzeugen hat von Anfang an einen besonderen Platz bei den Doppelbesteuerungsabkommen eingenommen. Der Verfasser zeight die historische Entwicklung auf und kommt zu der Schlussfolgerung, dass die internationale Luftfahrt mit möglichst wenigen steuerlichen Hindernissen konfrontiert werden sollte und dieser Grundsatz auch allgemein anerkannt ist. In der Praxis sollte dies darauf hinauslaufen, dass die Besteuerung ausschliesslich dort stattfindet, wo die Luftfahrtgesellschaften ihren Hauptsitz haben.

Frank J Schuchat:

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Der Verfasser beschäftigt sich mit den Bestimmungen des Economic Recovery Tax Act (Steuergesetz zur wirtschaftlichen Erneuerung), nach denen Gesellschaften mit "überschüssigen" Steueranrechnungs- und Abschreibungsbeträgen diese an andere Gesellschaften gegen Entgelt übertragen können.

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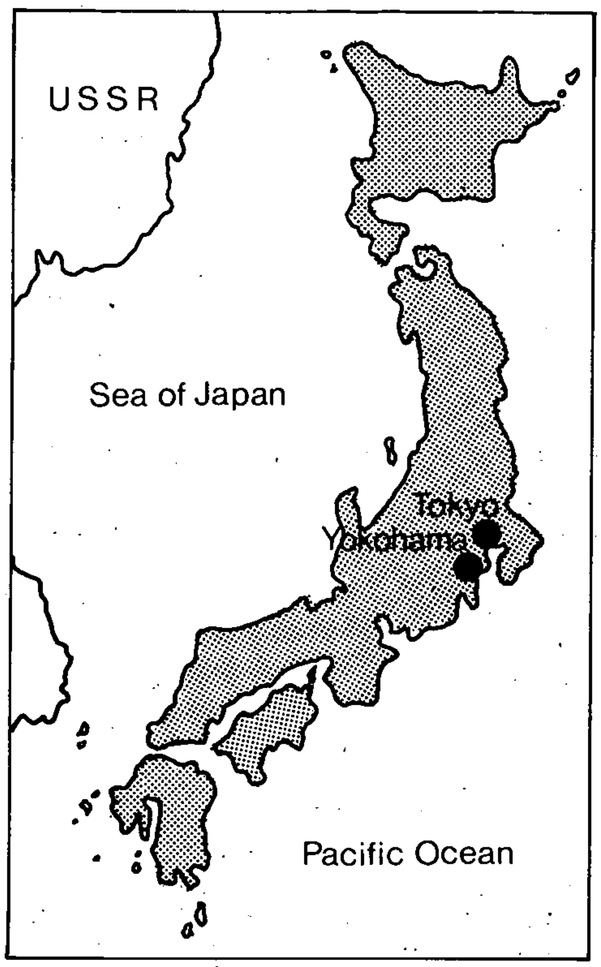
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TAXING FOR DEVELOPMENT:

Corporate Taxation in Japan

by Dharmendra Bhandari *



I. GENERAL

Japan has few mineral resources, has to import almost all its raw material and food, and still has the second largest economy in the non-Communist world (after the United States). Its economy grew faster than that of any other country in the world during the 1960s and its economic growth has been largely based on manufacturing exports. Economists predict that at the present rate of economic growth, Japan will overtake the United States in the next decade to be the leading economic super power.

Countries	*Real GNP growth rate* 1979	1980	1981
Japan	5.9	5	4
United States	3.2	–0.75	0.75
West Germany	4.5	1.75	–0.25
Great Britain	1.6	–2.25	–2
OECD average	3.3	1	2

Source: (i) Based on OECD Economic Outlook No. 28, December 1980.
(ii) Figures for 1980 are expected performance while those of 1981 are future projections.

Today, Japan accounts for 10% of the world's Gross National Product, even though it has 3% of the world's population and 0.3% of the world's land (of which only 15% is arable). A comparison of the percentage increase over the previous years of the real gross national product with the industrially advanced countries of the West will illustrate Japan's outstanding economic performance.

II. INTRODUCTION

The corporate tax policy of Japan is based upon the principle of reducing the effective rate of tax through various tax deductions and exemptions to encourage economic growth.

One significant measure, which was specifically aimed at encouraging exports prior to its amendment in 1964, was the total exemption of export income from taxable income. This measure had to be terminated when Japan became a full fledged member of the International Monetary Fund by accepting Article VIII of the IMF provisions. Japanese Corporate Tax Law, while terminating the tax exemption for export income, introduced new tax measures aimed at encouraging exports by providing a wide range of relief through depreciation, reserves and incentives. (These are discussed in detail later on.)

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Article VIII
General Obligations of Members

Section 1. ***Introduction***

In addition to the obligations assumed under other articles of this Agreement, each member undertakes the obligations set out in this Article.

Section 2. ***Avoidance of restrictions on current payments***

(a) Subject to the provisions of Article VII, Section 3(b) and Article XIV, Section 2, no member shall, without the approval of the Fund, impose restrictions on the making of payments and transfers for current international transactions.

(b) Exchange contracts which involve the currency of any member and which are contrary to the exchange control regulations of that member maintained or imposed consistently with this Agreement shall be unenforceable in the territories of any member. In addition, members may, by mutual accord, cooperate in measures for the purpose of making the exchange control regulations of either member more effective, provided that such measures and regulations are consistent with this Agreement.

Section 3. ***Avoidance of discriminatory currency practices***

No member shall engage in, or permit any of its fiscal agencies referred to in Article V, Section 1 to engage in any discriminatory currency arrangements or multiple currency practices, whether within or outside margins under Article IV or prescribed by or under Schedule C, except as authorized under this Agreement or approved by the Fund. If such arrangements and practices are engaged in at the date when this Agreement enters into force, the member concerned shall consult with the Fund as to their progressive removal unless they are maintained or imposed under Article XIV, Section 2, in which case the provisions of Section 3 of that Article shall apply.

Section 4. ***Convertibility of foreign-held balances***

(a) Each member shall buy balances of its currency held by another member if the latter, in requesting the purchase, represents:

(i) that the balances to be bought have been recently acquired as a result of current transactions; or

(ii) that their conversion is needed for making payments for current transactions.

The buying member shall have the option to pay either in special drawing rights, subject to Article XIX, Section 4, or in the currency of the member making the request.

(b) The obligation in (a) above shall not apply when:

(i) the convertibility of the balances has been restricted consistently with Section 2 of this Article or Article VI, Section 3;

(ii) the balances have accumulated as a result of transactions effected before the removal by a member of restrictions maintained or imposed under Article XIV, Section 2;

(iii) the balances have been acquired contrary to the exchange regulations of the member which is asked to buy them;

(iv) the currency of the member requesting the purchase has been declared scarce under Article VII, Section 3(a); or

(v) the member requested to make the purchase is for any reason not entitled to buy currencies of other members from the Fund for its own currency.

Residential status

All corporate taxpayers are classified as either domestic or foreign corporations. A domestic corporation is a corporation having its head office in Japan. A foreign corporation is a corporation other than the domestic corporation. Thus, a corporation whose head office is registered in a country outside Japan would be a foreign corporation, even if its main place of business is located in Japan. Domestic corporations are taxed on world-wide income while foreign corporations are taxed only on Japanese-source income.

The entities subject to corporate tax are:

(i) ordinary corporations (a joint stock company, limited company, other companies, etc.);

(ii) corporations in public interest, such as incorporated associations, foundations, etc.;

(iii) cooperative associations, such as agricultural cooperative associations, small enterprises cooperative associations, etc.;

(iv) non-juridical organisations with designated representatives or managers.

III. TAXABLE INCOME

Paragraph 1 of Article 22 of the Corporation Tax Law provides that the amount of income for each accounting period of a domestic corporation is the receipts for the accounting period concerned less the expenses for the same accounting period.

Paragraph 2 of Article 22 of the Corporation Tax Law provides that the amounts to be included in the receipts for the accounting period concerned in computing the income of a domestic corporation are, unless otherwise provided, the receipts derived from sales of assets, transfer or furnishing of assets or services, whether for a consideration or not, acquisition of assets by gratuitous transfer and any other transactions other than capital transactions, etc.

Paragraph 3 of Artricle 22 of the Corporation Tax Law provides that the amounts to be included in the amount of expenses for the accounting period concerned in computing the income for each accounting period of a domestic corporation are, unless otherwise provided:

(1) cost of sales, cost of completed work and similar costs corresponding to receipts for the accounting period concerned;

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Section 5. ***Furnishing of information***

(a) The Fund may require members to furnish it with such information as it deems necessary for its activities, including, as the minimum necessary for the effective discharge of the Fund's duties, national data on the following matters:

(i) official holdings at home and abroad of (1) gold, (2) foreign exchange;
(ii) holdings at home and abroad by banking and financial agencies, other than official agencies, of (1) gold, (2) foreign exchange;
(iii) production of gold;
(iv) gold exports and imports according to countries of destination and origin;
(v) total exports and imports of merchandise, in terms of local currency values, according to countries of destination and origin;
(vi) international balance of payments including (1) trade in goods and services, (2) gold transactions, (3) known capital transactions, and (4) other items;
(vii) international investment position, i.e., investments within the territories of the member owned abroad and investments abroad owned by persons in its territories so far as it is possible to furnish this information;
(viii) national income;
(ix) price indices, i.e., indices of commodity prices in wholesale and retail markets and of export and import prices;
(x) buying and selling rates for foreign currencies;
(xi) exchange controls, i.e., a comprehensive statement of exchange controls in effect at the time of assuming membership in the Fund and details of subsequent changes as they occur; and
(xii) where official clearing arrangements exist, details of amounts awaiting clearance in respect of commercial and financial transactions, and of the length of time during which such arrears have been outstanding.

(b) In requesting information the Fund shall take into consideration the varying ability of members to furnish the data requested. Members shall be under no obligation to furnish information in such detail that the affairs of individuals or corporations are disclosed. Members undertake, however, to furnish the desired information in as detailed and accurate a manner as is practicable and, so far as possible, to avoid mere estimates.

(c) The Fund may arrange to obtain further information by agreement with members. It shall act as a centre fore the collection and exchange of information on monetary and financial problems, thus facilitating the preparation of studies designed to assist members in developing policies which further the purposes of the Fund.

Section 6. ***Consultation between members regarding existing international agreements***

Where under this Agreement a number is authorized in the special or temporary circumstances specified in the Agreement to maintain or establish restrictions on exchange transactions, and there are other engagements between members entered into prior to this Agreement which conflict with the application of such restrictions, the parties to such engagements shall consult with one another with a view to making such mutually acceptable adjustments as may be necessary. The provisions of this Article shall be without prejudice to the operation of Article VII, Section 5.

Section 7. ***Obligation to collaborate regarding policies on reserve assets***

Each member undertakes to collaborate with the Fund and with other members in order to ensure that the policies of the member with respect to reserve assets shall be consistent with the objectives of promoting better international surveillance of international liquidity and making the special drawing right the principal reserve asset in the international monetary system.

(2) selling expenses, general and administrative expenses and other expenses (excluding expenses other than depreciation expenses, liability for which is not ascertained before the end of the accounting period concerned);
(3) losses for the accounting period concerned accruing from transactions other than capital transactions, etc.

Paragraph 4 of Article 22 of the Corporation Tax Law provides that the amount of receipts for the accounting period concerned as provided for in paras. 2 and 3 must be computed in conformity with fair accounting standards.

Further, paragraph 5 of the same Article provides that the term "capital transactions, etc." as used in paras. 2 and 3 is defined as transactions increasing or decreasing the amount of stated capital, etc. of a corporation or the distribution of earnings or surplus.

Exempt income

Items excluded from gross revenue in computation of taxable income are:

(1) *Dividends received:* Where a corporation (domestic or branch of a foreign corporation) receives dividends from a domestic corporation, taxable dividends are computed by deducting from the gross dividends the interest paid by the corporation on borrowed funds, in the ratio of the average book value of the shares concerned to the average total assets.

This exemption is not available if the relevant shares were acquired within one month prior to the end of the accounting period of the distributing company and sold within 2 months after the end of the accounting period. Where the dividends received, minus interest, exceed dividends paid out by the corporation, then 25% of the excess is included in taxable income. However, this inclusion does not apply to branches of foreign companies.

If may also be mentioned that dividends received from *foreign* corporations are not exempt. However, credit for taxes is given in double taxation treaties, which Japan has concluded with other countries.

(2) *Appreciation in value:* Appreciation in value is not included in income even if a corporation increases the value of the asset in its books. However, appreciation in value is recognized as income when entered in the books at the times of corporation reorganization and also in

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cases of revaluation of stock held by insurance corporations. Depreciation, however, cannot exceed the actual cost of the asset.

(3) *Tax refund:* Refunds of corporation tax, corporate inhabitant tax, etc. are not deductible as expenses.

(4) *Profit from consolidation or merger:* If a surplus accrues to an existing corporation after amalgamation or merger, the part of the surplus consisting of retained earnings of the amalgamated or merged corporation will not be included in gross income.

Non-deductible expenses

Items not deductible in computation of taxable income are:
(1) Certain taxes such as corporation tax, prefectural inhabitants tax, penalties, fines, etc.
(2) Capital expenditure which lengthens the useful life of fixed assets or increases their value.
(3) Certain amount of contributions or donations except for contributions to national or local government, or public welfare organizations, etc.
(4) Remuneration and retirement allowances of directors in excess of a reasonable amount or bonus paid to directors.
(5) Expenses not supported by vouchers, and also social and entertainment expenses in excess of the specified limit.
(6) A write-down in the value of assets except in the event of damage due to disaster or obsolescence in the case of inventories or fixed assets or substantial decline in the price of listed shares.

Deductible expenses

Normally, all necessary and reasonable expenses and costs may be deducted from gross income in order to arrive at net income.

(1) *Taxes:* Certain taxes such as excise taxes, interest tax on various national and local taxes, foreign taxes to which the foreign tax credit system is not applied for domestic corporations and enterprise taxes are deductible in computing taxable income.

(2) *Salaries, wages and pensions:* Salaries and wages paid to employees of a corporation are deductible. Pensions paid to former employees are also deductible as are retirement allowances paid to employees.

(3) *Bonuses:* Bonuses paid to employees are deductible but not if paid to directors. In the case of a person who is both a director and an employee, only that portion attributable to his status as employee is deductible.

(4) *Social insurance premiums:* Social insurance premiums, payment to employees' pension funds and similar payments by a corporation are deductible.

(5) *Entertainment expenses:* Entertainment expenses are deductible only to the extent considered reasonable by the tax authorities. Such expenses must be for the purpose of the business and supported by vouchers. Further, 90% of the excess of entertainment expenses over the fixed amounts cannot be deducted. The fixed amount is calculated as follows:

Corporations with capital of ¥ 10 million or less	¥ 4 million
Corporations with capital over ¥ 10 million but less than ¥ 50 million	¥ 3 million
Corporations with capital over ¥ 50 million	¥ 2 million

If the expenses for the current period are greater than 105% of that of the preceding period, such excess is disallowed. If it is less than that of the preceding period, however, the full amount, subject to the limit stated above, is deductible.

(6) *Contributions:* Contributions are generally not deductible except when made to
(a) national and local governments: fully deductible;
(b) public interest corporations, etc.: up to double the limit stated in (c) below;
(c) other contributions including contributions to political or religious organizations or societies: deductible up to half the total of 2.5% of profits plus 0.25% of capital.

(7) *Bad debts:* Bad debts may be deducted if:
(a) there is a reconstruction scheme, special settlement agreement or composition admission under legal procedures, etc.; or
(b) it is impossible to recover all the amount of debt because of insolvency; or
(c) business dealings have been suspended for more than a year; or
(d) the cost of collecting the debts will be more than the amount of debts.
For reserve for bad debts, see V. Reserves.

(8) *Deferred expenses:* Such expenses as are properly chargeable to capital account and recoverable by means of amortization over a period of more than one year are known as deferred expenses. Some of the significant manners of treating deferred expenses are explained below:
(a) deferred expense of less than ¥ 100,000 per item is deductible in the year in which it is incurred;
(b) the following specified deferred expenses may be expensed in the accounting period in which they are incurred:
- incorporation expenses;
- interest paid to shareholders under Section 291 of the Commercial Code before the corporation becomes profitable;
- research and development expenditures;
- expenses incurred in opening a business;
- expenses incurred in developing a new market, etc.;
- expenses incurred in issuing shares or debentures;
- discount on bonds.

(c) The amortization of deferred expenses such as lump-sum payments made to obtain know-how, premium paid for renting premises, etc. is computed in the same manner as the depreciation of intangible assets by applying the straight line method.
(d) Expenditure for research and development paid to specified associations mainly engaged in research work, is deductible in full in the year of payment.

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(9) *Royalties:* Royalties are treated as ordinary expenses. A lump-sum payment for an exclusive license is treated as an intangible fixed and depreciable asset.

(10) *Overseas travelling expenses and advertising expenses:* They are deductible to the extent that they are necessary, reasonable and are required for the active conduct of the business.

(11) *Penalties:* Penalties and fines are not deductible, whether imposed on the corporations or on their officers.

(12) *Repairs:* Expenses incurred for repairs and maintenance are deductible in full.

(13) *Bribes:* Deductibility of bribes depends on whether the payment of the bribe is objectively necessary for carrying on the business.

IV. DEPRECIATION

The Corporate Tax Law provides for deduction for depreciation of both tangible and intangible assets (including goodwill). Increased initial depreciation is granted to a corporation filing a blue return[1] on qualifying machinery, equipment and buildings in the accounting period in which the assets are acquired. Accelerated depreciation is granted for certain qualifying assets for certain consecutive accounting periods. Assets which cost less than ¥ 100,000 are deductible when acquired.

The methods of calculating depreciation are the: (i) straight line method; (ii) diminishing balance method; (iii) sum of year's digits method; (iv) production method; (v) replacement method; (vi) any other method specially approved by the District Tax Office.

A corporation may choose one method for each group of its depreciable assets from the depreciation methods mentioned above. The depreciation method must be reported in advance to the tax authorities and a change of depreciation method requires the approval of the tax authorities. Depreciation expenses are deductible for tax purposes to the extent they are entered into the taxpayers' books. The useful lives of fixed assets for computing the charge of depreciation are prescribed by statute. The useful lives in certain cases where wear and tear is faster than usual can be shortened upon approval of the tax authorities. If machinery and plant are used for a longer time than the average, then, upon approval of the tax authorities, extra depreciation is allowed.

The depreciation method for different kinds of depreciable assets, which should in principle be applied, is briefly specified below:

(1) *Tangible fixed assets:* straight line method, declining balance method or other method specially approved by the tax authorities.
(2) *Intangible fixed assets (excluding mining rights and goodwill):* straight line method or other depreciation method approved by the tax authorities.
(3) *Goodwill:* A method in which goodwill is amortized with the amortization limit being the acquisition cost.
(4) *Replacement assets:* straight line method, fixed percentage on reducing balance method or replacement method.

Statutory useful lives. For a better understanding, the statutory useful life of selected assets is shown below:

Description of asset	*Useful life (years)*
(1) Tangible fixed assets other than machinery and equipment	
Reinforced concrete buildings (for office)	65
Wooden buildings (for office)	26
Steel vessels (2000 tons or more)	15
Steel tankers	13
Airplanes	10
Electronic computers	6
Trucks	4
(2) Machinery and equipment	
Chemical condiment manufacturing plants	7
Sugar refinery plants	13
Beer brewery plants	14
Raw silk manufacturing plants	10
Pulp manufacturing plants	12
Chemical fertilizer manufacturing plants	10
Synthetic fiber manufacturing plants	7
Rayon yarn or staple manufacturing plant	9
Plate or sheet glass manufacturing plant	14
Cement furnaces	13
Iron and steel manufacturing plants	14
Electrical machinery manufacturing plants	11
Radio or television broadcasting equipment	6
Hydraulic power generation plant	22
(3) Intangible fixed assets	
Patent rights	8
Utility model rights	5

The statutory useful life of an asset is determined on the assumption that the asset is new and used in the normal manner. This period can be adjusted according to the actual condition of the asset by making application to the Regional Taxation Bureau.

The capital sum recoverable through depreciation is limited to 95%; the remaining 5% is deductible when the assets are written off or disposed. Normally, the accounting of depreciation for tax purposes is the same as for business accounting, but if depreciation for business accounting exceeds the allowable limit for tax purposes, the excess part is disallowed in that year.

Special depreciation. The Corporate Tax Law of Japan provides special depreciation measures to stimulate ac-

1. The blue return system is a tax incentive program designed to secure sound development of the self-assessment system and improvement of taxpayers' accounting practices. Thus, those corporations which maintain such accounts as required under the blue return system and report their income correctly are given certain privileges:
(a) losses may be carried forward for 5 years or backward for 1 year;
(b) special depreciation methods are allowed;
(c) special deduction for overseas transactions of technical services, etc. is allowed;
(d) the amount credited as reserves is allowed as expenses;
(e) in case errors are found in the calculation of taxable income based on the corporation's books and records, the tax authorities can correct the taxable income.

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tivities which the Government considers desirable. It should be noted that these measures make no provision for the cumulative amount of depreciation to be more than the cost of the asset but do provide for increased deduction in excess of normal depreciation, thus providing the benefit of the deferred payment of tax so that the company is left with more surplus which may be profitably utilized in other business activities.

The special depreciation methods can be broadly classified into (a) *increased initial depreciation* and (b) *accelerated depreciation*. Increased initial depreciation allows, in excess of normal depreciation, deduction of a portion of the acquisition cost of an asset for the first accounting period in which the asset is acquired, while accelerated depreciation permits a corporation to deduct a part of the acquisition cost of an allowable asset in excess of normal depreciation for certain consecutive accounting periods.

The special depreciation allowance may be credited to a special depreciation reserve account which is treated as tax-free profit in the balance sheet, and one seventh of such special reserve must be added back to income in the succeeding 7 years. Such a reserve thus provides an interest-free loan from the Government but not a reduction of tax.

The allowances for increased initial depreciation and accelerated depreciation for a few selected assets are mentioned below:

Increased initial depreciation

Description of asset	*Percentage of the cost of acquisition*
(a) Qualified machinery and equipment used for:	
(i) prevention of environmental pollution; (small and medium sized enterprises may opt for increased initial depreciation of 18% for the first 5 years)	
(ii) manufacturing in the free trade zone of Okinawa	27
(b) Qualified machinery and equipment used for manufacturing in severely depressed local industrial areas	20
(c) Qualified machinery and equipment:	
(i) designed not to cause environmental pollution	
(ii) for recycling which may contribute to the efficient use of resources	
(iii) for saving of energy	
(iv) used for manufacturing in developing areas	
(v) used to prevent accidents, fire, gas explosions, etc.	
(vi) special water supply equipment for industrial use	
(vii) railway facilities, distribution of gas in urban areas, nuclear plants for generation of energy	
(viii) buildings in the free trade zone of Okinawa which include production facilities	
(ix) electronic computers, but only large ones	20
(d) Qualified machinery and equipment and areoplanes, if the price is more than ¥ 800,000, acquired by small and medium sized enterprises	14
(e) Qualified buildings used for manufacturing and other equipment attached to it in the free trade zone of Okinawa	16
(f) Qualified steel vessels of not less than 500 tons gross (not less than 2,000 tons gross for an ocean-going vessel) owned by shipping companies	15
(g) Qualified equipment used by a medium sized enterprise:	
– Building used for manufacturing and other equipment attached to it in developing areas, excluding Okinawa free trade zone	14
(h) Qualified newly developed high quality plant or equipment with which the electronic equipment is combined	13
(i) Buildings used for manufacturing in undeveloped areas	10
(j) Qualified retail shops jointly operated by many retail merchants	8

Accelerated depreciation

In addition to ordinary depreciation based on statutory useful life, the following accelerated useful depreciation is allowed, if assets come within the following categories:

(a) 32% of ordinary depreciation for the first 5 years, on machinery used by members of cooperatives, textile industries, etc. for promotion of small and medium sized enterprises, or the structural improvement project of textile industry;
(b) 20% of ordinary depreciation of machinery, equipment and buildings of a corporation where not less than 20% of the employees are handicapped persons;
(c) 50 or 75% of ordinary depreciation for newly contructed houses for rent;
(d) 36% of ordinary depreciation for the first 5 years on facilities for storage of crude petroleum;
(e) 32% of ordinary depreciation for the first 5 years on storage facilities such as fireproof warehouses used for trade purposes and silos for grains.

V. RESERVES

While recognizing accepted accounting principles and the desire to attain specific economic policy aims, the Japanese Corporate Tax Law provides for deduction, as an expense, of the amount credited to specified reserves.

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It should be noted that these reserves provide for tax deferral but not tax exemption. These reserves can be broadly classified into two groups, i.e. *hikiatekin* (a to e), which are justified by generally accepted accounting principles, and *junbikin* (f to i), which are allowed with a view to attaining certain economic policy objectives.

(1) *Reserve for bad debts.* The amount deductible as reserve is subject to the following statutory limits:

Business of the corporation	*Percentage of receivables*
Retail or wholesale	1.6
Retail on installment payments	2.0
Manufacturing	1.2
Banking and insurance	0.5
Others	1.0

The reserve is treated as income in the following accounting period. The amount of reserve is increased to 116% of the ordinary allowance for corporations with capital of not more than ¥ 100 million.

(2) *Reserve for loss on returned goods unsold.* The amount deductible for such reserve is subject to specified statutory limits and is available to publications, pharmaceuticals, agricultural chemicals, cosmetics etc. The amount credited to such reserve is treated as income in the subsequent accounting period.

(3) *Bonus reserve.* Reserve for bonus is calculated by applying the formula specified in the tax law and such reserve is added back in full in the following accounting period.

(4) *Other reserves.* Reserves for retirement allowances, for special repairs and for repairs and guaranteeing certain products are also deductible subject to certain specified maxima, but are added back to the income in the subsequent accounting period.

(5) *Reserve for price fluctuations.* The maximum amount deductible for such reserves is in principle 1.7% of the book value of inventories. It is proposed to abolish this reserve within 5 or 10 years; during the transitional period, reduced deduction rates will be applicable.

(6) *Overseas market development reserve for small and medium sized enterprises.* Such reserve is allowed to a corporation with capital of not more than ¥ 1 billion and which derives income wholly or partly from overseas transactions comprised of export of goods, or processing of goods by the order of an exporter or large scale repairing of ships, the payment of which is made directly or indirectly in foreign currency. The amount that can be credited to such a reserve for meeting expenses to develop an overseas market is subject to the following limits:

(a) for corporations with capital of not more than ¥ 100 million, 3.6% in case of export of merchandise purchased from others and 8.4% for other exports;
(b) for corporations with capital of more than ¥ 100 million but less than ¥ 1 billion, 0.66% in case of exports of merchandise purchased from others and 0.9% for other exports.

One fifth of the amount credited to the reserve in one accounting period should be added back successively to the income in 5 succeeding years.

(7) *Reserve for overseas investment loss.* If a domestic corporation acquires the stocks of the companies mentioned below which are issued for the creation or the increase of capital of such companies, or it extends credit in the form of loans or purchase of debentures, it can credit a certain amount to a reserve account to meet possible losses of the value by the decline in their prices, etc. Such reserve is deductible subject to the following limits:

(a) specified overseas business company which has its head office in a developing country 15%
(b) specified overseas investment company having its head office in Japan if it is formed in order to invest in specified overseas business companies 15%
(c) nuclear fuel company, i.e. a foreign company which is engaged in recycling of nuclear fuel 40%
(d) specified overseas economic cooperation investment company which is engaged in investing in specified overseas economic cooperation company 25%
(e) specified overseas economic cooperation company engaged exclusively in activities making an important contribution to economic cooperation between Japan and the developing country in which the head office is situated 25%
(f) natural resources prospecting company and investment company which is exclusively engaged in investing in and prospecting for natural resources . . 100%
(g) natural resources development investment company which is exclusively engaged in making such investment . . 40%

The amount credited to the reserve may be held for 5 years, but from the sixth year one fifth of such amount should be added back to the income in 5 succeeding years.

(8) *Reserve for investment loss in free trade zones of Okinawa.* If a corporation acquires stock, for the creation or increase of capital, of a manufacturing company whose head office is in the free trade zone of Okinawa, it may credit 15% of the acquisition cost of such stock to such reserve against a fall in the market price of those shares. Such reserve can be held for 5 years but from the sixth year one seventh of such amount should be added back to the income in the succeeding 7 years.

(9) *Other reserves.* Other reserves which are provided by the Japanese Corporate Tax Law for the promotion of its economic policies are mentioned below:

- structural improvement project reserve for small and medium sized enterrises;
- reserve for prevention of mineral pollution of metal mining, etc.;
- depreciation reserve for specific railway construction;

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- depreciation reserve for the construction of atomic power generation;
- depreciation reserve for specific gas construction;
- forestation reserve;
- reserve for pollution control;
- stock transaction loss reserve;
- drought reserve, unusual risks reserve, security transaction responsibility reserve, reserve for losses caused by repurchase of electronic computers, and reserve for computer programs.

It must be noted that all these reserves are deductible as expenses under specified conditions but have to be added back to the income in subsequent years. Thus these provide for tax deferral and not tax exemption.

VI. TAX CONCESSIONS

Though the basic philosophy of the Japanese Corporate Tax Law is to provide relief through tax deferral by a wide range of reserves and depreciation allowances, it also provides a few tax incentives especially for promoting exports and in respect of capital gains.

(1) *Incentives for overseas technical service transactions.* If a corporation has derived income wholly or partly in respect of overseas transactions of technical services, it is allowed a special deduction, as follows:

(a) patents, know-how, etc. resulting from research work in the corporation which is alienated or offered in exchange, directly or indirectly, for foreign currency or its equivalent;
(b) copyrights (except for cinematographic films) sold or offered in exchange, directly or indirectly, for foreign currency or its equivalent;
(c) such technical services as planning, consultation, supervision, etc., related to the construction or production of plant or equipment, or specified technical services for agriculture or fisheries or surveys performed in exchange for foreign currency or its equivalent, on condition that the compensation for such services is ¥ 2 million or more per contract.

The deduction, however, shall not exceed 40% of corporate income.

From the examples in the next column it is clear that if a Japanese company exports patent and know-how even at a loss, it would have to pay less tax than if it does not export and can at the same time increase its cash resources.[2]

2. The incentive for export of patents and know-how, copyright, technical service fees, etc. has been considerably reduced in the last few years. The table below shows the high incentive given in the earlier years:

Year	*Special deduction in percentage*		
	Patent, know-how	*Copyrights*	*Technical service fees*
1964-1975	70	30	20
1976-1978	55	20	20
1979	35	10	20
1980	28	8	16

An explanation of one of the provisions with an attempt to coordinate the economic and legal aspects

Tax incentive for export of patents and know-how in Japan

A few examples are given below which clearly indicate the importance of such an incentive and that, even if the export of patent and know-how is below cost price, it would still be advantageous to Japanese companies, rather than not to export patents and know-how.

This is perhaps one of the reasons which stimulates Japanese companies to enter into a highly competitive and technologically advanced market in the world, as well as enabling them to earn foreign exchange.

Illustration: It is assumed that the rate of tax on a Japanese company is 42%; the cost of providing patent and know-how is ¥ 1,000. Suppose the company exports patent and know-how: (i) at ¥ 1,200; (ii) at ¥ 900; and (iii) if it does not export at all. Assuming the other business income of the company is ¥ 2,000, then

Case I

If patent and know-how are exported at	¥ 1,200	
Income from business		¥ 2,000
Income from export of patent	¥ 1,200	
Less cost	¥ 1,000	¥ 200
Gross taxable income		¥ 2,200
Less tax incentive @ 28% of ¥ 1,200		¥ 336
Taxable income		¥ 1,864
Tax payable @ 42% on ¥ 1,864 : ¥ 783		
Net amount available after taxes ¥ 1,081 + 336 =		¥ 1,417

Case II

If patent and know-how are exported at	¥ 900	
Income from business		¥ 2,000
Income from patent	¥ 900	
Less cost of patent	¥ 1,000	−100
		¥ 1,900
Less tax incentive @ 28% of ¥ 900		¥ 252
Taxable income		¥ 1,648
Tax payable @ 42% on ¥ 1,648 : ¥ 692		
Net amount available after tax ¥ 956 + 252 =		¥ 1,208

Case III

If a company does not export patent	
Income from business, being the gross total income	¥ 2,000
Tax payable @ 42%	¥ 840
Net amount available after payment of tax	¥ 1,160

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(2) *Incentives for prospecting for mineral deposits in Japan and abroad.* A special deduction is allowed in case of a corporation filing a blue return which has created a mineral reserve to meet expenses in prospecting for mineral deposits. Such a reserve is tax free for 3 years and after that it is treated as taxable income. The amount deductible shall not exceed:
   (a) 13% of the proceeds from sales of minerals mined, concentrated or processed by the corporation; or
   (b) 50% of the income derived with respect to the above-mentioned proceeds. However, the deduction shall not exceed 50% of corporate income.

   If a corporation having a prospecting costs reserve disburses new mineral deposits prospecting costs, or when the corporation having the overseas prospecting costs reserve disburses new overseas mineral deposits prospecting costs, the tax deferral provided above may be converted into an exemption from taxable income.

(3) *Special treatment for capital gains from sale of land or buildings.* The Corporate Tax Law also provides for deferred tax treatment and special treatment in respect of such capital gains when the specified conditions are fulfilled. This is discussed below in detail.

(4) *Investment tax credit.* An investment tax credit was introduced by the 1978 tax reform as a temporary measure to encourage investment by certain small and medium sized corporations in lieu of depreciation on plant and machinery used for energy saving or anti-pollution facilities. Such a credit is subject to a maximum ceiling of 20% of tax due.

VII. CAPITAL GAINS

Capital gains are, as a general rule, included in the ordinary income of the corporation and no tax concession is generally granted, However, there are exceptions to this rule as follows:

(1) *Exchange of properties.* Capital gains on exchange of any land, building, machinery and equipment, etc. which have been held by a corporation for more than one year for any similar property which has also been held by the other party for more than one year are not taxed if such transaction fulfills certain other conditions. This concession grants fair treatment to transactions which do not actually result in income for a taxpayer.

(2) *Expropriated property.* The proceeds of the expropriation of an asset are exempt income upto ¥ 30,000,000, if the asset is expropriated in accordance with the law providing for expropriation. Amounts received in excess of ¥ 30,000,000 are treated as taxable income.

(3) *Insurance proceeds.* The insurance proceeds received for damage to or loss of a fixed asset will not be taxed if the same kind of fixed asset is acquired within 2 years.

(4) *Replacement of business assets.* As an incentive to move from populated areas, if a corporation transfers specified assets consisting of land, building or structures in specified populated areas and acquires similar business assets outside these populated areas; it is allowed to reduce its taxable profits by way of reduced book entry.

(5) *Tax-free transfer of property to a controlled corporation.* When a corporation forms a subsidiary corporation owning 95% of all issued shares of the subsidiary, then the transferred property will not be included in the gross income of the transferor corporation. The subsidiary corporation is required to enter in its books the property it has acquired at the book value of the transferor.

   Similar incentive treatment is given to a new corporation in the electronics and machinery industries and such incorporation as is designated by the Small and Medium Sized Enterprise Modernization Facilitation Law without the above stock holding requirement.

(6) *Reduced book entry (Asshuku Kicho).* The concept of "reduced book entry" is peculiar to Japanese tax law.
   (a) When a corporation receives a subsidy or beneficiary contribution from the national or local government in order to acquire certain fixed assets, then the book value of the above fixed assets entered in the account books of the corporation is reduced by the amount of such subsidies or beneficiaries' contributions and these are excluded from the gross income of the corporation.

   Example:

Fixed assets	200
Book value	100
Subsidy (capital gains)	100

   The subsidy (100) is excluded from income.

   (b) Succession to book value of old property
      (i) Acquisition of new fixed assets if purchased with insurance compensation received for a loss of old property.

      Example:

Book value	100
Insurance proceeds received	200
Loss by fire	100
New book value	100

      The profit of 100 (insurance proceeds minus loss by fire) is excluded from the total income.
      (ii) When a corporation sells property and receives capital gains therefor, and acquires specific property, then this capital gain is excluded from the income if the cost of the acquired property equals the sales price of the property sold.

      Example:

Old property:	Book value	100
	Sales price	1000
	Capital gain	900
New property:	Acquisition cost	1000
	New book value	100

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In this case, the capital gain of 900 is excluded from the income.

If the acquisition cost of the new asset is less than the sales price then the proportion of the cost of the new asset to the ratio of the capital gains to the sales price is then excluded from the taxable income.

Example:

Acquisition cost 500
New book value 50

Exclude from total income $500 \times \frac{900}{1000} = 450$

The balance of 450 (900 – 450) is taxable.

VIII. CARRY FORWARD OR BACK OF LOSSES

An interesting feature of Japanese Corporate Tax Law is that it not only allows corporations filing a blue return to carry forward losses for 5 subsequent years, but also allows them to carry back losses for the previous year, thus enabling it to claim a refund of the overpaid tax computed by carrying back of such losses to the income of the accounting year immediately preceding the accounting year in which such loss is incurred.

IX. RATE STRUCTURE

The corporation tax rates are as follows:

(1) Tax rate for ordinary income of a domestic or foreign corporation not distributed as dividends:
  (a) Ordinary corporations
    (i) Corporations with capital of more than ¥ 100,000,000 . . . . . 42%
    (ii) Corporations with capital of less than ¥ 100,000,000
      – for annual income of more than ¥ 8,000,000 . . . . . 42%
      – for annual income of less than ¥ 8,000,000 . . . . . 30%
  (b) Cooperative associations and public interest corporations 25%

(2) Reduced tax rates for ordinary income distributed as dividends:
  (a) Ordinary corporations
    (i) Corporations with capital of more than ¥ 100,000,000 . . . . . 32%
    (ii) Corporations with capital of less than ¥ 100,000,000
      – for annual income of more than ¥ 8,000,000 . . . . . 32%
      – for annual income of less than ¥ 8,000,000 . . . . . 24%
  (b) Cooperative associations 21%

Reduced rates are applicable to the amounts distributed as dividends in excess of dividends, if any, received from domestic corporations.

(3) Tax rates for liquidation income:
  (a) Ordinary corporations 35%
  (b) Cooperative associations 21%

Foreign corporations are not liable to tax on liquidation income.

(4) Reduced rate applicable to special domestic medical corporations 23%

(5) Tax rate for retirement pension funds . . . 1%

(6) Special additional tax rates on family corporations
  – Income below ¥ 30,000,000 . . . . 10%
  – Income between ¥ 30,000,000 and ¥ 100,000,000 . . . . . 15%
  – Income above ¥ 100,000,000 . . . . 20%

A "family corporation" is a domestic company of which 50% or more of the capital stock is owned by not more than 3 shareholders and persons or corporations connected with them.

X. WITHHOLDING OF TAX

Both domestic and foreign corporations are subject to withholding of tax at source.

Domestic corporations. The following income received by a domestic corporation is subject to withholding of tax:
– dividends;
– interest income;
– remuneration for services of public entertainers.

The tax deducted at source must be paid to the Government before the tenth day of the month following that in which the tax is deducted. Further, credit is given to the corporation against its corporation tax for the tax withheld.

XI. AVOIDANCE OF DOUBLE TAXATION

Unilateral relief is granted to domestic corporations under the Japanese Corporate Tax Law for the foreign corporation tax paid on their foreign-source income. The foreign tax credit can be divided into two categories and is briefly discussed below:

(1) *Ordinary foreign tax credit.* Where a domestic corporation pays foreign corporation tax on its foreign-source income, a credit is provided against the Japanese corporate tax subject to the following limitation:

$$\text{Japanese corporation tax} \times \frac{\text{Total income from sources outside Japan}}{\text{Total income subject to Japanese corporate tax}}$$

Such credit cannot, however, exceed the amount of Japanese corporate tax payable on the world-wide income of the domestic corporation. Withholding taxes on interest and royalties are also creditable.

The excess of foreign taxes over the allowable credit may be carried forward for 5 succeeding years or carried back for the 5 preceding years.

(2) *Indirect foreign tax credit.* Where a domestic corporation receives dividends from foreign subsidiaries, a

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credit for the foreign corporate tax attributable to the dividends will be given to the domestic corporation if it holds at least 25% of the total issued capital or voting shares of the foreign subsidiaries for at least 6 months. Further, the foreign subsidiary must be established in the foreign country for purposes of carrying on business and not for tax considerations.

The indirect tax credit is computed as follows:

$$\text{foreign corporation tax on the subsidiary} \times \frac{\text{dividends received}}{\text{net income of the foreign subsidiary after foreign taxes}}$$

This computation has the effect of grossing up the dividends and the foreign corporation tax paid by the subsidiary which is attributable to the dividends.

Tax treaties

Japan has comprehensive double taxation avoidance agreements with Australia, Austria, Belgium, Brazil, Canada, Czechoslovakia, Denmark, Egypt, Finland, France, Germany, Hungary, India, Ireland, Italy, Korea, Malaysia, Netherlands, New Zealand, Norway, Pakistan, Philippines, Poland, Romania, Singapore, Spain, Sri Lanka, Sweden, Switzerland, Thailand, United Kingdom, United States and Zambia. With respect to income for which treatment is provided in the agreement between a treaty country and Japan, then the relevant provisions of the treaty are applicable. Most of these treaties provide relief from double taxation through foreign tax credit.

Power to issue directives

The National Tax Administration has the power to issue directives to its officers for the uniform interpretation and application of laws. These directives are also made public. However, the directives do not bind the courts of justice as a source of law, but are merely an interpretation of the law by the tax authorities. It is important to note that the court of justice seldom decides against the directives. The directives, therefore, play an important role in tax administration.

XII. ANTI-TAX HAVEN MEASURES

On the basis of the findings of the Report on Revisions of the Taxation System for Fiscal Year 1978, submitted by the Tax Council to the Prime Minister in December 1977, the Japanese Diet introduced 2 new sub-sections in the Special Taxation Measures Law dealing with cases of individuals and corporations in Japan which make use of tax haven countries, to reduce their tax liability in Japan.

The new legislation defines "tax havens" as "countries and areas in which the tax burden on all income or on particular types of income of corporations is significantly lower than that on income of corporations in Japan, designated as such by a cabinet order classifying them as countries and areas with low rates of taxation on all forms of income or on particular types of income".

The tax-haven countries have been classified into 3 categories: (1) countries with low rates of taxation on all income; (2) countries with low rates of taxation on income from foreign sources; (3) countries with low rates of taxation on income from specific businesses.

The anti-tax haven measures consist of computing the taxable income of the domestic corporation that is regarded as retained out of "undistributed income" of the special foreign subsidiary of the domestic corporation, multiplied by the proportion of shares held directly or indirectly in the special foreign subsidiary by that domestic corporation.

Taxation of a domestic corporation occurs when the special foreign subsidiaries are corporations located in tax haven countries and in which Japanese domestic corporations or residents hold directly or indirectly more than 50% of the shares issued.

Further, domestic corporations which hold directly or indirectly 10% or more of the shares issued by the special foreign subsidiary, and domestic corporations belonging to a group of stockholders of the same family that hold directly or indirectly 10% or more of the shares as a group, are also taxable on retained income. The condition regarding stock ownership is determined on the basis of the situation existing at the end of the business year of the foreign corporation.

However, the anti-tax haven measures are not applicable if the foreign subsidiary satisfies all the following conditions:

(1) The foreign subsidiary has a fixed facility such as an office, shop or factory which is deemed necessary to conduct its business in the country where its main office exists.

(2) The foreign subsidiary conducts the management and control of its business in the country where its main office exists.

(3) In case the main business of the foreign subsidiary is wholesale, banking, trust, securities business, insurance, shipping or air transport, the foreign subsidiary conducts its business mainly with persons other than related persons.

(4) The foreign subsidiary is not a corporation whose main business is to hold stocks, to offer patents, etc. or copyrights, or to lease vessels or aircraft.

(5) The amount of dividends received by the foreign subsidiary from other foreign corporations which come under these taxation measures does not exceed 5% of its local revenue.

In addition to the above provisions, the new measures also contain provisions to eliminate double taxation with respect to foreign corporation tax imposed on the undistributed income of the foreign subsidiary attributed to the domestic corporation and payment of dividends from already taxed income of the foreign subsidiary.

XIII. CONCLUSION

The success or otherwise of taxation ultimately rests on the reasonableness of the burden which is imposed on the assessees. Excessive taxation may restrict economic incentives and productive efforts, any may cause business activity and national income to decline. If efforts and achievements are recognized, there is no reason why taxes cannot be used creatively to achieve the economic goal of the nation.

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As a fiscal tool, taxation policy has to be directed at productive resources which are necessary for the economic development, but which the private sector is unable to provide for. Such a step towards direction of resources is needed by both the developed and developing countries according to the state of their economy and international economic situation.

The above study on corporate taxation in Japan illustrates the efforts on the part of the Government to use a taxation policy for her economic development which has qualities that could with advantage be adopted by other countries. It would not be an exaggeration to say that if the Japanese economy were to sneeze now, the entire world would catch a cold.

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The Development of Double Taxation Conventions with Particular Reference to Taxation of International Air Transport*

by D. Hund**

1. INTRODUCTION

One of the problems which almost inevitably have to be faced in any international operations is that of double taxation. And if one type of operation is virtually by definition international in character it is air transport. The second report of the OEEC Fiscal Committee of 1959 (in 1961 rebaptized OECD), which preceded the 1963 OECD Draft Double Taxation Convention, notes: "By the nature of their business, shipping, inland waterways transport and air transport enterprises are more exposed than most other industrial and commercial enterprises to the danger of multiple taxation on their income, as they are liable to be taxed simultaneously in their own countries and in the other countries where they receive payment for the carriage of passengers or goods or where their activities are exercised." The International Civil Aviation Organisation (ICAO) Council Resolution of 14 November 1966 expresses itself in similar terms.

Double taxation obviously forms a serious obstacle to running an internationally oriented business like an airline. It goes without saying, therefore, that action to prevent double taxation is of particular importance to airlines.

2. THE PREVENTION OF DOUBLE TAXATION

There are two main ways of setting up schemes to combat double taxation: unilateral schemes at the national level and international measures on a bilateral or multilateral basis. Many countries make it possible to exempt foreign airlines from taxation on a basis of reciprocity. In effect this is a national regulation. Bilateral regulations mean first and foremost comprehensive conventions for the avoidance of double taxation on income and capital. A variation on this theme is formed by conventions which restrict themselves to the avoidance of double taxation on profits from international air transport and/or from merchant shipping. A third possibility is offered by air transport agreements, which mainly relate to landing rights, capacity problems and route sharing. Also here a provision could be inserted relating to the avoidance of double taxation on any profits made by the operations in question. I do not want to express any preferences on these methods here. What I do want to talk about is the use of comprehensive tax conventions to avoid double taxation on profits from international air transport operations.

3. MODEL CONVENTIONS

The history of air transport goes back nearly a hundred years, but the present network of world-wide routes was not conceived until after the first world war. It is interesting to note that the period in which wider international attention began to be paid to the phenomenon of double taxation in general coincides more or less with the earliest days of international air transport, the 1920s, and that the tax position of air transport was treated separately more or less from the start.

In 1921 the League of Nations commissioned a panel of 4 experts to study the economic aspects of international double taxation. Their first report appeared in 1925. It said – and this was repeated in the recommendations attached to the report – that international *shipping* should be taxed according to a regime other than that which applied to ordinary businesses. Air transport was not considered at that time. However, the report led to a conference which was held in Geneva in 1928 and one outcome was a model convention for the prevention of double taxation in the special matter of direct taxes. There were 3 versions of this convention in order to facilitate adjustments to the various tax systems of the states taking part in the conference. Each of the 3 versions makes the levying of taxes on business profits outside the country where the enterprise has its fiscal domicile dependent on the presence of a permanent establishment. Each version adds the following provision, however: "Nevertheless, income from maritime shipping *and air navigation* . . . shall be taxable only in the State in which the real centre of management is situated." The Commentary on the 3 versions notes that the provisions on sea and air transport form an exception to the principle which normally applies in the case of enterprises, but gives no further explanation.

The League of Nations' work in the area of tax conventions was continued and led to 2 new model conventions: the *Mexico* convention of 1943 and the *London* convention of 1946. The Mexico draft devotes a separate article to shipping and air transport for the first time: Article 5. This reads: "Income which an enterprise of one of the contracting States derives from the operation of ships or aircraft registered in such State is taxable only in that State." Assuming that "an enterprise of one of the States" in most cases has its real centre of management there, we thus can establish that the basis of the Geneva document, i.e. that tax should be levied only in the country where the airline is established, is retained although *registration* in that country is also required. The commentary states that this is simply following the principle which had already been laid down in numerous bilateral conventions. I shall return to this point later.

Article 5 of the 1946 London model is also specially devoted to international air and sea transport: "Income

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The author's views are his personal ones, which do not necessarily reflect those of the Dutch Government.

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which an enterprise of one of the Contracting States derives from the operation of ships or aircraft engaged in international transport is taxable only in the State in which the enterprise has its fiscal domicile." Although here also precedence is given to domicile, it differs from the Mexico model in two ways. the requirement for registration has been dropped but there has been added the provision that the profit must have been obtained *in international transport.* Nevertheless the commentary states that the new wording is intended to make it still more explicit that "income from international maritime and air transport [is] taxable only in the country where the vessel is registered, provided the owner or operator has its fiscal domicile in that country". The provision is also intended "to facilitate the operation of international transport enterprises".

The demise of the League of Nations also put an end to its work in fiscal matters. Attempts to achieve model conventions continued elsewhere, however. The British Commonwealth produced a Model Commonwealth Taxation Agreement in 1964, for example. It too contains a special provision for international maritime and air transport under which taxation is levied only in the country of domicile.

The Andean Pact States in South America also drew up a model agreement, in 1971. Here the principle for air and maritime transport, laid down in Article 8, is once again taxation in the country of domicile, although the members of this organisation are well known as tenacious defenders of the principle of taxation in the source country. Nevertheless they were obviously not in complete agreement, for the model also contains an alternative Article 8: "The profits earned by a transportation enterprise from its air, land, sea, lake or river operations in any of the Contracting States, shall be taxable only by such Contracting State." In other words: taxation in the source country. The two possibilities are also embodied in Article 19 of a model convention that was published by the successor to the Andean Pact, the Latin American Free Trade Association (LAFTA).

What we have here for the first time is a departure from the principle that taxation takes place exclusively in the country of domicile which, as I said earlier, had been stipulated in the case of maritime and air transport from the earliest model conventions onward. I shall return to this point at a later stage.

Far more important is the work on model conventions undertaken by what was originally the Organisation for European Economic Cooperation (OEEC), later the Organisation for Economic Development and Cooperation (OECD). The organisation's model/draft conventions for the avoidance of double taxation on income and capital of 1963 and 1977 have had a tremendous influence on the bilateral double taxation conventions concluded over the past 20 years. Here again international sea and air transport is treated separately from other enterprises: Article 8, paragraph 1, which is identical in the two models, states: "Profits from the operation of ships or aircraft in international traffic shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated." The commentary to the OECD models, however, does not give the reasons which led to this treatment, which differs from the normal regime for profits. Presumably it was supposed that this treatment was at that time so widely accepted internationally that no explanation was necessary.

The most recent in the series of model conventions is the United Nations model double taxation convention between developed and developing countries, which dates from 1980. A group of experts from both developed and developing countries had been working on this model since 1968 and it differs from the OECD model conventions on a number of generally predictable points. As was evident in the Andean draft, developing countries are naturally more inclined towards greater powers of taxation for source countries than are the developed countries. Thus the UN model contains a wider interpretation of the term "permanent establishment" and higher rates of taxation at source on income from movable capital than are usually agreed between developed countries. In so far as shipping and air transport is concerned, the experts were unable to agree upon a common solution and as a result the model contains two alternatives. Article 8A, paragraph 1, is word for word the same as Article 8, paragraph 1 of the OECD models. Article 8B, on the other hand, provides for the right of the source country to levy taxes in the case of *shipping* but the principle of taxation solely in the country of domicile is maintained for *air transport.* The commentary on Article 8A, paragraph 1, states: "The exemption from tax in the source country of foreign enterprises engaged in international shipping traffic is predicated largely on the premise that the income of these enterprises is earned on the high seas, that exposure to the tax laws of numerous countries is likely to result in double taxation or at best in difficult allocation problems, and that exemption in places other than the home country ensures that the enterprise will not be taxed in foreign countries if their over-all operations turn out to be unprofitable. Considerations relating to international air traffic are similar."

Finally, mention should also be made of the United States Treasury Department Model Income Tax Treaty, which was first published in 1976 and partly revised in 1977; a new draft has recently been issued. In effect it is a standard draft that the United States tends to use as basis in its negotiations rather than a model treaty. All 3 published versions likewise lay down the principle that taxes on air and maritime transport are levied exclusively in the country in which the enterprise is established.

The conclusion from all this is that the position of international air transport in model conventions has remained essentially unchanged in over 50 years, i.e. taxation is levied exclusively in the country of domicile or of effective management.

Before discussing how much of this principle has remained intact in bilateral tax conventions, I should like to say a few words about some *multilateral* conventions.

4. MULTILATERAL TAX CONVENTIONS

The problems that arise in bilateral relationships pale beside those of multilateral ones. For this reason there have only been a few multilateral double taxation conventions

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in the past, none of which has had any great significance. I shall just briefly mention 4 examples:

(1) the 1963 convention between francophone African states;
(2) the multilateral Andean Pact convention of 1971;
(3) the Arab convention of 1973;
(4) the Comecon convention of 1979.

The francophone African convention contains a major departure from the domicile principle in applying the main rule for companies, i.e. taxation in the source state, but dependent on the presence there of a permanent establishment, to air and maritime transport. The Andean Pact convention, on the other hand, does provide for taxation exclusively by the state of domicile, which is also the case with the Arab convention and the Comecon convention (or multilateral Convention between the members of the Council of mutual economic aid (CMEA), as the Eastern European economic community is called).

Here too, then, there is an almost universal acceptance of the domicile principle.

5. BILATERAL TAX CONVENTIONS

The earliest comprehensive conventions for the avoidance of double taxation date from the beginning of this century. Since then over 500 of them have been concluded. You will forgive me for not having gone through all of them to check the provisions relating to air transport. However, I have gone some way towards doing this by looking at the provisions in the tax conventions concluded since 1965 and published by the United Nations. There are over 300 of them, and only a very small number, about 4%, provide for taxation in the source country (see Annex). This is hardly surprising in view of what I have just said about the model conventions and their enormous influence on treaty practice.

I have tried to see whether certain groups of treaties show any particular fixed pattern. First of all there is the group of developed countries, essentially the 24 member states of the OECD. There are some 200 treaties between these states, that is about 75% of the possible permutations and combinations between them. Almost without exception the provisions on air transport in these conventions follow Article 8 of the OECD models, that is taxation in the state of domicile. This is not surprising as the OECD formula provides for the possibility of a country making a reservation on any provision of the model convention with which it disagrees. None of the member states has made such a reservation with regard to air transport.

There are hardly any general tax conventions between OECD countries and Arab states. Given the attitudes on both sides – I refer to the Arab Convention I just mentioned – it is not likely that air transport would prove a stumbling block in negotiations. This may be the case, however, in relationships between developed and developing countries, in spite of the UN model convention, which puts air transport in a favourable position. Nevertheless, 119 of the 136 conventions in this category still follow the domicile principle. The proponents of taxation in the source country are only a small group: Singapore, Malaysia, Sri Lanka and the Philippines. With this in mind, it is worth noting the tax convention between the United States and the Philippines, whose ratification has been dogged for years by problems, partly due to the provision relating to air transport. It is remarkable that only one of the 10 conventions between developing countries that I have looked at provides for taxation in the source country. The last group I would like to mention is that of conventions with Eastern European countries which date from the last 10 years or so. Without exception, they uphold the principle of taxation in the country of domicile.

And last, but not least, my own country, the Netherlands: at present there are 32 conventions in force and 3 signed but not yet ratified. We are strongly in favour of placing as few fiscal obstacles in the way of international air transport as possible and we heartily support the OECD principle which, I take it, is also held by IATA: taxation exclusively in the state of effective management of the enterprise. We have been able to ensure that this principle has been respected in all the conventions we have concluded, with only one exception the convention with Singapore.

CONCLUSION

It may be seen that international air transport has occupied a special place in double taxation conventions from the very beginning. This in itself is a remarkable situation, for an airline is an enterprise and as such there is no reason to arrange the taxation of its profits in a way which departs from the internationally accepted practice for other enterprises, that is taxation outside the country of residence being made dependent on the presence of a permanent establishment. As we have seen, however, airlines have been treated differently for over 50 years.

There are two main reasons for this, one theoretical and one practical. The theoretical backgrounmd for exemption in the source country is that the profits of an airline are not primarily obtained where passengers and freight are loaded. No, the activity that produces the profits in the first place is flying and that is done mainly in international air space. The practical argument against treating airlines according to the same rules as other enterprises is the fact that it is almost impossible to arrive at an acceptable method of dividing profits between the various permanent establishments and the headquarters.

I realise that I have only been able to deal with certain aspects of the taxation of international air transport. I have not discussed the interpretation of the term "international traffic". Nor have I considered what exactly should be understood by "profits from air transport". Nevertheless I hope that I have been able to give you some idea of the historical development of international air transport from an international fiscal point of view. It is fair to say that it is accepted on a more or less worldwide scale that as few fiscal obstacles as possible should be put in the way of international air transport. In practice this means that taxation is levied only in the airline's home country. I have also pointed out that the Netherlands shares this principle and that it has been able to maintain it in some 35 general double taxation conven-

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tions, but also in a number of more restricted conventions, air transport agreements and a number of declarations on the basis of reciprocity.

It is therefore possible to state that the ICAO Council Resolution of 14 November 1966, which recommended the member states to take all possible steps to grant international air transport profits exemption from taxation on a basis of reciprocity, and which recommendation has since been repeated a few times, has been followed to a large extent by treaty concluding countries.

We should also note, however, that a number of developments around the world may make continuation of existing practices more difficult. First of all there is the increasing tendency of certain host countries, mainly developing countries, to make foreign airlines liable to taxation, even in spite of the UN model convention and in most cases despite the absence of a permanent establishment. But what is even worse: taxation is often not levied on a net basis but on a notional amount of profit which is not subject to revision in the light of actual profits. In this connection I should like to refer to the report which your organisation published in 1975, entitled "Taxation of international air transport, net income basis, an alternative to reciprocal exemption".

A second unfavourable development is the fact that one is increasingly confronted in practice with countries which, in spite of repeated urging, are not prepared even to discuss the problems of international air and maritime transport as they relate to double taxation. This means that the question of how to devise a suitable scheme cannot even be raised. A variation on this theme is the increasing unwillingness to deal with air and sea transport in anything other than a comprehensive double taxation convention. This makes any scheme partly dependent on the solution of problems which often have nothing to do with international transport.

A third development which, in my opinion, has to be rejected is the fact that some countries are only prepared to do business if exemption is granted for all taxes and levies which have some, sometimes distant, relation to air transport. Of course it is an honourable starting point. By no means, however, should the ultimate goal – taxation of profits from air transport only in the country of residence – be endangered by making a reciprocal exemption on such profits dependent on the willingness to grant exemption as well for all kinds of indirect taxes, sometimes even together with the demand to grant the airline's staff a kind of diplomatic status. Part of those matters is dealt with in air bilaterals. For others, a solution seems complicated. Anyhow, they should be dealt with separately.

The last unfavourable development I should like to point out – and one which has so far been mainly restricted to merchant shipping – is the increasing tendency of certain countries to give preferential treatment to their own companies. It is true that foreign lines are usually exempted from taxation but their opportunities for loading or unloading freight or for enabling passengers to embark or disembark are often drastically restricted, thus reducing the opportunities to realise profit and frustrating the effect of the exemption.

In my opinion these developments should be most emphatically rejected in the interests of the unimpeded exploitation of international airline services.

ANNEX

1	2	3	4	5	6	7	8	9
Contracting parties	*Period*	*Conventions signed*	*State of effective management*	*+ registration*	*State of residence*	*+ registration*	*State of source*	*No specific provision*
Developed countries	1956–1960	31	13	2	11	5	–	–
	1961–1965	28	19	1	4	4	–	–
	1966–1970	50	27	–	19	4	–	–
	1971–1975	28	13	–	–10	4	–	–
	1976–1980	12	5	–	7	–	–	–
		149	77	3	51	18	0	0
Developed country–developing country	1956–1960	21	1	1	16	2	1	–
	1961–1965	30	8	1	15	1	4	1
	1966–1970	33	4	–	20	4	3	2
	1971–1975	31	13	–	14	1	3	–
	1976–1980	21	6	–	11	1	1	2
		136	32	2	76	9	12	5
Developing countries	1956–1960	4	–	–	4	–	–	–
	1961–1965	–	–	–	–	–	–	–
	1966–1970	3	–	–	2	–	1	–
	1971–1975	3	2	–	1	–	–	–
	1976–1980	–	–	–	–	–	–	–
		10	2	0	7	0	1	0
Developed country–Eastern European country	1971–1975	6	3	–	1	2	–	–
	1976–1980	6	3	–	3	–	–	–
		12	6	0	4	2	0	0
	Total	307	117	5	138	29	13	5

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U.S.A.:
SAFE HARBOR LEASING – A Controversial Means for Distribution of Investment Incentives

by Frank J Schuchat *

Of all the provisions in the Economic Recovery Tax Act (ERTA) enacted by the United States Congress in 1981, perhaps the one generating the most public discussion is Section 201, which, by adding Section 168(f)(8) to the Internal Revenue Code, makes it easier for an entity with tax credits or depreciation deductions in excess of an amount it can take full advantage of, due to a lack of taxable income, to transfer those tax benefits to another, profitable entity, in return for cash.

The so-called safe harbor leasing provision of the ERTA is designed to allow all corporations to take advantage of the new Accelerated Cost Recovery System (ACRS),[1] which permits recovery of capital investments in certain productive assets over a shorter period of time than was previously allowed, as well as the 10% Investment Tax Credit (ITC).[2] Both ACRS and the ITC are measures to encourage capital investment, which is seen as the key to economic recovery. Without safe harbor leasing, it is argued, there would be distortions in the economy, due to uneven distribution of tax incentives, with older, profitable corporations receiving a competitive advantage over new enterprises and those suffering losses during the years the tax incentives are available to them. In addition, the accumulation of unused tax benefits is said to make some corporations attractive targets for takeovers, which would also reduce competition.

The "tax sales" which have so far taken place under Section 168(f)(8) have created a furor in the press, among citizens' groups and in the Congress, based on objections to the high cost in lost revenue (which according to Treasury estimates could exceed $27 billion by 1986), at a time when most Federal programs are on austerity budgets, the deficit is expected to reach record levels, and the administration is exhorting the public on the benefits of living with less government assistance. This article will discuss the mechanics of safe harbor leasing as well as some of the arguments put forward by those who would keep it in the Code and those who favor its elimination.

BACKGROUND

The general form for the transfer of tax benefits under the new provision is illustrated by the following two examples taken from the Temporary Regulations issued by the Internal Revenue Service.[3]

In the simple leasing transaction, X Corp. would like to acquire a $1 million piece of equipment, which is "qualified leased property" as defined by the statute, and which has a 10-year economic life and under ACRS can be depreciated over an accelerated period of 5 years. Y Corp. meets the requirements of Section 168(f)(8)(B) for a lessor, which will be discussed below, and has profits it wishes to shelter from tax. Y will purchase the equipment selected by X from the manufacturer for $1 million, paying $200,000 in cash and borrowing the remaining $800,000 from a bank, with a repayment schedule calling for 9 equal annual installments of principal and interest of $168,000. Y then leases the equipment to X under an agreement calling for 9 annual rental payments of $168,000. Both corporations elect to have the transaction characterized as a lease and to have the special rules of Section 168(f)(8) apply. Y will be treated as the owner of the property for federal income tax purposes and is therfore entitled to the investment tax credit and the ACRS deductions with respect to the property. Y will have a basis of $1 million in the property and must report the rental payments as ordinary income. Y will, however, be able to deduct from gross income the interest paid to the bank on the $800,000 loan. X will be permitted to deduct as a business expense the aggregate payments of rent.

In the sale and leaseback transaction the facts are the same except that X has already purchased the machinery for $1 million and enters into an arrangement with Y to transfer to it ownership of the property for federal tax purposes. In order to accomplish this, X will agree to sell the machinery to Y for an initial payment of $200,000 in cash, plus a note for $800,000, calling for repayment of principal and interest over a 9-year period in annual installments of $168,000. X, which has now transferred title to the property (but has retained possession), will agree to lease the property for 9 years with rental pay-

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1. IRC Section 168.
2. IRC Sections 38; 46. U.S. law permits a credit against tax for amounts invested in certain depreciable property. The credit is generally available in the year the property is first placed in service, and is currently 10% (prior to 1975 the credit was 7%). The adjusted basis of the property is not reduced by the amount of the credit. In effect the provision reduces the cost of capital expenditures, with the intent of encouraging productive investment.
3. Temp. Reg. Section 5c. 168(f)(8)(-1)(e). Treasury Decision 7791.

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ments totalling $168,000 per year. Again, the two corporations will elect treatment under Section 168(f)(8) and are therefore assured the transaction will be treated as a lease for federal income tax purposes.

The rental payments which X is required to make to Y are exactly equal in timing and amount to the debt service payments that Y must make on the note. Therefore, the two sets of payments cancel out each other and the only cash that need change hands between X and Y is the original $200,000, which is the cost to Y of securing the tax benefits that accompany ownership of the equipment, i.e. the investment tax credit and the ACRS deductions. Y's basis will be $1 million and it must report as income the rent it receives from X; however, that income is offset by the deduction for the interest paid to X on the note and the annual depreciation. X need not recognize a gain on the sale since the sale price of $1 million equals its basis in the property. X must report interest on the note as income but may deduct rental payments.

In either example, the user of the property, X, may have an option to purchase the property at the end of the lease period for a nominal price or a determinable price, and this will not affect the characterization of the transaction as a lease, nor will it be taken into consideration in determining the amount the lessor has "at risk" with respect to the property.

PRE-ERTA LEASING

Prior to enactment of Section 168(f)(8), it was possible to transfer tax credits or deductions through a leveraged lease; however, there was no "safe harbor", and the transaction had to meet specific guidelines in order to qualify for an IRS letter ruling characterizing it as a lease rather than a conditional sales contract.[4] The lessor had to have a minimum unconditional "at risk" investment in the property at all times of 20% of the *cost* of the property. Such minimum investment had to be an equity investment which, in this context, included only consideration paid and personal liability incurred by the lessor to purchase the property. The net worth of the lessor had to be sufficient to satisfy such personal liability and the lessor had to demonstrate that an amount equal to at least 20% of the original cost of the property was a reasonable estimate of the fair market value of the property at the end of the lease term. The property also had to have a remaining useful life at the end of the lease term of the longer of one year or 20% of the originally estimated useful life of the property.

The lessee was not permitted to have a contractual right to purchase the property from the lessor at a price less than the fair market value at the time the right was exercised and the lessor could not have a contractual right to cause any party to purchase the property, at the time the property was first placed in service or use by the lessee. The lessee could not furnish any part of the cost of the property, nor could he lend to the lessor funds required to purchase the property, nor guarantee any indebtedness created in connection with the acquisition of the property by the lessor. Finally, the lessor had to be able to demonstrate an expectation of profit from the transaction, apart from the value of or benefits obtained from the tax deductions, credits, allowances and other tax attributes arising from the transaction.

THE NEW RULES – A SAFE HARBOR

What the new law does is to deliberately ease the former requirements in order to encourage tax leasing. To qualify for the safe harbor, i.e. a guarantee of treatment of the transaction as a lease for federal tax purposes, the parties involved must first of all elect to treat the transaction as a lease rather than a financing arrangement. However, not all taxpayers may participate in tax leasing. To qualify as a lessor in one of these arrangements one must be a corporation other than a subchapter S corporation or a personal holding company, a partnership all of the partners of which are eligible corporations, or a grantor trust with respect to which the grantor and all beneficiaries are corporations or a partnership composed of corporations.[5]

The nominal lessor is also required to have, at all times during the lease term, a minimum investment "at-risk" in the property of at least 10% of the adjusted basis of the property. Although this "at-risk" requirement is a continuation of the old policy of insisting the nominal lessor have a stake in the cost of the leased property, it is less of a stake than under the previous guidelines, since it need only be 10% rather than 20%, and, more importantly, it is determined with respect to the adjusted basis of the property rather than the original basis.

The fact there may be an agreement between the lessor and the lessee requiring either or both parties to purchase or sell the property at some price (whether or not fixed in the agreement) at the end of the lease term will not affect the amount the nominal lessor is considered to have "at risk" with respect to the property. The fact the lessee is considered the owner for state or local law purposes will also not be taken into account in characterizing the transaction as a lease. It will not matter either that after the lease term no other person besides the lessee will be able to make use of the property.

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4. See Revenue Procedure 75-21, 1975-1 Cumulative Bulletin 715; Revenue Procedure 75-28, 1975-1 Cumulative Bulletin 752; Revenue Procedure 76-30, 1976-2 Cumulative Bulletin 647.

5. A Subchapter S Corporation is a true corporation which is treated as a partnership for Federal income tax purposes, i.e. corporate income is exempt from federal income tax with regard to the corporation itself, but is taxable for the individual shareholders, whether distributed or not. The shareholders must be fewer than 25, they must elect Subchapter S treatment, and must have only one class of stock (IRC Section 1371).
A personal holding company is a corporation subject to the personal holding company tax, which is imposed annually on all corporations which fit certain definitional requirements, regardless of whether their purpose was to avoid tax. Essentially, a personal holding company is an investment company, in which the majority of stock is held by 5 or fewer persons, and the bulk of its income is from dividends and interest (see IRC Section 541).
A grantor trust is a trust of which the grantor will be treated as the owner of the trust's assets for tax purposes, in general because certain attributes of control have been retained (see IRC Section 671).

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Another change from the old IRS guidelines is that the lessee, or a related party, may now provide financing, or guarantee financing for the transaction. That does not, however, allow the lessee to finance or guarantee the 10% minimum "at-risk" investment required of the lessor.

The lease term (including extensions) may not exceed the greater of 90% of the useful life of the property for purposes of Section 167 depreciation, or 150% of the present class life of the property.[6]

In order to be "qualified lease property" the property must meet one of 3 requirements, the first of which is that it is new Section 38[7] property of the lessor which is leased within 3 months after the property was placed in service, and which, if it had been acquired by the lessee, would have been new Section 38 property of the lessee. (The lessor may use the property within the 3-month period prior to the start of the lease.)

In case of a sale-leaseback transaction, "qualified property" includes property that was new Section 38 property when acquired by the lessee. The sale and leaseback must occur within 3 months of the date the property was placed in service by the lessee, and the adjusted basis of the lessor must not exceed the adjusted basis in the hands of the lessee at the time of the lease. A special rule applies for eligible property placed in service after 31 December 1980, and before the date on which the ERTA was enacted (13 August 1981). Such property will be deemed to have met the 3-month requirement if leased by 13 November 1981.[8] The third category of "qualified property" is mass commuting vehicles (as defined in IRC Section 103(b)(9))[9] which are financed in whole or in part by obligations the interest on which is excludable from income tax under Section 103(a). This special category, under which a lessee will receive the depreciation deduction even though the property is used by a tax-exempt organization or government unit in an exempt function, does not, however, qualify for the investment tax, credit, but only for the ACRS deductions.

The act states that, if the specified requirements are met, no other factors will be taken into account in determining whether the transaction will be effective to transfer federal tax attributes to the nominal lessee. The Treasury Department is authorized by the Act to promulgate regulations as may be necessary to carry out the purposes of the section, including regulations to insure that the aggregate amount of (and timing of) deductions and credits in respect of qualified leased property is limited to the aggregate amount (and timing) which would have been allowable without regard to the leasing provisions.

In case the lessee acquires the property at the expiration of the lease term, and subsequently disposes of it, the lessee will be subject to the normal rules for recapture of depreciation deductions under IRC Sections 47 and 1245,[10] just as if the lessee had been considered the owner of the property for the entire term of the lease. However, any amount recaptured already from the lessor when it transferred the property will not be recaptured again from the lessee.

REVISION OF REGULATIONS

In October 1981,[11] the Treasury announced regulations for safe harbor leasing which provided guidelines as to what subsequent events might disqualify a leasing transaction from safe harbor protection. Among the specified events was a transfer in bankruptcy or similar court-supervised proceeding. This set off a storm of criticism since, in the words of one concerned corporate executive, the effect of the regulations was "nearly to destroy the ability of poor companies with dubious credit to take advantage of the new law".[12] Since it was "poor" companies, or at least companies with a negative taxable income, which were the intended beneficiaries of the safe harbor leasing provision, the temporary regulations were subsequently amended.[13]

As it now stands, a transfer in bankruptcy or similar proceeding is not automatically a disqualifying event if (1) all lenders with secured interests in the property prior to the time the lease is consummated consent to release the federal income tax ownership of the property from their interest, (2) the lessor gives written notice of its tax ownership to the court, the trustee in bankruptcy, and the purchaser of the property, and (3) the lessor files a statement with its income tax return identifying the transferees and the property. All that having been done, the lessor will continue to be owner of the property for tax purposes, and the transferee will step into the shoes of the original lessee. The rule is mandatory for agreements executed after 31 May 1982, and elective for those before that date.

If, on the other hand, the lessee voluntarily sells or assigns its interest in the lease or in the property, the arrangement *does* lose its characterization as a lease under

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6. IRC Section 167(m)(1). Under the Class Life Asset Depreciation Range (ADR) system taxpayers were permitted to base depreciation deductions on a hypothetical useful life selected from within a range specified for designated classes of assets.
7. Section 38 property is property that may be depreciated annually and for which an investment tax credit is available. The category generally includes tangible personal property (except air conditioning and heating units); certain other tangible property (except buildings) tied to production or certain services; some research and storage facilities; qualified expenditures for rehabilitating business buildings; certain agricultural and horticultural structures and certain reforestation expenses.
8. This deadline caused a flurry of activity in September and October of 1981 as corporations rushed to qualify for leasing property already purchased and placed into service.
9. This provision exempts from tax interest paid on municipal bonds used to finance purchases of buses, subway and rail cars to be used by mass transit systems owned by government units. The theory is that by exempting interest from tax local governments can offer holders of their obligations an attractive yield at a lower cost to the local government. By permitting tax leasing of mass commuting vehicles, capital costs are further subsidized.
10. If property for which accelerated depreciation deductions or a credit have been taken is disposed of prior to the end of its useful life or the ACRS recovery period, part of the tax benefits are "recaptured", i.e. paid back to the Treasury.
11. Temporary Regs. Section 5c. 168(f)(8). Treasury Decision 7791.
12. Letter of 27 October 1981 from Chrysler Corporation President Lee A. Iacocca to Treasury Secretary Donald T. Regan, reprinted in *Tax Notes*, 16 November 1981, p. 1215.
13. Treasury Decision 7795.

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the safe harbor provision, unless within 60 days of the transfer the lessee's transferee gives written consent to take subject to the leasing of the tax attributes of the property to the nominal lessor.

Under the new regulations it is intended that corporations will have the flexibility needed to make maximum use of Section 168(f)(8) so that, as Congress intended, the lessee will obtain the benefit of capital investment incentives in an amount as near as possible to the tax incentives it would have received had it been able to take advantage of the ACRS deduction and the Investment Tax Credit without having to resort to a lease.

A QUESTION OF POLICY

The old guidelines, which made leverage leasing complicated and resulted in high transaction costs, were designed to insure that only genuine arrangements were recognized for federal tax purposes. In contrast, the new regime will be easier to work with because it represents more than simply a change in mechanical requirements or an easing of reporting obligations. As stated in the *General explanation of the Economic Recovery Tax Act of 1981,* prepared by the staff of the Joint Committee on Taxation, the new provision is

> . . . a significant change overriding several fundamental principles of tax law. Traditionally, the substance of a transaction rather than its form controls the tax consequences of a transaction. In addition, a transaction generally will not be given effect for tax purposes unless it serves some business purpose aside from reducing taxes. Because the leasing provision was intended to be only a transferability provision, many of the transactions that will be characterized as a lease under the safe harbor will have no business purpose (other than to transfer tax benefits). When the substance of the transaction is examined, the transaction may not bear any resemblance to a lease.[14]

However, to admit that a safe harbor for leverage leasing serves no business purpose save for reducing taxes does not mean that transferability of tax benefits does not serve any legitimate public objective. The investment tax credit and accelerated depreciation are intended to lower the cost of capital to firms in order to encourage capital investment, which is considered the key to economic growth. When some firms cannot take advantage of these incentives not only are their capital costs not decreased, they are in fact increased relative to other firms. This distortion should be addressed in some way. Therefore, we have the Congress encouraging leverage leasing by creating a safe harbor.

The basic principle is summed up in the following passage from an address by the Assistant Treasury Secretary for Tax Policy, John E. Chapoton:

> What tax leasing guarantees is that the investment stimulus of ACRS will be available equally to all firms which make new investments, whether or not the particular firm has significant current income. The choice of investments made in the economy will be determined by the economic profitability of the investments, not by special tax benefits available only to certain firms with particular tax characteristics. Far from being a special interest benefit for distressed industries or cash rich companies, leasing is a tool for spreading the investment stimulus of the new tax law more equally throughout the economy . . . . safe harbor leasing, which allows more efficient leasing transactions than under prior law, is an essential ingredient of the new ACRS rules.[15]

Since passage of the ERTA, corporations have been quick to arrange leasing transactions to take advantage of the new safe harbor provision. This has created considerable publicity, mostly adverse, which has in turn prompted several members of Congress to propose legislation to repeal Section 168(f)(8).[16] Whether or not such efforts will be successful remains to be seen.

Under temporary regulations issued by the Treasury, safe harbor leases are to be reported within 30 days after the transaction is executed,[17] so that when the Congress does reconsider Section 168(f)(8) it will be able to draw upon useful current data in considering how effective the provision has been. Nevertheless, the result of its reconsideration will hinge as much on politics as tax policy.

Although opposition to Section 168(f)(8) is based for the most part on its cost to the Treasury, and not on its effectiveness in dealing with the problem of distributing tax incentives made available in other parts of the Internal Revenue Code, the section can also be faulted in that respect.

According to one estimate, companies that "sell" their tax benefits appear to be getting about 60% of the value of those benefits.[18] That means that although the benefit results in a loss to the Treasury of the full amount which the lessee would have been entitled to had it been able to use the benefits itself, the intended beneficiary of the investment incentive, the lessee, gets much less assistance than the government has paid for. This is plainly not efficient. In addition, the fact that profitable corporations are able to take substantial deductions and credits by becoming tax lessors can undermine public confidence in the revenue system. On the other hand, if only profitable enterprises are able to take advantage of tax credits and deductions that are intended to apply across the board, there is also a risk that some corporate taxpayers will perceive the sytem as inequitable.

Accordingly, if the government is to continue to provide incentives to capital investment through the tax system, it may be necessary to consider alternatives to leverage leasing as a means for allowing all corporate taxpayers to take advantage of the incentives. The most obvious alternative is a refundable tax credit, i.e. a system where corporations without tax liability to offset would be given a payment in the same amount they would otherwise receive as a tax credit. Such a scheme might be complicated to administer. Neverthless, it has been considered be-

14. Report of 29 December 1981 at p. 104.
15. Address of 5 October 1981 before the Tax Society of New York University, reprinted in *Tax Notes,* 12 October 1981, pp. 867, 872.
16. At least 5 bills have been introduced in the Senate and 18 in the House of Representatives which call for repeal of the safe harbor leasing provision.
17. Treasury Decision 7800.
18. *Baltimore Sun,* 10 January 1982, p.A-1.

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fore, and is used in some countries, notably in Western Europe, as a means for distributing tax incentives for investment (see box). The major advantage of a refundable credit is that the incentive is more precisely targeted; in other words, the company which is supposed to receive the subsidy receives the whole subsidy, without having to share it with a lessor as under Section 168(f)(8).[19] The difficulty with a refundable tax credit is that it is likely to be politically impossible, particularly at a time of unprecedented deficits, for the Federal government to make cash payments to distressed corporations or profitable corporations, which for one reason or another have no U.S. income tax liability.

Another means of allowing corporations in a loss position to have the benefit of incentives would be to allow them to take advantage of those incentives over an indefinite period of time. This would, however, not be effective in many cases and in any event does not completely address the problem. Net operating losses and certain credits can already be carried over for a period of 15 years,[20] and any incentive that is only available several years down the road is really no incentive at all. The present value of the tax credit or deduction will always be much greater than the value of that same benefit taken several years in the future. That is why tax leasing has proved to be so popular among the lessees. Even after paying a premium to the lessor they still benefit because they receive an infusion of cash immediately. For many companies the promise of a tax benefit in the future means little; they may have disappeared before they are able to use it.

The problem addressed by tax leasing is by no means simple. If Section 168(f)(8) is abolished and nothing is put in its place, the tax incentives offered for capital investment will continue to cause distortions in the economy. However, some distortion is inevitable where the revenue system is too heavily depended upon as a vehicle for carrying out economic programs. Perhaps the real solution is for the Federal government to eliminate tax incentives for investment, which will increase its revenues and decrease its need to borrow money, thereby freeing a substantial amount of capital which would then be available at a lower cost to the private sector.

19. See Bierman and Bierman, "Leasing and the Tax Cut of 1981", *Tax Notes*, 19 October 1981, p. 875.
20. IRC Sections 46(b); 172.

SELECTED INVESTMENT SCHEMES IN EUROPEAN COUNTRIES AVAILABLE WITHOUT REGARD TO TAXABLE INCOME

NETHERLANDS: The Law on Investment Incentives (WIR), effective 24 May 1978, provides for a tax-free basic investment premium and a number of tax-free investment bonuses. (The law replaces two prior special tax incentives for investment: accelerated depreciation and an investment allowance.) The WIR premium and the total investment bonuses are credited against the taxpayer's income tax liability. The depreciable base of the assets concerned is not affected. Corporations operating at a loss may apply to the Tax Administration (Inspecteur der Vennootschapsbelasting) for payment of any excess over tax due. Non-residents may also benefit from these subsidies; however, where it affects their income tax liability, it may also affect the possibility of crediting Dutch income tax against income tax in their home country, e.g. the United States. Therefore, the net result will be no actual benefit from the cash subsidy.

FRANCE: A cash grant (Regional Development Grant) of up to 25% of amounts invested may be obtained by businesses which create or expand activities in designated areas where industrial problems exist.

GERMANY: The Investment Premium Law (Investitionszulagengesetz) provides for a tax-free investment aid of 8.75% of the amount invested in depreciable fixed assets for new businesses and expansion of business in certain development areas. Premiums varying between 7.5% and 20% of the cost of investment in new depreciable fixed assets are available where the assets are used in research and development, production and distribution of energy, and for any purpose where the assets were ordered or production commenced within stated time periods.

The government is presently considering offering a 10% investment grant for investment made during 1982 in new plant and buildings, provided the firm making the investment spends more than its average investment in the past 3 years.

SWEDEN: Investments made during certain stated time periods, in general ending 31 December 1979, were eligible for an investment allowance in the form of a 10% or 25% deduction (prior investment periods have been granted deductions of 20% and 30%) which could only be taken in the year of the investment. However, if the profit was insufficient to offset the entire allowance, the taxpayer could opt to receive cash in the amount of 4% or 10% of the investment.

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Tax Incentives of Industrialized Countries for Private Undertakings in Developing Countries

A Brief Introduction

by Eugen Jehle*

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I. INTRODUCTION

A. Background

In recent years, world-wide interest in the relationship between industrialized and developing countries has increased significantly. This is last but not least documented in the creation of specific international bodies and organizations that are preoccupied with all possible issues involved, directed to bring about an improvement in the economic and social situations of developing countries.

There is little controversy around the question that tax incentives for private undertakings, on the side of industrialized countries and/or developing countries, are only one device out of a vast variety of possibilities that could make a contribution to a more equitable distribution of wealth amongst nations. Furthermore, the degree of usefulness of such incentives will depend upon a great number of factors, such as the economic system of a developing country and the degree of development that has already been achieved.

B. Scope of this article

As indicated above, the appropriate means of support for developing countries are often difficult to identify. This article will present a short survey of possible tax incentive measures open to industrialized countries. It is quite clear that this catalogue of measures is only one component of a broader picture that, to be somewhat comprehensive, should also include *tax incentives provided by developing countries* and *the reconciliation of tax incentive measures as provided by industrialized and developing countries.*

Nevertheless, this article is confined to tax incentives for private undertakings in developing countries provided by industrialized countries. Indeed, it can be observed that there is renewed interest for this especially on the side of the industrialized countries these days for which one can assume the following reasons:

(1) the gloomy state of the economy of many industrialized countries themselves, documented by huge budget deficits, great balance of payment problems, etc., makes it very difficult for the respective governments to maintain or even increase the transfer of public funds to developing countries;

(2) the discovery of possible potential for economic growth through private undertakings in developing countries that may be beneficial to the developing country as well as to the economy of the industrialized country; i.e. where it is possible to support undertakings in developing countries that further economic development and employment opportunities there without representing a threat to the economic situation in the industrialized country, for example with respect to the unemployment question. This scheme will be of particular interest where financial facilities can be made available from third countries. As opposed to the direct transfer of financial facilities, tax incentives often do not cause an immediate outflow of public funds.

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There are certainly many more reasons but, at present, these two appear to be the most significant.

This short presentation of the most common tax incentive measures will basically refer to private undertakings such as participation in a corporation, investment by way of a permanent establishment, the granting of loans, and the transfer of technology. It mainly applies to taxes on income. Another important issue, namely, tax incentives for expatriates, will only be briefly mentioned.

C. General problems

The types of tax incentives that can be employed will often be a function of the tax systems that are applied in the countries involved. For instance, where an industrialized country applies the territoriality system, the consequences will be quite different vis-à-vis another industrialized country that applies a world-wide system of income taxation.

Another crucial point is the fact that it is, in theory, a generally accepted idea that the investor should benefit from a tax incentive granted by a developing country and not the tax authority of the industrialized country of which he is a resident; however, some systems may well eliminate any such efforts taken by developing countries.

A further problem area constitues the existence of different accounting systems for tax purposes in the countries involved.

In some cases, the measures to be discussed below can provide a solution, but others remain outside the scope of this article.

II. THE DIFFERENT TYPES OF TAX INCENTIVES*

A. Classification

The tax incentives that may be made available to industrial countries can be classified in different ways, for instance as capital-related or income-related incentives, as incentives classified according to the stage of a private undertaking at which they are available, and many more. Of course, the type of incentive will also depend on the type of the activity that is undertaken.

Furthermore, the granting of tax incentives and the availability of measures for the avoidance of double taxation are often closely interrelated. Indeed, those measures can themselves represent incentives and therefore they are here given the same attention as are "ordinary" tax incentives although there are, of course, arguments to take a different viewpoint.

This short survey follows mainly the "stage classification".

B. Pre-activity/Initial tax incentives

Under this category those tax incentives are listed that can be made available either in the planning period (see (1)) or at the time the undertakings are initiated (see (2) to (5)).

1. Future investment reserves

Future investment reserves are amounts that are deductible from taxable income before any undertaking in a developing country has been started.

The maximum amount deductible may be determined as a certain percentage of the taxable profit of a given year, as a specific fixed amount, or may be based upon any other assessment base (equity capital, etc.). The future investment reserve as created must result in an undertaking in a developing country within a specified period of time; otherwise the amounts deducted from taxable income must be added back and are subject to taxation at the normal rate. The amount of the reserve may either be "kept" within the enterprise or it may be required to be transmitted to an institution such as a national development company or development bank. The latter way could also provide access to additional funds, expertise, etc. at the time an undertaking is planned and started.

The future investment reserve provides a possibility to enterprises, particularly small and medium sized enterprises, to "prepare" themselves financially for ventures in developing countries which are already at the planning stage. It appears that the possibility to build up such a reserve would open the way to private undertakings in developing countries for enterprises that may otherwise be prevented from doing so.

With respect to domestic investment, the future investment reserve scheme has been applied in a number of countries, including Denmark,[1] Finland[2] and Sweden[3] for some time. A scheme with a similar effect, namely, pre-investment depreciation, is, for instance, employed in Norway.[4]

2. Valuation rebate

Upon investing a certain amount of capital in an undertaking, a "lump sum depreciation" of a certain percentage may be granted without the requirement that there actually be a drop in the value of the underlying item. By way of such a valuation rebate, a hidden reserve is created which need not be dissolved until the undertaking is disposed of. The effect of this measure is a tax saving in the initial year of the undertaking with no tax consequences in the following years. The advantage of this measure is the easy handling, i.e. there is no substantial bureaucracy involved.

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* Specific country references to various kinds of incentives and other measures have been established with the kind cooperation of the Staff of the International Bureau of Fiscal Documentation.
It must be noted that the references to specific countries are to serve as examples only and naturally cannot represent any kind of complete survey.

1. Law on Investment Reserve, of 18 November 1975, as amended.
2. Law on Investment Reserve and Allowance, of 28 December 1978, as amended.
3. General Investment Reserve Act, of 31 May 1979, as amended. For a detailed discussion of the Swedish scheme, see:
   (a) Claessen, F.M., "General Investment Reserve – New Provisions", in 20 *European Taxation* (1980) 12 at 389.
   (b) Norr, Martin, *Reserves for future investment: a Swedish Tax Incentive*, Vol. I of Selected Monographs on Taxation (Harvard Law School International Tax Program and the International Bureau of Fiscal Documentation, 1974).
4. Income and Net Worth Tax Act, Section 44A, Lit. 4b and 5b.

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The valuation rebate was, for instance, granted in West Germany under the Development Aid Tax Law, but was abandoned on the occasion of a later amendment of that law. The tax law of Austria contains a similar provision for investment abroad provided that certain requirements are met.[5].

3. General reserve

A "general reserve" is described in this article as a profit-deductible amount based upon the value of a private undertaking initiated in a developing country. The deduction of the reserve will usually take place in the year in which the underlying undertakings are being started. As to the amount of the reserve, there are numerous possibilities ranging from a rate of 1% to a rate exceeding 100%.

Another determinant of this type of incentive is the time period for which it is granted. The possibilities range, of course, from a dissolution at the time the undertaking is being disposed of to a dissolution within a relatively short period after its creation. In between there are many ways, for instance a dissolution in annual installments after a grace period of several years. The effect of this measure is basically a tax respite, the extent of which depends on the period during which the reserve may be maintained.

Provisions for a general reserve for undertakings in developing countries are contained in the tax laws of France,[6] Japan[7] and West Germany.[8]

4. Tax-free transfer of hidden reserves

The tax systems of most industrialized countries provide for the taxation of hidden reserves upon dissolution, either by way of capital gains taxation or by way of automatic inclusion of such amounts into profits due to the application of the accrual method. A dissolution of hidden reserves is usually assumed when an asset is sold or otherwise leaves the sphere of an enterprise (or country).

"Bearers" of hidden reserves may be all kinds of movable fixed assets but also intangible assets such as patents, trademarks, etc. In the latter case, the amount of hidden reserves may be particularly great when the underlying items represent the result of own research and development efforts and the tax law of the country in question does not require/allow the capitalization of the underlying costs. Indeed, the obligation to dissolve hidden reserves can frustrate the otherwise desirable transfer of assets to undertakings in developing countries. This effect can be avoided in allowing enterprises to maintain the book value of such items (in case it remains in the sphere of the enterprise). Where self-developed, non-capitalized intangible assets are being transferred, a solution may also be found in capitalizing the item with one unit of account (as pro memoria item). At any rate, where an industrialized country does not want to waive the right to tax the hidden reserves of items upon the transfer to a developing country, it could allow a combination of dissolving the hidden reserves with the creation of profit-deductible reserves.

In the first case, a tax-free transfer of hidden reserves would be the result whereas in the latter case (profit-deductible reserve) the consequence will depend upon the requirements with respect to the dissolution of those reserves. If the reserve may be maintained indefinitely, a generous tax respite will be the consequence whereby this transaction even may become a tax-free transfer (e.g. where a patent eventually expires).

5. Investment premiums (Investment tax credit/Cash grant)

A special form to promote private undertakings in developing countries is the investment premium to be granted by the authorities of the industrialized country.

There are arguments that this type of incentive need not necessarily be regarded as a tax incentive. In this article, however, it is being dealt with as a tax incentive; the only difference vis-à-vis other incentive measures is to be seen in the fact that the implications do not appear at the level of income but rather at the level of amount of tax due. The basic idea is that a private undertaking in a developing country will benefit from a premium (investment tax credit or cash grant) calculated as a certain percentage of, for instance, capital invested.

The advantages of investment premiums include the quick availability of liquidity for the enterprise. Furthermore, if the investment premium does not influence the acquisition cost to be used for possible depreciation and is also otherwise kept outside the accounting system for tax purposes, it is truly a one-time affair that does not encourage the blossoming of red tape.

At any rate, this type of incentive has become a popular incentive measure for domestic investment in a number of countries, including Canada,[9] the Netherlands,[10] Spain,[11] West Germany[12] and the United States of America.[13]

C. Tax incentives during operation

The pre-activity/initial tax incentives are mostly concerned with tax matters that arise at the first stage of an undertaking in a developing country, whereas the tax incentives during operation are mostly concerned with the outcome of those undertakings in subsequent years, i.e. the treatment of income – positive or negative – is the major issue.

Again it must be emphasized that precise answers to related questions will depend on the tax system of a specific industrial country; if the territoriality principle of taxa-

5. Einkommensteuergesetz, Sec. 6(7).
6. CGI, Article 39 octies A-loi no. 80-30 du 18.1.80.
7. "Overseas Investment Loss Reserve." For a detailed discussion, see: *Guide to Japanese Taxes,* Yuji Gomi 1981-82, at 332.
8. Entwicklungsländer – Steuergesetz, of 21 May 1979. For a detailed discussion of West German legislation in this context, see: Jehle, E., "The New Developing Countries Tax Law – Tax incentives for West German investments in the third world", 19 *European Taxation* (1979) at 349. As of 1 January 1982, this law has been repealed.
9. Income Tax Act, Sec. 127(5)-(12).
10. For instance: Law on Investment Incentives (WIR), of 24 May 1978.
11. For instance: Law 61/1978 of 27 December 1978, Impuesto sobre Sociedades, Article 25, as updated.
12. Investitionszulagengesetz, of 2 January 1979.
13. IRC, Secs. 38 and 46.

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tion is employed, the answers are different as compared with countries that adhere to the taxation of world-wide income.

In this context, there is, of course, another important issue, namely, the question as to how a developing country taxes private undertakings carried on by foreigners. Indeed, this is not the subject of this article but the underlying implications cannot be totally ignored. Thus, it will be necessary to mention briefly relevant measures.

One could argue that measures for the avoidance of double taxation, both unilateral and bilateral, are not by their very nature tax incentive measures of industrialized countries for private undertakings in developing countries, since, to a great extent, they are also employed in relationships between industrialized countries. However, whatever viewpoint one may employ, these measures are too important to be neglected and their implications may have a greater significance for a foreign investor than the aggregate of all other tax incentives. Furthermore, there are indeed measures that are uniquely designed for the relationship between an industrialized country and a developing country.

1. "Specific" tax incentives

In this article, those measures are defined as "specific" tax incentives (during operation) which usually do not fall under the category of measures for the avoidance of double taxation.

a. *Special depreciation*

A great number of industrialized countries provide a rather generous tax regime by way of allowing a fast depreciation of fixed assets. Although that regime is usually designed for domestic purposes it may nevertheless be applicable with respect to undertakings in developing countries, namely where such an undertaking is carried on as a permanent establishment and the system of taxation of world-wide income is applied.

The most common schemes are the following:

- *Full depreciation* for fixed assets in the year of acquisition. This regime is, for instance, applied in the Republic of Ireland[14] and in the United Kingdom;[15] other countries are also reported to be considering the introduction of this scheme into their tax system.
- *Accelerated depreciation,* i.e. a fast writing off of fixed assets by way of allowing high depreciation rates in initial years or an additional depreciation on top of the usual depreciation that is based on the useful life of an asset. At any rate, the depreciation base usually does not exceed 100%. This scheme is common practice in many countries, including Austria,[16] Belgium,[17] Japan[18] and Sweden[19] whereby there are often restrictions with respect to the specific type of fixed assets that are required.
- *Depreciation allowance,* i.e. the depreciation base exceeds the acquisition costs of a fixed asset. This scheme is, for instance, found in Belgium[20] and Finland[21] whereby it is also often restricted to specified types of assets or certain areas.

b. *Reserves for losses*

Where an undertaking in a developing country is maintained in the form of a subsidiary company or where a tax treaty provides for the exemption from taxation of income of a permanent establishment in the industrial country, no consideration of losses of such undertakings will usually be provided.

As an incentive measure, an industrialized country may include a provision in its national tax law that allows the creation of a profit-deductible reserve for such losses. Usually, such a reserve is dissolved as soon as the subsidiary company/permanent establishment operates at a profit.[22]

Generally speaking, the consideration of such losses is, for instance, possible in the international relationship in France,[23] West Germany[24] and the Netherlands[25] provided that certain preconditions are met.

c. *Depreciation to fictitious going concern value*

The tax laws of some industrialized countries provide the possibility of depreciation in those cases where the taxpayer can establish that the actual value of an asset is lower than its book value. This scheme may be opened for application for undertakings in developing countries on a fictitious basis. A systematic depreciation of a certain annual percentage of the initial investment spread over a number of years down to a certain fictitious going concern value without requiring economic justification represents an attractive possibility to provide a tax incentive for private undertakings in developing countries in that it allows the tax-free creation of hidden reserves. This scheme offers a "compensation" for the general risk that is always involved where there are undertakings in remote countries.

d. *Tax reliefs for expatriates*

Although it will usually be the developing country that taxes expatriates from industrialized countries employed in undertakings there, there are nevertheless certain situations where an industrialized country can provide reliefs for such persons. This is particularly true where an industrialized country bases its tax system upon citizenship; in this case, a substantial basic exempt amount can bring about the necessary incentive to work in a developing country.

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14. Finance Act 1971, Sec. 26, as amended.
15. Finance Act 1972, Sec. 67.
16. Einkommensteuergesetz, Sec. 8.
17. For instance: Law of 30 December 1970 regarding economic expansion.
18. Japan allows accelerated depreciation for a great variety of assets. For a detailed discussion, see: *Guide to Japanese Taxes,* Yuji Gomi 1981-82, at 316 ff.
19. For instance: Regulations to Sec. 29 of the Local Tax Act.
20. For instance: Income Tax Code, Art. 48 bis (introduced by Law of 10 February 1981).
21. For instance: Law on incentives for investments in certain regions, of 31 December 1975, as amended.
22. For a detailed discussion on the effect of losses in one country on the income tax treatment in other countries of an enterprise or of associated enterprises engaged in international activities, see: *IFA – Cahiers,* LXIVb, 1979.
23. For instance by way of:
    - CGI, Article 39 octies A loi No. 80-30 du 18.1.80.
    - CGI, Article 209 quinquies.
24. Auslandsinvestitionengesetz of 18 August 1969, Secs. 2 and 3.
25. Implied in the Dutch system of taxation of world-wide income (general rule).

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Relief measures in this context may also be extended to the social security system of the industrialized country; for example, where it appears to be desirable for an expatriate to remain in the social security system of his home country, this should be facilitated in the underlying legislation.

2. Tax incentives provided by measures for the avoidance of double taxation

Measures for the avoidance of double taxation can be based on (a) unilateral provisions of the national law, (b) bilateral treaties between two states, or (c) multilateral treaties between a number of states.

For the purpose of this article, i.e. the application of such measures as tax incentives in the relationship between developing and industrialized countries, only the unilateral and the bilateral approaches are significant.[26]

This article does not deal with those two legal approaches as such but with the methods that, in principle, may be offered by both.

The following is a presentation of different methods for the avoidance of double taxation with respect to taxes on income whereby the situation is, of course, regarded from the angle that a person (investor) in an industrialized country receives income from an undertaking in a developing country. (To some extent, these principles are also applicable to taxes on capital.)

Again, the discussion of the various methods basically refers to private undertakings in the form of subsidiary companies, permanent establishments, the granting of loans, and the provision of technology (royalties), as the case may be (see also above).

a. *Tax exemption method*

The exemption method actually "ignores" the income that arises abroad (source country), in this case a developing country. In other words: the source country will tax the underlying income according to its tax laws whereas the investor's home state (industrialized country) does not levy any taxes on the same income item. Thus, such income is tax free in the investor's home country.

This method makes sure that tax incentives granted by developing countries fully benefit the investor. As a general rule, tax incentives are granted by a developing country as a compensation for, for instance, an insufficient infrastructure. Thus, the tax exemtpion method enables an investor to operate under more difficult circumstances, usually under the same conditions as similar undertakings in a developing country. In this context, the exemption method is most relevant with respect to taxation of the profit of a permanent establishment; the tax exempt-status may either be based on a unilateral waiver of the investor's home country or on a tax treaty provision that allocates the exclusive right to tax to the state where the permanent establishment is located.

This method can thus be regarded as a simple but powerful incentive to carry on undertakings in a developing country (provided, of course, that the "tax climate" there is "pleasant").

A certain "sophistication" of the tax exemption method can be seen in the application of the so-called progression clause. This is to say that a country may well accept the right of another state to tax a certain item but nevertheless employ that tax rate for the (domestic) income that is applicable to the total income (i.e. including the tax exempt income). This measure is of course only relevant where the tax is levied at progressive rates.

Generally speaking, the tax exemption method is unilaterally applied, in different variations (e.g. depending on the type of income) in countries including Australia,[27] France[28] and the Netherlands.[29] Many countries refer to the tax exemption method in their respective tax treaties.

b. *International affiliation privilege*

The international affiliation privilege is a special form of tax exemption method for intercompany dividends. Where a corporation that is a resident of an industrialized country holds a certain percentage of the equity capital of a corporation in a developing country, the dividends paid by the latter to the former are tax exempt in the industrialized country.

As to the percentage necessary to qualify for this favorable tax treatment, there is no uniform picture. Some countries require a stake of at least 25% in the capital of the subsidiary company, others are satisfied with 20, 10, 5 or an even lower percentage rate. At any rate, the decisive criterion is often whether the parent company can exercise some influence on the subsidiary company by virtue of the shareholding.

An extension of this favorable treatment can also be considered in those cases where the shareholder is not a corporation but, for instance, a partnership. In many cases if may be desirable or even vital to carry on undertakings in a developing country in the form of a corporation whereas, it may be favorable to carry on business in the home country in a legal form other than a corporation.

This incentive measure is, for instance, unilaterally applied in Australia,[30] Belgium,[31] France,[32] the Netherlands[33] and Switzerland,[34] other countries referring to it in underlying tax treaties.

c. *Fictitious tax credit (Tax sparing credit/Matching credit)*

The currently fashionable method for the avoidance of double taxation with regard to the relationship between industrialized and developing countries is the fictitious tax credit.

Basically, the idea is that an industrialized country grants

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26. For a more detailed discussion of this subject, see for instance:
(a) *The Taxation of Companies in Europe, Guides to European Taxation,* Vol. II.
(b) "Unilateral Measures to prevent double taxation". *IFA – Cahiers,* LXVIb, 1981.
27. Income Tax Assessment Act, Sec. 23(g).
28. Implied in the French system of territoriality taxation.
29. Decree of 7 April 1965 (unilateral relief measures, Articles 3 and 7).
30. Income Tax Assessment Act, Sec. 46.
31. Income Tax Code, Articles 111-113.
32. CGI, Articles 145, 146(2) and 216.
33. Corporate Income Tax Law, Article 13.
34. Art. 59 Wehrsteuerbeschluss.

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a tax credit of a certain percentage for underlying income from a developing country without regard to how high or low (e.g. due to special tax incentives) the actual tax burden of that income has been in the developing country. Therefore, this mechanism is named the "fictitious tax credit", also referred to as tax sparing credit and matching credit. The income items for which it is usually employed are dividends, interest and royalties.

This method may be further refined. The most important approaches can be summarized as follows:

(i) the credit in the industrialized country equals precisely the tax ordinarily provided for in the developing country. Thus, any incentives that lower the ordinary tax burden are "spared" and benefit the investor;

(ii) the credit in the industrialized country intentionally exceeds the tax levied in the developing country.

Indeed, an almost unlimited number of variations can be designed. Many factors must be taken into consideration; the relevance of this is reflected by the fact that the fictitious tax credit is usually arranged for in bilateral treaties for the avoidance of double taxation where a reconciliation of the diverging factors – due to different tax systems, etc. in the industrialized and developing country involved – will be striven for. It is due to these difficulties that the fictitious tax credit has been employed as a unilateral measure for the avoidance of double taxation only in exceptional cases.

Indeed, many industrialized countries accept the inclusion of the fictitious tax credit (tax sparing credit) into tax treaties with developing countries. The unilateral granting of the fictitious tax credit is not very common; West Germany for instance is prepared to grant it in specific circumstances.[35]

d. *Lump sum settlement*

The application of an accounting and tax system in a specific developing country that differs totally from that in a specific industrialized country may be one out of many possible reasons that it does not appear to be advisable to employ one of the usual measures for the avoidance of double taxation but rather rely on taxation on a lump sum basis.

Again, a great variety of possibilities is available. For instance, one of the most efficient (and least bureaucratic) manners will be a situation where, in the case of a foreign permanent establishment, an industrialized country totally neglects the (foreign) calculations of income and taxes and applies a certain, usually low, tax rate on a possibly estimated (gross) income.

Another popular candidate for taxation on a lump sum basis can be income from personal services in the case of expatriates where the industrial country retains the right to tax but where a fair fixing of deductible expenses encounters great difficulties.

At any rate, the lump sum settlement will represent an attractive "tax incentive" where there is a striking disproportion between the actual amount of income and taxes and the effort in calculating income and taxes according to "well established principles".

e. *Direct tax credit*

The direct tax credit is a logical consequence of the strict application of the principle of taxation of world-wide income (or capital) in that it provides for the deduction of foreign taxes from the domestic tax liability that has been established on the basis of world-wide income (or capital).

Indeed, this measure for the avoidance of double taxation can only be regarded as a tax incentive if one regards the absence of other measures (or less favorable measures) as the only alternative.

Generally speaking, in applying the direct tax credit, the tax burden on income that thas been derived in a developing country will be equal to the tax burden on income that has been earned in the industrialized country of which a potential investor is a resident. Any tax incentive (low tax rate, etc.) provided by the developing country is cashed in by the tax authority of the industrialized country.

Thus a developing country may actually be forced to levy taxes at a high rate although the "economic environment" (poor infrastructure, etc.) makes it highly advisable to promote economic development with taxes that offer a low burden. This can have a particularly adverse impact where the interest of foreign investors is confined to a few specific fields (e.g. oil exploration) and less attractive (foreign) investment in other fields of vital importance is thus frustrated.

Within the method of the direct tax credit, there are also certain possible variations.

For instance, if the so-called per country limitation is applied, income and creditable taxes are established separately for each country. Thus, if there is income from two foreign countries whereby the tax burden of the first is lower than that of the industrialized country but the second is higher, the difference will be cashed in by the tax authority in the first case but in the second case the excess (tax burden developing country – tax burden industrialized country) may not be creditable but must be borne by the investor.

Where, however, the overall limitation is applied, income and creditable taxes are established as an aggregate and there is an inter-country compensation whereby a non-creditable residual tax burden appears only in those cases where the average tax burden of foreign-source income exceeds the tax burden of the industrialized country in question.

Another possible procedure is the limitation of the tax credit to specific types of income, i.e. the strict application of a schedular system of taxation in an international relationship.

The provision of a "carry-forward of foreign taxes" can offer some relief in those cases where the taxpayer in the industrialized country has no tax or an insufficient amount of tax to be credited against the foreign tax.

35. Körperschaftsteuergesetz, Sec. 26(3).

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The direct tax credit is, for instance, the method that is generally applied in Denmark,[36] Finland,[37] Japan,[38] West Germany,[39] Sweden,[40] United Kingdom,[41] and the United States of America.[42]

It is observed that some countries which usually do not grant the direct tax credit – either because they employ the territoriality system or their tax system does not provide for measures for the avoidance of double taxation – are prepared to grant it in the case of income received from developing countries. For instance, the Netherlands allow the direct tax credit for withholding taxes paid on dividends, interest and royalties provided they stem from developing countries.[43]

f. *Indirect tax credit*

The term "indirect tax credit" is usually referred to in cases where foreign taxes (e.g. paid in a developing country) may be credited against taxes in an industrialized country whereby the taxpayer of the foreign taxes is, from a legal point of view, not identical with the taxpayer that claims a credit for the foreign taxes paid.

The practical relevance of this incentive measure is generally confined to dividends. Where a parent company in an industrialized country receives dividends from a subsidiary company in a developing country, the availability of the indirect tax credit will allow a credit of the income tax paid by the subsidiary company against the tax liability of the parent company, on a proportional basis of course.

Thus, there is generally no difference in the tax burden between capital invested in a developing country and at home in an industrialized country (see above, direct tax credit).

The indirect tax credit is, for instance, available in Japan,[44] West Germany,[45] United Kingdom[46] and the United States of America.[47]

g. *Deduction of foreign taxes from the taxable base*

Generally speaking, this type of tax measure usually can be regarded as an incentive for undertakings in developing countries only in cases where there is otherwise no relief measure at all.

Nevertheless, depending on a number of other factors, this method can be favorable. For instance, where an investor suffers losses in the industrialized country and there is no carry-forward of foreign tax credits, this method may at least safeguard a carry-forward of losses whereby the foreign taxes are included in the relevant amount.

Furthermore, the possible application of this method in cases where other measures cannot be used may bring about some relief, e.g. where foreign taxes are not regarded as being equivalent to domestic taxes and a tax credit is therefore refused.

West Germany[48] and Japan,[49] for instance, offer their taxpayers an option between deduction of the foreign tax from income and a tax credit.

D. Tax incentives upon termination of activities

1. Tax-free re-transfer of hidden reserves

Where a private undertaking in a developing country is successfully terminated (e.g. the expiration of a joint venture carried on as a corporation, the disposal of a permanent establishment, the repayment of a loan, etc.), hidden reserves may have been generated.

To the extent that a possible taxation of those hidden reserves falls under the jurisdiction of an industrialized country, this country may consider the possibility to transfer hidden reserves as contained in such items into a new private undertaking in a developing country.

2. Tax reliefs for returning expatriates

Although this subject does not actually fall within the scope of this article, it should nevertheless be mentioned that there is a number of possibilities to make temporary work in developing countries attractive for executives, technicians, etc., last but not least by way of specific tax incentives and/or by generous treatment generally provided by in the tax system for such cases.

E. Summary

Many factors will influence the decision as to which type of incentive is to be granted for what type of undertaking. Indeed, each industrialized country has to design its own "package" of incentive measures that takes into consideration all relevant factors of taxation and groups them in a consistent manner. The table below provides a simplified survey as to which measures for the avoidance of double taxation may be offered by the tax system of an industrialized country.

III. CONTROL MECHANISMS

The possibilities for the tax authorities of an industrialized country to exercise control over private undertakings abroad are naturally limited. Indeed, they will generally be confined to the assistance of the tax authority of a developing country, as it may be arranged by virtue of a tax treaty under the "exchange of information clause".

Where the availability of a specific tax incentive of an in-

36. Assessment Law, Sec. 33.
37. Tax Credit Law, of 22.5.1981.
38. Income Tax Law, Article 95, Corporation Tax Law, Art. 69, Local Tax Law, Arts. 53 and 321-8.
39. Einkommensteuergesetz, Sec. 34c, Körperschaftsteuergesetz, Sec. 26.
40. National Income Tax Act, Secs. 24-27.
41. Income and Corporation Taxes Act 1970, Sec. 498.
42. IRC, Sec. 901.
43. Decree of 7 April 1965 (Unilateral relief measures, Art. 3a).
44. Income Tax Law, Article 95, Corporation Tax Law, Article 69, Local Tax Law, Arts. 53 and 321-8.
45. Körperschaftsteuergesetz, Sec. 26(2).
46. Income and Corporation Taxes Act 1970, Sec. 498.
47. IRC, Sec. 902.
48. Einkommensteuergesetz, Sec. 34c(2), Körperschaftsteuergesetz, Sec. 26(6).
49. Supra footnotes 18 and 38.

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Type of activity / Type of incentive	(1) Subsidiary company (inter-company dividends)	(2) Permanent establishment (profits)	(3) Portfolio investment (dividends)	(4) Granting of loans (interest)	(5) Provision of technology (royalties)
(a) Tax exemption method		X	0	0	0
(b) International affiliation privilege	X				
(c) Tax sparing credit (matching credit)	X	0	X	X	X
(d) Lump sum settlement	0	X	0	0	0
(e) Direct tax credit		X	X	X	X
(f) Indirect tax credit	X		0		
(g) Deduction of foreign taxes from taxable income		0		0	0

X = application is common practice 0 = application (if at all possible) is not common

dustrialized country will depend upon the fulfillment of certain requirements (e.g. the maintenance of "active" undertakings in industry, commerce or agriculture), a confirmation certificate of a chartered accountant firm or a Chamber of Commerce (possibly one in which the country is a partner) may be a possible means to exercise a certain control especially concerning tax incentives that are granted at the initial stage of an undertaking.

IV. FINAL REMARKS

Tax incentives provided by industrialized countries for private undertakings in developing countries can only support the efforts of the latter's governments to accelerate the pace of the improvement in the economic development of their countries. However, it is and should remain a passive role; the active part in this relationship must be played by the developing countries themselves. As far as taxation is concerned, it is the task of the repective governments to create a tax climate and design an investment policy that make it attractive for foreigners to take the risk that is always involved in starting entrepreneurial undertakings, particularly in geographically remote areas.

At any rate, it has been observed that a great number of industrialized countries offer an attractive package of tax incentives for undertakings within their boundaries. The extension of such provisions to undertakings in developing countries is certainly one of the available possibilities; this is particularly true were an industrialized country employs the system of taxation of world-wide income but confines certain incentive measures (e.g. investment premiums) to domestic investments.

Anyhow, it is difficult to evaluate the positive impact that tax incentives may have, those of developing countries and of industrialized countries; the general feeling is that one must not overestimate their significance. However, it is even more difficult (or extremely easy?) to evaluate the negative impact that excessive tax claims and the possible absence of reasonable reconciliation measures do have, i.e. how many private undertakings that would be economically viable and that could contribute a great deal to the development of available resources never leave the stage of a feasibility study for tax reasons?

Quite a number of efforts are being undertaken to bring about an improvement in this respect. But there are good reasons for the assumption that the simplicity and reasonableness of tax provisions have much greater positive consequences in the development process of an economy than supposedly "sophisticated" solutions.

Finally, it must again be stated that private undertakings are just one element in the great complex that is identified as the relationship between industrialized and developing countries, and tax incentives are only a small portion of that element. Indeed, there is no pat solution for the improvement of this relationship. Rather, it is necessary to elaborate individual solutions for the specific cases of individual countries.

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SWEDEN:

Budget 1982–83

Swedish tax has been dealt with in the Bureau's publications: Supplementary Service to European Taxation, *Sections A and B;* Guides to European Taxation, *Vol. II:* The taxation of companies in Europe; *and Vol. IV:* Value added taxation in Europe.

The Swedish Ministry of Economic Affairs and the Ministry of the Budget recently published a 168 page booklet entitled: *The Swedish Budget 1982/83.*

We reproduce below the pages dealing with taxation.

One of the main foundations for the estimation of Budget revenue is a forecast by the National Audit Bureau. In fiscal 1982/83 revenue is calculated to about 169 billion kronor.

The main revenue items are presented below. The estimates are based on the assumptions which have been adopted in the Economic Policy Statement.

Budget revenues. Billion kronor; estimated

	1981/82	*1982/83*	*Change*
Taxes on income, caital gains and profits	31.8	34.7	+2.9
Statutory social security fees	31.0	31.0	–
Property taxes	2.7	3.4	+0.7
Value-added tax	38.2	40.5	+2.3
Other taxes on goods and services	29.2	30.5	+1.3
Revenue from central government activities	17.5	18.2	+0.7
Other revenue	9.0	10.7	+1.7
Total revenue	159.4	169.0	+9.6

The revenue from taxes on **income, capital gains and profits** comes very largely from the state tax on personal income.

The present system

For individuals, state income tax is levied on a progressive scale. For the 1982 income year the rate ranges from 2% in the lowest taxable bracket (6,900–27,600 kronor) to 58% in the highest (above 207,000 kronor). The scale is indexed against inflation in that the brackets are adjusted annually to allow for price developments. As of 1982 allowance for prices is made excluding indirect taxes (incl. VAT), customs duty and charges, while an addition is made for subsidies. Changes in energy prices are disregarded, too.

There is also a local tax on income. This is levied at a proportional rate, which is decided by each country council and municipality. For 1982 the average rate is calculated to be 29.74%. A marginal tax ceiling operates to prevent the combined rate of state and local income tax from exceeding 85% in the highest income bracket and 80% below this.

For tax purposes an important concept is the *source of income.* Certain costs are deductible from each source's taxable receipts and the net result is entered as income or a deficit under one of the six sources or types of activity (employment, capital, real property excl. agriculture, business, agricultural property, and incidental). For assessment purpose the taxable receipts and deductible costs are computed separately for each source. The sum of the sources which show a surplus then constitutes *total income.* From this are deducted any deficits on other sources, other general deductions and any deduction for losses. What remains is *assessed income.* Tax is however calculated on *taxable income,* which in most cases equals assessed income (for local tax there is a further general deduction). Certain persons, chiefly those with a basic pension, are entitled to an extra deduction from assessed income. Final tax is then calculated with allowance for any tax reductions. For 1982 tax reductions are available for married persons whose spouse has little or no income, for single persons with a child living at home, and for certain forms of saving and share devidends.

For 1982 state tax is smaller than local tax on incomes up to around 171,700 kronor.

Total revenue from state tax on personal income is estimated at 27.1 billion kronor in fiscal 1982/83.

Companies pay state income tax at 40% of taxable income. The rate for economic associations is 32%. State tax revenue from these legal entities in fiscal 1982/83 is estimated at 5.8 billion kronor.

Besides the tax paid by individuals and legal entities on income, capital gains and business, this main revenue item includes several minor headings. Total revenue under this item is accordingly estimated at 34.7 billion kronor.

Proposed change to income tax

In the spring of 1981 the Centre, Liberal and Social Democrat parties agreed on a reform of income tax and the intention is to present a Bill to Parliament this spring. The proposed reform involves a marked reduction of marginal tax rates and restrictions on the tax value of deficit deductions. The reform is to be implemented over three years, starting with the 1983 income year. When it is fully operational, the marginal tax rate for most full-time employees will not exceed around 50%. At the same time, the tax value of deficit deductions will be limited to about 50% of the amount deducted, even for persons whose income incurs a marginal tax rate of more than 50%.

The reform is confined to state tax, i.e. it does not concern local income tax. Moreover, the new regulations apply only to individuals and others for whom state income tax is progressive.

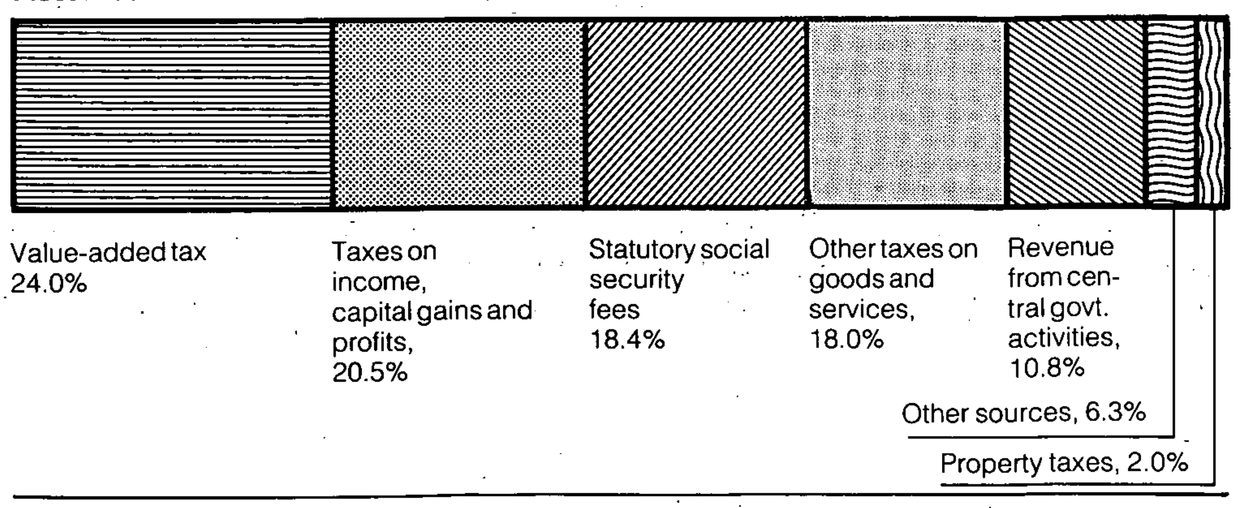
The tax agreement states that the reform should be financed in full by raising payroll charges or by means of a wider tax on factors of production.

In the present Draft Budget tax revenue has been forecast on the basis of unchanged tax regulations. The proposed reform's effects on the Budget are to be elucidated in this spring's Supplementary Budget Bill.

The item **statutory social security fees** comprises all charges that are calculated as a percentage of the wagebill and paid by employers and the self-employed. For 1982 there are 11 charges of this type. The revenue from them is accounted for in several ways; some are included in full in the Budget, others only partly or not at all. Those included in full – the charges for basic pensions, child care and adult education – are calculated to yield 31.5 billion kronor in fiscal 1982/83. Due to the construction of certain funds, the yield from the other charges is estimated to reduce Budgetary revenue by 0.5 billion kronor.

Total revenue from statutory security fees in fiscal 1982/83 is estimated at 31.0 billion kronor.

Sources of revenue
Fiscal 1982/83



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The main **property taxes** are those on capital, inheritances and gifts, and stamp duty.

For individuals, capital tax is progressive and starts at 1% on wealth between 400,000 and 600,000 kronor, rising to 2.5% on wealth above 1.8 million kronor. In fiscal 1982/83 capital tax is estimated to yield 0.9 billion kronor.

Total revenue from property taxes in fiscal 1982/83 is calculated to be 3.4 billion kronor.

Value-added tax (VAT) is levied as of 16 November 1981 at 17.7% of the taxable value (21.51% of the pre-tax price). Certain goods and services are partially or wholly exempt from VAT. Revenue from VAT is the largest individual item on the revenue side of the Budget. In 1982/83 it is estimated at 40.5 billion kronor.

Other taxes on goods and services are e.g. those on road traffic, petrol, spirits, wine, tobacco and energy. Revenue from this group in 1982/83 is estimated to total 30.5 billion kronor.

Road traffic taxes and petrol tax are calculated to yield about 9.4 billion kronor in 1982/83.

Petrol tax is levied on petrol and other motor fuels containing at least 70% petrol by weight, as well as on certain alcohols and alcohol extracts that are intended as motor fuel. The tax on petrol is to be increased to 1.20 kronor per litre as of April 1982.

Road traffic taxes are levied on vehicles and kilometreage. The vehicle tax is based on the vehicle's weight. The kilometre tax is charged if the vehicle is fitted to run on fuels other than petrol and liquefied petroleum gas, i.e. chiefly diesel oil. This tax varies with the vehicle's type and weight; it is levied on the number of kilometres driven (rounded down to the nearest ten).

Taxes on wines and spirits consist of a basic duty plus a percentage rate. The basic duty on spirits is a variable amount per litre, depending on the alcohol content, while for wine it is a constant amount per litre; the percentage rate is related to the price. Revenue from these taxes in fiscal 1982/83 is estimated to total 5.5 billion kronor.

Tobacco tax is levied by weight. In fiscal 1982/83 it is calculated to yield 2.9 billion kronor.

Energy taxes are levied at the following rates:

Petrol	0.34 kronor/litre
Liquefied petroleum gas	0.53 kronor/litre
Electricity	0.04 kronor/kilowatt-hour (0.03 for certain consumers)
Coal	12 kronor/tonne
Coke, incl. brickettes	14 kronor/tonne
Lignite brickettes, duff, etc.	6 kronor/tonne
Heating and fuel oil	253 kronor/m³

The total yield from energy taxes in fiscal 1982/83 is estimated at 7.9 billion kronor.

Customs duties are levied as a rule as a percentage of the article's dutiable value. A free trade agreement between Sweden and the EEC has been in force since the beginning of 1973. Duty-free trade had been introduced for most of the goods in question by mid-1977. In fiscal 1982/83 customs duties are estimated to yield 1.6 billion kronor.

Revenues from other central government activities comprise e.g. operating surpluses from the public enterprises, interest income and other central government charges. In fiscal 1982/83 these sources are estimated to yield 18.2 billion kronor.

JAPAN:

Budget 1982–83

See for a detailed discussion of the Japanese tax system the Bureau's publication:
Taxes and Investment in Asia and the Pacific.

The Japanese Ministry of Finance announced the following tax measures which the Government wishes to introduce in the financial year 1982-83.

I. Corporate income tax

(1) *Reserve for bad debts*

The reserve for bad debts will be reduced as follows:

Business of the corporation	*Percentage of receivables* Present	1982	1983
Retail or wholesale	1.6	1.4	1.3
Retail on installment payments	2.0	1.8	1.6
Manufacturing	1.2	1.1	1.0
Other kinds of business	1.0	0.9	0.8

(2) *Special depreciation*

The rate of the initial depreciation deduction will be reduced by 2 percentage points. For instance, the initial depreciation deduction for the prevention of environmental pollution will be reduced from 27 to 25%.

(3) *Entertainment expenses*

The deduction of entertainment expenses will be restricted. Under current law, corporations may deduct entertainment expenses in the following manner:

Corporations	*Deductible amounts*
– Corporations with capital of ¥ 10,000,000 or less	¥ 4,000,000 + 90% of the excess
– Corporations with capital over ¥ 10,000,000 but not exceeding ¥ 50,000,000	¥ 3,000,000 + 90% of the excess
– Corporations with capital over ¥ 50,000,000	¥ 2,000,000

Under the new provisions deduction will be limited to the fixed amounts and no deduction at all will be permitted for excess amounts. Corporations with capital in excess of ¥ 50,000,000 will no longer be allowed to deduct entertainment expenses.

(4) *Special tax treatment of capital gains derived from the transfer of real property*

A special additional capital gains tax is imposed on the sale or transfer of land, etc. acquired after 31 December 1969. The rate of this tax is 20%. This tax will henceforth apply to transfers of real property within 10 years after acquisition.

II. Individual income tax

Capital gains derived from real property acquired before 1 January 1969 (long term capital gains) are subject to a special income tax which is imposed at varying rates. This tax will henceforth apply to property transferred within 10 years from acquisition.

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ZAMBIA:

Budget 1982

Extracts from the Budget Speech pronounced on 29 January 1982 by Mr. Kebby S.K. Musokotwane, Minister of Finance

See for a detailed discussion of the Sri Lanka tax system the Bureau's publication: Taxes and Investment in Asia and the Pacific

FISCAL MEASURES

91. Mr. Speaker, Sir, it is evident from my earlier remarks that the economic and financial situation continued to deteriorate in the year just ended. I have also tried to convey the message that prospects for any meaningful improvement in this situation remain, at best, modest in the course of this year. In the light of this grim scenario and bleak outlook, the immediate and vital lesson for the Nation is, I believe, clear. The Nation must brace itself for more sacrifices and hard work.

92. Indeed, it is opportune for me to remind the House and the entire Nation that resources allocated to various national needs by the Government come from the people themselves through the payment of taxes and other levies. The responsibility of the Government is to collect such resources for equitable redistribution to important areas and for the purpose of achieving equitable distribution of incomes in the form of transfer payments.

93. Sir, I have in my address emphasised continued need to restructure the economy. The major component of this structural adjustment policy is the reallocation of our scarce resources away from consumption towards productive uses. This is one of the cardinal themes of this year's Budget. Consequently, the majority of budgetary and economic policy prescriptions included in this address are geared towards the attainment of this goal. Of critical significance are the following:

- the need for further reductions of subsidies;
- the need to move determinedly and progressively in the implementation of economic pricing;
- the need to enhance the operational effectiveness and financial viability of parastatal enterprises; and
- the necessity of restraining the growth and, preferably, achieving reductions of non-essential recurrent expenditures.

94. I have also made it clear that financial discipline and control are absolutely essential for all sectors particularly in the Government and parastatal sectors. With this in mind, Government expenditure has been set at levels which I believe to be realistic and necessary for the efficient operation of Ministeries and Departments. Therefore, Controlling Officers and others responsible for financial control and management should not view their responsibilities simply within the narrow limits of their respective agencies but within the broader national perspective.

95. Mr. Speaker, Sir, in arriving at the total expenditure, I have been guided by the level of recurrent revenue likely to be available this year. Of the total revenue of K1,038.3 million, I anticipate raising K135.7 million through new revenue measures which I shall announce shortly. In the case of Zambia, excessive reliance on taxes on international trade entails considerable risk, particularly during periods of depressed copper prices and economic conditions in general. This fact has been vividly demonstrated by the continued lack of mineral tax revenue as well as the unpredictable and fluctuating levels of revenue from import duties. As a consequence, I am compelled to rely on excise duties. The new measures will, admittedly, have the unpleasant but necessary effect of raising, for the Government, the required additional revenue. I have been compelled to resort to these measures in view of the inexorable increase in public expenditure. Therefore, society has, regrettably, to bear the burden of financing this increase in expenditure. It is my conviction that the ever-increasing demands made on the Government have to be matched by the readiness to make additional contribution through taxation.

96. Accordingly, I have had to broaden the scope of indirect taxation to raise the required revenue. The bulk of the additional revenue will therefore come from excise duties.

(a) Excise duty

97. Mr. Speaker, Sir, I propose to raise duty on the following items:

(i) Clear beer: by 5 ngwee per 375 millilitre bottle;
(ii) Opaque beer: by 1.2 ngwee per litre;
(iii) Cigarettes: by 10 ngwee on the most expensive brands of 20 cigarettes;
  - 5 ngwee on the middle brands of 20 cigarettes;
  - 3 ngwee on the cheapest brands of cigaresttes;

(iv) Pipe tobacco: from K3.00 to K4.00 per kilogram;
(v) Potable spirits: from K7.00 to K8.00 per proof litre;
(vi) Mineral water: by 4 ngwee per bottle;
No increases are proposed in respect of other non-alcoholic beverages such as orange squash, raspberry and strawberry juices which are predominantly consumed by our rural communities.
(vii) Sugar: by 4 ngwee per kilogram.

Sir, I expect to raise K12.5 million from clear beer, K2.0 million from opaque beer, K5.0 million from cigarettes, K4,000 from pipe tobacco, K250,000 from potable spirits, K6.7 milion from mineral waters and K2.4 million from sugar, as additional revenue.

Petroleum products

98. Mr. Speaker, Sir, Honourable Members are aware of the increasing portion of foreign exchange earnings consumed by imports of petroleum, oils and motor spirits. In 1980, the oil bill reached K130.0 million and rose sharply to over K205.0 million last year. This upward trend is expected to continue this year. In view of the soaring oil prices which are entirely beyond Zambia's control it is therefore imperative that the Nation should evolve a comprehensive energy policy. Such a policy shuld reflect the essential elements of fuel conservation, the development of alternative energy sources and measures to move towards a balance between demand and supply for energy. The current imbalance should be progressively restored by adequate price adjustments.

99. Mr. Speaker, Sir, pending the formulation and implementation of a comprehensive energy policy, I wish to urge the entire Nation to exercise the utmost economy in the use of this resource. In this respect the Government will continue to encourage and reward efficient energy use through the provision of appropriate incentives particularly for industry. The business community may wish to know that the Government, under the relevant customs and excise provision, may grant rebates in respect of imported equipment and machinery for the purpose of conversion to alternative and cheaper sources of energy, such as electricity.

100. Mr. Speaker, Sir, in view of the foregoing I propose to increase duty on premium and regular petrol by a flat rate of 3 ngwee per litre; an increase of 5 ngwee per kg on liquefied gas; and an increase of 9 ngwee per litre on diesel. The proposed increase on diesel should not have adverse implications for our farming community in respect of which significant incentives, including producer prices, have been awarded. As is well known, the cost of diesel is fully reflected in the determination of crop producer prices. Sir, on kerosene, I propose to introduce a modest increase in duty of 5 ngwee per litre. Honourable Members are aware that this product has for a long time enjoyed a zero-rate of duty. These measures are expected to yield K32.6 million.

101. These measures take effect from midnight tonight. However, I must caution and remind the business community that their current stocks for which they have paid the existing rates of duty are not affected by these measures. Consequently, the prices must remain unchanged. Adjustments may only be effected on sale of goods supplied by manufacturers after midnight tonight.

(b) Customs duty

(i) Bicycles

102. Mr. Speaker, Sir, I propose to remove the suspension of duty on all bicycles imported into the country. Sir, this measure is intended to afford protection to our budding

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Chipata Bicycle Plant which is expected to become operational this year. I consider this increase to be modest and should not therefore lead to disruption in the supply of imported bicycles as our plant establishes itself. The protection is merely designed to ease the plant's teething problemes in its infancy.

(ii) Boats, ships and launches

103. Under the provisions of the same subsidiary legislation, I have introduced a suspension of duty on all imported boats, ships and launches designed for use in fisheries and inland waterways, including vessels used in scientific research. I hope Mr. Speaker, Sir, that this will alleviate the hardship experienced by persons and organisations engaged in the activities I have just mentioned.

(iii) Customs tariff

104. Mr. Speaker, Sir, I propose to make adjustments to the existing customs tariff affecting various imported items. These adjustments have been necessitated by the need to take into account the rising prices of imports. These changed circumstances have made it appropriate to charge duty by value rather than by weight or quantity. I expect to raise K15.0 million from this change in the method of levying duty.

(c) Sales tax

105. Mr. Speaker, Sir, under the Sales Tax Act, I have not proposed any major revenue measures except that I have made structural changes in the tariff applicable to electricity, school uniforms and toothpaste. The significant aspect of these changes in respect of the last two items is that sales tax has been removed on school uniforms and the rate on toothpaste has been reduced from 50% to only 20%.

(d) Import licence levy

106. I propose to increase the levy on import licences from 2 to 5%. This increase is in conformity with the continued need for the rationalisation of the country's foreign exchange use and also to discourage frivolous applications for foreign exchange. This measure should discourage such behaviour without unduly deterring genuine and serious importers. I expect to raise K13.5 million from this measure which becomes effective from midnight tonight.

(e) Air passenger tax

107. Mr. Speaker, Sir, I propose to raise this tax from K8.00 to K10.00 on international flights and from K2.00 to K4.00 on domestic flights as from midnight tonight.

108. I expect to raise an additional K430,000 from this measure. In this measure I am fully cognisant of the need to promote tourism as well as domestic air transport. Notwithstanding both these objectives, it is clear that in the prevailing economic conditions these categories of passenger traffic should make additional contribution towards the maintenance costs of airport services and facilities. Furthermore, the Nation will readily acknowledge that Zambians have remained free to make frequent trips abroad despite the fact that such trips entail costly use of the nation's scarce foreign exchange resources. The Government does not intend to restrict this privilege. However, it is strongly felt that a modest increase should be imposed on those of our nationals who continue to enjoy this privilege.

109. In this connection it is worth noting that the Government intends to limit the number of trips abroad undertaken by public officials including civil servants and executives in the parastatal sector. This should create substantial savings for the Government and the Nation as a whole since it affects balance of payments through outflows of foreign exchange.

(f) Foreign currency purchase (education and travel) levy

Mr. Speaker, Sir, in my address, I made repeated reference to the foreign exchange constraint. In this connection, it has become imperative to rationalise our use of this scarce resource. Accordingly, I propose to impose a levy of 10% on the kwacha equivalent of foreign currencies applied for and purchased from any commercial bank within the Republic in respect or travel and education outside Zambia. For this purpose, I am proposing to exempt from the purview of this measure, travel undertaken on Party and Government business, approved medical grounds as well as Government sponsored scholarships. I expect to raise K2.5 million from this source.

(g) Commodity loans

111. Mr. Speaker, Sir, I propose that commodities procured by Government under certain commodity arrangements with donor countries should be sold on the open market. I believe that this measure is necessary in order to rationalise the procurement and utilisation of such commodities and equipment similarly obtained. It would further encourage a co-ordinated and disciplined approach to the procurement and utilisation of external assistance on the part of Government agencies. It is therefore essential that the Government should resort to the arrangement I have proposed in order to finance the local cost component of externally funded projects. I expect this measure to yield K58.1 million. This proposal is with immediate effect.

(h) Income tax

112. Mr. Speaker, Sir, I now wish to propose a number of measures affecting direct taxes. Sir, before I do so, I would like to state that a number of representations have been made by our citizens, individually and severally, regarding the high incidence of our tax. I have received and considered such representations with sympathy. In line with the democratic nature of the Party and its Government, I have, in the recent past, made a few concessions which have lessened, to a certain degree, the incidence of direct taxes. At the same time, I should stress that the major constraint to significant reductions in the effective tax burden continues to be the inadequate levels of revenues available to the Government relative to the increasing levels of expenditure. I should point out that it is extremely difficult to effect meaningful reductions in Government expenditures, especially recurrent, without impairing the operational effectiveness of Government agencies. In spite of the foregoing, I wish to propose the following tax measures:

(i) Personal allowances

113. Mr. Speaker, Sir, I propose to raise:
- Married allowance from K1,500 to K1,700;
- Single allowance from K600 to K650;
- Child allowance from K225 to K275;

Sir, it is my considered opinion that the increased allowances I have just proposed, modest as they may appear, will effectively reduce the tax burden on the Zambian people, I estimate that these measures will result in a loss of K8.0 million to Government.

(ii) Married women

114. Mr. Speaker, Sir, several representations have been made to me by our working married women to reduce the tax burden currently borne by them. Indeed, the UNIP National Council, at its 16th Session, considered and adopted a resolution in this matter.

115. Sir, under the present system, the taxable incomes accruing to a wife and husband are taxed separately at parallel rates. The underlying cardinal characteristic of the present system is the recognition of the family as a single taxable unit. The effective tax burden on the family is lower under this system as opposed to the system which prevailed prior to 1st April, 1970. Until then, the income accruing to the wife was added to that of her husband for the purpose of determining the tax payable. Consequently, the husband's income was subject to tax at a higher rate. As an illustration, under the present system, both the husband and wife, after taking into account personal allowances to the husband, are taxed separately but at the same rate of 5% each on their respective first taxable K1,000. In short, they pay an amount of tax of K50 each. This is in contrast to the old system whereby this same family would have paid K150 in taxes.

116. Sir, in view of the foregoing, and given the desirability of continuing to consider the family as one taxable unit, I am proposing that the working wife and husband should be allowed to elect for separate assessment so that the married allowance can be apportioned between them.

117. Mr. Speaker, Sir, for this purpose, the husband and wife will be required to make an irrevocable election six months prior to the commencement of the effective charge year regarding the apportionment of married allowance.

118. I believe, Sir, that this is a reasonable and equitable way of implementing the directive of the Party on this issue. In this way, the demands of those wives who insist that their husbands are not fulfilling their role as head of the household, will be met.

(iii) Savings

119. Mr. Speaker, Sir, it is now a matter of public interest and concern that the rate of savings remains unsatisfactory. It is therefore

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the wish of the Party and its Government to encourage savings. I need not over-emphasise the importance of savings for investment, employment generation and accelerated development in general.

120. In order to provide an inducement to greater savings, I propose to increase the tax relief on interest earned by individuals on savings accounts from K200.00 to K400.00 held in commercial banks. In particular recognition of the need for the Zambia National Building Society to attract more resources for lending, I propose to increase tax relief on interest earned on savings accounts from K200 to K500. In the case of the Zambia National Credit and Savings Bank, I propose to raise the tax relief to K600. I trust that these measures will motivate Zambians to save more.

(iv) Pension contributions and annuities

121. Mr. Speaker, Sir, under section 37 of the Income Tax Act, relief in respect of pension contributions is limited to K1,200 or 10% of the contributor's basic emoluments liable to tax for each charge year. I propose that the figure of K1,200 be raised to K2,400. Under the same section, relief on an annuity is limited to K2,400 of the individual's assessible income. I propose that the figure of K2,400 be raised to K3,000.

(v) Co-operatives

122. Mr. Speaker, Sir, the Party and its Government attach great importance to the role of the co-operative movement in the development of this Nation, in particular rural development. It provides an effective and efficient means of increasing production, leading to a better distribution of incomes. This would further result in the reduction of the existing rural/urban income disparity. In line with this objective, I propose to increase the income of a member allowed for tax purposes from K600 to K800 per annum.

(vi) Donations to UNIP

123. Sir, I propose to grant income tax relief in respect of donations to the party from the public and institutions alike. I trust that this measure will attract the necessary funds to facilitate the implementation of vital Party projects and programmes.

124. Mr. Speaker, Sir, the measures I have proposed will take effect from 1st April, 1982.

(vii) Company tax

125. Mr. Speaker, Sir, the Party and its Government are determined to strengthen the role and contribution of our commercial enterprises to the development of this Nation. To that end the Government recently granted a wide range of incentives and concessions. However, the contribution of our enterprises has been constrained by the methodology used in determining and collecting taxes levied on them.

126. Under the present system, tax liability is assessed on the basis of profits earned by companies and self-employed individuals in the year preceding the charge year. This is in contrast to the present method of collecting taxes on current basis applicable to the wages and salaries of employees under the Pay As Your Earn (PAYE) Scheme. In other words, the earners of wages and salaries are taxed on the basis of current income. Sir, this difference in the basis of assessing tax is, to say the least, discriminatory. It discriminates in favour of companies and businesses and against the employees. It affords the concerned tax-payers the opportunity of an interest-free loan at the expense of Government. It further provides those tax-payers with an opportunity to take advantage of depressed economic or inflationary conditions.

127. Lastly, it makes the implementation of public programmes difficult in that the flow of tax revenue is rendered uneven and unpredictable.

128. In view of the foregoing. Mr. Speaker, Sir, I propose that the tax liability on profits of companies and self-employed individuals should be assessed on current income basis. The tax wil be payable on a quarterly basis. This proposal will make income tax reflect the current state of our economy and responsive to the changes in the economy. In order to facilitate and reduce the burden on the affected tax-payers, I further propose the following transitional arrangements:

(a) For the charge year (1981/82) ending 31st March, 1982 the tax will be payable on 14th August and 14th December, 1982.
(b) For the charge year (1982/83) ending 31st March, 1983, profits and other accrued income will be estimated by the affected tax-payers and the tax liability will be assessed at current rates applicable as from 1st April, 1982. The tax so assessed will be payable to the Commissioner of Taxes in the following quarterly instalments:
30th June, 1982
30th September, 1982
30th December, 1982
30th March, 1983
(c) For the charge year (1983/84) and subsequent charge years ending 31st March each year, tax will be due and payable in the four quarterly instalments except that payment must be made not later than the 14th of the following month after the due date.

129. Mr. Speaker, Sir, it will be evident that the proposed current basis of tax assessment introduces, in effect, some degree of self-assessment on the part of the affected tax-payers. On receipt of the actual income tax returns and accounts for 31st March of each year, the Commissioner of Taxes will determine the correct tax liability and give credit, wherever applicable, for the provisional tax paid. Any shortfall will be paid within thirty days, as at present.

130. The degree of self-assessment arising from my proposal will entail the freedom on the part of the affected tax-payers to revise their estimate in respect of any subsequent instalment payment. This, however, will be subject to the condition that any under-estimation of the tax liability (at the end of the accounting period) by a third, will attract a 10% penalty on the amount so under-estimated. Such penalty must be paid within thirty days. The existing 5% penalty imposed monthly on the outstanding tax will remain in force.

131. Notwithstanding the proposed system, the Commissioner of Taxes will still retain the power to issue a demand notice for assessment to any tax-payer in respect of any charge year, as already provided for under the Income Tax Act.

132. Mr. Speaker, Sir, it is evident from what I have just elaborated that the tax burden will be quite heavy during the transitional period. It means that tax due for two years will be paid in one year. However, it should be appreciated that this will occur but once in the 1982/83 charge year.

133. Mr. Speaker, Sir, in recognition of the hardship that might be experienced by some tax-payers during the transitional period, I am proposing a reduction of the company tax rate from 50% to 45% from 1st April, 1981. I am confident that with this reduction business activity will not be adversely affected as we move to the proposed rational system in tax administration.

(viii) General

Undistributed profits

134. Mr. Speaker, Sir, I now wish to discuss the undistributed profits tax (UPT) which has been a subject of numerous representations by affected tax-payers. Indeed a specific resolution was adopted on this issue by one of the Economic Symposia organised recently under the auspices of the Rt Honourable Prime Minister.

135. In recognition of the several representations made to me as the imperative need to stimulate business activity and reactivate our economy, I have decided to introduce a more effective and workable system "of deeming" in place of the undistributed profits tax.

136. Sir, the new provision will essentially remove the indiscrimate penalty for non-distribution and identify only those companies which never plough back their profits into the business. This will be evidenced by, for example, accumulations of cash or investments in non-trading assets. Furthermore, the tax on undistributed profits will be levied on the shareholders to whom the income properly belongs. The details of this provision will be given in the relevant legislation which this House will consider soon.

Tax clearance certificate for small-scale business and self-employed individuals

137. Mr. Speaker, Sir, tax evasion is committed in various forms such as failure to report income to the Tax Department, under-stating income and by the maintenance of poor or no business records. Unwittingly or not, this amounts to concealing their correct income for tax purposes.

138. In order to ensure that they are compelled to observe the law and report their income to the Department of Taxes, I am proposing that they be required mandatorily to obtain tax clearance certificates to show that they have satisfied their tax liability before their trade licences can be issued or renewed. Sir, it is only fair that the tax burden should be borne equitably by all eligible persons. Unless this is achieved, all attempts to make meaningful reductions in the effective tax rate will be futile.

(i) Parastatals–Revenue contribution

139. Mr. Speaker, Sir, last year I raised the matter of parastatal organisations and their

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contributions to Government revenue. At the time my proposal was to make them liable to tax as any other commercial enterprise, I regret to report that I am unlikely to raise any significant revenue by this method due to the seemingly poor performance of the majority of the parastatal organisations.

140. Sir, total Government investment in the parastatal sector is in excess of K1.5 billion of which about K750 million is in the form of equity. I propose to impose a levy of 1.5 per cent on this equity in the parastatal sector. This levy will help us to expose inefficient parastatal organisations and identify the underlying contributing factors, such as poor management, structural or other organisational defects.

141. By this measure, I do not intend to penalise the efficient and profitable organisations. Such organisations shall not be required to pay both company tax and the proposed levy. They shall only pay the greater of the two. In essence, the levy shall apply to those parastatal enterprises which continue to be inefficient in spite of the progressive implementation of economic pricing for their products. I expect to raise K11.25 million from this measure.

(j) Fines, licences and fees

142. Mr. Speaker, Sir, in the prevailing conditions, I have noted that some of the fines, licences and other taxes are far too low and have not been revised for a long time now. I propose to effect changes to the relevant pieces of legislation in order to raise additional revenue for Government. This proposal will become effective from 1st April, 1982. I expect to raise K2.0 million from this measure.

(k) Revenue administration

143. Mr. Speaker, Sir, in order that Government does not lose revenue due to it, I intend to strengthen its principal revenue collection agencies that is, the Departments of Income Tax and of Customs and Excise. In this connection, I have deliberately increased the allocation of funds to these Departments to make their operations more effective. In addition, I propose to establish a Revenue Unit in my Ministry which will, among other functions, liaise closely with all revenue collection agencies within the Republic. It is my sincere hope that by strengtening our revenue collection, the Government should be able to tap resources which have so far remained uncollected.

PART VI

INCENTIVES

(a) Agricultural sector

(i) Farming income tax rate

144. Mr. Speaker, Sir, last year I announced additional measures to boost the implementation of the Operation Food Production Programme. The measures included accelerated depreciation of farming machinery, equipment and implements at 50% of the cost of the assets on a straight-line basis. I restricted the maximum tax rate to 25% on farming income, and introduced a development allowance for growers of tea, coffee and citrus fruits. This year, I propose a further reduction of the tax rate to 15% on income arising from agricultural operations.

(ii) Selective employment tax

145. Mr. Speaker, Sir, I propose to remove the payment of Selective Employment Tax on the incomes of expatriate personnel engaged in the agricultural sector. The measures I have announced should go a long way towards increased agricultural production, food sufficiency and improved nutritional standards throughout the Republic.

(b) Industrial sector

(i) Foreign exchange credit

146. Mr. Speaker, Sir, Hon. Members will have noted that one of the main themes of my address has been on foreign exchange or the lack of it. Indeed in his address to the 16th National Council of the United National Independence Party on the 14th December, 1981, His Excellency the President stated among others and I quote:

> "This lack of alertness to the export opportunity is understandable considering the transportation and other problems that we have had in the past. But this indiffence must end now if we are to survive. From now on it's 'EXPORT or PERISH'."

147. Sir, in response to this timely warning my Ministry has taken time to study the problem and evolve methods to make export trade enterprising and lucrative to those engaged in it. In this connection, I propose to introduce, in consultation with my colleague in the Ministry of Commerce and Industry, measures which will entail the following:

- the establishment of an Export Guarantee Agency to protect the interest of Zambian exporters;
- the introduction of foreign credit system by which any exporter who earns foreign exchange will be given credit of up to 50% of the net foreign exchange earned; and
- preferential tax rate on income earned from exports.

(ii) Wear and tear allowance

148. Sir, as Honourable Members are aware manufacturers of soft drinks have been unable to satisfy the market, particularly to rural areas. In order to facilitate wider distribution of these products, I propose to grant them relief on any new plant and machinery they acquire provided they establish such plant and machinery in rural areas. In this case depreciation will be over a five-year period and based on the sum-of-years-digits method.

(c) Training of Zambians in professional fields

149. Mr. Speaker, Sir, last year, I increased the rate of selective employment tax to 20% and disallowed the tax as a deduction for tax purposes. I have since given sympathetic consideration to the effect of this tax and have decided to grant some relief for expenses incurred in the training of Zambian employees towards professional qualifications in such specialised and professional fields as accountancy, architecture.

In next issues:

The welfare cost of taxation: its meaning and measurement
– by *Nizar Jetha*

The Peruvian tax reform
– by *Pedro Massone*

Singapore's 1982 Budget
– by *Lee Fook Hong*

Tax relief for Americans abroad – an overview
– by *Piroska E. Soos*

The 1982 income tax changes in the Republic of South Africa
– by *Erwin Spiro*

Highlights of the tax proposals of the Indian Budget for 1982-83
– by *Dharmendra Bhandari*

Taxation of foreign business activities in Austria
– by *Wolfgang Gassner* and *Geoffrey Pink*

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MALTA:

Budget 1982

Extracts from the Budget Speech pronounced on 2 August 1981 by
Dr. J. Cassar, Minister of Finance,
Customs and People's Financial Investments.

REVENUE 1982

Revenue during 1982 is estimated to amount to a total of £M218.8 million. This is made up of ordinary revenue of £M203.2 million, grants amounting to £M8.6 million and foreign loans of £M7 million.

Revenue from customs is estimated to amount to £M44.1 million, that is, about 3 million more than in 1981.

Although we shall raise the rate of customs duties on 2 items as I shall explain later on, the increase in the total revenue from customs is mainly due to higher prices for imported merchandise which, as the House is aware, is taxed ad valorem, that is according to value.

We are proposing to increase slightly customs duty on imported wines and lead crystal. As regards the increase in customs duties on imported wines, of 9 cents on a bottle of wine, 10 cents on a bottle of vermouth, and 12 cents on a bottle of champagne, this increase is intended to protect further local wines, whilst the increase in the rate of duty on lead crystal, which will now be as high as that on ornamental glass, as it was some time ago, is intended to eliminate the difficulty which often arises in distinguishing one from the other. These measures are estimated to increase Revenue by about £M100,000 a year.

Entertainment tax exemptions

In order to further encourage sports and cultural activities in our country, Government intends to exempt cultural live shows by local talent and football from entertainment tax.

The reduction in revenue from this source is expected to be about £M130,000.

INCOME TAX

Now I come to the measures which the Socialist Government will propose on income tax. But before I go into detail I would like to say something about this tax and the many rumours circulating about it.

Income tax was introduced in Malta by the Labour Party when this came to power for the first time in 1947. From the very beginning opponents of the Labour Party came all out against it, there were some who even tried to get religion into it. Time proved us right because many came to believe that as the main direct tax, income tax is the most just tax on earth and this results in the fairest and most just distribution of wealth.

But, over the years, people who should know better continued to make political capital out of income tax. During the 1960s there was one party that advocated an end to income tax. The Nationalist Party, which was then in power, was against this, ridiculed the idea and declared it as impossible. But later, one the eve of the 1971 elections, the Nationalist Party also promised that if re-elected it would abolish income tax. The people voted otherwise. The same thing happened in 1976 although once again the Nationalist Party reiterated the promise of abolishing income tax.

Today the Opposition Party has suddenly abandoned the promise of an end to income tax. But at the same time they seize every opportunity to incite the people against this tax. Such tactics should come to an end. All honest people should know and understand that Government expenditure, which is to the benefit of the whole population, must come from somewhere and when it comes to taxes, income tax is the most just tax of all.

Against this background I will now come to the measures which we are proposing.

First of all, in order that income tax will not erode the greater part of the wage increase I announced earlier, we are proposing that as from basis year 1982 personal allowances will rise by £M130 for a married couple and £M75 for a single person. This means that the personal allowance for a married couple will rise from £M1070 to £M1200 and for a single person from £M635 to£M710.

This means also that since the Maltese Socialist Party came to power, personal allowances have risen by £M660 for a married couple and by £M410 for a single person, that is these allowances more than doubled under the Socialist Administration. It is worth mentioning here that in the period 1962–1971 these personal allowances rose by only £M120 and £M60 respectively, a rise of approximately only 25%.

Moreover, we are proposing another measure in connection with income tax. In fact the tax rates and the bands regulating this tax which will come into effect as from basis year 1982 will be adjusted as shown in Table No. VI which I will read.

These measures are really very important because of their effect on the taxpayer whether employed or self-employed.

TABLE VI
Changes in income tax rates

Present rates		
Personal deductions:	Single	£M 635
	Married	£M 1,070
Rates:		
On the first taxable	£M 100	5c in the £M
On the next	£M 100	10c in the £M
On the next	£M 500	15c in the £M
On the next	£M 500	20c in the £M
On the next	£M 600	25c in the £M
On the next	£M 1,200	30c in the £M
On the next	£M 600	40c in the £M
On the next	£M 600	50c in the £M
On the next	£M 800	60c in the £M
On the rest		65c in the £M
New rates		
Personal deductions:	Single	£M 710
	Married	£M 1,200
Rates:		
On the first taxable	£M 200	2c in the £M
On the next	£M 100	5c in the £M
On the next	£M 100	7c in the £M
On the next	£M 200	10c in the £M
On the next	£M 300	15c in the £M
On the next	£M 500	20c in the £M
On the next	£M 700	25c in the £M
On the next	£M 1,500	30c in the £M
On the next	£M 700	40c in the £M
On the next	£M 700	50c in the £M
On the next	£M 2,000	60c in the £M
On the rest		65c in the £M

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To bring out this point more clearly Tables VII and VII detail the effect of these income tax measures as well as the reduction in tax in the various income brackets.

While once again I call upon the House to take these tables as read, I feel it is appropriate at this stage to give some general examples.

As a result of the changes we are proposing, a person who this year pays £M15 in tax, in 1982 will pay only £M4 – a saving of 73% in tax. A person now paying £M30 per annum will pay £M9 in 1982 – thus saving 70%. Those now paying between £M75 and £M130 in tax will next year pay between £M34 and £M79 – thus saving between 55% and 38% and this always in spite of the fact that their income will rise through pay increases and higher social benefits.

The above examples cover the great majority of Maltese workers, including those in factories, at the Drydocks and in the Civil Services.

As a result of these measures and the increases in pay, bonus and children's allowance, a married worker with 3 children earning the minimum wage next year will have about £M224 more left in his pocket after paying his income tax and insurance contributions. If the same worker, married with 3 children, is in Government employment in Group C or a clerk he will have £M230 in his pocket.

A Drydock's worker is also at this level. Even those who are single or married without children will also be having next year about £M90 more in their pockets than they have this year. This means that every worker supporting a family of 5 persons, no matter who he is and where he works, will not only have all the increase of £M3 a week left, together with the increase in bonus, but because of the new income tax measures he will have left at least another pound per week.

Although everybody is going to pay less tax, those earning the minimum will still be paying a small amount. The Socialist Government believes that everyone is in duty bound to help carry a bit of the social burden; everyone must think of others and contribute for the good of others according to his means, if we really want to have a Christian and humane society, a socialist society.

Those who are in the high income bracket, including the self-employed, will also be benefiting from the measures we are proposing because they too will be having more money left at their disposal.

This is being done because it is right that the relativity between those who earn most and those who earn less must not continue to be closed up: this is being done so that the incentive to work will also remain for those in the higher income bracket.

On the basis of 1982, at the present rates, the Government was expecting to collect £M22 million in tax from the employees and the self-employed.

With the £M3 a week increase in wages and the £M16 increase in bonus together with the increase in children's allowance, Government next year would have collected, at present rates, £M26 million. Taking the new rates and the increase in the ceiling which we are proposing for next year, it is calculated that from the employees and the self-employed we will be collecting about £M18 million.

This means that through these measures on income tax, tax collection on the basis of assessment for the basic year 1982 will be about £M8 million less than what the income would have been had not these measures been taken.

The government could do this because it enlarged and strengthened the public sector which is now yielding enough tax so that Government is in a strong position to make this concession.

The Socialist Government, in the name of honest and serious people, hopes that in this way motivation for work will increase as will reliability in paying income tax.

At the same time it must be appreciated that, as I have already explained, these increases will cost the Government a great deal of money and it is therefore essential that everyone cooperates, particularly the self-employed who do not pay through the PAYE system as employees do. Every effort must be made so that tax due is collected efficiently during the same year the income or profit is earned. For this goal to be attained, as has been done in the case of employees with the introduction of the PAYE system, another reform must be put through whereby payment of provisional tax is effected more frequently so that during the year of assessment (the year following the one during which income or profit is earned) it will only be necessary to make some minor adjustments as in the case of PAYE.

It is hoped that the self-employed will reciprocate the good will Government is showing by effecting these decreases in taxation. At

TABLE VII
How the net income* of several categories of employees is going to increase

Status, income & increase	*National minimum wage*	*Group C employed by Government*	*Group D Clerk II, etc. employed by Government*	*Clerk III, Teacher I etc. employed by Government*
	£M	£M	£M	£M
Married, 3 children				
Net income 1982	1954	2213	2287	2511
Net income 1981	1730	1983	2057	2275
1980 Increase £M	224	230	230	236
Percentage increase	12.9%	11.6%	11.2%	10.4%
Married, 2 children				
Net income 1982	1862	2119	2193	2416
Net income 1981	1640	1892	1968	2183
1982 Increase £M	222	227	225	233
Percentage increase	13.5%	12.0%	11.4%	10.7%
Married, 1 child				
Net income 1982	1722	1979	2053	2276
Net income 1981	1511	1765	1839	2053
1982 Increase £M	211	214	214	223
Percentage increase	14.0%	12.1%	11.6%	10.9%
Married without children				
Net income 1982	1540	1797	1871	2094
Net income 1981	1350	1604	1678	1892
1982 Increase £M	190	193	193	202
Percentage increase	14.1%	12.0%	11.5%	10.7%
Single				
Net income 1982	1481	1712	1782	1992
Net income 1981	1282	1521	1591	1795
1982 Increase £M	199	191	191	197
Percentage increase	15.5%	12.6%	12.0%	11.0%

* The net income includes the annual bonus and children's allowance where applicable and does not include the National Insurance Contribution and income tax. Where salaries are scaled, the salary has been calculated as having reaching half the scale.

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TABLE VIII
How much you will be saving with the new income tax rate

Taxable amount	*How much you used to pay before*	*How much you will be paying in 1982*	*How much you will be saving*	*How much you are going to pay less than before expressed as %*
£M	£M	£M	£M	£M
200	15	4	11	73.3
300	30	9	21	70.0
400	45	16	29	64.4
600	75	36	39	52.0
900	130	81	49	37.7
1,400	240	181	59	24.6
2,100	430	356	74	17.2
3,600	940	806	134	14.3
4,300	1,300	1,086	214	16.5
5,000	1,720	1,436	284	16.5
7,000	3,020	2,636	384	12.7

the same time, the Government will be taking administrative measures through the Department of Inland Revenue so that every employee paying PAYE will benefit immediately during 1982 itself from the reductions being proposed in income tax. In fact action towards this end has already been taken when, after this year's Budget, employers were requested to reduce PAYE rates in accordance with the new rates approved last November.

Mr. Speaker,
At the beginning of my speech I briefly showed how the Maltese Socialist Government succeeded, during the past decade, in building a strong economy and increasing the national wealth and how, during this time, it has distributed this wealth on the principles of social justice by helping those who were mostly in need. I also explained that the aim of this Budget is that we follow the principles as propagated in the 5-year Development Plan – 1981/85 in order to consolidate all that we have achieved in the economic and social fields.

Since this Budget is being presented a few months before the general elections, some had predicted that we would use this Budget to create some false sense of well-being. In fact, these same people have also said that when last November we budgeted for a surplus of £M22 million we purposely did this, so that we would have enough money to distribute during election time.

However, it seems that these people have forgotten, or would have wished others to forget, that the Socialist Government has never waited for election time to distribute national wealth to those who deserve it. This Budget is just one of the 11 Budgets which this Government has presented during these past 10 years. It is similar to all the previous Budgets, the purpose of which was to establish a sound economy and increase the national wealth. All these Budgets have contributed towards the progress attained in the social field, to such an extent that even foreigners are mystified how, despite our limitations, we were able to achieve such a high level of progress. This progress is evident in today's standard of living of the workers, in the beautiful and comfortable houses they are occupying in the high protein food which the workers' families are consuming, in the large number of television sets that have been purchased and are still being purchased, in the ever increasing number of telephones installed in workers' houses, in the number of vehicles on the road and how the shops are always thronged with customers. All this apart from the fact that the workers today, as never before, are well insured against any mishap that may occur to them or their families and this thanks to the excellent free social services which the Socialist Government is providing. This is real and true progress which no one can deny, whichever argument one puts forward, be it the water situation or income tax assessments.

The Maltese people are enjoying this wealth because during the past 10 years they had a courageous and hard working government which has always frowned upon indolence. This wealth did not come from nothing.

Consequently this Budget, by improving the benefits to all classes of the population, especially the workers, is following this Government's previous Budgets, it is following the right way, in a responsible and serious manner, that has always led us to victory.

Most of the changes proposed were enacted in Act No. XL of 1981.

Individual persons who have been granted a residence permit under the Immigration Act, 1970 or on or after 14 November 1972 are subject to income tax at favourable rates. These persons are often indicated as "new residents" and they may generally not engage in business, profession or employment or take part in politics.

The rates are:

For every pound of the first £200	2c
For every pound of the next £100	5c
For every pound of the next £100	7c
For every pound of the next £200	10c
For every pound of the next £300	15c
For every pound of the next £500	20c
For every pound of the next £700	25c
For every pound of the remainder	30c

Provided that the minimum liability of any such individual in respect of any year of assessment shall be one thousand pounds.

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THE EUROPEAN UNION

On 24 and 25 February 1982 the recently installed Institutional Committee of the European Parliament met with a view to organising its work which will eventually result in a draft for a Treaty to establish a European Union replacing the present forms of European cooperation such as the European Communities, political cooperation and the EMS. It is intended that the European Parliament will adopt a proposal for a European Union which will then be submitted for ratification to the national authorities.

Mr. A. Spinelli submitted a working document to serve as a basis for a preliminary discussion and which, among other things, will enable the "coordinating rapporteur" to prepare a draft resolution on guidelines for subsequent work.

The working document lists a number of tasks which the European Union should fulfill, including: the pursuance and development of the aims set out in the Treaties of Rome and Paris, the development of economic and monetary union, combatting inflation and unemployment, contributing to the harmonious social and economic development of the world as a whole, and maintaining the greatest possible degree of openness and stability in the world economy with regard to trade and monetary matters.

The European Union will, of course, need financial means and the working document states with respect to taxation:

> In accordance with appropriate agreed procedures, the Union and the Member States shall from time to time effect a redistribution inter se of their respective powers of taxation on the basis of the general plan for the Union's development as accepted in principle by the Member States.
> — Within the limits of the distribution of powers thus agreed the Union and States shall determine their taxes and budgets independently.
> — While it is in general desirable that the same tax collecting body shoud collect both national taxes and Union taxes, the respective accounting systems must be kept strictly separate so as to put an end to the present practice under which certain items of Community revenue are made to pass through national budgets.
> — Within the limits of the distribution of powers thus agreed, the Union's taxation and budget shall be proposed by the Government, adopted by Parliament, submitted to the Council – which may propose amendments supported by reasons or reject them by a simple majority of votes – and adopted at a second and final reading by Parliament.

Conference Diary

APRIL 1982

Management Centre Europe: International Tax Conference (including: Organisation of international groups; Selected tax aspects of international business planning; Governmental attitudes towards business in the tax field: the carrot and the stick). Nice (France), April 5-7 (English).

Management Centre Europe: Managing and developing foreign subsidiaries (including: Tax in international operations). Brussels (Belgium), April 5-7 (English).

Oyez-International Business Communications Ltd.: The world is your tax haven (Three one-day seminars). Amsterdam (The Netherlands), April 26 (English); Bruxelles (Belgium), April 29 (English); Paris (France), May 4 (English).

MAY 1982

Management Centre Europe: Leasing in the 80's (including: The harmonisation of taxes in the E.E.C. and relevance for leasing). Brussels (Belgium), May 5-7 (English).

Seminar Services International: International Tax Planning (including: Use of tax treaties and tax treaty developments; legislation to counter use of tax havens and U.K. draft legislation on international tax avoidance). Amsterdam (the Netherlands), May 12-13 (English).

AMR International: Subcontracts and joint ventures in the Middle East, the legal and financial issues (including: Taxation and the Subcontractor). London (United Kingdom), May 13-14 (English).

International Tax Planning Association: 8th Annual Conference (including: The U.S. tax haven report; international tax planning for entertainers and athletes; taxes on non-residents; anatomy of a tax haven). Florence (Italy), May 19-21 (English).

Management Centre Europe: International cash management (including: International tax aspects in cash management). Nice (France), May 24-26 (English).

The Inter-American Center of Tax Administrators (C.I.A.T.): XVIth General Assembly on the basic subject Non-tax compliance. Asunción (Paraguay), May 24-28 (Spanish, English, French and Portugese).

Institute for International Research: The Zürich International Corporate Finance Conference (including: Legal, accounting and tax issues of different hedging forms; tax leveraging). Zürich (Switzerland), May 24-26 (English).

JUNE 1982

Management Centre Europe: Taxation of international group companies and branches (Seminar). Brussels (Belgium), June 3-4 (English).

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SEPTEMBER 1982

36th Annual Congress of I.F.A.: I. The tax treatment of interest in international economic transactions. II. Taxation of payments to non-residents for independent personal services. Montreal (Canada). Sep-

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tember 12-16 (English, French, German, Spanish).

Confédération Fiscale Européenne (C.F.E.): Third European Congress of Tax Consultants (including: State of tax harmonisation in Europe; The application of wealth taxes and taxes arising on death to foreign assets and liabilities; The practical application of international tax provisions (working groups)). Aix-la-Chapelle (France), September 30 to October 2 (English, French, German).

OCTOBER 1983

37th Annual Congress of I.F.A.: I. Tax avoidance/tax evasion. II. International problems in the field of turnover taxation. Venice (Italy), October 10-15 (English, French, German, Spanish).

FOR FURTHER INFORMATION PLEASE WRITE TO:

AMR International: 6-10 Frederick Close, Stanhope Place, London W2 2HD (United Kingdom).

Confédération Fiscale Européenne (C.F.E.): Secrétariat Général, Postfach 1340, Dechenstrasse 14, D-5300 Bonn 1 (Federal Republic of Germany).

Georgetown University Law Center: 600 New Jersey Avenue, N.W. Washington, D.C. 20001 (U.S.A.).

Inter-American Center of Tax Administrators (C.I.A.T.): Executive Secretary of C.I.A.T., P.O. Box 215 zona 1, Panamá.

International Fiscal Association (I.F.A.): General Secretariat, Woudenstein, Burgemeester Oudlaan 50, P.O. Box 1738, 3000 DR Rotterdam (the Netherlands).

International Tax Planning Association: 33A Warwick Square, London SW1V 2AD (United Kingdom).

Institute for International Research: 70 Warren Street, London W1P 5PA (United Kingdom).

Management Centre Europe: Avenue des Arts 4, B-1040 Brussels (Belgium).

Oyez-International Business Communications Ltd: Norwich House, 11-13 Norwich Street, London EC4A 1AB (United Kingdom). French residents should register with Euroforum, 16 Place Vendome, 75001 Paris (France).

Seminar Services SA: 1 passage Perdonnes, CH-1005 Lausanne (Switzerland).

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The Municipality of São Paulo enacted Law No. 9,322 of 25 September 1981 exempting from the tax on services (Imposto sobre Serviços de Qualquer Natureza) the individual performances of Brazilian humorists.

The measure met the "serious" objection of being discriminatory because it favors only a particular kind of theatrical spectacle, and is thus detrimental to similar activities which are facing difficulties in providing a bit of "culture".

Besides (the comment goes on) rather than look for a cheaper laugh for the people, an exemption should be provided to lower the cost of the health services.

Some questions arise: is laughter important?, how important is it?, can it be encouraged with tax incentives?

Source: Imposto Fiscal, No. 572, Publicações Associadas Paulista Ltda., São Paulo, 20/10/1981, page 1493.

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Der Verfasser untersucht die wichtigsten Aspekte dieser Steuerreform, z.B. die Besteuerung der Unternehmens- und Investitionseinkommen, die Besteuerung des von Nichtansässigen erzielten Einkommens sowie die neue Umsatzsteuer.

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L'auteur étudie les points les plus importants de la réforme, à savoir l'imposition des revenus professionels et d' investissements, des revenus des non-résidents et la nouvelle taxe sur le chiffre d'affaires.

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Developments in Latin America

THE PERUVIAN TAX REFORM (1981)

by Pedro Massone*

I. INTRODUCTION

During 1980, the Peruvian government appointed a National Commission for Tax Reform composed of Drs. Roberto Dañino Zapata, General Secretary of the Ministry of Economy, Benedicto Cigueñas Guevara, Under Minister of Finance, and Armando Zolezzi Moller, General Director of Taxes.

In addition, Law No. 23,230, enacted on 15 December 1980 under Article 188 of the Political Constitution of Peru, vested the Executive Branche with the authority to issue Legislative Decrees referring to taxes and other subjects.

On the basis of the work developed by the National Commission for Tax Reform and using its delegated authority, the Peruvian Government enacted several legislative decrees introducing new legislation regarding income tax, sales taxes, mining and other subjects.

The new legislation includes the following acts:

(1) Legislative Decree No. 200 of 12 June 1981 introducing an entirely new income tax law (Ley General de Impuesto a la Renta), which contains changes concerning tax jurisdiction, allowable deductions, tax rates, reorganization of companies, etc.;

(2) Legislative Decree No. 190 of 12 June 1981 introducing an entirely new sales tax law, which contains changes concerning the coverage of the sales tax, tax rates, tax credits, excise taxes and a special tax on goods which Peru traditionally exports ("traditional goods");

(3) Legislative Decree No. 213 of 12 March 1981 introducing amendments to the net worth tax that include provision for the avoidance of economic double taxation and the measurement of brackets in tax units (see II.E. below);

(4) Legislative Decree No. 184 of 12 June 1981 introducing rules on a betterment contribution;

(5) Legislative Decree No. 187 of 12 June 1981 introducing amendments to the Tax Code of 1966 as regards the Fiscal Court and other subjects;

(6) Legislative Decree No. 109 of 12 June 1981 introducing an entirely new General Mining Law, which contains rules on mining taxation and tax incentives; and

(7) other rules on tax evasion, tax amnesty, and various other subjects.

From this brief survey, it is easy to realize that the reform deals with many subjects and refers to a number of laws which cannot be covered in detail within the limits of an article. It is, therefore, convenient to restrict the scope of this work to the most relevant aspects of the reform, that is to say, the principal features of the taxation of business income, taxation of particular types of income (e.g. income from mining, other income specially taxed, investment income and income derived by non-domiciliaries) and sales taxes.

Such topics as income taxation of individuals, net worth tax, betterment contribution and tax code will not be considered.

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* Professor of Tax Law at the University of Valparaíso.

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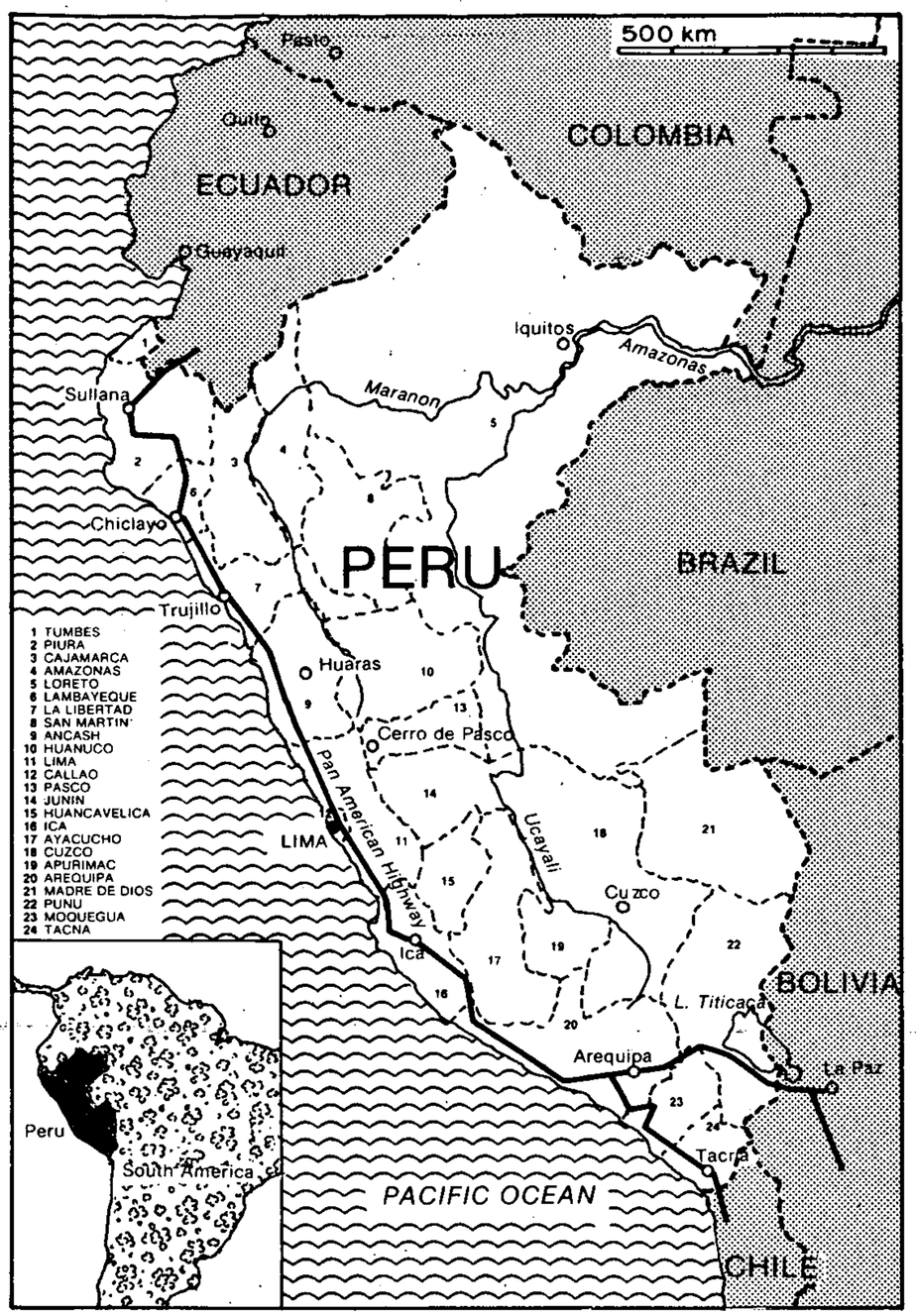


Chart by Van Pelt – Amsterdam

II. TAXATION OF BUSINESS INCOME

A. General description

Originally, the Peruvian income tax system was principally schedular. Later on, Supreme Decree No. 287-68-HC of 13 August 1968 introduced a change-over from the schedular to a global system and consequently its regulations provided for assessment on the aggregate income of the taxpayer whether he was a natural or a juridical person. This approach was confirmed by the new income tax law enacted with Legislative Decree No. 200 of 12 June 1981.

In fact, except for rates and a few special standards (e.g. personal allowances), the income tax is levied under rules which are the same for individuals and legal entities.

The new income tax law enters into force as from taxable year 1982 (assessment year 1983) and is applicable to taxable periods starting on or after 1 January 1982.

The old income tax law included in Supreme Decree No. 287-68-HC, its complementary legislation, regulations thereto and any provision referring to income taxation or which is in conflict with the new law is revoked. However, exemptions, allowances, other tax benefits, tax credits referred to in Decree-Law No. 22,401,[1] amendments thereto, laws pertaining to certain sectors of activity and laws stimulating the economy are not revoked and remain in force.

B. Taxable persons

The income tax law is levied, on individuals, married couples, undivided inheritances and legal entities.[2]

For income tax purposes, legal entities include only:
- corporations organized in Peru;
- partnerships organized in Peru and limited by shares, in that proportional part corresponding to stock shares;
- cooperatives;
- enterprises belonging to the social property (i.e. unions and similar organizations);
- state-owned enterprises;
- mining and oil enterprises irrespective of their legal organization;
- charities, societies, industrial, fishing and mining communities as regards the taxable income;
- sole proprietorships, companies and entities of any kind organized outside Peru, which derive Peruvian-source income;
- branches or agencies in Peru of sole proprietorships, companies and entities of any kind organized outside Peru; and
- agricultural companies of social interest, and cooperatives for agricultural production.

Income derived by sole proprietorships, commercial limited liability companies and other companies not considered to be legal entities under the rules discussed above, inclusive of the income belonging to the general partners of a partnership limited by shares, is attributed to the owners or shareholders, irrespective of actual distribution. Likewise, income derived by de facto companies, joint ventures and property held in common is attributed to members thereof, irrespective of actual distribution.

C. The concept of income

1. General income concepts

The tax under consideration is levied on the income derived from capital, work, or the joint application of both factors, and also on earnings statutorily considered to be taxable income. Income from the following sources is specifically considered to be taxable:
- the assignment of property to a member upon his

1. Decree-Law 22,401 of 22 December 1978 provides a system of tax credits which replaces investment allowances as from the taxable year 1979.
2. The following persons and entities are exempt from the income tax:
- the government and agencies thereof (sector público), except for state-owned enterprises which are taxable;
- universities, educational and cultural centers;
- charities (fundaciones) duly organized under the law and provided they pursue statutorily any of the following aims: education, culture, advanced research, charity, social and health assistance and social benefits for the personnel of enterprises;
- mutual assistance entities; and
- peasant and indigenous entities (communidades campesinas y nativas).

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withdrawal from a business association or upon total or partial dissolution thereof. The income arising from the assignment is taxed with the association;[3]
- the transfer of goods carried out within 2 years as of the termination of activities performed by a business enterprise.

Taxable income also includes the following items:
(1) any compensation paid to an enterprise under insurance contracts covering its personnel and any compensation not covering real damage;
(2) any difference between premiums or contributions paid by insured persons and sums paid by insurance companies upon maturity of life insurance policies providing a dowry or other benefits paid on life insurance policies;
(3) royalties;
(4) capital gains arising from the transfer of specified property;[4] and
(5) results from the habitual sale, exchange or transfer of goods.

For computation purposes, income is classified into the following categories:
- *first category*, including income from real property;
- *second category*, including other capital income (dividends,interest, royalties, etc.);
- *third category*, including income from commerce, industry, business and similar sources;
- *fourth category*, including income from professional services (fees and remuneration of board members); and
- *fifth category*, including income from employment (wages, salaries and participation in profits).

Income derived by legal entities and enterprises domiciled in Peru is included in the third category irrespective of its nature. Moreover, income not specifically included in another category is deemed to be third category income.

2. Tax jurisdiction

The income tax is levied on Peruvian-source income only, irrespective of the nationality of individuals and the country where legal entities are organized.[5]

The following items of income are considered to be from Peruvian sources:
- income from real estate located in Peru;
- income from capital, assets or rights located or used for economic activities in Peru;
- income received with respect to personal services performed in Peru;
- profits derived from civil, commercial and other activities carried out in Peru; and
- income from the transfer of shares or participations in the capital of enterprises or companies organized in Peru.

The following items are also considered to be Peruvian-source income:
- interest, commissions, premiums and any sum paid for loans, financing or, in general, for any capital placed in Peru;
- interest on debts, when the debtor-company has been organized in Peru;
- wages and any remuneration paid or credited by enterprises domiciled in Peru to members of administrative boards performing activities abroad;
- royalties; [6] and
- fees or remuneration paid by the Peruvian government and agencies thereof (Sector Público Nacional) to persons performing representative or official duties abroad.

As regards expenses incurred abroad it is presumed, unless it can be proved to the contrary, that such expenses have been incurred for the production of foreign-source income.

3. Taxable period and allocation rules

For income tax purposes, the taxable period runs from 1 January to 31 December. The same rule applies to the commercial period but the tax administration may, upon request, authorize a different closing date for activities and businesses having special characteristics.

Items of income are allocated to taxable periods under the following rules:
(1) third category income (i.e. business income) is deemed to be produced in the commercial period during which it arises. The income belonging to legal entities shall then be included in the taxable period during which the corresponding commercial period is closed. Likewise the income originating from sole proprietorships or from partnerships not considered to be legal entities for income tax purposes shall be allocated by the owner or partner to the taxable period during which the commercial period is closed;
(2) first category income (i.e. income from real property) shall be allocated to the taxable period during which it arises; and
(3) other income (i.e. non-specified income) shall be allocated to the taxable period during which it is collected.

The above rules shall be similarly applied to the allocation of expenses.

In the computation of third category it is possible to cosider expenses paid in the period but incurred in preceding periods. However, if the amount was known when incurred and no provision was made for payment, the late deduction shall be limited to 80% of the expense. If the amount of the expense was not known or anticipated when incurred, however, a full deduction may later be allowed by the tax administration.

Income from the transfer of goods in installments to be paid during periods exceeding one year as from the date of the transfer may be allocated to commercial periods during which installments are due for collection.

For income tax purposes, income which is at the beneficiary's disposal is deemed to be collected.

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3. For income tax purposes the value of the assignment cannot be less than the following minimums provided by the law:
   - for inventories, the price of transactions made with third parties;
   - for securities, their quotation in the stock market; and
   - for fixed assets, the market value or, if transactions thereon are not frequent, the assessed value.
4. For the taxation of capital gains see Section III. D.1. below.
5. In the old income tax law, persons resident or domiciled in Peru were traxed on world-wide income.
6. The Peruvian law does not provide further specification.

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4. Reorganization of companies

The income tax law includes some provisions that regulate and facilitate the reorganization of companies and enterprises. For these purposes a reorganization includes only mergers and split offs.

The provisions of the law are:
- the taxation of income arising from the appreciation of goods transferred as a result of the reorganization is deferred until distribution thereof;
- the value of the goods, transferred as a result of the reorganization are carried over to the acquirer. Likewise, the values on which depreciation is calculated and the useful life taken for these purposes shall not be changed as a result of the reorganization;
- losses incurred by the transferor can be offset against income derived by the acquirer, under the same terms existing prior to the reorganization; and
- organization and pre-operative expenses incurred by the transferor can be amortized by the acquirer under the same terms existing before the reorganization. The same rule applies to the amortization of the price paid for intangible assets.

D. The computation of taxable income

1. General description

The computation of taxable income is made through the following stages:
(1) gross receipts;
(2) net receipts;
(3) gross income;
(4) net income; and
(5) taxable income.

Net receipts from the transfer of goods are established by deducting, from gross receipts, refunds, bonuses, discounts and similar items, provided they are in accordance with market practices.

Gross income is defined as the aggregate of taxable proceeds arising in the taxable period. As regards proceeds from the transfer of goods, gross income is represented by net receipts minus deductible costs.

The cost of transferred goods is the acquisition or production cost or, as the case may be, the acquisition or inventory value established under the law. For property subject to depreciation, the cost is reduced by depreciation allowances.

For immovable property, the cost is calculated under the following rules:
- if the property has been acquired for a consideration, the cost is the acquisition value as adjusted for inflation under indexes established in regulations to the law;[7] and
- if the property has been acquired gratuitously, the cost is the cadastral value as adjusted for inflation under indexes established in regulations to the law.[8]

For shares and participations, the cost is calculated under the following rules:
- if the shares and participations were acquired for a consideration, the cost is the acquisition value; and
- if the shares and participations were acquired gratuitously, the cost is the market value or, if there is no market value, the cost is established under regulations to the law.[9]

In order to establish the *net income*, the expenses necessary to produce the income and to conserve its source may be deducted from gross income unless the deduction is specifically excluded. In the absence of proof to the contrary, it is presumed that expenses incurred abroad are related to foreign income and are consequently disallowed as a deduction.

The *taxable income* of legal entities is equal to their net income. The taxable income of individuals domiciled in Peru is equal to net income less specified personal deductions and allowances.

2. Specific deductions

It has been said that, in order to establish net income, the expenses necessary to produce the income or conserve its source may be deducted unless specifically excluded.

The law also provides that, under certain limits and conditions, the deduction of some items is specifically allowed in the computation of third category income (business profits), i.e. amortization, bad debts, collection expenses, depreciation, entertainment, fees, gifts, interest, leasing payments, losses, organization and pre-operative expenses, premiums, reserves, royalties, retirement pensions, salaries and other remuneration, social benefits, taxes and travel expenses.[10]

The following discussion shall cover only those specific deductions which have the most relevant interest within the group.

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7. Not received at the time this article was completed.
8. Not received at the time this article was completed.
9. Not received at the time this article was completed.
10. The law also specifies that the following items are not deductible in calculating taxable income:
(1) personal expenses of the taxpayer and his family;
(2) the income tax;
(3) fines, surcharges, interest for late payments and other penalties applied by the government and its agencies (sector público nacional);
(4) gifts other than those allowed as a deduction by the law;
(5) sums invested in the acquisition of assets or in permanent improvements;
(6) allocations to reserve funds which are not allowed as a deduction by the income tax law;
(7) amortization of intangible assets. However, the price paid for intangible assets can be fully deducted as an expense when incurred or amortized in up to 10 years;
(8) exchange losses sustained as regards that part of foreign financing which exceeds an amount equal to 3 times the net worth of the debtor. The limit can be changed by the government where not appropriate to the requirements of specific activities;
(9) interest paid to entities abroad that are economically connected with the debtor, in that part which is above the limit established in regulations to the law and interest on that part of financing which is above 3 times the net worth of the debtor. The rules do not apply where the limit has been amended by the government;
(10) trade commissions originating abroad for the purchase or sale of goods, in that part exceeding usual payments in the country where commissions originate;
(11) losses incurred in the sale of securities for the acquisition of which a tax incentive has been received; and
(12) taxes assumed by the payor of income which are due by the recipient thereof, except for the 10% tax levied on interest paid abroad under rules discussed in Section III. E.4. below.

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a. *Depreciation*

Amounts representing depreciation allowances corresponding to fixed assets are deductible. Allowances are calculated annually and, if not taken in due time, may be deducted in subsequent periods.

The depreciation rate for buildings and structures is 3% per year. For other fixed assets used for the production of taxable income, depreciation rates are calculated at percentages established in accordance with their useful life. The percentages are then applied to the acquisition or production value of goods or to values resulting from revaluations made under the law. The value of permanent improvements must also be considered. Regulations can authorize that depreciation allowances be taken under other rules.

If personal property becomes obsolete or is no longer used, the taxpayer can go on taking depreciation allowances or take a full deduction of the balance in one single period.

b. *Entertainment*

Entertainment expenses belonging to the business are deductible for that part which, in the aggregate, does not exceed both 1% of gross receipts and the number of tax units specified in regulations to the law.[11]

c. *Fees*

Remuneration paid to members of a corporation's board of directors for the discharge of their duties is deductible up to a sum which, in the aggregate, does not exceed 6% of pre-tax business profits.

d. *Interest*

Interest and financing expenses are deductible provided they are incurred in order to acquire goods or services for the production of income in Peru or to protect its source. Taxpayers deriving interest and other income from financing which is free from income tax may deduct only interest and financing expenses that exceed tax-free income. This limit does not apply to interest derived from securities acquired to discharge an obligation established in the law or in the Central Bank rules, or from securities yielding an interest not above 50% of the rate established by the Central Bank for rediscount granted to commercial banks.

e. *Losses*

Taxpayers domiciled in Peru may set off the aggregate net loss incurred in a taxable period against net income arising during 4 successive years computed as of the first year showing profits. Any balance not so compensated cannot be carried forward.

In the computation of losses, exempt income and dividends must be taken into account (i.e. to reduce the loss or to eliminate it). By contrast, personal allowances of individuals (e.g. family allowances for spouse, children and dependents) are not taken into account to increase losses.

Taxpayers performing economic activities requiring large investments and long periods to consolidate production may enjoy longer periods to carry forward losses, under rules to be established in regulations.[12]

Extraordinary losses of assets devoted to the production of taxable income, as a result of acts of God, force majeure or crimes, are deductible provided the loss is not covered by compensation or insurance. The normal decrease in inventories is also deductible.

f. *Royalties*

Royalties are deductible under the rules established in regulations to the law.[13]

E. Tax rates

1. General rates

Resident legal entities are taxed at progressive rates ranging from 30 to 55% applied to brackets expressed in tax units,[14] as shown in the following chart:

Taxable income (tax units)	*Percentage levied on excess over lower limit*
0 - 150	30
150 - 1500	40
1500 - 3000	50
more than 3000	55

2. Surcharges

a. *Capitalization tax*

Profits capitalized by means of issuing stock dividends within 6 months from the closing date of the taxable year are subject to a 15% "capitalization" tax which must be paid within the first 15 days of the month following the month during which the capitalization is decided. This is a final tax excluding taxation on the relevant stock dividends and can be paid by the corporation out of undistributed profits or free reserves without further tax liability for the shareholder.

The relief attached to the capitalization tax[15] is not available during the 5 years following a capital reduction or if the tax is not paid in due time. Likewise, if the capitalization is carried out within 6 months and the capitalization tax is paid within the time limits as stated above but the corresponding company liquidates or distributes its capital within 5 years as from the date of the public deed containing the capitalization, then the difference between the 15% tax and the normal income tax on dividends will be due.[16]

Legal entities are not allowed to establish freely disposable reserve funds in excess of 100% of their paid-in capi-

11. Not received at the time this article was concluded.
12. Not received at the time this article was concluded.
13. Not received at the time this article was concluded.
14. The tax unit was introduced by Legislative Decree No. 7 of 30 December 1980 and is to be adjusted every year in accordance with changes in prices. For taxable year 1981 it is 350,000 Soles.
15. Recourse to the capitalization tax and the benefits attached thereto involve a tax relief in the sense that in the absence thereof the 25% withholding tax on dividends would be due.
16. The normal tax on dividends is currently 25%.

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tal. Any sum above the limit which is also above 2 tax units must be compulsorily capitalized or distributed within 12 months as from the date of the balance sheet in which the excess appears.

If the capitalization is carried out within 6 months as from the closing date, the capitalization tax and the benefits attached thereto apply.

If the capitalization and/or distribution are carried out after 6 months but within 12 months as from the closing date of the taxable year, the 25% tax on dividends is due upon distribution. However if the capitalization or distribution is not carried out within 12 months as from the closing date, the sum exceeding 100% of paid-in capital shall be subject to the 25% withholding tax on dividends, surcharges and interest as if distributed to shareholders, irrespective of actual distribution.[17]

b. *Additional rate (tasa adicional)*

There are certain specific instances where non-compliance with the tax law is penalized with an additional rate of tax (tasa adicional). In fact, the following items shall be subject to an additional rate of 40%:

- any sum registered as an expense which later on is discovered to be really taxable income;
- any sum charged to profits or to freely disposable reserves, provided it represents an indirect disposal of income which has escaped tax control; and
- any sum which upon a tax control is assessed as income and which has not been reported in tax returns.

The additional rate is not applicable to income derived by branches or agencies (see Section III. E. 2. below).

F. Income tax administration

1. Annual returns and payments

Individuals, married couples, undividend inheritances and legal entities deriving income subject to tax must file an income tax return not later than 30 April of every year, including additional information on net worth, as may be requested.

Branches and agencies in Peru of individuals or legal entities domiciled abroad must also file returns showing the income available for the non-domiciliary.

Sole proprietorships, individual enterprises with limited liability and partnerships not treated as legal entities for income tax purposes shall file, after the closing of the commercial period and under terms and requirements established in regulations,[18] a return showing the net income or loss of the commercial period; this income or loss shall be attributed to the owners or partners proportionally to their participation in the enterprise's capital.

The tax due in accordance with the income tax return must be paid at official or private banks before the filing thereof. The tax corresponding to income in foreign currency shall be paid in Peruvian currency. For this purpose, the income in foreign currency must be converted into Peruvian currency in accordance with the exchange rate at the date on which income arises or is collected, as the case may be.[19]

2. Tax prepayments

In addition to annual returns and payments, taxpayers are required to make monthly prepayments which are creditable against the final liability to income tax.

For calculating the monthly prepayments, legal entities can choose one of the following methods:

(1) pay for each of the first 2 months of the period 10% of the income tax paid in the second preceding taxable year and pay for the remaining months of the period a portion of the tax paid in the preceding year to be established under rules enacted every year by the Finance Ministry;
(2) calculate the monthly prepayment on the basis of a balance sheet showing the income of the corresponding month; or
(3) pay 2% of third category gross receipts arising in the month.

If the legal entity fails to choose one of the methods, the tax administration shall calculate and charge the prepayment under methods (1) or (3), as it may prefer.

Likewise, the income tax law offers individuals several alternatives for the computation of the amount of prepayments (not covered in this article).

3. Tax audits

If an annual income tax return is not filed, the tax administration shall require the taxpayer to prepare it and to pay any tax due, inclusive of surcharges and interest, within 30 days. If after that term the taxpayer does not satisfy the requirement, the tax administration may, without further delay, charge and compulsorily collect a sum equal to the rax of the last period for which a return or assessment exists, multiplied by the number of delinquent periods, plus surcharges and interest. In these cases, the taxpayer's rights are limited to refund claims for excessive collection.

Besides the steps mentioned above, the tax administration may estimate the taxpayer's income and, for that purpose, use any of the following techniques:

- calculate the income by means of coefficients based on capital, the amount of transactions and income of other periods, the amount of purchases and sales, inventories of merchandise and products, bank deposits, normal business results of similar enterprises, salaries, rent and other overhead;
- calculate the income on the basis of external signs of wealth such as rent paid for dwellings, value of dwellings, value of estates used for entertainment, vehi-

17. Before the tax reform, industrial companies with receipts above 590 "annual minimum wages" for the Lima Province had to either pay a tax of 2% on after tax profits for scientific research or use a similar amount for scientific or research programs approved by the appropriate government agency (Instituto de Investigación Tecnológica Industrial y de Normas Técnicas). This levy is still in force after the tax reform because it originates from a special law which was not specifically amended by the reform.
Moreover, a surtax of 2% on behalf of the "Fondo te Compensación Nutricional" was levied on the full taxable profits of legal entities the profits of which were above 60 tax units (unidades impositivas tributarias). It might be understood that this last levy was revoked by the new income tax law. However, Law No. 23,337 of 15 December 1981 specifically extended its application to 1982.
18. Not received at the time this article was concluded.
19. For allocation rules, see Section II. C.3. above.

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cles, boats, luxury horses, servants, travel abroad, social clubs, education, works of art, etc.;
- calculate the income on the basis of changes or increases in the taxpayer's capital and any other data available to the tax administration;
- use general averages and percentages for a certain product or branch. No proof shall be admitted to rebut said averages or percentages when the taxpayer has not filed his income tax return; or
- calculate the income on the basis of differences in stocks, averages of estimated receipts, market values and technical indexes provided in regulations to the law.[20]

For assessment purposes, it is presumed, with right of rebuttal, that any difference between expenses of an individual and reported income is unreported net income. Likewise it is presumed, without right of rebuttal, that any capital increase the origin of which cannot be justified by the taxpayer is unreported net income.

The income tax law includes a rule under which any audit performed by the tax administration must begin with the return corresponding to the last taxable period, provided one has been filed. If there is no objection to the return, the tax administration may not charge taxes due for previous periods. This standard does not apply if the last taxable period cannot be audited due to the taxpayer's fault.

When the income tax return of the last taxable period has been considered correct by the tax administration, but later on it appears not to be so, then the tax control can be extended to the periods which originally could not be covered because of the scheme.

III. TAXATION OF PARTICULAR TYPES OF INCOME

A. The concept of domiciliary

The new Peruvian income tax law contains some rules dealing specifically with the taxation of income belonging to non-domiciliaries, referred to below, especially in Section III. E. Domiciliaries and non-domiciliaries are defined in the following manner.

For income tax purposes, the following are considered to be domiciled in Peru:
- Peruvian individuals who under the general law are domiciliaries of Peru;
- foreign individuals who have lived or been present in Peru for 2 successive years or more. Temporary absences not above 90 days in each taxable period are not taken into account;
- persons discharging abroad representative duties or official positions for the government or its agencies (sector público nacional);
- legal entities organized in Peru;
- branches, agencies and other permanent establishments in Peru belonging to individuals or legal entities not domiciled therein. In this case, the branch, agency or permanent establishment is considered to be domiciled in Peru only as regards its Peruvian-source income; and
- inheritances of persons who were at their death domiciliaries of Peru, under the income tax law.

Non-domiciliaries who have been present in Peru for 6 months and have been registered as taxpayers can elect to be treated as domiciliaries for income tax purposes.

On the other hand, individuals shall cease to be regarded as domiciliaries for income tax purposes, if they leave Peru and become residents of another country. Where it cannot be proved that an individual has become a resident of another country, he shall be regarded as a domiciliary unless he is absent from Peru for 2 successive years or more. Temporary visits to Peru not lasting more than 90 days in each taxable period are not taken into account.

B. Taxation of income from mining

1. Taxation rules

The General Mining Law introduced by Legislative Decree No. 109 of 12 June 1981 regulates the exploitation of all mineral resources existing in Peruvian soil, subsoil or sea, except for petroleum, other hydrocarbons, guano deposits and medicinal mineral waters.[21]

In Peru, mineral resources are inalienable State property. Mining activities may be carried out by State-owned enterprises or, under government concessions, by private individuals and legal entities, either Peruvian or foreign. Concessions are irreversible as long as the concessionnaire complies with requirements established in the General Mining Law. The mining industry is considered to be of public interest.

The government may retain for the State exclusive mining rights on certain minerals or in certain areas (áreas de reserva nacional). The government can also establish special rights in favor of the State (derechos especiales del estado) and grant them to state-owned enterprises. The nature of the special rights is similar to that of concessions.

The law authorizes the establishment of "special mining enterprises" (empresas mineras especiales), that is to say, corporations with minimum state participation of 25%, organized under the General Mining Law with the purpose of carrying out mining activities protected by special rights in favor of the state or, as the case may be, by concessions granted to private persons. Individuals and legal entities, either Peruvian or foreign, can participate in the special mining enterprises.

Concessionnaires are subject to the payment of surface and registration duties. They are also required to make investments, carry out activities and reach production levels established in the law. Mining activities are subject to income tax but are exempt from other taxes.

The income tax is levied, as regards mining activities,

20. Not received at the time this article was concluded.
21. Under Decree-Law No. 17,440 of 19 February 1969, petroleum and other hydrocarbon deposits are State property, and petroleum and petrochemical industries are public services. Law No. 23,231 of 26 December 1980 permits the state-owned company Petroperu to grant secondary and tertiary petroleum recovery operations to foreign firms. Previously this practice was disallowed.
Decree-Law No. 22,775 of 6 December 1979, as amended by Decree-Law 22, 862 of 5 January 1980, established a new regime for oil contracts and introduced tax rules applicable to oil contractors and to Petroperu.

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under ordinary rules of the Income Tax Law, with the following deviations:

- Income derived and losses incurred by partnerships limited by shares (for that part belonging to general partners), commercial limited liability companies, general partnerships, limited partnerships, mining limited liability companies, special mining enterprises and any form of enterprises receiving tax incentives granted in contracts entered into with the government under Article 157 of the General Mining Law[22] are allocated to partners proportionally to their participation in the entity's capital.

  Under this scheme, the taxpayer is the partner. The income tax paid by the company is considered to be a prepayment to be credited against the partners' liability up to the limit of that liability and proportionally to the partners' shares in the company's capital. Moreover, the liability to the income tax arising for individuals from mining activities is limited to the tax resulting from the application of ordinary rates to mining income only (i.e. as separate from other income).

- The acquisition value of mining rights and that of special rights of the state shall be amortized as from the period during which the production minimum becomes compulsory.
  For amortization purposes, the acquisition value includes the acquisition price or the registration cost, as the case may be, and prospecting and exploration expenses incurred up to the date on which a production minimum becomes compulsory.[23] The amortization is to be spread over a period determined by the taxpayer considering the deposit's life as calculated in accordance with the mineral reserves and the production minimum already referred to.[24]
- Exploration expenses incurred as from the date the production minimum established in the law becomes compulsory can be fully deducted or amortized using an annual percentage which is determined considering the deposit's life as calculated in accordance with mineral reserves and the production minimum. Development and preparation expenses permitting the deposit exploitation for more than one period can be fully deducted in the period during which they are incurred or amortized in up to 3 periods including that one during which they are incurred.[25]
- Branches or foreign enterprises not domiciled in Peru receiving tax incentives granted in contracts entered into with the government under Article 157 of the General Mining Law[26] may remit abroad an amount equal te depreciation allowances taken on fixed assets, capitalized expenses and profits, provided the balance sheet of the period shows a profit, or a loss which does not exceed depreciation allowances registered in the period. If losses exceed depreciation allowances of the period, remittances related thereto shall be reduced in an amount equal to the difference. Special mining enterprises and companies receiving tax incentives granted in contracts entered into with the government under Article 157 of the General Mining Law[27] that have among their partners one or more branches of foreign enterprises not domiciled in Peru shall, for remittance purposes, allocate depreciation allowances and amortizations among their partners proportionally to their share in the capital's.
- Any person performing mining activities shall contribute 1% of his after tax profits to the Geological and Metallurgical Institute (Instituto Geológico Minero Metalúrgico).

2. Tax incentives

The General Law on Mining grants several tax benefits for the promotion of mining activities. The incentives refer to depreciation and revaluation, investment and reinvestment, permanency of taxation rules, contracts with the government, and special rules.

a. *Depreciation and revaluation*[28]

Depreciation allowances for investments made by mining enterprises in machinery, equipment, installations, housing, social welfare, vehicles and earthworks, up to 300 tax units in the year, can be taken at a 100% rate.

Depreciation allowances of the same investments exceeding 300 but not 900 tax units in a year can be taken at a 20% rate except where the normal depreciation rate is higher. Depreciation allowances on that part of investments exceeding 900 tax units in the year are taken under ordinary rates for mining.

If the exchange rate of Peruvian currency against the American dollar changes by more than 5%, fixed assets can be revalued free from income and other taxes. Capitalization of the net balance of the revaluation (revaluation of assets less adjustment of debts incurred in foreign currency to buy the assets) is also free from taxation.

b. *Investment and reinvestment*

Mining enterprises are entitled to a tax credit if they reinvest in their own operations - or invest in other mining enterprises - in an amount not exceding 40% of their net income.

Persons not engaged in mining activities can also take advantage of the above credit, provided they make investments in mining enterprises. If the credit is not actually used by these persons, it can be taken by the enterprise receiving the investment. The above tax credit is calcu-

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22. This kind of contract is discussed in Section III. B.2.d. below.
23. The taxpayer can elect to deduct prospecting and /or exploration expenses in the period during which they are incurred.
24. If the mining rights are abandoned or revoked before the production minimum becomes compulsory, the acquisition value shall be fully deducted. If the mining rights are abandoned or revoked, or the mining deposit is depleted after the production minimum becomes compulsory but before the acquisition value has been fully amortized, the taxpayer can choose to deduct immediately the balance or go on with the amortization.
25. If the mining reserves are depleted or mining rights are revoked, the taxpayer can choose to deduct immediately the balance of expenses or go on with the amortization.
26. This kind of contract is discussed in Section III. B.2.d. below.
27. This kind of contract is discussed in Section III. B.2.d. below.
28. The provisions on depreciation allowances and revaluation discussed herein are not applicable where a contract has been entered with the government, under Article 157 of the General Mining Law.

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lated by applying the average or effective income tax rate to the investment or reinvestment.[29]

In order to receive the benefits, it is necessary to prepare investment and/or reinvestment programs and obtain approval therefor from the government (Dirección de Fiscalización Minera).[30]

The investment program can be carried on directly by each separate enterprise or by means of joint ventures or legal entities organized for that purpose. Assets acquired under investment programs cannot be transferred before depreciation allowances representing 90% of their value have been taken without considering accelerated depreciation. It is, however, possible to transfer the asset to another mining enterprise which will not enjoy a credit for the sum invested in the acquisition.

The credit from investments belonging to mining enterprises shall be used to pay the income tax due for the period during which the investment is carried out. Any balance of credit shall be used to pay the income tax due for up to the 3 following periods.[31] The amount of the credit or balance thereof not used to pay the income tax of the period during which the investment is carried out is adjusted at the end of each period during which the value of the Peruvian currency against the American dollar changes by more than 5%.

The capitalization of the investments and reinvestments made by mining enterprises under rules discussed above is exempt from income and other taxes.[32]

c. *Permanency of taxation rules*

Mining enterprises commencing operations exceeding 350 but not 5,000 metric tons per day are given the guaranty that the taxation rules will not change for a period of 10 years as from the commencement of operations.

Mining enterprises already producing more than 350 but not more than 5,000 metric tons per day which increase their production capacity by 100% without exceeding 5,000 metric tons per day, are also assured the above privileged treatment for a period of 10 years as of the date on which the increase of production has been effected. If the growth is between 50 and 100%, the period of permanency is proportionally reduced.

Operations are deemed to be commenced or the increase effected once actual operations represent at least 80% of projected production, during 90 successive days.

The guaranty that the taxation rules will not change means that the taxpayer is subject to the tax regime in force on the date on which the program is approved and that no tax subsequently established shall be applied. This privileged tax treatment also covers assessment and payment rules but, in this case, the taxpayer can elect to be taxed under any new rules. Should any tax be replaced by a new one, the taxpayer shall pay the new tax up to the sum which would be due in the year under repealed rules. Anticipation of payments and compulsory loans in favor of the state are prevented by the scheme.

d. *Contracts with the government*

In order to promote investment and facilitate the financing of mining projects involving an initial production of at least 5,000 metric tons per day or increases of current production aimed at reaching the above level,[33] the Executive Branch is authorized to conclude, with the approval of the Council of Ministers, contracts with mining enterprises by means of which one or more of the following benefits may be granted:[34]

(1) the guaranty that the taxation rules in force on the date on which the contract was signed will remain applicable during 10 years;
(2) the authorization to use higher rates of depreciation allowances as regards machinery, equipment and other fixed assets, within the aggregate limit of 20% per year;
(3) the authorization to revalue the book of machinery and installations when the value of the Peruvian currency against that in which the investment was made undergoes a change which exceeds 5%.[35] The revaluation and subsequent capitalization of the appreciation are free from income and other taxes or duties;
(4) the reduction of the ordinary corporate income tax as calculated at rates in force on the date on which the contract is entered into, during the period which is necessary to recover the investment plus 3 additional years. The reduction that can be granted is limited to one third of the ordinary progressive rates.[36] This means that at least two thirds of the rates in force on the date on which the contract is concluded remain applicable;
(5) the authorization to keep accounting records in American dollars or in the currency in which the investment is made, provided the contract establishes that 80% of the production, or the additional production resulting from the contract, shall be exported. The system must be used for periods not shorter than 5 years and during such period the taxpayer is not allowed to revalue assets;
(6) the guaranty that the legal rules will remain applicable regarding the disposal of foreign currency de-

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29. Under Decree-Law No. 22,401 the tax credit is normally calculated by applying the medium rate of income tax of the investment or reinvestment and by subsequently adjusting (in certain cases) the balance of that computation according to an "index of selectivity". This index varies for different activities and according to the priority level of the enterprise receiving the investment. As regards mining, however, the index is 1 and can therefore be disregarded.
30. Reinvestment programs must be submitted for approval during the taxable period or at least 60 days before the final income tax becomes due. The mining agency (Dirección de Fiscalización Minera) shall take the decision on the program within 45 days. If the decision is not taken or notice of the decision is not served within the 45-day term, the program is automatically approved. In order to enjoy the credit, enterprises must also file, within 60 days of the end of the corresponding period, a sworn return directed to a mining agency (Dirección de Fiscalización Minera) showing investments made in the period. In order to receive investments from third parties, it is necessary for an enterprise to have its programs approved by the government and use the funds received in discharge of the program within 3 years of the date of receipt.
31. Enterprises dealing with less than 5,000 metric tons per day can choose to take the credit under the aforesaid rules or under special rules.
32. Ordinary income taxation on capitalization is discussed in Sec. II. E.2.
33. Some other specified enlargements are also eligible for the scheme.
34. Incentives listed herein do not exclude the possibility for an enterprise to obtain the priviliged treatment as explained in Section III. B.2.c. above, provided the requirements discussed therein are met.
35. This possibility is not available for enterprises keeping their financial records in foreign currency.
36. For ordinary rates see Section II. E.1. above.

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rived from the sale of products, as in force on the date in which the contract with the government is signed; and

(7) no discrimination as regards foreign exchange.

The above contract concluded between the government and mining enterprises shall be in force for the period which is necessary to recover the investment by using the gross income concept, less the income tax, the contribution to the Geological and Metallurgical Institute (Instituto Geológico Minero Metalúrgico) and profit shares payable to workers (participaciones liquidas y patrimoniales). For this purpose:

- "gross income" means the selling price minus costs. Depreciation allowances, amortization of invested capital, and investments or reinvestments for which tax incentives have been received are, in this case, not deductible as costs; and
- "investment" includes assets representing the acquisition of mining rights, the prospecting, exploration and development thereof, the purchase of machinery and equipment, winning plants, systems for power production, installations, earthworks, support facilities, housing and social welfare. Investments and reinvestments for which tax incentives have been received shall not be taken into account for the computation of investments to be recovered.

The contract may be revoked if the beneficiary does not provide assurances that the financing will be obtained within 18 months as of the date of its signature or if the work has not been commenced and finished within the time limit established in the contract, unless the delay is due to acts of God or force majeure.

e. *Special rules*

The general mining law includes special taxation rules for less developed areas, engineering ventures with foreign participation and small miners.[37]

Mining enterprises commencing their activities in the Jungle Region or in other areas of Peru which, due to geographic difficulties, have not benefitted from mining development receive the following additional incentives:

- for each ton of mineral ore or product that is sold, a tax credit certificate equal to 10% of the f.o.b. or ex factory value thereof with a minimum of 0.5% of a tax unit and a maximum of 1.5% of a tax unit. The certificate can be used for the payment of income and other taxes or transferred to other taxpayers for the same purpose; and
- concessionnaires for exploration can obtain an extension of their concessions for 5 additional years provided they meet certain requirements related to investments.

Engineering companies and professionals not domiciled in Peru rendering assistance services or preparing projects for mining, are wholly or partly exempt from income tax if they create, with Peruvian engineering companies or professionals, any kind of company or joint venture and contribute technology not available in the country. The activities of these enterprises must be performed in Peru unless it is necessary to carry them out abroad for sound reasons. The exemption is 100% if the Peruvian participation reaches at least 51% and is proportionally reduced if the Peruvian participation is less than 51%. The exemption applies to the income tax on dividends and profits belonging to the foreign company or professionals.

C. Other income specially taxed

The Peruvian income tax law provides special rules for the taxation of the following income-producing activities: communication, film distribution, imports and exports, insurance, news, oil-related services and transportation. Considering that these rules relate to international activities, a short description is given.

a. *Communication*

Income arising from communication services between Peru and foreign countries is considered to be Peruvian-source.

Where such income is derived by domiciliaries of Peru, it is presumed without right of rebuttal that its entire amount is Peruvian-source. This rule does not apply to branches or permanent establishments in Peru of foreign enterprises. Persons not domiciled in Peru and branches or agencies of foreign enterprises providing communication services in Peru are presumed, without right of rebuttal, to derive net Peruvian-source income equal to 5% of gross income from radiograms, telephone calls and similar communications made from Peru to another country.

b. *Film distribution*

Income arising from the leasing and other kind of exploitation of films, tapes, matrixes and other elements used for the projection or reproduction of images and sounds is considered to be Peruvian-source.

Where such income is derived by domiciliaries of Peru, it is presumed, without right of rebuttal, that its entire amount is Peruvian-source. This rule does not apply to branches or permanent establishments in Peru belonging to foreign enterprises.

Persons not domiciled in Peru and branches or agencies of foreign enterprises distributing cinematographic and similar films to be used by domiciliaries of Peru are presumed, without right of rebuttal, to derive net Peruvian-source income equal to 20% of gross receipts for the use of films for cinema or television, videotapes, soap operas, records, comics or any other similar means for projection, reproduction or broadcasting of images and sounds.

c. *Imports and exports*

Income arising from the export of goods produced, manufactured or purchased in Peru is considered to be Peruvian-source. For these purposes exports include remittances abroad made by subsidiaries, branches, representatives, purchasing agents and intermediaries acting for individuals and legal entities operating abroad.

For income tax purposes, the value of imports cannot ex-

37. Rules for small miners do not seem to offer special interest and are thus not discussed in this article.

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ceed the ex factory value in the place from where they originate, plus expenses to the Peruvian port. Any excess amount shall be treated as taxable income of the importer, unless proof to the contrary is provided.

Likewise, for the same purposes, the value of exports cannot be less than the "real value", that is to say, its value in the consumer's market minus expenses. Any deficient sum shall be treated as taxable income of the exporter, unless proof to the contrary is provided.

d. *Insurance*

Income arising from insurance, reinsurance and back cessions is considered to be Peruvian-source.

Where such income is derived by domiciliaries of Peru, it is presumed, without right of rebuttal that its entire amount is Peruvian-source. This rule does not apply to branches or permanent establishments in Peru belonging to foreign enterprises.

Non-domiciliaries insuring risks in Peru are presumed, without right of rebuttal, to derive Peruvian-source income equal to 7% of:
- net premiums (exclusive of commissions paid in Peru) remitted by enterprises organized and domiciled in Peru; and
- income (net of commissions) received for reinsurance covering risks located in Peru, or referring to residents thereof or to property located therein.

e. *News*

Income arising from the supply of news by international agencies is considered to be Peruvian-source.

Where such income is derived by domiciliaries of Peru, it is presumed, without right of rebuttal, that its entire amount is Peruvian-source. This rule does not apply to branches or permanent establishments in Peru belonging to foreign enterprises.

International news agencies are presumed, without right of rebuttal, to derive net Peruvian-source income equal to 10% of gross remuneration received for the provision of news and, in general, information and material for printing to persons or entities that are domiciled in Peru or use the material therein.

f. *Oil-related services*

Contractors and subcontractors not domiciled in Peru, rendering specific services related to the exploration, drilling, development and transportation of oil, are presumed, without right of rebuttal, to derive net Peruvian-source income equal to 25% of gross receipts.

Contractors and subcontractors domiciled in Peru, rendering the same services, are presumed to derive a minimum taxable income equal to 15% of gross receipts.

g. *Transportation*

Income arising from transportation between Peru and foreign countries is considered to be Peruvian-source.

Where such income is derived by domiciliaries of Peru, it is presumed, without right of rebuttal that its entire amount is Peruvian-source. This rule does not apply to branches or permanent establishments in Peru belonging to foreign enterprises.

Persons not domiciled in Peru and branches or agencies of foreign enterprises rendering transportation services in Peru are presumed, without right of rebuttal, to derive net Peruvian-source income equal to 1% of gross income from transportation by air and 2% of gross income from transportation by sea.

Persons not domiciled in Peru leasing airplanes are presumed, without right of rebuttal, to derive net Peruvian-source income equal to 60% of gross receipts arising from such leasing.

Income from the leasing of boats and airplanes is taxed at a 10% rate.

D. Taxation of investment income

1. Taxation of capital gains

Capital gains from the transfer of property are taxed only when derived from *habitual* transactions[38] or if they arise from the transfer of the following items:
- immovalbe property, provided the transferor has made in the taxable period or in the 2 preceding periods at least 2 purchases and 2 sales of immovable property;
- shares, provided the transferor has made in the same period at least 10 purchases and 10 sales;
- immovable property previously acquired with the purpose of being subsequently transferred or which is sold within a development or subdivision scheme;
- property received as a payment for habitual transactions;
- personal property which may be depreciated;
- goodwill, trademarks and similar items;
- property belonging to legal entities or enterprises organized abroad and performing in Peru activities that produce third category income;
- business or enterprises; or
- rights or concessions.

2. Taxation of dividends paid to domiciliaries

Dividends paid to legal entities are not computed in calculating the aggregate income of the recipient. However, dividends paid to legal entities are subject to a 25% withholding tax which is creditable against the same tax due on subsequent distributions.[39] Dividends paid by legal entities domiciled in Peru out of exempt dividends or interest received from other companies are not taxable, provided the redistribution is carried out within the 2 periods following the one during which they were received.[40]

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38. It is presumed that transactions are not habitual if they refer to:
- immovable property acquired gratuitously by inheritance;
- immovable property which has been used by the vendor for dwelling purposes for at least 1 year;
- immovable property owned for at least 2 years;
- shares and participations acquired gratuitously by inheritance; and
- shares and participations owned for at least 2 years.

39. The tax, however, cannot be refunded.

40. For allocation purposes, distributions are deemed to be first paid out of exempt dividends or interest and subsequently out of other income.

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In order to benefit from the credit or exemption referred to, it is necessary that the following conditions be met:
- if the redistribution is made in shares, it must be made in the same shares as previously received. However, the company making the redistribution may capitalize the shares received from another company and make the redistribution in its own shares;
- if the redistribution is made in cash it must be paid out of cash dividends; and
- if the redistribution is made in kind it must be made with the same items received from another company.

Dividends paid to resident individuals are subject to a 25% withholding tax representing a prepayment which is creditable against the final liability to the income tax. Dividends paid on shares distributed to workers under the scheme of workers' participation in profits[41] are subject to income tax under the same rules applicable to salaries, as long as the employment condition exists. After retirement, however, they are taxed as ordinary dividends.

Stock dividends can be subject to the same regime of dividends unless the capitalization tax or other rules discussed in Section II. E. 2. apply.

The concept of dividend includes:
- income distributed to shareholders by corporations and partnerships limited by shares whether in cash, kind or shares of the distribution company;
- distributions of shares representing a revaluation of fixed assets which is in excess of the amount authorized by the law;
- sums received upon the liquidation of a company which are in excess of the normal value of shares and certain specified premiums;
- shares in profits;
- any loan or delivery of goods to shareholders not exceeding profits and free reserves which is not refunded within 12 months; this standard is not applicable to banks and financial institutions; and
- any sum which, upon a tax audit is assessed as third category income, provided the payment thereof represents an indirect disposal of income which has escaped taxation. In this case the tax discussed in Section II.E.2.b. is due.

On the other hand, the term "dividend" does not include:
- certain specified premiums;
- shares of the distributing company representing the capitalization of revaluations authorized by law. If the shares are distributed to legal entities, the shares must be registered by the recipient in a special reserve account to be used for offsetting losses and distributed only upon the sale of the shares for which they were received.

3. Taxation of interest paid to domiciliaries

Interest paid to domiciliaries is taxed as ordinary income of resident individuals and corporations. However, a final 40% withholding tax is levied on interest paid on bearer bonds and securities.

For the purposes of income taxation, it is presumed, without right of rebuttal, that any loan produces at least the interest charged by the Central Bank on rediscount to commercial banks. This assumption is not applicable in specified instances including loans granted by non-domiciliaries from abroad. Moreover any sum refunded by the debtor which exceeds amounts received is presumed to be interest.

The law provides for the following exemptions:
- interest on loans granted by the Peruvian government or agencies thereof (sector público nacional); and
- interest on savings deposits and contributions.[42]

4. Taxation of royalties paid to domiciliaries

Royalties paid to a Peruvian individual or corporation are considered to be business profits and treated as ordinary income.

The term "royalty" is deemed to include any consideration in cash or in kind paid for the use of or the right to use any patent, trademark, design or model, plan, secret formula or process, and copyrights of literary, artistic, or scientific work, as well as for information concerning industrial, commercial or scientific experience.

Recipients of royalties may deduct 10% of such income during the period necessary to recover expenses incurred in Peru for the acquisition, production and registration of the assets for which the royalties are paid.

E. Taxation of income derived by non-domiciliaries

1. General rules for the taxation of non-domiciliaries

Income of any kind paid or credited to beneficiaries not domiciled in Peru is subject to final withholding tax at the following rates:
- dividends: 30%;
- interest: 40%, 10% or exempt;[43]
- royalties: 25%;
- income from the leasing of boats or airplanes: 10%;
- after tax profits of branches or agencies belonging to nonresidents: 30%;
- pensions or remuneration for personal services rendered in Peru: progressive rates used for resident individuals which range from 2 to 65%; and
- non-specified income: 40%.

The withholding tax is calculated on the following amounts which, for this purpose, are deemed, without right of rebuttal, to be net income:
(1) for first category income (i.e. income from real property), the tax is levied on the net or taxable income established under special rules provided by the law;

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41. The scheme for workers' participation in profits is discussed in the Introduction to the Peruvian chapter in Section C of *Corporate taxation in Latin America* (International Bureau of Fiscal Documentation, Amsterdam).
42. There are also some items which are exempt in accordance with legislation existing prior to the enactment of the current income tax law and which has not been revoked by the new legislation, i.e.:
- interest on bank certificates in foreign currency and deposits in foreign currency with financial enterprises (Decree-Laws No. 22,038 and 22,891);
- interest on securities issued by the government agency for development "Cofide" (Decree-Laws No. 21,020 and 22,891); and
- interest on bonds issued by financial enterprises and fixed term deposits (Decree-Laws No. 18,957, 20,114 and 22,891).

43. For further discussion, see Section III. E.4. below.

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(2) for royalties, the tax is levied on gross receipts minus deductions (discussed in Section III. E.5. below);
(3) for life pensions, the tax is levied on gross receipts minus a deduction equal to 50% thereof, made to recover the investment and limited, in the aggregate, thereto;
(4) for other non-specified second category income (e.g. dividends and interest), the tax is levied on the total of the income paid or credited to the non-domiciliary;
(5) for income specially taxed (i.e. derived from communication, film distribution, imports and exports, insurance, news, oil-related services and transportation), the tax is levied on the corresponding amount established under the rules discussed in Section III. C. above;
(6) for other non-specified third category income (i.e. business income),[44] the tax is levied on the amount paid or credited to the non-domiciliary;
(7) for fourth category income (i.e. income from professional services), the tax is levied on 90% of sums paid or credited to the non-domiciliary.
(8) for fifth category income (i.e. income from employment), the tax is levied on 100% of sums paid or credited to the non-domiciliary; and
(9) for income not listed above, originating from the transfer of goods or rights or from the exploitation of goods subject to wear and tear, the tax is levied on receipts minus invested sums (costs).

For withholding tax purposes, income derived from business associations not considered to be legal entities for income tax purposes shall be deemed to be paid or credited to the beneficiary abroad as from the date on which the annual income tax returns are due.

2. Taxation of income derived through branches

Profits derived by branches or agencies established in Peru are taxed in accordance with ordinary rates (see Section II. E.1.), and, in addition, the after tax profits that are available to the principal abroad are subject to a 30% withholding tax.

Expenses incurred by a branch, which represent taxable income for other branches or agencies, are deductible, provided the payment can be duly controlled and does not constitute indirect distribution of profits.

3. Taxation of dividends paid to non-domiciliaries

Dividends paid to beneficiaries not domiciled in Peru are subject to a 30% withholding tax which is final.

For the concept of dividend see Section III. D.2. above.

4. Taxation of interest paid to non-domiciliaries

Interest paid to non-domiciliaries can be subject to 3 different tax regimes:
- the interest is subject to a 40% final withholding tax if no other specific rule is provided for;
- the interest is subject to a 10% final withholding tax, if it is paid to legal entities on loans or financing specified by the law and discussed below; or
- the interest is exempt from income taxation in instances discussed below.

The instances where interest paid to legal entities is subject to 10% tax are the following:
- interest on foreign financing, provided:
  - the proceeds of the financing are sold in the Single Exchange Market (this requirement applies to cash loans only);
  - the annual interest (inclusive of commissions, premiums and any other charges) does not exceed by more than 3 points the prime rate of the financial market from which the monies come; and
- interest paid abroad by banks and financial enterprises established in Peru for the use of their credit lines abroad.

The following interest is exempt from income tax:[45]
- interest on development loans granted by international organizations or by institutions belonging to foreign governments;
- interest on loans granted by foreign institutions for the construction, acquisition, installation or operational start of new fixed assets, or for working capital which is necessary for the establishment or development of the enterprise, provided some additional requirements are met; and
- interest on saving deposits and contributions.

5. Taxation of royalties paid to non-domiciliaries

Royalties paid to beneficiaries not domiciled in Peru are subject to a 25% withholding tax, which is final.[46]

Any recipient of royalties may deduct 10% of such income during the period necessary to recoup expenses incurred in Peru for the acquisition, production and registration of the assets for which the royalties are paid.

Non-domiciliary recipients of royalty payment habitually performing research and experimentation in order to find the kind of assets for which the royalties are paid can deduct the corresponding expenses, up to 5% of gross royalties. The government may, for specific cases, change the limit.

In case of technical services requiring activities which are partially performed in Peru and partially performed abroad, net income is presumed to be 40% of gross receipts.

Royalties paid for technical, economic, financial or any other assistance rendered from abroad by governmental agencies or international organizations are exempt from income taxation.

IV. SALES TAXATION

A. The general tax on sales

1. General description

The Peruvian legislation in force before the 1981 reform included a sales tax (Impuesto a los Bienes y Servicios) which covered goods and services. For goods it was a value-added tax levied at the producer and wholesale

44. Not referred to in (5) above or in (9) below.
45. For more exemptions, see footnote 42.
46. For the concept of royalty, see Section III. D.4. above.

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levels. However, no credit was granted for the acquisition of fixed assets and services.

Legislative Decree No. 190 included in the reform package introduced a new general tax on sales (Impuesto general a las ventas) which extends the coverage of sales taxation to the retail level, taxes some services previously exempt and grants credits for fixed assets and services. The change entered into force on 1 November 1981.

2. Taxable persons

The general tax on sales is levied on individuals and legal entities that:
- perform sales of taxable goods, irrespective of the stage of the production and distribution process at which their activity is carried out;
- import goods; or
- render specified services listed in Appendix II to the law.

3. Taxable transactions

The general tax on sales is levied on the following transactions:
- the sale of movable goods carried out in Peru;
- the rendering of specified services listed in Appendix II to the law; and
- the importation of goods. Exports of goods are not subject to the tax.[47]

For the purpose of the tax, a "sale" is any transaction by means of which goods are transferred for a consideration. Taxable sales also include:
- any disposal of goods made by an enterprise, its owner or partner, for purposes other than business activities; and
- any disposal of goods not allowed as an expense for income tax purposes.

A "sale", however, does not include the transfer of inventory under a merger transaction or at the alienation of an enterprise.

For purposes of the tax, "movable goods" are those goods that can be moved from one place to another, rights thereon, boats and airplanes.

The services subject to the tax are listed in Appendix II to the law and include the following items:
- lodging services, sale of food and drink carried out in lodging establishments, tourism facilities, restaurants, bars, night clubs, clubs and any similar establishment;
- services rendered by general warehouses (almacenes generales de depósito);
- data processing, tabulation and electronic computation;
- advertising, publicity and similar services;
- cleaning of buildings, chimneys, windows and similar services;
- radio and television broadcasting (inclusive of closed circuit television services);
- repair, maintenance, reconstruction and alternation of movable property;
- laundry and dyeing services;
- services of hair dressers, beauty parlors, saunas, masseurs and the like;
- furniture decoration;
- photographic services;
- photocopies, copies, reductions and similar services; and
- leasing and subleasing of movable property.

Financial leasing is also taxed. However, the leasing and subleasing of agricultural machinery are exempt.

Exempt items are listed in Appendix I to the law which is in force up to 31 December 1990. The list includes: living animals, meat, fish, milk, butter, eggs, honey, plants, flowers, vegetables, fruit, coffee, cereals, flour, seeds, edible oil, sugar, cacao, pasta, bread, food for animals, unprocessed tobacco, salt, sulfur, graphite, sand, plaster, medicines, fertilizers, pesticides, India rubber, rubber, hides, wood, cork, copybooks, books, newspapers, periodicals, wool, cotton, hemp, machinery for agriculture, etc.

Exemptions cover the sale of used property carried out by individuals or legal entities not performing business activities. Future exemptions not listed in Appendix I to the law must be granted specifically and be included therein. General exemptions[48] already granted or to be granted in the future shall not be deemed to include the general tax on sales. However, imports previously exempt from the old tax on goods and services are automatically exempt from the new general tax on sales.

4. Taxable amount

The tax is calculated by applying the rate, as the case may be, to:
- the value of sales;
- the full amount of receipts from services; or
- the c.i.f. customs value of imports, as increased by duties and taxes on imports but exclusive of the general tax on sales.

The "value of sales" or the "receipts from services" include the full amount to be paid by the acquirer of goods or user of services. This amount comprises the full value of invoiced goods or services, inclusive of sums charged separately even if originating from complementary services, interest, financing expenses or any expense incurred on account of the purchaser or user of services.

Also included in the value of sales or the receipts from services are the excise tax (Impuesto Selectivo al Consumo) and any other taxes on production, sales or services. However, as regards the sale of gasoline and fuels

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47. The liability to the tax arises:
- as regards the sale of goods, either on the date on which the invoice is issued or on the date on which the good is delivered, whichever is first;
- as regards the sale of boats and airplanes, on the date on which the contract is signed;
- as regards the disposal of goods for purposes other than business activities, on the date of the disposal;
- as regards the rendering of services, either on the date on which the invoice or receipt of payment is issued or on the date on which the consideration is received (whichever is first); and
- as regards the importation of goods, on the date on which customs clearance is applied for.

48. I.e. exemptions which do not specifically mention the general tax on sales.

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derived from petroleum, the tax on vehicles (Impuesto de Rodaje) is not included in the value of sales for the computation of the general tax on sales. Likewise discounts and bonuses shown in invoices are not included in the taxable amount, provided they are in accordance with normal trade practices.

The price of assembly or installation "in situ" of pre-fabricated parts, performed by the vendor of such parts,is to be included in the value of sales. This provision covers pre-fabricated parts of bridges, watertanks, depots and stores, railways, highways, lifts, mechanical ladders, plumbing, sprays for fire prevention, central heating, ventilation, air conditioning, lighting, electric circuits, similar facilities in buildings and any structures.

5. Computation of the tax

The general tax on sales is essentially a value-added tax. This means that the tax rate provided by the law is applied to taxable amounts and the tax liability resulting from that calculation is reduced, where appropriate, by crediting against this liability the tax on goods or services supplied to the taxpayer.

The Peruvian sales tax law provides for a single 16% rate. Nevertheless, industrial enterprises established in less developed areas receive tax reductions. In addition, enterprises established in the Jungle Region benefit from even more substantial reductions and exemptions. These special regimes shall be further discussed in Section IV. A.6. below.

The tax credit is granted for purposes of the general tax on sales if it is registered separately in invoices substantiating the acquisition of goods and services and also for this tax paid on imports.

In order to enjoy a credit on the acquisition of goods and services:
- the acquisition price must be deductible as an expense or cost under the income tax legislation;
- the goods and services must be used to perform transactions subject to the general tax on sales or on "non-traditional exports";
- the tax must be registered separately in the invoice substantiating the acquisition of a taxable good or service or in the import documents;
- the invoice must be issued in the way established in regulations to the law; and
- the invoice or importation document must be registered in the taxpayer's record of purchases.

The credit originating from the acquisition of goods subject to depreciation (fixed assets) must be divided in 4 annual installments and taken as from the calendar year during which the use of such goods commences. If an asset is sold before the 4-year term has elapsed, any unused balance of the credit can be offset only against the tax arising from the sale of the asset itself. However, if the enterprise has not commenced operations, the credit arising from the acquisition of fixed assets may be refunded, provided the asset has not been put into use.

Where a taxpayer simultaneously performs taxable and non-taxable transactions, certain provisions established in regulations to the law must be taken into account for the computation of the credit.[49]

When an enterprise is reorganized or transferred, the existing tax credits thereof can be transferred to the new or acquiring enterprise. However, if an enterprise is liquidated, the credit is not refunded.

6. Special rules

a. *Less developed areas*

Industrial enterprises of the first, second and third priority[50] established or to be established in less developed areas[51] pay the general tax on sales under more favorable rules.

The "less developed areas" entitled to the tax reduction include any area of Peru other than the provinces of Lima, Cañete, Chancay and Huaral of the Department of Lima, and Callao.

The special rules provide for a tax reduction which is calculated under the following provisions:
- the tax debit of the month (i.e. the tax liability arising from goods and services sold in the month) is reduced by 15% of its amount;
  for enterprises that are established in less developed areas on or after 1 January 1980, the reduction for the first 5 years as from commencement of operations is 40%;
  for enterprises that were already established in less developed areas before 1 January 1980, the reduction for that part of the 5-year period (computed as from commencement of operations) which was still available when Legislative Decree No. 190 entered into force (i.e. on 1 November 1981) is 30%; and
- the tax credit is calculated on purchases and services received under ordinary rules and is not limited or affected by the reduction of the debit.

Thus, by reducing the debit and maintaining the credit untouched, a reduction is produced in the final tax.

b. *Jungle Region*

Taxpayers domiciled in the Jungle Region enjoy a more favorable regime as regards the general tax on sales, even if compared with less developed areas in general.

The Jungle Region encompasses the departments of Loreto, Ucayali, San Martin, Amazonas, and Madre de Dios.

To be eligible for the benefits a person must:
(1) be domiciled in the Jungle Region; and
(2) perform 75% of his transactions in the Jungle Region.

Legal entities must in addition:
(3) be organized and registered in the Jungle Region; and
(4) have their management in the Jungle Region.

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49. Article 31 of Supreme Decree 245-81-EFC of 4 November 1981.
50. Under the General Industrial Law (Decree-Law No. 18,350 of 27 July 1970, as amended) industrial activities are classified in 4 priority groups. For further discussion, see Industrial Incentives in Section 6.02 of the Peruvian chapter in Section C of *Corporate Taxation in Latin America*.
51. For incentive purposes it is necessary to separate ordinary "less developed areas" from some less developed areas which enjoy an even more privileged regime, e.g. the Jungle Region which is discussed in Section IV. A.6.b.

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Commercial enterprises belonging to the government or to its agencies only need comply with requirements (3) and (4).

The benefits available for the Jungle Region are the following:

(1) the importation of goods specified in an Appendix to Decree-Law No. 21,503, to be consumed in the Jungle Region, and imports of raw materials for the production of such goods are exempt from the general tax on sales. This exemption does not apply to goods similar to those already produced in the region in an amount sufficient to cover the needs thereof;
(2) the sale of the goods specified in an Appendix to Decree-Law No. 21,503 to be consumed in the Jungle Region and the sale of raw materials for the production of such goods are exempt from the general tax on sales;
(3) sales and services subject to the general tax on sales (i.e. sales and services which are not exempt under the rules discussed in (1) and (2) above) may receive the tax reductions granted to the enterprises established in less developed areas;
(4) merchants established in the Jungle Region that purchase, from taxpayers established outside the region, the goods specified in an Appendix to Decree-Law No. 21,503, to be consumed in the Jungle Region, may receive a refund of the general tax on sales invoiced for the purchase. If the purchase is made from a producer receiving the benefits granted to enterprises established in less developed areas, the refund is limited to 60% of taxes invoiced. This refund does not cover the purchase of goods similar to those already produced in the region in an amount sufficient to cover the needs thereof; and
(5) manufacturers established in the Jungle Region producing the goods specified in an Appendix to Decree-Law No. 21,503, to be consumed in the Jungle Region, may receive a refund of the general tax on sales invoiced for the purchase from other areas of Peru of raw materials to be used in such production. If the purchase is made from a producer receiving the benefits granted to enterprises established in less developed areas, the refund is limited to 60% of invoiced taxes.

7. Tax administration

a. *Tax returns, payments and refunds*

The tax arising from sales and services must be calculated monthly and paid in to authorized banks within the first 15 days of the month following that during which transactions are carried out. The tax arising from imports is calculated by the customs service and must be paid together with custom duties.

If no liability to the tax arises in a particular month, the taxpayer must notify the tax administration. Where credits arising in a month exceed liabilities, the balance is carried forward to subsequent months.[52]

A refund may be obtained as regards:

- credits belonging to enterprises that have not commenced operations, provided the credits arise from the acquisition of fixed assets that have not yet been used; and
- credits corresponding to exports[53] to which persons are entitled who do not perform transactions subject to tax (or who perform them to an extent which is not sufficient to absorb the credits within 3 months). Under the same circumstances credits to which exporters are entitled can be used to satisfy some specified taxes (e.g. income tax prepayments).

Taxpayers subject to the general tax on sales must additionally file annual returns showing their acquisitions of the year, whether taxable or exempt.

b. *Tax audits and control*

The tax administration is vested with the power to estimate the value of goods and services, if the value is not specified or if the value indicated by the parties does not seem to be reliable.

If the tax on monthly sales has not been paid and if no notice on the absence of liability to the tax been given,[54] the tax administration may require that the taxpayer comply with his duty within 10 days.

If after the 10 days' term the taxpayer has not complied the tax administration may charge and compulsorily collect, without further delay, a sum established on the basis of the tax paid in previous periods, increased by surcharges and interest. If the tax administration makes use of this authority, the taxpayer's rights will be limited to refund claims based on excessive collection. The steps taken by the tax administration do not preclude its power to assess any tax actually due on the basis of other elements.

Where the taxpayer omits to prepare and deliver invoices or the registration thereof or where the tax administration has sound reasons to believe that the taxpayer's notices, self-assessments and returns are not correct, the tax administration may assess the tax on the basis of differences in inventories, averages of estimated sales, market values, and other data specified in regulations to the law.

The tax administration may assume, unless proof to the contrary is provided, that differences in inventories between those registered in the taxpayer's books and those accounted by the tax administration correspond to unreported sales of the last preceding year. The amount of unreported sales is then calculated by applying to the difference in inventory established by the tax administration the same rate that taxable sales of the last preceding year bear to the closing inventory of the same year.

The unreported sales computed as aforesaid are allocated to the different months of the year proportionally to reported sales of each month and the tax is then calculated without considering the credits that may exist. At the same time, unreported sales are deemed, without right of rebuttal, to be net income and subject to the income tax.

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52. For credits arising from the acquisition of fixed assets, see Section IV. A.5. above.
53. Note that credits corresponding to exports are available only as regards non traditional exports.
54. See Section IV. A.7.a. above.

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The tax administration may also assume, unless proof to the contrary is provided, that sales in a particular month are equal to a daily average of sales which is multiplied by the working days of the month.

The daily average is established on the basis of sales made by the taxpayer under the control of the tax administration during 5 consecutive or alternative days in the month. If the 5 days' control is carried out in at least 4 alternate months of the same calendar year, the average of monthly sales and services established as aforesaid can be used to calculate the sales of the non-controlled months of the year. The difference in sales between those reported by the taxpayer and those estimated under the preceding rules is also treated as net income and subject to the income tax.

Furthermore, the same percentage that unreported sales of the last year, as established under the preceding rules, bear to reported sales of the same year can be used to assess unreported sales of the preceding year, provided the tax administration can prove that accounting records do not correspond to actual transactions.

c. *Small taxpayers*

Small taxpayers, i.e. taxpayers with annual sales not above 200 tax units, can choose to be taxed under a simplified system. Under this system the liability to the General Tax on Sales (tax debit) equals a certain percentage (which cannot exceed 16%) of an amount of sales equalling 200 tax units.

Under the scheme, the taxpayer is permitted to credit against his liability the tax paid on acquisitions of the period, but, if credits exceed debits, no refund is granted.

Individuals whose annual sales are not above 35 tax units are not subject to the general tax on sales. This exemption does not cover importers.

B. The excise tax

1. General description

The Peruvian legislation existing to the 1981 tax reform included several separate excise taxes.

Legislative Decree No. 190 introduced a new excise which is in force as from 1 November 1981 and replaces the separate taxes previously levied on tobacco, manufactures thereof, non-alcoholic beverages, beauty products, coca, petroleum derivatives, alcohol, alcoholic beverages, cars and tourism services.

The new excise tax is levied at production level on specified goods and services at rates up to 116% (for Virgina-type cigarettes).

2. Taxable persons

The excise tax is levied on:
- producers and economically connected enterprises, as regards sales carried out in Peru;
- importers of goods subject to the excise tax; and
- persons rendering services subject to the excise tax.

For the purposes of the excise tax, "producer" means any person taking part in the last stage of the process by means of which goods receive the condition of a product subject to the tax, even if the activity is performed by using the services of a third party.

For the same taxation purposes, enterprises are deemed to be economically connected if:
- one of the enterprises owns more than 30% of the capital of another enterprise, either directly or through a third enterprise;
- more than 30% of the capital of 2 or more enterprises belongs to the same person, either directly or indirectly;
- more than 30% of the capital of 2 or more enterprises belongs to a married couple, or to persons who are close relatives, as specified in the law.

If an item is sold by the producer to an economically connected enterprise, both this sale and the sale made subsequently by the connected enterprise are subject to the excise tax, unless the following conditions are met:
- proof is submitted that the price of the first sale is not below the price charged for the same items by the producer to unconnected enterprises; and
- sales to unconnected enterprises are not below 50% of the sales made by the producer in the period.

When the subsequent sale by the connected enterprise is subject to the excise tax, then the tax paid upon the purchase from the producer is creditable against the liability for the subsequent sale.

3. Taxable transactions

The excise tax is levied on:
- sales of specified products carried out in Peru at producer level;
- importation of the same specified products; and
- the rendering of specified services.

For the purposes of the excise tax, the term "sales" has the same meaning it has for the purposes of the general tax on sales. Likewise, the liability to the excise tax arises under the same rules as provided for the general tax on sales.

The specified items on which the tax is levied are listed in Appendices III and IV to the law.[55]

4. Taxable amount

The excise tax is calculated by applying the corresponding rate, as the case may be, to:
- the value of taxable sales;
- the full amount of receipts from taxable services; or
- the c.i.f. customs value of imports as increased with customs duties.

The rules used to determine the taxable amount for the purposes of the general tax on sales are also applicable to the excise tax. The general tax on sales and the excise tax, however, are excluded from the taxable amount. For gasoline and fuels derived from petroleum, the taxable amount is the ex factory price exclusive of the general tax on sales and the circulation tax. (Impuesto de Rodaje).

For imported cigarettes, the c.i.f. customs value cannot be less than 0.03% of a tax unit per pack or 20 units.

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55. See footnote 56 below.

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5. Tax rates

The rates of the excise tax are specified in Appendices III, IV and V to the law. The principal rates for sales are: 10, 20, 25, 30 and 40%. The rate for services is 10%.[56]

C. Special tax

The exports of traditional products are subject to a "special tax" payable by exporters and by state-owned commercial enterprises that export on account of third parties.

The tax is calculated on the f.o.b. value of exports at a 3% rate. For products listed in Appendix VI to the law the rate is 2%. Some of the products included in the list are: common salt, natural graphite, natural sands, quartz, clay, chalk, calcium phosphate, pumice-stones, emery, marble, hip slate and other construction stone, magnesia, plaster, asbesto and borates.

V. FINAL REMARKS

Although this article was not intended to and does not cover the new legislation in its entirety, it easily conveys an idea of the broad coverage thereof. The recent Peruvian tax reform includes, in fact, new statutes for all the principal taxes.

An attempt was made in this report to show what seemed to be the principal aspects of the new legislation. It may now be useful to summarize those features that are most relevant and interesting:

(1) the change-over from the principle of world-wide taxation of income derived by residents or domiciliaries of Peru to the limited taxation of the Peruvian-source income. With this change Peru follows the views held on the subject by the prevailing Latin American doctrine;
(2) the design of the progressive income tax tables for individuals and corporations with brackets expressed in tax units, which amounts to an automatic adjustment of those brackets for inflation;
(3) the reorganization of sales taxation, including:
   - the reinforcement of the value-added nature of the general sales tax by covering the retail stage and a number of services previously exempt and by granting credits for fixed assets and services; and
   - the consolidation of most excise taxes (which are now included in a single law) following the views of LAFTA experts and the example of other Latin American countries (e.g. Brazil, Chile and Mexico);
(4) the provision for rules on the reorganization of companies, covering both the income tax and sales taxes, in an area where, with very few exceptions, this kind of rule is lacking;
(5) the rules on less developed areas which together with other tax benefits previously in force represent an incentive scheme the growth and importance of which reminds one of the Brazilian scheme;
(6) the new mining legislation reflecting the importance of this activity for the Peruvian economy and including important tax incentives;

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56. A 10% rate applies to: color television sets, specified cars and cameras. The Executive Branch can include new items in the list of products subject to the 10% rate, provided there is an increase in the customs duties on these products.
A 20% rate applies to: firework articles, carpets, rugs, wigs, porcelain and ceramic figures, decorative crystal objects, imitations of fine pearls, and imitations of precious and semi-precious stones, domestic freezers, domestic washing machines for dishes, domestic dryers, grinders, mixers and fans, musical boxes, appliances for the recording and reproduction of sounds, appliances for the recording and reproduction of images and sounds for television, musical boxes and similar items, tapes, videotapes, lighters, pipes, cigar-holders, and toilet sprays.
A 25% rate applies to: mineral and effervescent water, beer, wine, vermouths, cider, cognac, brandy, grappa, pisco, perfumes, beauty products and furs.
A 30% rate applies to: caviar, rum, liquor, similar beverages, fine pearls, diamonds, precious stones, semi-precious stones, artificial stones, articles made of gold, fine pearls, precious stones, semi-precious stones or artificial stones, glasses made of precious metals or covered therewith, watches made of precious metals or covered therewith, worked ivory, mechanical, electrical and electronic toys, pens, pencils and lighters made of precious metals or covered therewith.
A 40% rate applies to: specified cars, yachts, and pleasure boats.
Different rates apply to the following products:
- black tobacco cigarettes 56%
- Virginia-type cigarettes 116%
- gasoline for motors
  - coast and highlands 60%
  - jungle 14%
- kerosene for domestic use
  - coast and highlands 13%
  - jungle 14%
- kerosene for industrial use
  - coast and highlands 34%
  - large mining enterprises 39%
  - jungle 22%
- gasoil (diesel 1)
  - coast, highlands and great mining 43%
- gasoil (diesel 2)
  - coast, highlands and great mining 46%
  - jungle 22%
- fuel oil (petroleum residual 5)
  - coast, highlands and great mining 46%
- fuel oil (petroleum residual 6)
  - coast, highlands and greatmining 56%
  - jungle 22%
- liquified petroleum gas 13%

Different rates apply to the follwing services:
- commissions and interest received by banks, financial and credit institutions. 17%
(exemption is granted to the Agrarian Bank of Peru, interbank transactions, commissions and interest derived from direct cash loans);
- insurance premiums, interest and commissions received by insurance companies 10%
(for reinsurance the tax is levied on the receipts belonging to each company. Exemption is granted to insurance covering transportation of products marketed by the Government, insurance covering export financing, premiums and commissions for reinsurance received or transferred in the Peruvian market);
- international tickets for passenger transportation 14%
(exemption is granted to diplomatic and consular personnel and members of international organizations discharging their duties in Peru);
- cable, telex and long distance telephone services; 15%
- local telephone services; 10%
- leasing and distribution of films; 10%
- leasing and subleasing of immovable property 5%
(exemption is granted for the leasing and subleasing of dwelling houses the rent of which is limited under Decree-Law No. 21,938).

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(7) the control powers vested in the tax administration, especially as regards the broad possibilities to presume or estimate the amount of taxable income and sales. These powers can represent an important tool for the enforcement of the tax law in countries where control is difficult due to the number of taxpayers, the poor development of business organization and low compliance; they must, however, be wisely managed because the risk of unfair use seems to be inherent in the nature thereof; and
(8) the restriction imposed on the audit and assessment powers of the tax administration for the case in which the taxpayer's last return is not objected to. This permanent provision is a Latin American novelty and represents a very special encouragement to compliance.

In accordance with information received after this article had been prepared, Law No. 23,337 of 14 December 1981 introduced amendments to some of the subjects discussed here. For further information on such amendments the reader is referred to a note to be published in forthcoming issues of the *Bulletin* and *Tax News Service*.

CHINA – U.S.A.

Agreement with respect to the mutual exemption from taxation of income derived by air and shipping transport enterprises signed

On 5 March 1982, the Chinese Minister of Finance, Mr. Wang Bingqian, and the Ambassador of the U.S.A. to China, Mr. Arthur W. Hummel, signed an agreement that exempts air and shipping transport enterprises of one state from taxation of income in the other state.

Although this is not the first agreement of this nature to which China is a party, the Editors of the *Bulletin* nevertheless find that this very agreement is of particular interest to the world of taxation since it was concluded after implementation of major tax reforms in the People's Republic of China.

It should be noted that China has not yet concluded any comprehensive treaty for the avoidance of double taxation but it is understood that negotiations in this field are going on with a number of countries.

Note: The Bureau has published a comprehensive description of the Chinese tax system in its loose-leaf work *Taxes and Investment in Asia and the Pacific* (also available as an offprint: *Investment and Taxation in the People's Republic of China,* 3rd edition; the 4th edition will be available in the near future).

The government of the United States of America and the government of the People's Republic of China have agreed as follows, with respect to mutual exemption from taxation of transportation income of shipping and air transport enterprises:

Article I

Income and profits of an enterprise of a contracting state from the operation of ships or aircraft in international traffic shall be taxable only in that contracting state.

Article II

1. The term income and profits from the operation of ships and aircraft includes:
(A) Income and profits from the operation of passenger, cargo, or mail transportation service by the owner or charterer of a ship or aircraft, and the sale of tickets related to such transporation;
(B) Income and profits from the rental of ships or aircraft which are operated in international traffic by the lessee;
(C) Income and profits from the rental of ships or aircraft if such rental is incidental to the operation of ships or aircraft in international traffic; and
(D) Income and profits from the rental or use of containers (and related equipment for the transport of containers) used in international traffic.
The income and profits referred to in (A) through (D) above are, in such case, derived by an enterprise of a contracting state.
2. The term international traffic means any transport by a ship or aircraft, except when such transport is soley between places in the other contracting state.

Article III

Gains derived by an enterprise of a contracting state from the alienation of ships, aircraft, or containers operated in international traffic shall be taxable only in that state.

Article IV

1. The term enterprise means:
(A) A state-owned or collectively-owned enterprise of, and an enterpriser carried on by a resident of, the People's Republic of China; and
(B) An enterprise carried on by a company incorporated in the United States of America and an enterprise carried on by a resident of the United States of America.
2. The term enterprise also includes a participation in a partnership or joint business by an enterprise referred to in Paragraph 1.

Article V

Salaries and other remuneration derived by a resident of a contracting state employed as a member of the crew of a ship or aircraft operated in international traffic shall be exempt from tax in the other contracting state.

Article VI

The competent authorities of the contracting state shall seek to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of this agreement.

Article VII

Nothing in this agreement prevents a contracting state from taxing its residents and citizens.

Article VIII

Each of the contracting states shall notify the other contracting state in writing, through diplomatic channels, upon the completion of their respective legal procedures to bring this agreement into force. The agreement shall enter into force on the date of the later of such notifications and the provisions shall take effect on January 1, 1982.

Article IX

This agreement shall remain in force indefinitely. However, either contracting state may terminate the agreement by giving six months prior notice to the other contracting state, through diplomatic channels, in which case the agreement shall cease to have effect as of January 1 following the expiration of the six months period.

Done at Beijing this fifth day of March 1982, in duplicate, in the English and Chinese languages, the two languages texts having equal authenticity.

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India: Finance Bill, 1982

Summary of Proposals relating to Direct Taxation

by Kailash C. Khanna

CORPORATE TAXATION

Tax relief has been proposed for Indian exporters whose export turnover during the accounting year exceeds the export turnover of the immediately preceding year by more than 10%. The goods in relation to which the tax concession will be provided and the rate at which the relief will be calculated will be notified by the Central Government after taking into account the cost of manufacture of such goods, the prices of similar goods in the foreign market, the need to develop foreign markets for such goods, the need to earn foreign exchange, the destination of export and any other relevant factors. The maximum amount of deduction to which the taxpayer will be entitled will not exceed 10% of the amount of income tax otherwise payable by the taxpayer on the profits and gains from the export of such goods.

With a view to encouraging construction, engineering and similar projects overseas, there is a proposal that where a resident Indian taxpayer derives any profit from the business of execution of a project under a contract with a foreign enterprise, he will be entitled to a deduction from taxable income of 25% of such profits, subject to certain conditions. First, 25% of the profits from the project should be credited to a special reserve account, which shall not be available for distribution by way of dividends or profits for 5 immediately succeeding assessment years. Secondly, the consideration for the project should be payable in foreign currency and the taxpayer will be required to remit into India in foreign exchange an amount equal to 25% of such profits within a period of 6 months from the end of the relevant accounting year. If the amount credited to the reserve account or the amount actually remitted into India is less than 25% of the profits of the project, the deduction will be restricted to the amount so credited or remitted, whichever is less.

It is proposed to extend, up to 31 March 1987, the grant of investment allowance now admissible at the higher rate of 35% to specified plant and machinery.

Another suggestion seeks to exempt from tax intercorporate dividends in the case of 3 more industries, namely, synthetic rubber, rubber chemicals and basis drugs.

PERSONAL TAXATION

No changes in the slab rates of tax have been proposed except in the following cases:

(1) on income between 60,001 and 70,000 Rs. – from 50 to 52.5%;
(2) on income between 70,001 and 85,000 Rs. – from 52.5 to 55%;
(3) on income between 85,001 and 100,000 Rs. – from 55 to 57.5%.

Under the existing law, deduction in respect of LIC premium, employee's contribution to Provident/Superannuation Fund, deposit of 10/15 Year Post Office Cumulative Time Deposit, etc. is allowed at the following rates:

- on 5,000 Rs. – 100%
- on next 5,000 Rs. – 50%
- on balance – 40%

It is now proposed to increase the rate of deduction as under:

- on 6,000 Rs. – 100%
- on next 6,000 Rs. – 50%
- on balance – 40%

It is also proposed to raise the maximum amount qualifying for deduction from 30,000 to 40,000 Rs.

At present, standard deduction is allowed to salaried employees at the rate of 20% of their salary subject to a maximum of 5,000 Rs. It is proposed to increase the rate to 25% without any change in the ceiling of 5,000 Rs.

Under the existing law, income up to 3,000 Rs. received by an individual by way of interest on Government securities, interest on certain debentures, dividends on shares in Indian companies, interest on bank deposits, etc. is exempt up to 3,000 Rs. It is proposed to raise the exemption limit from 3,000 to 4,000 Rs.

Encashment of unutilised earned leave received by employees of Central/State Governments at the time of their retirement will be exempt from tax without any limit; others will qualify for relief up to 6 months' salary or 25,000 Rs., whichever is less.

It is also proposed that the exemption limit of interest received from the Unit Trust of India should be raised from 2,000 to 3,000 Rs.

At present, investment in certain specified new equity shares by individuals qualifies for deduction at 50% of the cost of acquisition. This deduction is available only in the year of acquisition and up to a shareholding of 10,000 Rs. It is proposed to increase the amount of 10,000 Rs. to 20,000 Rs.

It is proposed to modify the provisions relating to exemption from capital gains on transfer of house property. The condition of self-occupation of the property by the taxpayer is intended to be deleted and the period for construction of a new property is proposed to be increased from 2 to 3 years. Likewise, capital gains arising from the transfer of certain long term capital assets will be entitled to tax exemption provided the net consideration is utilised by the taxpayer for the purchase or construction of a house property within the specified period. It is also proposed to relate the deduction in respect of long term capital gains to the period for which the capital asset has been held; higher deduction will be allowed if the capital asset is held for a longer period.

With a view to encouraging savings, it is proposed to issue a new series of capital investment bonds with a maturity period of 10 years carrying simple interest at

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7% per annum payable annually. The interest on this bond will be exempt from income tax without any ceiling limit.
It has also bee proposed that the value of these bonds will be exempt from wealth tax without any ceiling limit.
Gifts of these bonds by the first holder up to 1,000,000 Rs. in one or more previous years will also be exempt from gift tax.

In order to encourage private savings, a Social Security certificate will be introduced. Under this scheme an individual between the age of 18 and 45 can invest up to 5,000 Rs. and the amount will triple in 10 years. The main feature of this scheme is that in the case of death of the investor during the 10-year period, his nominee or legal heir will immediately become entitled to the full maturity value of the certificate. The details of the scheme will be notified later.

WEALTH TAX

Under the existing law, exemption from wealth tax is available up to 150,000 Rs. representing shares in Indian companies, bank balance, Post Office Savings, etc. This limit is proposed to be raised to 165,000 Rs.

The value of conveyance(s) owned by an individual is now exempt from wealth tax up to 30,000 Rs. It is proposed to increase this limit to 75,000 Rs.

With a view to providing an incentive to increased savings, it is proposed to introduce a new capital investment bond. Investment in this bond will be exempt from wealth tax without any limit.

It is also proposed to raise the wealth tax exemption limit in respect of investment in a Unit Trust from 25,000 to 35,000 Rs.

Highlights of the Tax Proposals of the Indian Budget for 1982-83

by Dharmendra Bhandari*

With the Prime Minister, Shrimati Indira Gandhi, entrusting the Finance portfolio to Mr. Pranab Mukherjee, the youngest Finance Minister in India, just a few weeks before the presentation of the budget, it was expected that Mr. Mukherjee's budget would give a boost to the sagging Indian economy. However, the general feeling is that Mr. Mukherjee's maiden budget neither offers any solution to the problems which the Indian economy faces nor does it seek to give a fillip to the industrial growth of the country.

DIRECT TAXES

In framing his direct tax proposals, the Finance Minister has spelt out his motto thus: Save-invest-produce and get concession to export. In order to mobilise private savings for public use, the Government has decided to issue two new savings investments. Firstly, under the Social Security Certificates, an individual between the ages of 18 and 45 can invest up to 5,000 Rs. which will triple in 10 years. The second instrument is the Capital Investment Bond. These bonds will have a maturity of 10 years and carry an interest rate of 7%, exempt of income tax, wealth tax and, in the case of gift tax, up to 10 lakhs Rs.[1] in the case of the first holder.

It is proposed to increase the monetary ceiling of deduction in respect of Life Insurance, Provident Fund, etc., from 30,000 to 40,000 Rs. The Minister has also proposed to raise the ceilings for exemption of income from investment in specified financial assets such as bank interest, dividends, government securities, etc. from 3,000 to 4,000 Rs. and in case of units from 2,000 to 3,000 Rs. He has also proposed to double the amount of deduction of equity investment in new industrial companies and housing finance companies from 10,000 to 20,000 Rs. Further, with a view to providing an incentive to taxpayers who do not own a residential house, it is proposed to exempt from tax long term capital gains arising from the transfer of assets where the net consideration received is invested by the taxpayer in a residential house.

The Finance Minister has also proposed to boost investment in India by the large number of non-resident Indians working abroad. Firstly, any investment without repatriation rights made by non-residents of Indian origin, so long as it is not for transaction in commercial land, will be treated on the same footing as investments of resident Indian nationals. They will be allowed to invest, with repatriation rights, in any new or existing company up to 40% of the capital issued by such company. Secondly, the interest rates on new deposits of maturities of one year and above held in non-resident external accounts will carry interest of 2% above the rate permissible on local deposits held by persons resident in India. The test of "residence" as laid down for taxation purposes has also been liberalised to avoid hardship to Indian citizens earning income in foreign countries who come to India for short spells.

With a view to earning more foreign exchange, the Finance Minister has proposed a reduction in income tax on export profits for exporters whose turnover in 1982-83 is in excess of 10% of their turnover in the current year. In view of the large construction contractors working

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1. 1 lakh = 100,000.

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outside India, 25% of their profits will be exempt from income tax subject to certain conditions.

INDIRECT TAXES

While giving concession in direct taxes, the Finance Minister has relied heavily on customs duties to raise revenues. His main proposal is to raise the auxiliary duty on all categories of imports by 5% except for petroleum products. Basic customs duties on several items such as polyester chips, electric goods and certain items of iron and steel have also been increased. There is a heavy increase in excise duty on cement which has been raised from 71.50 to 135 Rs. a tonne.

In order to boost production in certain industries like fertilizers, steel products, paper, etc., it is proposed to give excise duty concession for 38 industries on output in excess of 110% of their 1981-82 output.

There are several other tax proposals of little importance that it is difficult to focus attention on all of them. The numerous minor concessions, relaxations and incentives reflect a certain predilection to please diverse sections of the society – understandable in a year of likely mini general elections – but do not add up to a strategy of a growth-oriented budget.

INDIA:

Budget 1982-83 Aimed at Increase of Production and Saving

Extracts from the Budget Speech pronounced on 28 February 1982 by Mr. Pranab Kumar Mukherjee, Union Finance Minister.

See for a detailed discussion of the Indian tax system the Bureau's publication TAXES AND INVESTMENT IN ASIA AND THE PACIFIC

Sir, before I present my tax proposal, I would like to indicate the broad objectives I have kept in view. While we take comfort in our success in reducing inflation, it is of the utmost importance that the budget itself should not give rise to further inflationary expectations. Any large uncovered deficit beyond prudent limits is inherently inflationary. It also gives rise to adverse expectations with regard to the behaviour of prices. It is therefore my major concern to keep the budgetary deficit as low as feasible.

Another important objective is to avoid measures which would place undue burdens on the low-income and middle-income groups. These groups are the worst sufferers in time of inflation.

As I have already indicated, providing adequate incentives for increasing production and savings in the economy is a prime objective of this budget. Larger savings and increases in productivity can significantly help moderate inflationary pressures and also generate resources for development. The buoyancy in revenue and the decline in the rate of inflation in the environment of strong agricultural and industrial growth in 1981-82 confirm this.

Salaried taxpayers

Sir, coming now to direct taxes, my first proposal concerns salaried taxpayers. There have been many representations that the income-tax exemption limit should be raised, taking account of increases in the cost of living. I cannot accept, as a principle, that income limits for exemption from tax should be fixed with reference to cost of living. Nevertheless, I believe some relief to salaried taxpayers within the lowest taxable slab would be appropriate. At present, salaried taxpayers are entitled to a standard deduction equal to 20% of the salary, subject to a ceiling of Rs. 5,000. I propose to raise the rate of deduction from 20% to 25%, without disturbing the ceiling of Rs. 5,000. This will give a significant measure of relief to those with salaries up to Rs. 20,000. The loss of revenue would be Rs. 21.58 crores in 1982-83.

Another measure of relief seems deserved for those at the end of their working lives. I propose to exempt from income-tax, subject to certain conditions, the encashment benefit in lieu of unavailed earned leave given to employees when they retire.

Taxpayers who are not in receipt of house rent allowance are entitled to a deduction up to Rs. 300 per month in respect of the house rent paid by them. However, persons receiving house rent allowance are entitled to an exemption up to Rs. 400 per month in respect of the house rent allowance received by them. I propose to raise the monetary ceiling from Rs. 300 to Rs. 400 per month also for those who are not receiving house rent allowance.

The owner of a self-occupied house is entitled to a deduction, from the annual letting value of the house, of an amount equal to one-half of the annual letting value or Rs. 1,800 whichever is less. I propose to raise the monetary ceiling of Rs. 1,800 to Rs. 3,600.

The annual letting value of a newly-constructed house let out on rent has been reduced by an amount up to Rs. 2,400 in respect of each residential unit for a period of five years. With a view to providing a stimulus for construction of houses, particularly for persons with relatively lower incomes, I propose to raise the monetary limit of Rs. 2,400 to Rs. 3,600.

Long term saving

I propose to liberalise the scheme of deduction in respect of long-term savings such as life insurance, provident fund contributions, etc. A deduction of 100% will be allowed in respect of the first Rs. 6,000 of the qualifying savings, plus 50% of the next Rs. 6,000 of such savings plus 40% of the balance. The monetary ceiling in respect of the savings qualifying for deduction is also being raised from Rs. 30,000 to Rs. 40,000. The higher monetary ceiling in respect of the qualifying savings in the case of authors, playwrights, artists, musicians, actors, sportsmen and athletes, is also being raised from Rs. 50,000 to Rs. 60,000. These incentives for larger savings will result in a revenue loss of Rs. 26.17 crores in a full year and Rs. 19.76 crores[1] in 1982-83. It may be desirable in due course to provide a wider choice of eligible modes of savings to taxpayers. I therefore propose to extend the existing tax concession in relation to investment in notified Central government securities.

I find that out of the new life insurance policies issued by the Life Insurance Corporation of India, nearly 15% policies lapse before the end of the following year. Such a high volume of lapses shortly after the issue of the policies is a matter of concern. It also implies that the very purpose for which the tax concession is allowed in respect of premia on such policies, which is to promote long-term savings through life insurance, is frustrated. I propose, therefore, to provide that were a taxpayer discontinues a life insurance policy before premia for two years have been paid, no deduction will be allowed in respect of the premia if any paid under the policy and, if such deduction has been allowed, the same shall be withdrawn.

Under the existing incentives for stimulating savings and investment, income up to Rs. 3,000 from investment in specified financial

1. 1 crore = 10,000,000.

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assets, such as government securities, units in the Unit Trust of India, bank deposits and shares in Indian companies, is exempt from Income-Tax. In addition income up to Rs. 2,000 from units in the Unit Trust of India is exempt from tax. I propose to raise the ceiling of Rs. 3,000 to Rs. 4,000 and the separate ceiling in respect of income from units, from Rs. 2,000 to Rs. 3,000. This measure will result in a revenue loss of Rs. 12.12 crores in a full year and Rs. 9.09 crores in 1982-83.

As a parallel measure, I propose to raise the ceiling of the value of investments in specified financial assets exempt from wealth-tax from Rs. 150,000 to Rs. 165,000. In addition, the separate exemption of Rs. 25,000 provided in respect of units in the Unit Trust of India is proposed to be raised to Rs. 35,000. The revenue loss will be Rs. 1.54 crores in a full year, but there will be no loss in 1982-83.

At present, taxpayers are allowed a deduction, in the computation of taxable income, of 50% of amounts invested in equity shares of new industrial companies and companies engaged in providing long-term finance for construction or purchase of houses for residential purposes. The maximum investment in a year qualifying for this deduction is limited to Rs. 10,000 with a view to encouraging larger investments in such companies. I propose to raise the monetary ceiling for investment to Rs. 20,000.

High incomes

While I have given some relief to those in the lowest taxable income range, I consider that there is scope for more progression in the tax rates for high incomes. I, accordingly, propose to modify the rates of personal taxation, so as to raise the rate of income-tax on the slab of Rs. 60,001 to Rs. 70,000, from 50% to 52.5%, and on the slab of Rs. 85,001 to Rs. 100,000 from 55% to 57%. This would yield Rs. 3.24 crores in a full year and Rs. 2.43 crores in 1982-83.

Withholding tax

Deduction of tax at source from dividends, interest on securities and other interest causes considerable inconvenience, and even hardship, to a large number of small investors whose taxable income is below the exemption limit. For the convenience of such persons, I propose to provide that income-tax shall not be deducted at source if the recipient furnishes a declaration to the payer of such income to the effect that his estimated total income of the relevant year will be below the exemption limit.

I also propose to provide that tax will not be deducted at source from interest paid on such securities of the central government or a state government as may be notified by the central government in this behalf.

Residence

The tests of "Residence" in India laid down for taxation purposes result in hardship to Indian citizens earning income in foreign countries who come to India for short spells. An individual is regarded as resident in India in a year if he stays here in that year for 30 days only, and also maintains a dwelling house here for 182 days or more. As this test causes hardship to persons working outside India, who come home even on relatively short visits, I propose to delete this test of residence.

Under another test, persons who have been in India for 365 days or more in the four years preceding the relevant year, become resident in that year by being in India for 60 days or more in that year. In the case of Indian citizens who are employed abroad and who come to India on leave or reaction, the period is 90 days. I propose to extend this benefit also to the self-employed and those in other occupations, irrespective of their avocation abroad or the nature of their visit to India.

Indian citizens who go abroad for purposes of employment are now chargeable to tax in India on their foreign income, if they have stayed in India for more than 60 days that year. I propose to liberalise the provision so that an Indian citizen who leaves India in any year for purposes of employment shall not be treated as resident unless he has been in India for 182 days or more in that year.

Foreign exchange earners

I will now come to some proposals regarding foreign exchange earnings. I propose to provide some tax relief to exporters whose export turnover for any year exceeds that of the immediately preceding year by more than ten percent. The tax relief, to be calculated at a specified percentage of such excess turnover, would be limited to ten percent of the income-tax otherwise payable on export profits. The rate at which the tax relief will be calculated and the goods qualifying for the purpose of this concession will be notified by the Central government.

With a view to strengthen the competitiveness of our construction contractors who have undertaken projects outside India, I propose to exempt 25% of the profits derived by them from such foreign contracts, subject to certain conditions.

With a view to augmenting the capital base of Indian banks engaged in banking operations in foreign countries, I propose to provide that those banks which are approved in this behalf by the Central government would be entitled to a deduction up to 40% of their income carried to a special reserve account.

Interest-tax levied under the Interest-Tax Act forms an integral part of our credit policy. However, taking note of the escalation in costs of industrial projects, I propose to exempt scheduled banks from payment of interest-tax on the interest received by them on loans sanctioned in foreign currency for import of capital plant and machinery. With a view to improving the competitiveness of export of capital plant and machinery, I propose to exempt interest paid on credit sanctioned by scheduled banks for export of capital plant and machinery on deferred payment terms outside India.

Incentives

Investment allowance at the higher rate of 35% is granted in respect of machinery and plant installed for the manufacture of articles made with know-how developed in government laboratories, public sector companies, recognised institutions and universities. This concession is available in relation to machinery and plant installed up to 31st March, 1982. I propose to extend this tax concession for a further period of five years.

Dividends received by a domestic company from an Indian company engaged exclusively or almost exclusively in the manufacture of specified articles are completely exempt from income-tax, having regard to the importance of basic drugs, synthetic rubber and rubber chemicals (including carbon black). I propose to extend the benefit of this tax concession to dividends received from companies engaged in the manufacture of these articles as well.

At present, scheduled commercial banks are allowed a deduction in respect of provisions made by them for bad and doubtful debts relating to advances made by their rural branches. The deduction is limited to 1.5% of the aggregate average advances made by the rural branches. In order to promote rural banking and to assist non-scheduled commercial banks operating in the rural sector, I propose to extend the benefit of this tax concession to them also.

Energy saving and protection of the environment are high priority areas. I, therefore, propose to allow depreciation at 30% on devices and systems for energy saving, or for minimising environmental pollution or for conservation of natural resources. The list of the qualifying items will be notified in due course.

At present, taxpayers are entitled to 100% deduction in respect of donations made to approved institutions engaged in carrying out programmes of rural development. I propose to extend this concession to donations made to approved institutions for use in programmes of conversation of natural resources.

Hon'ble members will be happy to hear that I propose to place donations made to the national children's fund at par with donations made to other funds of national importance such as the National Defence Fund, the Jawaharlal Nehru Memorial Fund, and the Prime Minister's National Relief Fund.

Capital gains

I consider that some rationalisation of the taxation in respect of capital gains is desirable. In the case of non-corporate taxpayers, long-term capital gains up to Rs. 5,000 are deducted in full. Of the balance amount, a deduction of 25% is allowed where the gains relate to lands and buildings and of 40% where the gains relate to other assets. I propose to modify these provisions so as to relate the deduction to the period for which the capital asset has been held by the taxpayer, and allow a larger deduction in cases where the asset has been held for a longer period. The aggregate deduction in respect of capital gains relating

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to gold, bullion or jewellery will, however, be restricted to Rs. 50,000 only.

There is an acute shortage of housing, and house building activity has to be given impetus. With a view to providing an incentive to taxpayers who do not own a residential house, I propose to exempt from tax long-term capital gains arising from the transfer of other assets where the net consideration is invested by the taxpayer in a residential house.

At present, capital gains arising from the transfer of a house used for personal residence by the taxpayer are exempt from income-tax to the extent that such gains are utilised by the taxpayer for constructing or purchasing a house for purposes of personal residence within a specified period. These conditions often lead to hardship. I, therefore, propose to remove these restrictive conditions.

Charitable and religious trusts are required to conform to the investment pattern laid down in the Income-tax Act. Any trust which has not changed over to this pattern of investment will forfeit exemption from tax from the assessment year 1982-83. These trusts have been given adequate notice to change their investment pattern and, ordinarily, I would not have proposed any modification in these provisions. However, I find that the whole gamut of the provisions relating to charitable and religious trusts is under consideration by the economic administration reforms commission. As the government would like to carefully consider the recommendations of the commission in this matter, I propose to amend the relevant provisions so that such trusts do not forfeit exemption from income-tax for the assessment year 1982-83.

My distinguished predecessor had made an announcement in the Lok Sabha on March 31, 1981 that the provisions of the Income-tax Act relating to the investment pattern of trust funds would be modified. So as to permit charitable and religious trusts or institutions to invest the trust funds in immovable properties as well, I am proposing an amendment of the relevant provisions of the Income-tax Act to fulfil the assurance given by him.

Wealth tax

While the levy of wealth tax on agricultural property was discontinued by the Finance (No. 2) Act, 1980, owners of tea, coffee, rubber and cardamom plantations continue to be chargeable to wealth tax. Our experience is that the valuation of agricultural land forming part of such plantations leads to administrative difficulties, complaints of harassment and litigation. The yield from this levy is also insignificant. I, therefore, propose to discontinue to levy of wealth tax on such plantations as well.

The value of tools and instruments necessary to enable the taxpayer to carry on his profession or vocation is exempt from wealth tax up to an aggregate amount of Rs. 20,000, which appears inadequate. I propose to raise it to Rs. 50,000. I also propose to raise, from the present Rs. 30,000 to Rs. 75,000, the ceiling of the value of conveyances, including motor cars, for the purpose of exemption from wealth tax.

Gifts

Stamp duty paid on an instrument relating to the gift of any property is allowed as a deduction from the gift tax payable by the taxpayer in cases where the amount of gift tax exceeds Rs. 1,000. I propose to allow the benefit of this deduction even where the gift tax payable does not exceed Rs. 1,000.

Luxury hotels

The Hotel Receipts Tax Act, 1980 provides for the levy of a tax on the gross receipts of luxury hotels. As the levy of this tax may adversely affect the flow of foreign tourists into India, I propose to discontinue this levy in relation to the chargeable receipts of such hotels accruing or arising or received by them after the 27th February, 1982. The revenue loss would be about Rs. 6 crores.

. . .

Auxiliary customs duties

Mr. Speaker, sir, I now turn to the area of indirect taxes. Taking customs duties first, my principal proposal is with regard to auxiliary duties of customs. This levy, which has been imposed on an annual basis since the 1973 budget, is proposed to be continued during 1982-83. The balance of payments position has been continued during 1982-83. The balance of payments position has been under pressure in recent times and will continue to be so for some time to come. However, a liberalised regime of imports has been a feature of our economic policies. This will be continued in order that investment and production, particularly in essential and priority sectors, are not hampered or slowed down. There is no strong reason, however, where those who have access to imports in a difficult situation should grude to pay a little more. I accordingly propose to increase the rates of auxiliary duties by five percentage points on all categories of imports, which some exceptions.

I am excluding from the proposed increase in auxiliary duty essential items like crude petroleum, bulk petroleum products, such as kerosene and high speed diesel oil, and some other items on which import duty rates have been adjusted in the recent past on price parity considerations. Fuller details of these proposals are available in the budget papers.

My proposals relating to auxiliary duties of customs are expected to yield an additional revenue of Rs. 290 crores.

Basic customs duties

In the light of the present market conditions, and the need for encouraging a few selected industries, it is necessary to effect certain changes in the basic customs duties. I propose to raise the basic customs duty on cork and cork articles from 40% to 60% ad valorem; on certain categories of dyestuffs, from 60% to 100% ad valorem; and on certain other categories of dyestuffs, pigments and colours and paints and varnishes, from 100% to 150% ad valorem. I also propose to increase the basic customs duty on certain items of iron and steel, such as melting scrap of stainless steel and heatresisting steel, and certain categories of alloy steel excluding stainless steel and heat-resisting steel, from the existing levies to 60% ad valorem. The effective rate of basic customs duty on copper pipes and tubes, blanks and hollow bars of prescribed specifications will be increased from 40% to 60% ad valorem. The basic customs duty on polyester chips is being increased from 100% to 140%. These proposals are likely to result in additional revenue of Rs. 42 crores.

It may be recalled that in the last budget, an effective customs duty of 15% ad valorem was imposed on imported newsprint on which there continues to be large foreign exchange outgo. The government has received representations against this levy. I propose to convert the ad valorem levy to a specific total levy of Rs. 825 per metric tonne so as to obviate automatic increase in its incidence on account of rising international prices. There will be no revenue loss.

The indigenous zinc and lead industries are facing difficulties owning to escalation of input costs, particularly of imported concentrates. In order to enable them to increase their capacity utilisation, I propose to reduce the total customs duty incidence on imported zinc concentrates from 50% to 15% ad valorem and that on lead concentrates from 50% to 5% ad valorem. Simultaneously, I propose to increase the customs duty on imported zinc metal from 50% advalorem to 60% ad valorem. In order partly to offset the revenue loss, I propose to increase excise duties on indigenously produced, zinc metal, zinc scrap and zinc products by Rs. 715 per metric tonne and that on lead metal and scrap by Rs. 374 per metric tonne. The excise duty on zinc pipes and tubes will go up from 38.5% to 49.5% ad valorem. These measures, taken together, would result in an overall loss of about Rs. 41 lakhs.

With a view to improving the competitive position of Indian chromite ore in the context of falling prices in the export market, I propose to convert the existing specific rates of export duty applicable to different grades of the ore and concentrates to an ad valorem duty of 10%. The revenue sacrifice is of the order of Rs. 1 crore.

I also propose to fully exempt two fertilisers – calcium ammonium nitrate and ammonium sulphate from customs duties. The import duty on internal combustion engines and non-interchargeable parts of such engines for manufacture of power tillers is also proposed to be reduced from 125% to 50%.

I propose to fully exempt 10 more bulk drugs imported for manufacture of life-saving drugs and medicines. Details are being notified.

During the past few years, the government has been using the fiscal mechanism for accelerating the growth of the electronics industry. As a further step in this strategy, I propose to raise the basic customs duty on electronic items such as computers, calculating machines, accounting machines, cash registers and certain electronic sub-assemblies

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from the existing levels of 40, 50 and 60% to 100% ad valorem. On the other hand, I propose to extend the scope of the present import duty concessions to cover 45 new items of capital equipment and 13 new items of raw materials and components used by the electronics industry. The customs duties leviable on these items are proposed to be reduced from the respective existing rates to 53% ad valorem in the case of machinery and instruments and to 55% ad valorem in the case of raw materials and components. The net revenue gain from these proposals is Rs. 13 crores.

Free trade zones

Representations have been received that it is not always possible for units in the free trade zones to export their entire production, and that a provision should be made to allow a proportion of the goods manufactured in these zones to be cleared into the domestic tariff area. It has been decided, subject certain conditions, to allow such removals up to 25% of the production of a unit for sale or use within the country on payment of appropriate duties. Provision is being made in the Finance Bill to amend the Customs and Central Acts for the purpose.

Excises

On the Central excise side, the levy of special duties of excise is proposed to be continued at the existing rates during the year 1982-83. The existing exemptions from the special duty are also proposed to be continued.

As I said earlier, my basic approach has been that additions to revenue from Central excise duties should essentially come from increased production. I am also avoiding recourse to measures which could affect retail prices over a wide spectrum of goods. I have accordingly selected only a very few items for increased taxation. In selecting these items, I have kept in view the demand and supply situation which has resulted in undue profits to trading channels, the scope for subjecting certain articles of elite consumption to a higher rate of tax, and the need to restructure the excise and customs duties applicable to certain basic industries.

The government has decided to introduce scheme of "levy" and "free" sale of cement, and a dual pricing policy based on this concept. Details of the new scheme are being notified by the government separately. There has been no increase in the low level of basic excise duty on cement since January, 1977, even though thereafter the price of cement has increased very substantially. I propose to increase the total excise duty on ordinary portland cement, portland pozzolana cement, blast furnace slag cement and masonry cement, from Rs. 71.50 to Rs. 135 per metric tonne. The more expensive special varieties of cement will be subject to higher rates of duty. The effective total excise duty on cement produced in mini cement plants is proposed to be fixed at Rs. 100 per tonne.

I also propose to impose a basic customs duty of 10% ad valorem on imported cement, together with full countervailing duty. No auxiliary duty would be leviable on imported cement. These proposals will give additional revenue of Rs. 158.73 crores on the central excise side and Rs. 39.60 crores on the customs side. The impact of the proposed increase in excise duty per bag of cement of 50 kilograms would work out to Rs. 3.175.

Electronic appliances

In the recent past, certain expensive electronic goods favoured by the affluent are being produced in increasing quantities. These are now subjected to a very low incidence of duty at eight percent ad valorem under item 68 of the central excise tariff. I now propose to carve out new entries in the excise tariff, and subject video cassette recorders and reproducers, television cameras and video cameras, and similar goods to a basic excise duty of 25% ad valorem. Blank and recorded video and audio tapes of the spool and cassette types, as also video discs, are also proposed to be subject to a basic duty of 25% ad valorem. Recordings which are not for commercial purposes will be exempt. I also propose to levy basic duty at a higher rate of 40% on electronic machines for games of skill or chance, including those used for television games and video games. These proposals would yield revenue of Rs. 3.83 crores.

Toilet preparations

Toilet preparations not containing alcohol are liable to central excise duty at the basic rate of 100% ad valorem whereas those containing alcohol attract duty under the Medicinal and Toilet Preparations (Excise Duty) Act at only 60% ad valorem or Rs. 13.20 per litre of pure alcohol content, whichever is higher. Some misuse because of these differential rates has come to notice. I, therefore, propose to raise the alternative ad valorem rate of 100% ad valorem so as to place both categories of toilet preparations more or less at par. The revenue yield from this measure is expected to be Rs. 2.3 crores and would accrue mostly to the states.

Textiles

Hon'ble members may recall that the textile policy statement of March, 1981 envisaged a review of fiscal levies on man-made fibres and yarn. While cotton will continue to enjoy the predominant position in textiles, it is necessary to encourage increased consumption of blends of cotton and man-made fibres and yarns, if we are to achieve the plan target of even a modest increase in the per capita availability of cloth. For some time past, blended fabrics containing polyester fibre in proportions too small to impart the requisite durability and easycare properties to the fabrics are flooding the market with stampings thereon which would mislead the public.

From the point of view of better utilisation of polyester fibre, it is necessary to encourage blends of desirable proportions, and discourage blends which do not really serve the intended purpose. I therefore propose to make certain changes in the fiscal levies applicable to man-made fibres and yarns. I propose to increase the duty on blended cotton yarn and cellulosic spun yarns containing up to one-sixth by weight of polyester fibre from the existing average total incidence of Rs. 1.63 per kilogram to Rs. 7.5 per kilogram. The total incidence on such blended yarns containing more than one-sixth but less than 50% of polyester fibre, which seems to be desirable blends in Indian conditions, is proposed to be reduced from Rs. 22.50 per kilogram to Rs. 11.25 per kilogram. Similarly, the incidence on blends containing 50% or more but less than 70% of polyester fibre is being reduced from Rs. 30 per kilogram, to Rs. 22.50 per kilogram. There will be no change with regard to blends containing 70% or more of polyester fibre.

It is proposed to increase the total incidence of central excise duty on acrylic fibre from Rs. 12.50 to Rs. 17.50 per kilogram and simultaneously to reduce the countervailing duty on imported fibre from Rs. 37.50 to Rs. 30 per kilogram.

Turning to viscose staple fibre the excise duty is being raised from Rs. 3.12 per kilogram to Rs. 4 per kilogram and the duty on polysonic and high wet modulus fibres is being reduced from Rs. 5 to Rs. 4 per kilogram.

Acetate filament yarn which is used in the decentralised sector is not produced in adequate quantities in the country. It is proposed to reduce the customs duty on it from 125% to 20% ad valorem so as to facilitate imports of this yarn.

I do not propose to change the excise or basic customs duty rates applicable to other fibres such as acetate fibre and polyester fibre and other filament yarns such as viscose, nylon and polyester filament yarn.

These proposals would result in a net loss of Rs. 13 crores on the central excise side and a gain of Rs. 12.94 crores on the customs side.

At present, there is no basic duty leviable on man-made fabrics, the incidence of such duties having been shifted to the fibre and yarn stages. These fabrics attract only additional excise duties in lieu of sales tax. While the present rate structure is progressive on fabrics having ex-factory price up to Rs. 10 per square metre, it is not so in respect of the higher priced fabrics since the duty applicable to them is a uniform 5.5% ad valorem. There are very high-priced fabrics in this range, catering to affluent consumption, and these fabrics can well bear a moderate increase in duties. I therefore propose to introduce further progression in the rate structure in such a way that fabrics having ex-factory prices of more than Rs. 20 per square metre would attract duty at 7.5% ad valorem. The additional revenue from this proposal is estimated at Rs. 35 crores, which will go to the States. The proposal would also be a step towards fulfilment of the Centre's commitment to the State to increase the overall incidence of additional excise duties in lieu of sales tax, as a percentage of the value of clearances. I am sure that Parliament and the States would whole-heartedly welcome this step.

The overall effect of the duty changes on blended fabrics containing cotton, cellulosics and polyester would be a decrease in the price

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of desirable blends and an increase in the price of the other less desirable blends.

I have included in the Finance Bill some provisions designed to achieve simplification and greater clarity in the tariff nomenclature and thereby minimise the scope for classification disputes. These measures are not designed as revenue raising exercises, but because of the changes in classifications, some revenue will accrue. The proposals cover, among others, major petroleum products, artificial and synthetic resins and plastic materials.

Paper

I also propose to rationalise and restructure the tariff relating to paper and paper boards, the primary objective being to exempt small scale paper converters from payment of excise duty and to release them from excise control. In order to recoup the consequent loss in revenue, I propose to raise the basic excise duty on industrial varieties of paper and paper boards by a small margin of 2.5% ad valorem. However, certain converted papers of high value-added categories are proposed to be subject to basic excise duty at 32.5% ad valorem. Similarly, specified articles made of paper and paper board are proposed to be brought within the purview of the tariff item but effectively restricting the levy to printed cartons and printed boxes.

Tyres

In recent years, the scheme of input excise duty relief has been extended to cover certain specified industrial products. I propose to further extend input duty relief in respect of synthetic rubber, carbon black and rubber processing chemicals going into the production of tyres. To make up for the revenue loss, I propose to raise the duty leviable on tyres from a total of 60.5% to 66% ad valorem. While tyres for tractors and scooters will also enjoy the benefits of the input duty relief, I do not propose to increase the final duty rates on them. As this is intended to be a balancing exercise, no credit for additional revenue is being taken.

Aluminium

As the House is aware, the administered price of aluminium metal is revised periodically, keeping in view escalations in input costs. In order to contain the incidence of excise duty, it is proposed to levy duty at specific rates. The rates would be Rs. 3,085 on electrolytic grade ingots, Rs. 3,125 on billets, Rs. 3,330 on wire rods produced by primary producers and Rs. 3,280 on wire bars. There would be no change in the rates of countervailing duties. The proposal will give some relief to the finances of State Electricity Boards.

Glass

As an anti-avoidance measure, I propose to add to the present ad valorem levy on flat glass, a specific levy at the rate of Rs. 5.50 per millimetre thickness per square metre. Effective rates of duty are being prescribed at lower levels for different categories of flat glass.

Biri

The Government has received a large number of representations alleging malpractices in the biri industry, on account of the present differential rates of excise duty applicable to branded and unbranded biris. Many state governments and associations have urged that this distinction should be done away with. A suggestion to the same effect has also been made in a recent meeting of labour ministers. Taking note of these points, I propose to do away with the existing duty differential and to subject both branded and unbranded biris to a uniform composite duty rate of Rs. 3.60 per thousand. Simultaneously, the existing quantum of unbranded biris eligible for duty free clearance is also being reduced from 30 lakhs to 20 lakhs in a financial year. This would still leave self-employed family units, petty shop-keepers, etc. out of the tax net.

Aerated water

The general scheme of excise duty concession applicable to small manufacturers of 72 specified groups of commodities is being extended to manufacturers of asbestos fibre and yarn. Some misuse of the scheme with a view to avoiding excise duty on popular brands of aerated waters has come to notice. I therefore propose to take aerated waters out of the scope of the general scheme and devise a new scheme for it. Essentially, small manufacturers who sell their products under their own brand or trade names would continue to enjoy the benefits available under the present scheme. However, manufacturers who produce and bottle aerated waters under brand or trade names in pursuance of agreements with the owners of such brand or trade names would not be eligible for the concession. This also is purely an anti-avoidance measure.

Dyestuffs

The general scheme referred to earlier seems to have been similarly exploited by certain small manufacturers of synthetic organic dyestuffs. Under the present scheme, clearances up to Rs. 7½ lakhs are fully exempt and an additional Rs. 7½ lakhs are subject to duty at ¾ths of the duty rate applicable to the organised sector. In view of the relatively high rate of duty on dyestuffs and the fact that techniques of production of some dyestuffs are comparatively simple, it appears there has been a proliferation of small units with consequent deleterious effects on the quality, and also on the industry as a whole and on exports. I, therefore, propose to delete dyestuffs from the purview of the general scheme.

Under a new scheme which is being announced in respect of dyestuffs, very small manufacturers whose clearances do not exceed Rs. 1 lakh per annum will be fully exempt from excise duty. In the case of other small manufacturers, clearances up to Rs. 15 lakhs of dyestuffs will be subject to 50% of the duty applicable to the organised sector. All manufacturers will be brought under excise control. The monetary content of the present scheme of relief is, by and large, maintained under the new scheme.

Electronic goods

At present, certain specified consumer electronic goods manufactured in the small sector attract duty rates lower than the normal rates. To restrict this duty concession to genuine small manufacturers, it is proposed to restrict the scheme of duty exemption to manufacturers with total anmnual turnover not exceeding Rs. 2 crores.

Matches

With regard to the match industry, I do not propose to disturb the existing duty structure. Small manufacturers whose clearances have not exceeded 150 million matches in the preceding financial year would continue to be eligible for the concessional rate of duty of Rs. 1.60 per gross boxes on clearances up to 120 million matches in the financial year. The concession will not be available if the matches are marketed under the labels of manufacturers who pay duty at Rs. 4.50 or Rs. 7.20.

As Hon'ble members are aware, the government has been using the excise duty mechanism as a powerful incentive for the growth of the cottage sector of the match industry. A number of manufacturers in the middle sector have, however, challenged in courts of law, the excise concession scheme for the cottage sector and obtained judgements in their favour. This may result in refund of substantial amounts of duty to the middle sector units. As the element of duty at the higher rate would have already been passed on to the millions of consumers, any refund of such duties would only result in unjust enrichment. A provision has been made in the Finance Bill to obviate this contingency.

Assessable value

There have been some disputes in the recent past regarding the determination of assessable values of excisable goods from a given cum-duty price, resulting in considerable litigation. This has resulted in locking up substantial amounts of revenue. It is proposed to suitably amend section 4 of the Central Excise and Salt Act to make it clear that in computing the amount of duty of excise deductible from the cum-duty price, the effective amount of duty of excise payable on the goods under assessment shall alone be taken into account. This amendment is being given effect to, retrospectively from 1st October, 1975.

Captive consumption

It has been the long-standing practice to

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charge excise duty on goods used for captive consumption within the factory where they are produced. Some doubt had, however, been cast on this position as a result of judgements of some High Courts, which interpreted certain provisions of the Central Excise Rules to hold that duty could not be collected on such goods as they had not been 'removed' from the factory. A number of manufacturers have also obtained stay orders from courts based on the same grounds. The matter has been taken up in appeal. Nevertheless, in order to place the position beyond doubt, the relevant Central Excise Rules have been suitably amended. A provision has also been included in the Finance Bill so that these amendments will have retrospective effect and the collections of duty made in accordance with the existing practice will also be validated.

Productivity Year

As the House is aware, 1982 has been designated by the Prime Minister as the "Productivity Year". With the improvement in infrastructural facilities, it is hoped that industrial production would register further growth in the current year. The fiscal mechanism could be judiciously deployed in furthering this objective. With this in view, I propose to formulate a scheme of excise duty concession for increased production of goods during the period of 12 months commencing on the 1st March, 1982 and ending on the 28th February, 1983. The scheme would cover 38 tariff items including some basic raw materials, other important industrial inputs and certain finished products. Some of the items are caustic soda, fertilisers, synthetic resins, steel ingots and steel products, internal combustion engines, wires and cables, two and three wheeled motor vehicles, light and heavy commercial vehicles, tractors, railway wagons, man-made fibres and filament yarn, tyres and writing and printing paper. A full list may be found in the Budget papers. The benefits of the scheme would accrue only in cases where the production in the 12 months period referred to above exceeds 110% of the production during the base period, namely, the 12 months ending on the 28th February, 1982. The duty concession would be 1/5th of the total amount of duty paid on the excess production computed, as explained earlier, in respect of goods carrying basic excise duty of 20% ad valorem or less, and 1/10th of the duty in other cases. The amount so computed for the whole period would be given as a credit which may be utilised for payment of Central excise duty during the financial year 1983-84.

The scheme will apply also to small scale manufacturers, who actually pay duty. It is proposed to ensure that those small scale units which are eligible for the benefits of the relevant excise duty concession schemes and are within the respective cut-off points during the year 1981-82, would continue to be eligble to the said benefits in 1983-84, even if they produce and clear goods in excess of the eligibility limits in the productivity year.

I am sure that industry will rise to the occasion and respond to this generous gesture of the government and achieve new peaks of production. Since the government would also be a beneficiary of the higher production in the shape of increased collection of excise duties, I do not propose to take any amount as revenue loss on account of the proposed concession.

Common consumption

I have already referred to the need to minimise the impact of my proposals on the middle and poorer sections of society. I propose to go further and give some concessions on articles of special interest to those sections. I propose to partially or fully exempt from excise duties several articles of common consumption. Some of these products are of interest to the student community, some are of general utility, yet others of interest to the disabled and one in the interest of horticulture. I propose to fully exempt from excise duty, pencils, erasers, pens including ball point pens and refills, laboratory glassware, enamelware, thermos flasks and parts, water coolers, candles, tooth brushes, spectacles and spectacle frames, one-day alarm clocks, domestic water filters, handpumps, Braille typewriters, invalid carriages and helmets. Further, I propose to reduce the basic excise duty on specified fruit and vegetable preparations from 15% to 10% ad valorem. I also propose to increase the present value limits of Rs. 15 per pair of footwear for eligibility to full duty exemption, to Rs. 30 per pair. Lac is also being exempted. In order to reduce the packaging cost involved in the sale of milk in laminated paper packs, I propose to exempt from excise duty low density polyethylene film and paper to be used by the Indian Dairy Corporation for the manufacture of such paper packs. This measure should enable larger marketing of milk in paper packs which have a longer shelf life, and also help in the fuller utilisation of surplus milk produced in flush seasons.

At present, mopeds of engine capacity up to 75 cc bear a reduced rate of excise duty of 10% ad valorem. This fuel-saving personalised conveyance is becoming increasingly popular particularly in urban and semi-urban areas. I propose to extend the concession to mopeds of engine capacity to 100 cc which are expected to be more fuel-efficient.

I had referred earlier to certain adjustments of excise and customs duties consequent on a review of the fiscal levies on man-made fibres and yarn. The production of blended cloth in the handloom sector is at present around 12 million metres. In order to enable the handloom sector to register faster growth, I propose to fully exempt from excise duties polyester blended fabrics woven on handlooms from processing stage duties if they are processed in factories set up by the state handloom development corporations or apex cooperative societies approved in this behalf by the Central government. This concession involves a revenue loss of Rs. 4 crores. I also propose to exempt metallised man-made filament yarn from the whole of the excise duty considering its use in saris and the like. The value of this concession is about Rs. 1 crore.

These excise duty concessions I have just referred to entail a total revenue sacrifice of Rs. 13.77 crores in a full year.

Where the changes are to be made by notifications effective from 28th February, 1982, copies thereof will be laid on the table of the House in due course.

My proposals will yield a net sum of about Rs. 196.13 crores from excise duties and Rs. 391.35 crores from customs duties. The yield from duties under the Medicinal and Toilet Preparations (Excise Duties) Act will be Rs. 2.30 crores in a full year. Taking all the proposals together, the net accrual to the Central exchequer in a full year will be Rs., 487.60 crores and that to the states will be Rs. 102.23 crores.

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UNITED KINGDOM:

Budget 1982-83

A Budget for Industry and Jobs

Extracts from the Budget Speech pronounced on 9 March 1982 by the Chancellor of the Exchequer, Sir Geoffrey Howe.

A discussion of the U.K. Budget will appear in the International Bureau of Fiscal Documentation's tax journal: EUROPEAN TAXATION.

. . .

This will be a Budget for industry – and so a Budget for jobs. But it will be a Budget for people as well. It is a Budget that will strengthen the foundations of economic recovery.

. . .

So this afternoon, I want to remind the House once more of two figures that virtually tell it all. Since 1960 the real purchasing power of the average citizen in Britain has risen by over two-thirds. But the real rate of return on the capital employed in British industry has fallen by five-sixths. In other words, our present living standards have for years been plundered from the store of investment for the future.

Nor have we put to good use the investment that has been made. Too often we have tried to mitigate the inescapable consequences of poor productivity and shrinking international competitiveness, by clinging to manning levels that could not be sustained.

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REDUCTIONS IN TAXATION

Although most of the measures which I shall announce today involve reductions in taxation, I am also proposing some additions to public expenditure, totalling some £350m in 1982-83. This includes an increase of £150m in the Contingency Reserve to accommodate some of the expenditure measures: this brings the reserve in 1982-83 to £2,400m. The planning total for 1982-83 given in the White Paper is £115.15bn, in cash, compared with £110.2bn which is the cash equivalent of last year's projections for 1982-83. But the increases I now propose will be more than offset by other changes in costs, and the total will therefore be £114.9bn.

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CHARITIES

The Government is deeply conscious of the contribution to our national life that is made by many of our charitable organisations. Two years ago, I introduced substantial new tax relief for convenated donations to charities. I also doubled the exemption from capital transfer tax for charitable bequests or gifts made within one year of death.

We have been urged to relieve charities from VAT on their purchases. The attractions of this are obvious. But it raises substantial difficulties. The more one studies how it might be done – and we have looked into it exhaustively – the more insuperable appear the problem of definition of administration and of equity that stand in its way. So, reluctantly, I have had to be satisfied with other ways of helping charities instead.

First, I propose to take the Capital Transfer Tax exemption for qualifying gifts to charities a stage further, by increasing it, for gifts made within a year of death, from £200,000 to £250,000.

Secondly, I intend to abolish Stamp Duty completely on transfers of assets to charities.

Thirdly, as the National Council for Voluntary Organisations has suggested, I propose to remove beyond all doubt any liability to Development Land Tax where a charity disposes of property which has been subject to roll-over relief.

Taken together, these measures constitute significant new assistance to charities and voluntary organisations. They build still further upon the significant benefits which charities have derived from earlier action by this Government. Our record continues to be one in which we can justifiably take pride.

DISABLED

I now come to the particular problem of the disabled which we have always had very much in mind. Last year, the International Year of the Disabled, I introduced a range of value added tax reliefs for charities concerned with the disabled. I am now able to announce three further measures of help.

First, there will be some extension of the existing VAT reliefs for disabled people and the charities serving them.

Secondly, mobility allowance. The rate will be increased – by more than the expected rise in prices – from £16.50 a week to £18.30. This will mean that it has risen by over 80% since the Government took office. This represents a considerable increase in real terms.

In addition I propose this year to respond to a particularly important request made on behalf of the disabled to successive governments in recent years. I propose that from 6 April the mobility allowance should be wholly exempt from income tax. This is a major step: it means an increase in net income of up to £5 a week for the working disabled. They deserve every encouragement, and the change will, I know, be widely welcomed.

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NATIONAL INSURANCE SURCHARGE REDUCED

I now turn to what can be done in this Budget directly to benefit business, industry, and hence jobs.

Our prime purpose is to help private commerce and industry to help itself, by cutting its costs. And I have no doubt, from the representations I have received, that the single measure business would most welcome is a reduction in the National Insurance surcharge.

This surcharge was imposed and then increased by the previous Government. Indeed, in their last two-and-a-half years in office, the last Government increased the combined charge on employment, the employers' National Insurance contribution and the National Insurance surcharge, from 8½% to 13½%.

The surcharge is, of course, a tax on employment. It raises production costs. It is not rebatable on exports and it either puts up prices or cuts into profits. But it is an extremely cost-effective tax. It raises large amounts of revenue, at little administrative cost. It is much easier to put on a tax of this kind than to take it off.

This Government has already protected businesses, and so employment, from any increase in employers' National Insurance contribution rates for two consecutive years. Had we not done so, employers would have had to find nearly £1 billion more in the coming year than will actually be the case.

It is now time to offer more positive relief. I accordingly propose to cut the rate of the National Insurance Surcharge from 3½ to 2½%. This will help to reduce costs throughout the economy and will be of value to all businesses, whatever their tax position.

The cut will operate from August 2, which is the earliest practicable date.

But I am anxious that industry should not suffer from this unavoidable delay. I shall therefore propose an extra ½% reduction between August 1982 and April 1983. The effect of this will be to ensure that business as a whole will enjoy in the last two-thirds of 1982-83 the equivalent of a whole year's reduction of 1% in the surcharge.

The proposal is intended to reduce business costs in the private sector. However public sector employers also pay the surcharge, and in order to leave them exactly where they would have been without the change, appropriate reductions will be made in the relevant cash limits and the Votes of central government and the NHS, in the Rate Support Grant to local authorities, and in the External Financing Limits of the nationalised industries. The necessary changes will be announced as soon as possible. This will reduce the cost to a net figure of £640m in 1982-83.

The aim of the relief I have just announced is to help business costs and employment. If it were to find its way into higher pay, that would totally defeat the object of the exercise, and would obviously have to be taken into account in future.

It is crucial that this should not happen. In proposing this reduction, we are offering business and industry, management and workforce, an exceptional opportunity to im-

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prove their own performance and prospects. I believe that they will take it.

NO CHANGES OF VAT RATES: EXCISE DUTIES UP

I come now to the indirect taxes. I propose no change in the rate of VAT.

For the excise duties there has grown up in recent years a sensible presumption that they should be adjusted in line with the movement in prices from one year to the next. That, after all, is what happens automatically with VAT and the ad valorem duties, and also to the personal tax allowances, unless parliament decides otherwise. And that is the basis of my approach to excise duty changes this year.

I start with the duty on tobacco. Last year the duty was increased twice – March as part of the Budget measures and in July to help recoup the loss of revenue from the derv duty reduction.

I have taken account of that in proposing this year an increase that is the equivalent of 5p, including VAT, on the price of a typical packet of 20 cigarettes. There will be consequential increases for other tobacco products. These changes will take effect from midnight on Thursday.

Next, alcoholic drinks. I propose to increase the duties from midnight tonight by amounts which represent about 2p on the price of a typical pint of beer, 10p on a bottle of table wine, and 13p on a bottle of sherry – all including VAT. The full increase in the price of a bottle of spirits necessary to take account of inflation would have been over 50p. However, in the light of the representations about the state of the Scotch whisky industry which I have received from hon. friends representing Scottish constituencies and others, I have decided that it would be appropriate to limit the increase on spirits to 30p a bottle, again including VAT.

Next, the oil duties. Last year, as the House will recall, I felt it right to go some way to meet the representations made to me by hon. members in favour of a lower increase in the case of derv than of petrol, in view of the impact of derv duty on industrial and distribution costs. I have decided this year slightly to widen that differential.

There is a strong case for a larger increase in the petrol duty than in the other duties, for our average pump prices are currently among the lowest in the European Community. They have moreover been favourably affected by the recent changes in the price of oil. Pump prices have been falling rapidly.

Against this it has been impressed upon me by a number of my hon. friends from rural constituencies, in all parts of the kingdom, that pump prices in remote areas are very much higher than those in more heavily populated areas. Yet dependence on cars for transport is greatest in the more scattered communities.

On balance, I think it would be right, at least at this stage, not to impose any real increase in the oil duties. I propose, therefore, to limit the increases in the duties on both petrol and derv to amounts which no more than compensate for one year's inflation. The duty on petrol will accordingly increase by the equivalent, including VAT, of about 9p a gallon or 2p a litre. This will still leave most pump prices lower than they were at the end of last year. The duty on derv will increase by the equivalent, including VAT, of about 7p a gallon or 1.5p a litre. As almost all derv is used by businesses, this smaller increase will help to hold down business costs.

As last year, I propose no change in the rate of duty on heavy fuel oil. I am not able, as some would wish, to cut the rate, but leaving it unchanged will help industry as the duty burden continues to fall in real terms.

Last year I undertook to review the rate of duty applied to aviation gasoline, or AVGAS. I have given very careful consideration to the reppresentations which I have received on behalf of air taxis, flying schools, crop-spraying and other specialist services, and from those concerned with air travel in the Highlands and Islands of Scotland.

I cannot accept in full the arguments which have been put to me, but I have decided that it would be right to reduce the AVGAS duty rate to one-half of that on petrol. Including VAT, this amounts to a reduction of about 32 pence a gallon or 7 pence a litre.

All these changes take effect for oil delivered from refineries and warehouses from 6 pm tonight.

I also propose to increase most rates of vehicle excise duty. For the motorist the increase will be £10, from £70 to £80. Duty levels on most other groups of vehicles will be increased by about 12%.

I propose to make two important changes in the VED on commercial vehicles, I have decided that it would offer a substantial, and justifiable, help to small and medium sized businesses at this time to bring the duties on about half a million light commercial vans more closely into line with those on cars.

On the other hand, it would be appropriate, in the light of the conclusions of the Armitage Report, to impose on the heavier lorries – the 80,000 or so of more than 9 tons unladen weight – a licence duty which more closely reflects the actual cost which they impose on the road network.

So the duty on this category will be increased by about a quarter. These changes have effect for licences taken out after today.

The changes I propose for commercial vehicles reflect the Government's intention to get a fairer balance between the taxation burden on different groups of lorries and their road costs. I propose to take a further step in this direction by including in the Finance Bill provisions for restructuring the basis of VED on heavy lorries, to a gross weight method of assessment, and for taxing all light commercial vehicles in due course at the same rate as cars. The House will recall that the framework for this major reform of the VED system was set out in the 1981 Transport Act. It will involve substantial changes in the pattern of commercial vehicle taxation and I think it right that the road transport industry should have time to adjust. I therefore propose that the rates of duty on the new gross-weight basis should take effect from October 1.

And, last of the excise duties, taxes on betting and gaming. Many of my Hon. Friends pressed last year for substantial increases here; and I made some changes in July. I now propose no further increase in the rates of duty on general betting and bingo, both of which were increased then.

But I have decided that pool betting duty, which has been unchanged since 1974, should go up from 40% to 42½% from 1 April. I also propose increases from the same date in the rates of duty on casinos, where I believe the existing rates are too low. Full details of the new rates, and other changes which I shall be announcing today, will be given in press notices this afternoon.

My rt. hon. friend, the Chief Secretary, announced last summer that Customs and Excise would undertake a comprehensive review of gaming machine taxation. A very large number of representations were received during the course of this review, from and on behalf of clubs, public houses, amusement arcades, and others. In the light of these representations I have decided that it would not be appropriate to introduce an ad valorem duty on gaming machines, or to impose an excise duty on amusement machines, such as Space Invaders. I have also decided that duty should no longer be charged on 2p gaming machines which are mostly to be found in the seaside arcades.

However, I have decided that there should be significant increases from October 1 in most rates of the existing licence duty on 5p and 10p gaming machines.

The total effect of all these changes on excise duties will be to raise an additional £1,150m in 1982-83 and £1,165m in a full year. The impact effect on the RPI will be about three-quarters of 1%. This has been fully taken into account in my forecast of falling inflation in the year ahead.

OIL FIELDS

I have spoken of the oil duties: I now turn to the oil-fields. The development of the North Sea has been a story of enterprise and success, which is almost entirely due to the skill and enterprise displayed, and risks accepted, by the private sector. As a nation, we must never forget the great debt we owe to those on the oil rigs and elsewhere, who have been responsible for exploration and development. It is important for them as well as for the British people that the rewards should be fairly shared.

Last year, in the light of the massive increase in oil prices which had occurred in earlier years, we changed the structure of North Sea tax, to make it more responsive to changes in price. At the same time tax revenue from the North Sea was brought forward, with an increase in the total level of taxation. I also invited the industry to suggest better ways of raising the revenue we needed. I am grateful to them, and others who have commented, for their careful and considered response.

As I have mentioned, the current fall in oil prices reduced the revenue the Exchequer receives. I recognise that it reduces the revenues of the oil companies as well – but it also reduces the tax they have to pay.

Detailed study has convinced me that, subject to some marginal adjustment, the total tax burden is not such as to discourage exploration or development. Nor is it so high as to de-

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prive the oil industry of a reasonable and often attractive yield.

In these circumstances I cannot reduce the overall tax burden to the extent that the industry would have wished. But I do agree with them on the need for some change of structure.

ABOLITION OF SUPPLEMENTARY PETROLEUM DUTY

I see, in particular, the advantage of profit-related taxes in relation to additional investment in existing fields. The Supplementary Petroleum Duty will therefore be abolished with effect from the end of this calendar year.

INCREASE OF PETROLEUM REVENUE TAX

I propose at the same time that the rate of Petroleum Revenue Tax should be increased from 70% to 75%; and that arrangements should be introduced for advancing PRT payments. Advance payments of PRT, although computed in the same way as SPD, will not be a separate tax but simply an acceleration of the existing tax.

They will thus differ fundamentally from SPD in being fully set off without limit against ordinary PRT liabilities when these arise. This structural change is one which representatives of the industry have proposed.

As from mid-1983, there will also be a monthly instalment system of payment of PRT in order to secure a smoother public sector cash flow.

These changes will not affect the revenue yield of rather over £6bn in the coming year. But in 1983-84 there will be a net cost, after allowing for the saving in interest due to the new system of instalment payments, of some £70m.

I have spoken earlier about current uncertainties in relation to oil prices and the future yield of tax from the North Sea. But I am aware of the concern felt by the industry about the number of changes in the regime there have been in recent years.

For this reason, my hope is that the new tax structure I have proposed will provide a more secure and stable regime for the future, permitting development to go ahead, uninhibited by major fiscal uncertainties.

I propose a number of other minor changes partly in response to the views put forward by the industry. And I propose that regional development grants paid in respect of expenditure incurred after Budget Day should be taken into account for the purposes of PRT and ring fence Corporation Tax.

We shall also need to legislate next year to deal with certain special problems affecting PRT expenditure reliefs, pipeline tariffs, and other non-oil receipts: these will be the subject of a consultation document which will be issued shortly.

These fiscal measures, combined with the decisions we have already announced on the abolition of the state's sole right to buy gas, and on the creation of the new private sector oil company, will provide a sound basis for another decade of successful enterprise in the North Sea.

MICROELECTRONICS

I turn now to the continuing effort to encourage innovation in industry. If we are to win still more worthwhile orders both at home and abroad British industry must continue to improve its design and production techniques.

There is no more important area to which this applies than microelectronics and information technology. The Government have already given a lead by designating 1982 as Information Technology Year. We have already authorised investment of well over £2bn in the British Telecommunications network in the coming year – more in real terms than at any time since 1974-75. This investment will breed new services, new firms and new jobs. So will the development of alternative and competing services for electronic communication such as the new Mercury network for business.

Because new technology is important on a wider front, I propose to make a further allocation for this purpose. My Rt. Hon. Friend, the Secretary of State for Industry, will shortly be announcing a series of new and expanded schemes. These will include additional assistance towards space technology, and production engineering – including the introduction of a special scheme of assistance to small engineering firms.

And the 100% first-year allowances for leased television sets, which were due to be phased out this June, will be extended for a further year for sets incorporating a teletext facility. This will encourage the wider use of a leading product of British Information Technology.

FISCAL JUSTICE

These measures will be worth £130m over three years.

I have now virtually completed my review of proposals involving spending, and spending foregone. I have described my decisions on excise duties, and the major cut in National Insurance Surcharge which we propose. In the remainder of my speech I shall be dealing primarily with fiscal issues.

I wish to deal first, and briefly, with the key issue of fiscal justice. All Chancellors of the Exchequer come under pressure every year to remedy hardships and anomalies in the tax system. This year has been no exception, and by the end of this afternoon I shall have been able to meet a large number of such points.

But there is another side to this medal. Justice is indivisible. Justice to the taxpayer must be matched by justice to the Exchequer. The revenue must be protected and maintained if the burden is not to fall more heavily on the general body of taxpayers.

We must all be glad to see the courts adopting a new approach towards artificial avoidance schemes. As a direct result, we expect to collect a very large sum of tax, possibly as much as £400m, which might otherwise have been avoided.

TAX EVASION

The proper vigilance of the Revenue Departments in these matters needs to be matched by the determination of Parliament to legislate where this is needed. Last year I asked Parliament to do so on a number of important matters. This year I propose further action.

We must, however, tread a very careful path between safeguarding the interest of the taxpaying community on the one hand and avoiding economic damage on the other.

This need for caution applies, for example, to the proposals affecting the tax liability of companies engaged in international business, on which the Inland Revenue put out consultative papers last year.

COMPANY RESIDENCE

These papers and the draft clauses dealing with these matters have caused considerable anxiety. In the case of company residence the primary objective was simply to replace the present ill-defined rules with ones which were clearer and more certain. This was not an attempt to extend the coverage of the tax. But I accept that some people might be adversely affected. The matter therefore needs to be looked at again.

TAX HAVENS

The problem of tax havens was a different one. If one has an open world in which there is free movement of capital and of persons – something which in itself is a good thing – this offers increased opportunities for tax avoidance. We must be very careful not to prejudice legitimate business, particularly because of the importance of London as a financial centre. We need to find the right middle road, and one which is accepted as right. It is to this end we shall be directing our efforts. Clearly this precludes legislation this year on any of these topics.

INTERNATIONAL LEASING

I now turn to the areas in which I do propose to take action in this Finance Bill.

First, international leasing. At present, assets leased abroad attract capital allowances at what is, in many cases, a favourable rate of 25% per annum. Leasing of this kind has grown sharply.

Moreover, there is evidence of U.K. tax incentives being used to subsidise deals between other countries – deals by foreign businesses in foreign-made goods, competing with our own home producers. I therefore propose, for new commitments after today, to reduce from 25% to 10% the rate of writing-down allowance for all assets leased abroad.

FILMS

Second, films. Investment in films qualifies for 100% first year allowances. As with other capital provisions, these investment incentives are available without regard to whether the film is made in this country or overseas.

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There is evidence that schemes for investment of this kind – primarily in foreign-produced films – are currently being marketed actively in this country. The potential loss to the revenue is very great.

I propose, therefore, to withdraw the 100% first year allowance for films and to introduce in its place a provision which will, in broad terms, allow companies to write off expenditure over the income-producing life of the film.

A change of this kind could have serious implications for the British film industry, if introduced immediately, at a time when there are signs that it is just beginning to establish a new and more competitive position.

I intend therefore to introduce transitional relief for British-made films – broadly speaking, films registered for the purposes of the Eady levy arrangements – for a two-year period. I shall be consulting the industry about the form which this assistance might take.

SHIPPING

Third, shipping. Here again, arrangements are being made to exploit U.K. investment incentives for the benefit of foreign businesses. In this case, a typical arrangement may involve a foreign shipping company chartering a vessel built abroad from a company specially set up in the U.K. to attract 100% capital allowances. I propose to reduce the rate of capital allowance in these cases to the 10% rate for international leasing generally. I am concerned to safeguard the position of British companies chartering their vessels abroad in the course of a genuine shipping business, and I shall be discussing with the shipping industry how best to do this.

On each of these three subjects – international leasing, films, shipping – the changes will take effect from today. I shall be bringing forward the necessary detailed legislation at Committee Stage.

LOANS

Fourth, so-called Section 233 loans. These are contrived arrangements under which interest paid on certain bank loans escapes liability to corporation tax in the hands of the banks. In future these payments will be taxed like other interest payments. The new rules will apply from today. In the case of contracts entered into before today, the new rules will apply to payments due on or after 1 April 1983.

DOUBLE TAX RELIEF AND BANKS

Fifth, by taking advantage of double tax relief banks can lend overseas at abnormally low interest rates at the expense of the U.K. taxpayer.

I propose to include in the coming Finance Bill measures to stop this exploitation of our tax system. They will take effect from 1 April 1982 but in the case of existing loans will apply only to interest arising from 1 April 1983.

While the measures I have announced will help, we shall need to give much further thought in the coming year to the problem of how best to ensure a sufficient contribution to tax revenues from the banking sector. The problem is not an easy one, as the benefit of some of the devices I have just described is shared between the banks and their domestic customers. There is a danger that measures directed to ensuring that the banks pay a more equitable amount of tax are all too simply bypassed by the banks shifting the burden on to their customers. For these reasons I have forborne from taking action earlier, but as Burke said, "There is however a limit at which forbearance ceases to be a virtue."

BUILDING SOCIETIES

On a different note, a number of building societies have recently issued a new form of negotiable bond. I have no reason to believe that any improper use has been made of these new bonds. But as an obvious precaution, I propose to extend to these bonds, from today, the existing provisions dealing with the "manufacture of dividends."

GOLDEN HANDSHAKES

I also propose some tighten-up of the law relating to very large golden handshakes. The tax relief will be withdrawn on a sliding scale with the effect that the excess of sums over £75,000 will be fully charged to tax.

We owe it to the ordinary taxpayer to take action in these fields. It is on him that the cost would fall if we did not do so.

HELP FOR BUSINESS AND INDUSTRY

I now revert to my principal theme: help for business and industry, and hence for jobs and people. Last year's Budget contained a number of measures to help the construction industry, an industry which can make a particularly significant contribution to the creation of new jobs. It is, accordingly, right to give it further help this year.

HOUSING

As I have already mentioned, our new public spending plans provide work for the construction industry in 1982-83 worth about £10¼bn – an increase of 14%.

This year local authorities have greatly underestimated the success of our policy of selling council houses and land. The extra revenue which this is bringing in has not been spent. For 1982-83, they have been assured that they can spend up to a total of some £3bn on housing.

This will include about £1bn of funds which they can expect to receive mainly as a result of the success of the right-to-buy legislation. This should allow an increase of nearly one third in the scale of their capital spending, compared with what they seem likely to spend in 1981-82.

In addition I now propose a charge for 1982-83, designed to help private home-owners whose houses fall well short of today's standards.

The value of grants given for major repairs, and for the provision of basic amenities in the home, under the Home Improvement Grant System, will be increased for a limited period, to a maximum 90% of the eligible cost, instead of the 75% currently available.

This increased rate of grant will apply only to applications received before the end of 1982. The purpose is not to add to longer term demands on the industry but to encourage the take-up of immediate spare capacity. We also intend both to enable more people to get grants for home insulation and to increase the value of these grants.

To pay for these changes and to encourage local authorities to make more general improvement grants available, their capital allocations in 1982-83 will be increased by £100m. This will be over and above the expenditure provided for in the White Paper.

My Rt. Hon. Friend, the Secretary of State for the Environment, has already announced measures for 1982-83 to give priority to inner city projects that offer the greatest degree of participation by the private sector.

Building on this, up to £70m of the provision for the Urban Programme and for Derelict Land reclamation in 1983-84 will be earmarked for projects that encourage participation by the private sector.

DERELICT LAND

We have also decided to offer further encouragement to the private sector and nationalised industries to bring derelict land into productive use; we shall increase the grant payable from 50% of the cost of reclamation to 80%, in Assisted Areas and Derelict Land Clearance Areas when legislation can be brought forward. The cost will be contained within the existing programme.

In addition, we shall give further encouragement to new private investment in housing for rent. I now propose to introduce capital allowances, at the rate of 75% for the first year only, for expenditure on the construction of properties wholly for letting as assured tenancies by bodies approved by the Secretary of State. The scheme will run for an experimental period of five years. Allowances may be claimed for expenditure incurred as from today.

In my Budget two years ago, I introduced the small industrial workshop scheme, under which industrial buildings allowance can be claimed on the construction of small buildings at the rate of 100%. The scheme has been a resounding success.

SMALL BUSINESSES

Over 5,000 new workshops have already been constructed for letting to small businesses, at an estimated Exchequer cost spread over several years, of £125-£150 million.

The scheme has succeeded in increasing the stock of industrial workshops at or near the upper size limit. But there has been relatively little investment at the very small end of the range. I therefore propose to extend the scheme for very small workshops, of not more than 1,250 square feet, for a further two years, until March 1985.

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I also propose to bring within the scope of the industrial buildings allowance certain kinds of servicing, repairing and warehousing activities. This too will improve the small workshop scheme.

I also propose to deal with the liability to VAT of certain kinds of building alterations, where there has in the past been serious doubt about what was liable to charge. A recent judgment of the House of Lords would have led, if applied in its entirety, to VAT being charged at the standard rate on a range of non-structural building alterations which had previously been free of charge. Though clarifying the law, this judgment would have imposed an extra £80 million of tax on the industry, which it can ill afford at present.

So I intend to re-establish the clarity needed, but in a way which will relieve the industry of all but £10m of the extra tax burden. I shall, in due course, lay before the House an Order, which will have the effect of continuing to zero-rate three important kinds of alterations which might otherwise be adversely affected by the House of Lords' judgement.

These are the most commonly recognised forms of double glazing, loft and cavity wall insulation and damp-proof coursing. This useful simplification of the law will cost the revenue about £70m a year.

The other kinds of non-structural alteration covered by the judgement will become subject to VAT but, pending the completion of discussions with the industry, no steps will be taken to apply the tax before about the beginning of September.

My final proposal in this area concerns Stamp Duty on house purchase. I propose to raise the exemption by £5,000, to £25,000, and the other thresholds also by £5,000, at a total cost of £70m in 1982-83.

This change should be widely welcomed. It will help to improve job mobility and give some encouragement to house construction. But most of all it will help those who have been saving to buy their first homes. By the end of this Parliament, nearly three out of five families will own their own homes. This will represent a significant extension of the property-owning democracy.

And, taken together, these proposals will mean more work for the construction industry, and more jobs for those who work in it.

Evident in the measures I have announced so far is the Government's consistent determination to help create the right conditions for the new investment needed to create new jobs. But this Budget, like its two predecessors, is designed also to provide a special tonic for small businesses.

BUSINESS START-UP SCHEME

There can be no doubt that higher rates of interest and the consequent reluctance of companies to borrow long-term at high fixed rates have caused a distortion of balance sheets. Too much reliance is now placed on short-term bank finance. As a result there is additional pressure on monetary growth.

A number of suggestions have been made for reducing the burden of interest rates on companies. We are all indebted to my hon. friend, the member for North-West Surrey, and others, for the way in which they have focused public attention on this problem. In many cases, the selectivity in the remedies proposed would favour lending by the banks and lending to "tax-exhausted" companies. We have considered these ideas very carefully. But they raise difficult questions of principle, and we are not persuaded that they offer the best solutions to the problems they are designated to solve. Moreover, consultations are still not complete on the Corporation Tax Green Paper, which raises major questions about incentives to investment, and we are still considering how best to ensure a proper contribution to tax revenues by the banking sector.

However, we can all agree that the basic problem of financing profitable expansion and investment demands urgent and continuing attention. A particularly important aspect of this is the provision of equity capital, about which I have some new proposals to make.

The Business Start-Up Scheme, which provides income tax relief for investments of up to £10,000 in the equity of companies starting new trades, has been widely welcomed. I propose for 1982-83 and 1983-84 to increase the annual limit from £10,000 to £20,000. As less than a full year has elapsed since it became law, some potential investors may have been unable to use up the full £10,000 limit in 1981-82.

I therefore propose that, in addition, any unused balance of this year's limit should be added to next year's. This means that, in some cases, the effective limit for 1982-83 will be as much as £30,000. These improvements should provide a further stimulus to investment in new enterprises.

Where capital for small businesses generally is concerned, many people have emphasised the importance of the new provisions introduced in the 1981 Companies Act for companies purchasing their own shares. Clearly, it would be wrong to change the tax law in such a way that these provisions could be used to pay out what would amount to tax-free dividends. But there is scope for tax changes which will significantly increase the attractions of equity capital, both to the investor and to the entrepreneur.

I now propose that certain purchases of their own shares by unquoted trading companies, mainly small and family businesses, should not be subject to ACT and income tax. They will be treated instead as sales of shares by the shareholder, and therefore, subject in most cases to Capital Gains Tax only. This measure will be of special benefit to small companies which have a limited market for their shares.

EMPLOYEE PARTICIPATION

Two years ago, I relaxed the conditions governing profit-sharing schemes and reintroduced legislation enabling employees to take up options to buy shares in their companies without incurring income tax liability.

I did this because I have no doubt that employees who own shares in the company for which they work develop a greater sense of commitment to the success of the business. Since I made my first changes two years ago, the increase in the numbers of employee share schemes has been extremely encouraging. In 1979 there were only 30 such schemes. Now there are over 400.

This is exactly as we should wish. Wider share-ownership is good for the business, good for the worker and good for Britain.

It is important to maintain and extend this progress. Accordingly, I now propose to increase the value of shares that can be allocated each year to any one employee from £1,000 to £1,250. I also propose to amend the detailed rules to help simplify the administrative problems arising on rights issues. We should also give some help and incentive to those who acquire share options outside the ambit of approved schemes. I therefore propose to make it easier for them to pay the income tax chargeable on the exercise of such an option by providing that it should be collected over three years rather than in a single sum.

In the last two years we have substantially relaxed the rules for tax relief for interest on money borrowed to invest in small companies. This year I propose to move a stage further. If a shareholder works full-time in the management of a business he will in future be able to qualify for tax relief to invest in that business even though he does not have more than 5% of the shares.

PILOT LOAN GUARANTEE SYSTEM

Now, loan finance. In my last Budget I announced the establishment of a pilot loan guarantee scheme. The scheme started in June 1981. Since then the demand for loans has far exceeded expectations.

Last October, in response to that demand, we increased the allocation for the first year from £50 million to £100 million; but with 2,700 loans worth almost £100 million already approved after only nine months, some further increase is desirable. Accordingly, I propose to increase the amount which the participating institutions may lend to £150 million for the first year. In addition a further £140 million will be available for loans under the scheme during its second year, to June 1983.

CORPORATION TAX RATE FOR SMALL COMPANIES

I also propose that the limits for the "small companies" rate of corporation tax should go up again from £80,000 to £90,000, and from £200,000 to £225,000. This will mean that this Government has increased the lower limit by 80% and the upper limit by more than 150%.

PRE-TRADING RELIEF

As a further help for new businesses, the period for income and corporation tax relief for pre-trading expenditure will be extended from one to three years.

ENTERPRISE AGENCIES

Many hon. members, I know, have been impressed by the value of the work done by local

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enterprise agencies. These agencies depend in the main on businesses already established in the local community. They clearly play a valuable part in helping small local firms to start and to prosper.

I therefore propose to allow businesses to deduct for tax purposes the contributions they make to certain enterprise agencies, which concentrate on helping small firms. I hope this measure will encourage more widespread support for such agencies. The relief will be available from March 31 and will run for 10 years.

VAT

On VAT, I have two principal changes to propose. The registration threshold will be increased from £ 15,000 to £ 17,000. And I propose to introduce VAT relief for services supplied before registration. This measure, and the extension of relief for pre-trading expenditure, will reduce the costs of starting a new business.

The total revenue cost of these measures to help small firms is about £ 80m in a full year.

I also want to make it easier for those who have recently left school or college to start a business. Hitherto they have not been able to qualify for the socalled 714 certificates under the construction industry tax deduction scheme. The present system, designed to prevent tax evasion, may actually keep young people out of work as sub-contractors in the industry. The certificates are widely used in the industry but the existing rules require an individual to show that he already has three years good record as a taxpayer before he can secure a certificate.

By definition, someone who has just left school or college cannot qualify under this three-year rule. I now propose to change it, so as to enable school and college leavers to obtain special certificates. I also propose a guarantee scheme which may help others to obtain these special certificates.

PENSION RELIEF

Finally, the self-employed. A decade of inflation has eaten into the value of money which they had put aside to provide for their retirement. I therefore propose to increse the limits on retirement annuity relief for contributors who are now in their 50s and 60s - to 20% for those born between 1916 and 1933, to 21% for those born in 1914 or 1915, and to 24% for those born in 1912 or 1913. I also propose to alter the present restricions on the relief to allow more self-employed people to benefit from these higher levels. These changes will cost £ 12 million in 1982-83 an £ 25 million in a full year. They will provide a significant improvement in the position of the older contributor whose lifetime savings have suffered particularly from high rates of inflation in the 1970s.

The self-employed play a key role in the economy. Their contribution to its vitality, its adaptability, is apparent to all. A long with small businessmen, they fully merit this extra encouragement.

CAPITAL TRANSFER TAX

I turn now to a part of our tax system which is impeding the efficient working of capital markets and doing injustice to individuals and businesses alike: the capital taxes.

There is room for wide differences of view about the principle of taxing capital. But there is no case whatever for maintaining a system of capital taxes which, by holding back business success and penalising personal endeavour, does serious economic and social damage.

In each of the last two budgets, we have taken significant steps to reduce such damage. I propose carrying this process a stage further today.

The threshold for Capital Transfer Tax will now be increased to £ 55,000. The rate bands which apply above the thresholds have remained virtually unaltered since the tax was introduced in 1975. It is time they were extended. Under the new scale, details of which will appear in the FSBR, the top rate of tax will be reached at £ 2.5m.

In real terms, this is still not as high as the figure set by my predecessor, when he introduced the tax, in 1975. The lifetime scale will be improved to a similar extent. The cost this year will be £ 35m: and in a full year £ 85m.

I also propose that the indexation principles, already applied to income tax allowances, should in future apply as well to the CTT threshold and bands.

I should add that it is my intention that the Finance Bill should deal with the new regime for settled property. Draft clauses were published in December. The comments we have received will help us to clarify and improve the provisions. They have more than justified this exercise in open Government. I am grateful to all those who have contributed. There will also be a number of technical provisions related to the heritage. I have decided, in the light particularly of the reductions in the lifetime rates of charge I made last year, not to alter the rate at which the periodic charge is payable.

I also propose that foreign currency accounts belonging to individuals who have no connection with the U.K. should not be caught by the CTT. It is important for London's position as the world's leading financial centre that this matter should be cleared up.

CAPITAL GAINS AND INFLATION

I now come to the incidence of Capital Gains Tax on inflationary gains. This is a matter which has rightly given rise to a great deal of discontent. No-one has yet succeeded in finding a solution to this problem.

Innumerable proposals for full indexation, for tapering and other ingenious devices have been put forward. None, unfortunately, overcame all the practical difficulties. I cannot, however, allow this injustice to continue. It is intolerable for people to be permanently condemned to pay tax on gains that are apparent but not real – that exist only on paper.

I propose, therefore, that, as from this April, gains, including those of companies, will, in principle, be calculated after taking account of inflation which occurs after that date. No relief will, however, be given in respect of the first year of ownership. The problem we seek to solve is one which relates essentially to assets held for a period of years, and it would not be appropriate to extend relief to assets bought and sold within a comparatively short period of time.

Because we have not found it possible to extend the new scheme to cover past gains, I propose also that the exempt slice should be increased to £ 5,000. That is the best solution to the problem of the past and will simplify administration both for the taxpayer and the Revenue. For the future, I intend that this threshold too should be statutorily indexed.

There will be no revenue cost in the coming year. In 1983-84 the cost of these two measures will be £ 55m.

But this ought not to be looked at as a measure of the cost to the Exchequer. It is rather a measure of the tax which ought never to have been levied in the first place. This change is no more than simple justice, which should be welcomed on all sides of the House.

The benefit of these measures will be of substantial help to business as well as the individual. They will significantly increase the attraction of equities to U.K. taxpayers. One result should be that companies can raise more equity at lower cost than would previously have been possible. An increase in the scale of equity issues by companies will help to reduce their dependence on bank borrowing.

ROLLOVER RELIEF

I also propose a number of other specific changes: in future, rollover relief will be available on compulsory purchase; and, completing our policy of avoiding a double charge of CGT and CTT on the one event, rollover relief will also be available on assets coming out of trust. These proposals invoice no cost this coming year and a cost of £ 11m in 1983-84.

I believe that these changes, taken together, will be widely welcomed as a further major reform of the capital taxes.

REDUCTION OF THE PERSONAL INCOME TAX

But for the vast majority of individuals what really matters is income tax. And income tax is far and away the biggest source of Government revenue. This year about 26m income taxpayers wil contribute, in round figures about £ 30m to the Exchequer.

Quite rightly people look for some reduction in their own tax burden. As I have explained at the outset, and demonstrated by my proposals, the paramount aim of this Budget is to help industry, to encourage business, to create jobs.

But I want also to assist people directly. The one helps the other. People need industry but industry also needs people - as workers, as customers, as investors. We remain firmly

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committed as ever, over the years, to reduce the burden of direct taxation. It is essential to do so: to improve incentives: to remove disincentives: te reduce the poverty trap.

There are always, of course, competing arguments as to whether one should reduce the rates of income tax or raise the thresholds at which people pay tax. Any Chancellor would like to be able to do both. But this year, given my principal aim, I have had to make a choice.

We have already reduced the basic rate of tax from 33% to 30%, and reduced the higher rates of tax as well. I propose, therefore, to concentrate the relief that is available this year on raising the tax thresholds.

The single personal allowance will accordingly be increased by £ 190 to £ 1,565 and the married allowance by £ 300 to £ 2,445.

The additional allowance for single parents will, as a consequence, rise by £ 110 to £ 880. So too will the widow's bereavement allowance. And there will be corresponding increases in the age allowances, the higher rate threshold and bands, and the threshold for the Investment Income Surcharge. Effect will be given to changes under PAYE as from the first pay day after 26 April.

These increases are up to 2% points *more* than the 12% required to take account of inflation in 1981. They are worth £ 1.8bn this year and almost £ 2½bn in a full year. As a result some 1.2m people who would have paid tax next year will not now have to do so. This news will be very welcome both to the House and to the country at large.

In framing this year's Budget, Mr. Speaker, it has been my purpose to give as much encouragement as I believe we can afford to an economy which is now moving in the right direction.

To hearken to the voices that urge us only to "borrow, borrow, borrow" would perform no service to British industry or to the unemployed. On the contrary, it would lead only to the dead end of a plummeting exchange rate or a rocketing rate of interest - most probably to both.

Better by far to secure, as I have done, a prospective level of borrowing that is below that of the year now ending and so to maintain our progress towards stables prices.

And at the same time, as in each of my three earlier Budgets, to achieve substantial tax reforms, to promote the wider ownership of wealth, and to encourage the productive private sector, which in these past three years has made giant strides towards the restoration of our reputation as a trading nation.

This is a Budget that will give confidence at home that growing markets will be there for those prepared to go out and win them. And so a better prospect of employment opportunities for those who look only for the chance to work.

And confidence abroad that Britain stays on course, to put a dismal record of performance behind us once and for all.

This Budget is designed to give that double boost to confidence. I commend it to the House and to the nation.

THE FINANCIAL STATEMENT

INCOME TAX

It is proposed: to increase the single person's allowance and the maximum wife's earned income relief from £ 1,375 to £ 1,565 and the married allowance from £ 2,145 to £ 2,445.
– to increase the additional personal allowance and widow's bereavement allowance from £ 770 to £ 880.
– to increase the age allowance for the single person from £ 1,820 to £ 2,070, for the married from £ 2,895 to £ 3,295 and the age allowance income limit from £ 5,900 to £ 6,700.
– to increase the basic rate limit to £ 12,800.
– to increase the width of the 40% band to £ 2,300, the 45% band to £ 4,000 and the widths of the 50% and 55% bands to £ 6,200.
It is proposed: to raise the threshold for the investment income surchage for 1982-83 from £ 5,500 to £ 6,250.
– to revise the system of reliefs available to individuals receiving payments above £ 25,000 on termination of employment.
– to exempt mobility allowance from tax.
– to raise from £ 1,000 to £ 1,250 the maximum annual value for appropriations of shares to an employee under an approved profit sharing scheme.
– to alter the basis for the exemption limit for capital receipts arising from shares held under approved profit sharing schemes.
– to allow the income tax payable on the exercise of a share option by a director or employee to be paid by instalments over three years.
– with effect from 1983-84, to change the arrangements for giving mortgage interest relief.
– to increase the percentage limit on retirement annuity relief from 17½% to 20% for individuals born between 1916 and 1933, from 20½% to 21% for those born in 1914 or 1915 and from 23½% to 24% for those born in 1912 or 1913, and to remove the existing ban on the provision of these higher rates of relief for individuals with pensions or pension rights under sponsored superannuation schemes in respect of any previous full-time employment.
– to extend relief for interest paid on money borrowed for investment in a close company to borrowers who own 5% or less of its ordinary share capital, provided that they act for the greater part of their time in the management or conduct of the business.
– in respect of the relief for investment by outsiders in certain new corporate trades ("Business Start-up Scheme") to increase the limit for each of 1982-83 and 1983-84 by £ 10,000 and for 1982-83 by any unused balance of the limit for 1981-82.

INCOME TAX AND CORPORATION TAX

It is proposed: to extend the definition of an industrial building for industrial buildings allowance purposes to include buildings used for certain repairing and servicing activities.
– to extend the small industrial workshop scheme for a further 2 years, for industrial buildings not exceeding 1,250 sq ft.
– to allow relief for contributions to certain enterprise agencies.
– to extend, for one year, the 100% first year allowance for expenditure on rented television sets incorporating a teletext facility.
– to introduce a first year capital allowance, at the rate of 75%, for expenditure in the construction of certain buildings for letting as private residential accommodation, under the assured tenancies scheme.
– to extend the relief for pretrading expenditure.
– to exempt dealers in Eurobonds from the provisions designed to prevent loss of tax through bond-washing.
– to bring certain securities issued by building societies within the provisions designed to prevent loss of tax through the manufacturing of interest.

INCOME TAX, CORPORATION AND CAPITAL GAINS TAX

It is proposed in appropriate cases to change the tax treatment of distributions made by companies in purchasing their own shares.

CORPORATION TAX

It is proposed: for the financial year 1981 to increase the limit for the "small companies" rate of corporation tax from £ 80,000 to £ 90,000 and the limit for marginal relief from £ 200,000 to £ 225,000.
– to amend the definition of "distribution" as it affects borrowing in the form of "equity loans".

CORPORATION TAX AND CAPITAL GAINS TAX

It is proposed: to adjust expenditure allowable in calculating gains on disposals having regard to future increases in the retail prices index.
– to increase the level of exemption for gains on chattels.
– to introduce a rollover relief for compensation paid on compulsory purchase.

OIL TAXATION

It is proposed: to extend Supplementary Petroleum Duty (SPD) for the chargeable period ending on 31 December 1982, only.
– to increase the rate of Petroleum Revenue Tax (PRT) from 70 to 75% for chargeable periods ending after 31 December 1982, and to spread its collection in monthly instalments after 30 June 1983.
– to introducing a system of advance payments of PRT for chargeable periods ending after 31 December 1982, at a rate of 20% of gross profits less an oil allowance of ½m tonnes per chargeable period, the advance payments to be set off against current or later liability to PRT or, failing set-off, repaid at the end of field life.

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– to amend the point of charge for PRT an SPD for certain arm's-length sales of gas and to provide alternative rules for determining the market value of ethane used for petrochemical purposes.
– to allow Corporation Tax relief for certain losses and charges outside the oil production "ring fence".
– to disallow for the purposes of PRT and ring fence Corporation Tax expenditure incurred after Budget day to the extent that it is met by Regional Development Grants.

CAPITAL GAINS TAX

It is proposed: to increase the threshold from 1982-83 so as to exempt individuals on the first £ 5,000 of capital gains in a year and most trusts on the first £ 2,500.
– to require for the future an annual revision of the thresholds for individuals and trusts in the light of changes in the retail prices index.
– to extend the rollover relief for lifetime gifts to transfers out of settlement.
– to revise the rules for gains arising on the termination of a life interest in settled property.

CAPITAL TRANSFER TAX

It is proposed: to introduce new rate schedules for both death and lifetime transfers as follows:

Band of chargeable value £ '000	*Rate on death %*	*Lifetime rate %*
0 - 55	Nil	Nil
55 - 75	30	15
75 - 100	35	17½
100 - 130	40	20
135 - 165	45	22½
165 - 200	50	25
200 - 250	55	30
250 - 650	60	35
650 - 1,250	65	40
1,250 - 2,500	70	45
Over 2,500	75	50

It is proposed: to require for the future an annual revision of the rate bands in the light of changes in the retail prices index.
– to increase the exemption limits for transfers within one year of death to charities to £ 250,000 and for transfers to non-domiciled spouses to £ 55,000.
– to restructure the charge to tax on discretionary trusts.
– to exempt from the charge on death non-sterling bank accounts of depositors who are not domiciled, resident or ordinarily resident in the United Kingdom at the time of their death.

CAPITAL TRANSFER TAX AND INCOME TAX

It is proposed: to alter the conditions on which the Treasury may designate trusts as maintenance funds for heritage purposes and to amend the charges to tax which may arise following the setting up of these funds.

VALUE ADDED TAX

It is proposed to amend Section 20(1) and Schedule 1 to the Finance Act 1972 so as to increase the registration and deregistration limits. From 10 March 1982 the registration limits will become £ 17,000 per annum and £ 6,000 per quarter. From 1 June 1982 the deregistration limits will become £ 16,000 per annum where estimated future turnover is concerned, and £ 17,000 per annum where past turnover is concerned.
It is proposed to amend paragraph 11 of Schedule 1 to the Finance Act 1972 in order to restrict the Commissioners' powers to grant discretionary registration to certain traders.
It is proposed to apply, by Order, the zero-rate of VAT to supplies of building alterations by way of the most commonly recognised kinds of double glazing, loft and cavity-wall insulation, and damp-proof coursing.

ALCOHOLIC DRINKS

It is proposed from midnight 9-10 March 1982, to increase:
(a) the rates of duty on spirits from £ 13.60 (for mature spirits) and £ 13.63 (for immature spirits) to a uniform rate of £ 14.47 per litre of alcohol in the spirits;
(b) the rate of duty on beer from £ 18.00 to £ 20.40 per hectolitre and the charge for each additional degree of original gravity above 1030 degrees per hectolitre from £ 0.60 to £ 0.68;
(c) the rates of duty on wine by the following amounts per hectolitre:
Wine of an alcoholic strength:
– not exceeding 15%: from £ 95.20 to £ 106.80.
– exceeding 15% but not exceeding 18%: from £ 122.90 to £ 137.90.
– exceeding 18% but not exceeding 22%: from £ 144.70 to £ 162.30.
– exceeding 22%: £ 162.30 plus £ 14.47 (instead of £ 13.60) for every 1%, or part of 1%, in excess of 22%;
– surcharge on sparkling wine: from £ 20.90 to £ 23.45;
(d) the rates of duty on made-wine by the following amounts per hectolitre:
Made-wine of an alcoholic strength:
– not exceeding 10%: from £ 61.80 to £ 73.10.
– exceeding 10% but not exceeding 15%: from £ 92.50 to £ 103.80.
– exceeding 15% but not exceeding 18%: from £ 113.90 to £ 127.80.
– exceeding 18%: £ 127.80 plus £ 14.47 (instead of £ 13.60) for every 1%, or part of 1%, in excess of 18%;
– surcharge on sparkling made-wine: from £ 9.60 to £ 10.75;
(e) the rate of duty on cider and perry from £ 7.20 to £ 8.16 per hectolitre.

STAMP DUTIES

It is proposed: to raise with effect from 22 March 1982 the level below which transfers of property (other than stocks and shares) are not liable to stamp duty from £ 20,000 to £ 25,000, to adjust the associated bands of reduced rates of stamp duty correspondingly and to alter certain limits affecting stamp duty on new leases.
– to exempt transfers of assets to charities.

HYDRO CARBON OIL

It is proposed, from 6 pm on 9 March 1982, to alter:
(a) the rate of duty on light hydrocarbon oil (other than aviation gasoline), petrol substitutes and spirits used for power methylated spirits from 13.82p to 15.54 per litre;
(b) the rate of duty on heavy hydrocarbon oil for use as road fuel from 11.91p to 13.25p per litre;
(c) the rate of duty on aviation gasoline from 13.82p to 7.77p per litre;
(d) the rate of duty on gas for use as road fuel from 6.91p to 7.77p per litre.

TOBACCO

It is proposed, from midnight 11-12 March, to increase:
(a) the specific element in the duty on cigarettes from £ 19.03 to £ 20.68 per 1,000 cigarettes (the ad valorem element remaining unchanged);
(b) the duty on cigars from £ 35.91 to £ 39.00 per kilogram;
(c) the duty on hand-rolling tobacco from £ 30.96 to 33.65 per kilogram;
(d) the duty on other smoking and chewing tobacco from £ 22.96 to £ 24.95 per kilogram.

POOL BETTING DUTY

It is proposed to increase the rate of pool betting duty from 40% to 42½% on events on and after 1 April 1982.

GAMING LICENCE DUTY

It is proposed, from 1 April 1982, to increase the rates of gaming licence duty. The advance payment will remain at £ 250, but the second payment, to be made up to five months after the licensing period, will be a proportion of the gross gaming yield (stakes less winnings) in each six-monthly period as follows:
5% of the first £ 500,000 plus
12½% of the next £ 1,750,000 plus
25% of the remainder of the gross gaming yield.

BINGO DUTY

It is proposed, from 27 September 1982, to restrict the existing exemptions from bingo duty so that al large-scale bingo (where the value of prizes has exceeded £ 300 in any one day or £ 1,000 in any one week) is made liable to duty.

GAMING MACHINE LICENCE DUTY

It is proposed, from 1 October 1982, to abolish the existing duties on all "2p per play" machines and to increase the annual rates of licence duty on other machines as follows:
(a) Premises with local authority approval: from £ 60 for the first machine and £ 120 for subsequent machines to £ 120 for each "5p per play" machine and £ 300 for each "10p per play" machine;
(b) Premises without local authority ap-

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proval: from £ 200 to £ 300 for each "5p per play" machine and from £ 400 to £ 750 for each "10p per play" machine.

It is proposed to amend the comparable provisions in the Miscellaneous Transferred Excise Duties Act (Northern Ireland) 1972 so that the abolition of duty on "2p per play" machines and the new rates at
(b) above will also apply in Northern Ireland.

SURCHARGES AND REBATES OF EXCISE DUTIES

It is proposed to amend the Excise Duties (Surcharges or Rebates) Act 1979 to allow surcharges or rebates to be applied to individual rates of the duties to which that Act applies.

It is proposed to increase the excise duty on most mechanically-propelled vehicles chargeable under Section 1 of the Vehicles (Excise) Act 1971 and under Section 1 of the Vehicles (Excise) Act (Northern Ireland) 1972 by about 12%. This figure is broadly descriptive. There will be some variations within particular vehicle categories. The duty on most cars will rise by £ 10 to £ 80. The rates of duty on certain groups of light commercial vehicles will be marginally reduced and a larger selective increase of 25% will be applied to all duty levels on goods vehicles over 9 tons unladen weight . These changes have effect in relation to licences taken out after 9 March.
It is additionally proposed to include provision in the Finance Bill for the restructuring of vehicle excise duty on heavy goods vehicles from an unladen weight to a gross weight basis of assessment and to introduce a new taxation regime for light commercial vehicles. These changes, which were foreshadowed in the 1981 Transport Act, will take effect from 1 October 1982.

NATIONAL INSURANCE SURCHARGE

It is proposed to reduce by 1 percentage point to 2½% the surcharge paid in respect of employees by secondary Class I contributors under the provisions of the National Insurance Surcharge Act 1976. This reduction will take effect from 2 August 1982. It is also proposed to reduce the rate of surcharge payable in respect of earnings between 2 August 1982 and 5 April 1983 by a further ½ percentage point.

Approximate direct effects of changes in duty rates on certain product prices

(All except VED* inclusive of 15% VAT)

Spirits duty	30p on a bottle of spirits
Beer duty	2p on a pint of beer of average strength
Wine duty	10p on a bottle of table wine
Fortified wine duty	13p on a bottle of sherry
Petrol duty	9p on a gallon of petrol
Derv duty	7p on a gallon of derv
Tobacco duty	5p on a packet of 20 cigarettes
Vehicle excise duty	£ 10 on a car licence

* Vehicles excise duty

CANADA: SALES TAX REFORM

Implementation date delayed

The following is the full text of a Finance Department Communiqué dated April 13, 1982:

The Honourable Allan J. MacEachen, Deputy Prime Minister and Minister of Finance, today announced the proposed implementation date for conversion of the manufacturer's sales tax to the wholesale level will be January 1, 1983.

The Minister said the postponement from June 1, 1982 to January 1983 is in response to requests from wholesalers and other members of the business community for more time to study the draft legislation and to prepare for its implementation.

The Minister expects to make the draft legislation available by the end of the month for public study and comment. He added that the January 1, 1983, implementation date is tentative and that he will confirm it later in the summer once he has had time to assess public comments on the draft legislation.

This structural change in the sales tax is intended to correct a bias in the application of the tax that now favours imported goods over competing domestic manufactured goods. It will also deal with other inequities and anomalies resulting from the wide variations in the way goods are marketed. The change follows detailed studies and public consultations over the past seven years.

The Minister emphasized that the shift in tax to the wholesale level will yield no additional revenues to the federal government. Any overall revenue gain from adopting the wholesale price base will be offset by the reduction of the general sales tax rate from 9 to 8%.

For some products the tax rate reduction will not fully offset the effect of changing to a wholesale base for the tax. However, it will mean a direct reduction in tax on a wide range of other products – those that do not flow through wholesalers or that are already subject to tax at the wholesale level. For example, it is estimated that on North American automobiles, which are sold by manufacturers directly to dealers, there will be reductions in the federal sales tax averaging between $100 and $200 per car.

The Minister noted that the reduction in the general tax rate from 9 to 8% will take place six months after the conversion to the new tax base in order to offset a one-time revenue loss resulting from refunds of tax already paid on wholesaler's inventories.

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MIDDLE EAST

Bahrain

BAHRAIN.
Second edition.
Hong Kong, The Hongkong and Shanghai Banking Corporation, 1981. 27 pp.
Business and travel information, economic facts and figures and taxation in Bahrain in the *Business Profile Series*.
(B. 51.842)

Jordan

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Business and travel information, economic facts and figures and taxation in Jordan in the *Business Profile Series*.
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Hong Kong, The Hongkong and Shanghai Banking Corporation, 1981. 20 pp.
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Australia

AUSTRALIAN INCOME TAX-LAW AND PRACTICE:

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  releases 43 and 44

Butterworths, Pty., Ltd., Chatswood.

Belgium

FISCALE DOCUMENTATIE VANDEWINCKELE

Tome I, release 42
Tome IX, release 124
Tome XIII, releases 34 and 35
Tome XVI, release 145
CED-Samsom, Brussels.

GUIDE FISCAL PERMANENT

release 432
Editions Service, Brussels.

GUIDE PRATIQUE DE FISCALITE

Tome I, release 42
CED-Samsom, Brussels.

L'INDICATEUR FISCAL

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CED-SAMSOM, Brussels.

Canada

CANADA INCOME TAX GUIDE REPORTS

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CCH Canadian, Ltd., Don Mills.

CANADA TAX SERVICE – RELEASE

releases 352, 365-368
Richard de Boo, Ltd., Toronto.

CANADIAN TAX REPORTS

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CCH Canadian, Ltd., Don Mills.

DOMINION TAX CASES

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Common Market (EEC)

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  release 223

Kluwer, Deventer.

Denmark

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- Dobbeltbeskatningsoverenskomster
  release 14

A.S. Skattekartoteket Informationskontor, Copenhagen.

France

BULLETIN DE DOCUMENTATION PRATIQUE DES TAXES SUR LE CHIFFRE D'AFFAIRES ET DES CONTRIBUTIONS INDIRECTES

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Editions Francis Lefebvre, Levallois-Perret.

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Editions Législatives et Administratives, Paris.

DICTIONNAIRE PERMANENT – FISCAL

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Editions Législatives et Administratives, Paris.

JURIS CLASSEUR – CODE FISCAL

release 206
Editions Techniques, Paris.

German Federal Republic

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release 1
Von der Linnepe Verlagsgesellschaft, Hagen.

HANDBUCH DES UMSATZSTEUER-GESETZES

releases 11 and 12
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RECHTS- UND WIRTSCHAFTSPRAXIS STEUERRECHT

release 265
Forkel Verlag, Stuttgart.

STEUERERLASSE IN KARTEIFORM

release 245
Verlag Dr. Otto Schmidt, Cologne.

STEUERRECHTSSPRECHUNG IN KARTEIFORM

release 361
Verlag Dr. Otto Schmidt, Cologne.

WORLD TAX SERIES – GERMANY REPORTS

release 151
Commerce Clearing House, Chicago.

International

FISCALITE EUROPEENNE

releases 3 and 4
Les Cahiers Fiscaux Européens, Nice.

JURA EUROPAE

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C.H. Beck'sche Verlagsbuchhandlung, Munich.
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Imprimerie Saint-Paul, Luxembourg.

The Netherlands

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  release 87

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- Loonbelasting 1964
  release 78
- Vennootschapsbelasting
  release 36

Noorduijn, Arnhem.

CURSUS BELASTINGRECHT

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S. Gouda Quint – D. Brouwer, Arnhem.

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Norway

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B. releases 37-39, 1-3, 5, 7-8
Norsk Skattebetalerforening, Oslo.

Peru

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release 48
Editorial Economia y Finanzas, Lima.

South Africa

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Juta & Co., Ltd., Capetown.

United Kingdom

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United States

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Conference Diary

MAY 1982

Management Centre Europe: Leasing in the 80's (including: The harmonisation of taxes in the E.E.C. and relevance for leasing). Brussels (Belgium), May 5-7 (English).

Seminar Services International: International Tax Planning (including: Use of tax treaties and tax treaty developments; legislation to counter use of tax havens and U.K. draft legislation on international tax avoidance). Amsterdam (the Netherlands), May 12-13 (English).

AMR International: Subcontracts and joint ventures in the Middle East, the legal and financial issues (including: Taxation and the Subcontractor). London (United Kingdom), May 13-14 (English).

International Tax Planning Association: 8th Annual Conference (including: The U.S. tax haven report; international tax planning for entertainers and athletes; taxes on non-residents; anatomy of a tax haven). Florence (Italy), May 19-21 (English).

Practising Law Institute: Real estate syndications (including: Special problems of foreign investors; The non-resident alien individual partner). San Francisco (U.S.A.), May 20-21 (English).

Management Centre Europe: International cash management (including: International tax aspects in cash management). Nice (France), May 24-26 (English).

The Inter-American Center of Tax Administrators (C.I.A.T.): XVIth General Assembly on the basic subject Non-tax compliance. Asunción (Paraguay), May 24-28 (Spanish, English, French and Portugese).

Institute for International Research: The Zürich International Corporate Finance Conference (including: Legal, accounting and tax issues of different hedging forms; tax leveraging). Zürich (Switzerland), May 24-26 (English).

JUNE 1982

Management Centre Europe: Taxation of international group companies and branches (Seminar). Brussels (Belgium), June 3-4 (English).

Seminar Services International: Taxation of international financial transfers (including: The taxation of foreign currency gains and losses; The revaluation of foreign assets on the balance sheet; Operating holding and finance companies in the Netherlands and the Netherlands Antilles; Double tax agreements and disclosure agreements between tax authorities). Amsterdam (the Netherlands), June 9-10 (English).

Practising Law Institute: Real estate syndications (including: Special problems of foreign investors; The non-resident alien individual partner). New York City (U.S.A.), June 17-18 (English).

Georgetown University Law Center: The Fourth Annual Institute on Multinational Taxation (including: Current developments in international tax rules outside the U.S.; Tax treaties – the changing landscape). Washington, D.C., (U.S.A.), June 24-25 (English).

JULY 1982

Practising Law Institue: International estate planning (including: Taxation of non-resident alien in the U.S.; The use of foreign situs trusts). New York City (U.S.A.), July 22-23 (English).

SEPTEMBER 1982

36th Annual Congress of I.F.A.: I. The tax treatment of interest in international economic transactions. II. Taxation of payments to non-residents for independent personal services. Montreal (Canada). September 12-16 (English, French, German, Spanish).

Confédération Fiscale Européenne (C.F.E.): Third European Congress of Tax Consultants (including: State of tax harmonisation in Europe; The application of wealth taxes and taxes arising on death to foreign assets and liabilities; The practical application of international tax provisions (working groups)). Aix-la-Chapelle (Germany), September 30 to October 2 (English, French, German).

OCTOBER 1983

37th Annual Congress of I.F.A.: I. Tax avoidance/tax evasion. II. International problems in the field of turnover taxation. Venice (Italy), October 10-15 (English, French, German, Spanish).

FOR FURTHER INFORMATION PLEASE WRITE TO:

AMR International: 6-10 Frederick Close, Stanhope Place, London W2 2HD (United Kingdom).

Confédération Fiscale Européenne (C.F.E.): Secrétariat Général, Postfach 1340, Dechenstrasse 14, D-5300 Bonn 1 (Federal Republic of Germany).

Georgetown University Law Center: 600 New Jersey Avenue, N.W. Washington, D.C. 20001 (U.S.A.).

Inter-American Center of Tax Administrators (C.I.A.T.): Executive Secretary of C.I.A.T., P.O. Box 215 zona 1, Panamá.

International Fiscal Association (I.F.A.): General Secretariat, Woudenstein, Burgemeester Oudlaan 50, P.O. Box 1738, 3000 DR Rotterdam (the Netherlands).

International Tax Planning Association: 33A Warwick Square, London SW1V 2AD (United Kingdom).

Institute for International Research: 70 Warren Street, London W1P 5PA (United Kingdom).

Management Centre Europe: Avenue des Arts 4, B-1040 Brussels (Belgium).

Practising Law Institute: 810 Seventh Avenue, New York, N.Y. 10019. (U.S.A.).

Seminar Services SA: 1 passage Perdonnes, CH-1005 Lausanne (Switzerland).

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THIRD EUROPEAN CONGRESS OF TAX CONSULTANTS

under the auspices of the President of the Federal Republic of Germany

Professor Dr. Karl Carstens

from 30 September – 2 October 1982 in Aix-la-Chapelle, Eurogress

CONGRESS PROGRAMME (PROVISIONAL)

Thursday, 30 September 1982

09.00 Opening of the Congress:
Dr. Wilfried Dann, Steuerberater, President of the C.F.E.

09.15 PAPER:
Count Otto Lambsdorff, Federal Minister of Economic Affairs of the German Federal Republic, Bonn
Increasing Economic Relations in a United Europe

10.00 PAPER:
Christopher Tugendhat, Vice-President of the Commission of the European Communities, Brussels
State of Tax Harmonisation in Europe

11.00 PANEL DISCUSSION I
Open questions and possible conflicts following the implementation of the 6th EEC directive relating to VAT

Languages: English, French, German

Chairman: Dr. Wilfried Dann, President of the C.F.E.

Participants:
Allemagne: Mr. Geist
Belgique: Mr. Timmermann
France: Mr. Ebrad
Italie: Mr. Prof. Croxatto
Pays-Bas: Mr. Warning
Royaume-Uni: Mr. Pyne-Gilbert
Commission of the European Communities: not yet available.

13.00 Luncheon for all participants at the Eurogress

15.00 WORKING GROUP A 1
Tax problems of establishing business activities abroad by medium-sized enterprises

Languages: German, English

Referees:
Allemagne: Mr. Dr. Schelle
Pays-Bas: Mr. Udink
Royaume-Uni: Mr. Stitt

15.00 WORKING GROUP A 2
The application of wealth taxes and taxes arising on death to foreign assets and liabilities

Languages: German, French

Referees:
Allemagne: Mr. Prof. Dr. Wacker
Belgique: Mr. Brandès
France: Mr. Saint-Bauzel

15.00 WORKING GROUP A 3
The professional relationship between the tax consultant and his client

Languages: English, French, German

Referees:
Allemagne: Mr. Mittelsteiner
Irlande: Mr. Johnston
Italie: Mr. Bertorello

17.30 End of the professional part of the first day of the Congress

Friday, 1 October 1982

09.30 WORKING GROUP B 1
The practical application of international tax provisions

Languages: English, German

Referees:
Belgique: Prof. Dr. A. Tiberghien
Danemark: Mr. Jørgen Skou
Royaume-Uni: Mr. Jones

09.30 WORKING GROUP B 2
The taxation of foreign income and gains from foreign possession of individuals

Languages: French, German

Referees:
Allemagne: Mr. Dr. Rädler
Espagne: Mr. Santacana
Pays-Bas: Mr. Booij

09.30 WORKING GROUP B 3
Organizing and equipping a tax consulting practice

Languages: English, French, German

Referees:
Allemagne: Mr. Sebiger
France: Mr. Gumez
Pays-Bas: Mr. Telman

12.30 Luncheon for all participants at the Eurogress

14.00 PANEL DISCUSSION II
International tax control

Languages: English, French, German

Chairman:
Joseph Delattre, President of the Tax Committee

Participants:
Allemagne:
Belgique: Mr. Denys
Espagne: Mr. Gros
France: Mr. Delattre
Irlande: Mr. Bale
Pays-Bas: Mr. Smid
Royaume-Uni: Mr. Jenning
Commission of the European Communities: not yet available

16.30 PAPER:
Dr. Wilfried Dann, President of the C.F.E.

Perspectives for the Future of Tax Consulting in Europe

17.00 End of the Professional part of the second day of the Congress

TAX TREATY:
Netherlands Antilles – United States

On 4 February 1982 the U.S. Treasury released the following text of a joint statement relating to the recently concluded round of negotiations on a new income tax treaty between the Netherlands Antilles and the United States.

The Minister of Finance of the Netherlands Antilles, Mr. Marco J. de Castro, and the Assistant Secretary (Tax Policy) of the United States Treasury Department, Mr. John E. Chapoton, announced today that further negotiations between the Government of the Netherlands Antilles and the Government of the United States, for the purpose of agreeing on a new income tax convention, were held in Washington, D.C. from February 1 through 4, 1982. The chief negotiator for the United States was A.W. Granwell, International Tax Counsel, and the chief negotiator for the Netherlands Antilles was Harold Henriquez, Minister Plenipotentiary.

During these negotiations, there was a review of the main issues. There was a detailed discussion of the possible solutions to reconcile the respective tax, enforcement and economic policy goals of the two governments in light of the historical relationship between the two countries.

The two delegations will resume the negotiations shortly. The next meetings have been scheduled for the spring of 1982.

In the meantime, the present treaty relationship between the United States and the Netherlands Antilles will remain in effect and will be administered in accordance with its terms.

See for the text of the present tax treaty 31 *Bulletin for International Fiscal Documentation* 1977 at 399.

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Hong Kong:

More Tax Concessions

by Y.C. Jao *

In a previous article in this ***Bulletin,*** *the present writer summarized and discussed recent tax changes and reforms in Hong Kong from 1976 to 1981.[1] It was shown there that simplification and rationalization of Hong Kong's tax system in recent years has on balance resulted in a lower burden of personal taxation, a higher tax yield and a greater fiscal surplus. In the latest 1982-83 Budget presented by Hong Kong's new Financial Secretary, Mr. John Bremridge, on 24 February 1982, more tax concessions were announced. Some of the tax cuts, in particular the abolition of the interest withholding tax on foreign currency deposits, clearly have certain international implications. This short article aims to describe the tax concessions and analyze their economic significance.*

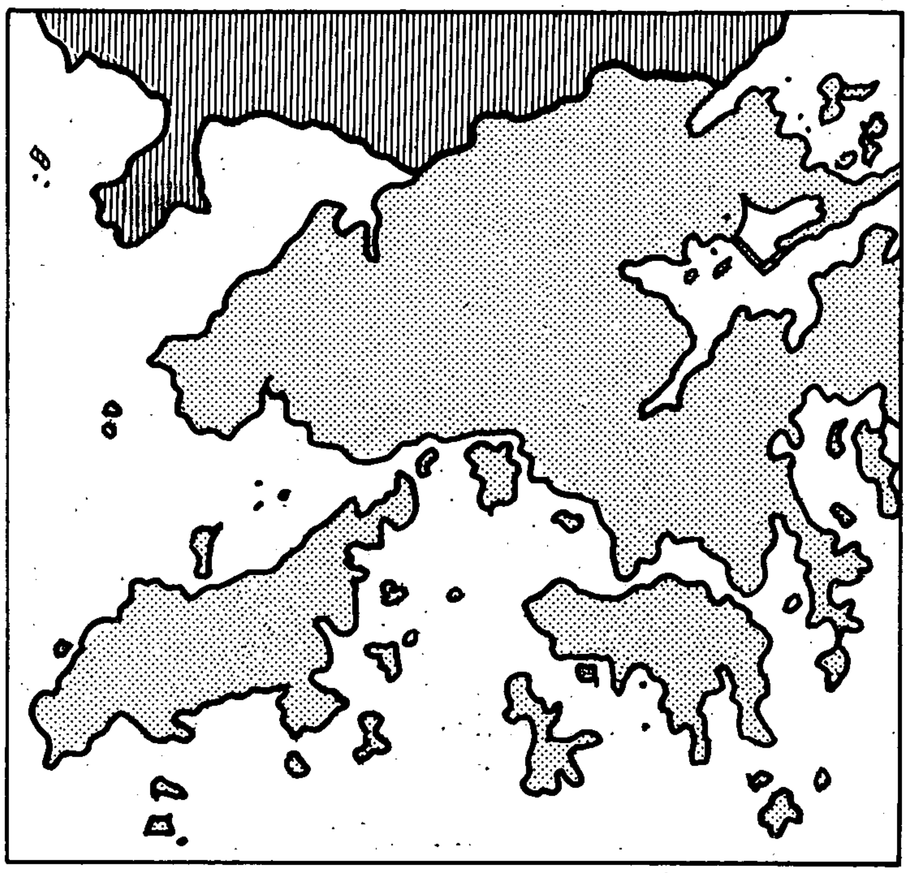
Tax concessions for 1982-83

Tax concessions proposed in the latest budget may be discussed under four headings as follows:

(a) Business taxation

In the previous fiscal year, the initial allowance for capital assets was raised from 25 to 35% to provide more incentive for entrepreneurs in replacing and upgrading their capital equipment, machinery and plant. In the latest budget, this initial allowance has been further increased to 55% for expenditure incurred on the provision of qualifying plant and equipment. As an example, an item of spinning or weaving machinery ranking for the annual rate of allowance of 30% will now qualify for a total write-off of 68.5% in the year of acquisition.[2]

A related concession concerns the allowance for industrial buildings. Under existing legislation, allowance for industrial building is granted by reference to the cost of construction only, no account being taken of the profit element in the final purchase price. This has now been amended so that both the initial and annual allowances for industrial buildings will henceforth be computed by reference to the net price paid by the final user. In Hong Kong, where until very recently profit margins in the property market have tended to be very high, the tax saving is not inconsiderable for a manufacturer who buys rather than leases a factory building for industrial production.



These concessions have been taken in recognition of the difficulties Hong Kong industrialists are now facing: world-wide recession, rising protectionism in developed countries, and growing competition from other low-wage developing countries. Such tax concessions may not go far enough in satisfying the clamour for more direct subsidy to the troubled industrial sector, but in the light of Hong Kong's traditional non-interventionist policy and philosophy, they probably represent the most the Government can do.

(b) Interest withholding tax

From the international point of view, a more important, and perhaps also more controversial, concession is the abolition of the interest withholding tax on foreign currency deposits. Debate on the pros and cons of this move has been going on in Hong Kong since at least 1970, when the territory began to emerge gradually as a financial centre. In the late 1960s several multinational banks had plans of establishing the Asian-dollar market – which was in effect an extension of the Euro-dollar market – in Hong Kong, but they were frustrated by the refusal of the Hong Kong Government at that time to abolish the interest withholding tax on foreign currency deposits. As a result, the Asian-dollar market was launched in 1968 in Singapore, whose government was only too glad to grant tax exemption as an inducement to multinational banks for setting up an offshore banking centre. Since then, the two city-states have been competing fiercely for the position of the leading financial centre for the Asian-Pacific

* Reader in Economics, University of Hong Kong.

1. Y.C. Jao, "Tax Changes and Reforms in Hong Kong", 35 *Bulletin for International Fiscal Documentation* 8-9 (1981), pp. 401-07.
2. 55% + (45% x 30%) = 68.5%.

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Region. Both in the process have grown enormously in financial stature. Most analysts agree that, being the host country for the Asian-dollar market, Singapore clearly leads as a funding centre, while Hong Kong – which has a much larger economy, is more centrally situated and is geographically closer to such large borrowers as the Philippines, South Korea, Taiwan, and eventually China – is more favoured as a syndication centre.[3] Hong Kong is reputed to be next to only London and New York in having the largest number of foreign banking institutions represented in one form or another.

With the removal of the interest tax on offshore currency deposits, it is widely expected that at least part of the US$80 billion Asion-dollar market based in Singapore will be repatriated, though not immediately, to Hong Kong. Singpore will still grow as a financial centre, but not at the fast rate as in the past. In any case, it will no longer be in a position to virtually monopolize the Asian-dollar market. Hong Kong in the meantime will grow both as a funding and syndication centre, a trend that will be conducive to the much needed diversification of its economy.

Hitherto there have been at least two major reasons for opposing the abolition of interest tax on foreign currency deposits. The first is the loss in revenue to the Treasury, particularly when interest rates remain at a historically high level. However, the international banking lobby has apparently succeeded in persuading the authorities that the loss in fiscal revenue will be more than offset in the long run by visible and invisible incomes resulting from Hong Kong's further development as a financial centre. The second is the fear that, if the corresponding tax on domestic currency deposits is not also abolished, a large-scale switching from domestic to foreign currency deposits may take place, which in turn will lead to an unacceptable depreciation of the Hong Kong dollar. As a precaution against this danger, it was announced in the Budget that the interest withholding tax on Hong Kong dollar deposits would be simultaneously lowered from 15% to 10%. The critics, however, maintain that this reduction does not go far enough to forestall the possibility of currency switching. Another valid point raised by the critics is that the differential treatment of foreign and domestic currency deposits violates one of the fundamental precepts of public finance, namely, horizontal equity.

(c) Personal taxation

In the previous article, the present writer described how various allowances have been increased over the years, the net effect of which has been to mitigate the tax burden of middle income groups, and to exempt lower income groups from personal tax altogether.

In the current Budget, more allowances have been granted to those liable to Salary Tax and to those who elect for Personal Assessment. First, the level of personal allowances is raised from HK$15,000 to HK$20,500 for single persons and from HK$30,000 to HK$41,000 for married couples. The present supplementary allowance of HK$7,500 each for the taxpayer and his/her spouse remains unchanged, so that the total allowances are now HK$28,000 for a single person and HK$56,000 for a married couple. The new allowances are nearly 25% higher than the existing ones, and considerably in excess of the current rate of inflation (about 15%). Second, child allowances are raised from HK$7,000 to HK$8,000 for the first child, and from HK$5,000 to HK$5,500 for the second child, but present allowances for the third to ninth child remain unchanged. Third, the dependent parent allowance is also increased from HK$7,000 to HK$8,000. All told, these increased allowances will exempt 92,000 persons from tax liability. In addition, an estimated further 55,000 persons who elect Personal Assessment will also benefit through reduced liability.[4] As an illustration, Appendix A shows Salary Tax payable by various taxpayers with the same income but in different personal circumstances. As can be seen clearly, at the same salary income of HK$108,000 (= US$18,462) per annum, which is fairly typical of middle-class income level in present-day Hong Kong, the effective tax rate under the new system of personal allowances ranges from 13.9% for a single person to only 1.7% for a married person with two children and two dependent parents. This compares favourably with those under most tax jurisdictions, with the exception of tax havens.

(d) Estate duty

The exemption limit for Estate Duty (inheritance tax) was raised last year to HK$1 million, and this is now further doubled to HK$2 million, in recognition of rising asset values in an inflationary environment. Concomitantly, the marginal rates applicable to estates over HK$2 million have also been revised, ranging from 10% to 18%. Details of the new schedule are presented in Appendix B. Finally, the principal matrimonial home of the deceased, who leaves a surviving spouse, is also exempted from Estate Duty.

CONCLUSIONS

Hong Kong's low tax policy, in so far as it minimizes disincentive effects on saving, investment and work effort, has been one of the contributing factors for the territory's remarkable economic growth – averaging some 9% per annum in real terms – in the post-World War II period. Further measures have been taken since 1976 to provide more tax relief to middle-income groups and incentives for business investment. In effect, Hong Kong has been pursuing the basic tenets of what is now fashionably called "supply-side economics", without, however,

3. For a more detailed analysis, see S.Y. Lee and Y.C. Jao, *Financial Structures and Monetary Policies in Southeast Asia* (London: Macmillan, 1982), Chapters 2, 3 and 9.

4. The Hong Kong tax system is a schedular one, i.e. taxes are levied separately on different sources of income, such as salary, interest, profits, etc. Personal Assessment is a voluntary option open to resident taxpayers who choose to aggregate their incomes from all sources for tax assessment, against which personal allowances are granted, which would otherwise be confined only to those who pay Salary Tax.

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self-consciously adopting its more extreme dogmas.

Moreover, since various tax concessions have been granted on the basis of a healthy state of fiscal surplus and reserve, Hong Kong has been able to avoid the serious complications arising from an over-hasty and doctrinaire application of "supply-side economics".[5]

5. Despite tax concessions totalling some HK$1,370 million, the Hong Kong Government is still able to budget for a surplus of some HK$2,300 million in the current 1982-83 fiscal year. The accumulated fiscal reserves as at 1 April 1982 are estimated at about HK$23,000 million (approximately US$3,930 million).

Appendix A

Tax payable by various taxpayers with same annual income

(Hong Kong dollars)

	Single $	*Single with 2 dependent parents* $	*Married with no children* $	*Married with 2 children* $	*Married with 2 children and 2 dependent parents* $
Annual salary income	108,000	108,000	108,000	108,000	108,000
Less: personal allowance	28,000	28,000	56,000	56,000	56,000
	80,000	80,000	52,000	52,000	52,000
Less: child allowance	—	—	—	13,500	13,500
Less: dependent parent allowance	—	16,000	—	—	16,000
Net chargeable income	80,000	64,000	52,000	38,500	22,500
Tax thereon	15,000	11,000	8,000	4,700	1,875
Effective tax rate	13.9%	10.2%	7.4%	4.4%	1.7%

Source: *The 1982-83 Budget Speech*,, 24 February 1982.

Appendix B

Marginal rates for estate duty

New schedule

Net estate value (HK$)	*Tax rate (%)*
2,000,001 – 2,500,000	10
2,500,001 – 3,000,000	12
3,000,001 – 3,500,000	14
3,500,001 – 4,000,000	16
4,000,001 and above	18

15 Percent Tax – and Still Taxpayers Grumble

by Mary Lai

Like all taxpayers around the world, Hong Kong people complain of the tax burden imposed on their shoulders by their government.

However, Hong Kong, the tiny British territory perched on the edge of China, enjoys one of the lowest and simplest forms of taxation in the world. The current standard rate of 15% has been in force since 1 April 1966.

"Despite the low taxation rate, Hong Kong's internal revenue yield has increased from HK$2,896.4 million (£263.31 million; US$526.62 million) in the 1975-76 fiscal year to HK$11,231.4 million (£1,021 million; US$2,042 million) in the 1980-81 fiscal year", said Mr. Anthony Au-Yeung, Deputy Commissioner of the Inland Revenue Department of the Hong Kong Government.



Mr. Anthony Au-Yeung, Deputy Commissioner of Inland Revenue of the Hong Kong Government, said the Government's policy is to keep the rate of taxation low in an attempt to provide an incentive for local investment and there is more than sufficient revenue to cover public expenditure.

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In return for his tax contribution (and a single person earning less than HK$2,333 (£212.12; US$424.24) a month pays nothing), the man-in-the-street gets a first class police force, 9 years of free and compulsory education up to the age of 15, medical services at a nominal charge of HK$3 (27p; US$0.55) per visit and a host of social security schemes.

"The government's policy of maintaining a comparatively low level of taxation plays an important role in economic stability and provides an incentive for investment. Furthermore, due to growing prosperity, Hong Kong's recurrent revenue is more than sufficient to finance its public expenditure", said Mr. Au-Yeung.

In his budget speech to the Legislative Council on 24 February 1982, Hong Kong's Financial Secretary, Mr. John Bremridge, said that he does not believe that it is generally appropriate for the Government to raise taxation when it does not need the money – either for its immediate expenditure or in order to further strengthen prudent reserves.

Hong Kong's Inland Revenue Ordinance provides for the levying of four separate direct taxes on income arising in or derived from Hong Kong for a year of assessment which ends on 31 March. Based, as it is, on a territorial source of income criterion (limiting the charge to tax on income from Hong Kong only), residence/non-residence is not a factor in the system. By the same token there are no tax incentives (other than the low tax rates charged) for overseas investors wishing to set up business or work here. The taxes levied under the Ordinance are profits tax, salaries tax, property tax and interest tax.

Profits tax is charged on profits arising in or derived from a trade or business carried on in Hong Kong. Profits of unincorporated businesses are taxed at 15% and corporations at 16.5%. Generally, all expenses incurred in the production of assessable profits are deductible, as are charitable donations to the extent of 10% of net assessable profits. There is no withholding tax on dividends paid by corporations and dividends received from corporations are exempt.

Salaries tax is calculated on a sliding scale which varies from 5 to 25% on HK$10,000 (£909.09; US$1,818.18) segments of assessable income, that is, income after the deduction of personal allowances. However, the overall effective rate is limited to a maximum of 15% of income before the deduction of personal allowances. These allowances are: for the taxpayer HK$28,000 (£2,545.45; US$5,090.91); for his wife HK$28,000; for his children a maximum of HK$25,500 (£2,318.18; US$4,636.36) ranging from HK$8,000 (£727.27; US$1,454.54) for the first child to HK$1,000 (£90.9; US$181.82) for the ninth; and HK$8,000 for each of his or his wife's dependent parents.

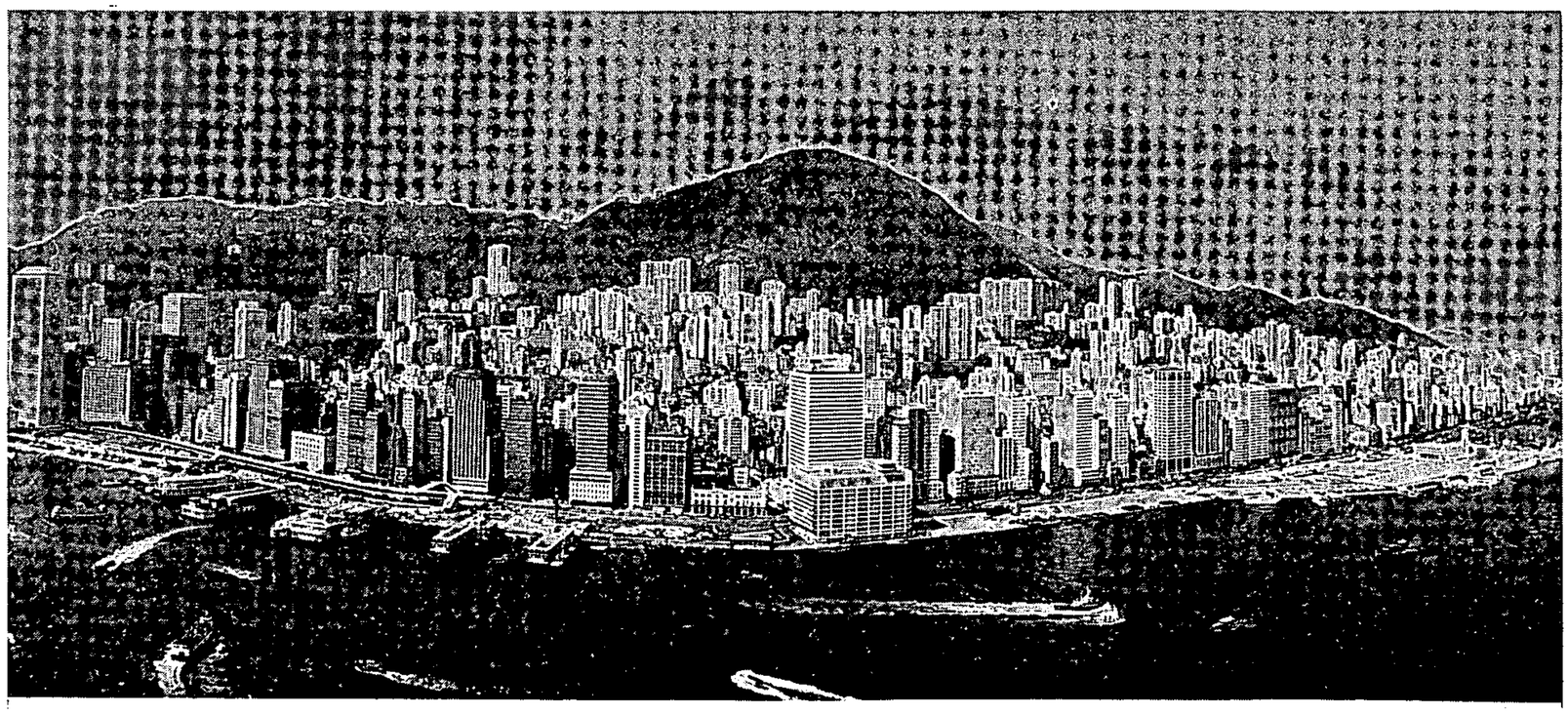
Apart from the deduction of expenses necessarily incurred in the production of income, and charitable donations up to 10% of taxable income, there are no other allowances.

With the exception of property occupied by an owner for his own residential purposes, vacant premises and property in certain undeveloped parts of the New Territories, property tax is charged at the standard rate of 15% on the net estimated rental value and is levied annually on the owner of land and/or buildings in Hong Kong.

Property owned and used for business purposes by a corporation carrying on business in Hong Kong is exempt from property tax; although if there is any profit derived from the ownership, it is chargeable to profits tax.

Interest tax is charged on Hong Kong dollar time deposits with banks and deposit-taking companies at a flat rate of 10%. Foreign currency deposits placed with licensed banks and registered and licensed deposit-taking companies are exempt from interest tax. Interest (other than interest on foreign currency deposits placed with licensed banks and deposit-taking companies) in the hands of a corporation carrying on business in Hong Kong is chargeable to profits tax because any interest so received is deemed to be part of the profits of the corporation.

"Unlike many other territories, Hong Kong's tax legislation does not charge any sources of earnings and profits



Hong Kong, the tiny British territory on the edge of China, enjoys one of the lowest and simplest forms of taxation in the world. The current standard rate of income tax of 15% has been in force since 1 April 1966.

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which fall outside these four categories", said Mr. Au-Yeung.

Other sources of internal revenue include estate duty, stamp duty, entertainments tax, betting duty, business registration fees and hotel accommodation tax.

In the current financial year, 1 April 1981 to 31 March 1982, it is estimated that internal revenue will account for HK$14,672 million (£1,333.82 million; US$2,667.64 million) or 41.7% of the Government's total revenue.

The largest contribution to the internal revenue pot comes from profits tax which accounts for HK$7,095 million (£645 million; US$1,290 million) or 48.4% of the total internal revenue.

"Our philosophy is not only to keep each and every taxation levy, be it direct or indirect, simple and easy for the taxpayers, but also productive and inexpensive for the Government to administer", said Mr. Au-Yeung.

The Inland Revenue Department is staffed by some 3,300 officers and is divided into 5 operational units, each of which is headed by an assistant commissioner.

The cost of tax collections in Hong Kong is among the lowest in developing and developed countries. It represents something on the order of 1% of total revenue collections, which is very satisfactory.

While conceding that tax evasion exists in Hong Kong, Mr. Au-Yeung said it is a problem from which no country in the world is spared.

"We have had some measure of success in the detection of evasion over the past several years. In 1981, our Investigation Unit completed investigation into 240 cases of tax evasion involving omitted income and profits amounting to HK$£380 million (£34.55 million; US$69.1 million)."

Under present legislation, the maximum penalty for tax evasion is 3 years imprisonment plus a monetary penalty (over and above the basic back tax) of 300% of the total amount of tax evaded.

Mr. Au-Yeung said a number of statutory provisions were first introduced in 1969 which provided the basic background to the expansion of investigation work. These involved the power to require a statement of assets and liabilities and of outgoings and receipts; the power to apply for a search warrant, with the consent of magistrates, to enter premises and seek books and records; the requirement for taxpayers to maintain sufficient records to enable profits to be ascertained and the requirement to retain those records for not less than 7 years.

Preventive measures include the supply of more intormative and illustrative tax returns to taxpayers and publicity on both television and in the printed media reminding taxpayers of their obligation to notify the department of their income.

There has been pressure in recent years for separate taxation for married women. At the present their income is assessed as part of their husbands' earnings. Mr. Au-Yeung reiterated what the Financial Secretary said in his budget speech – that the Government would have another look at the question of separate taxation next year.

"Separate taxation for married women will cost the Government no less than HK$200 million (£18.18 million; US$36.36 million) in lost internal revenue a year.

"Such a proposal, apart from policy considerations, will involve considerable changes in administrative procedures and computer programmes; these will take time to study and evaluate to ensure a smooth and efficient transition if the decision is taken to implement separate assessment."

Mr. Au-Yeung said given the low level of direct taxation, Hong Kong will not introduce a "pay-as-you-earn" collection system in the foreseeable future because of a variety of reasons. "Firstly, the system is rather complicated and expensive to operate. Certainly, it is not as simple as people think it is.

"Secondly, experience elsewhere has shown that there is a real cost for employers, requiring both money and time in keeping costly tax records. This in a way means that the administration of the collection system will be passed on from the Government to the employer.

"Thirdly, it requires a large policing operation to ensure that the tax is correctly deducted and promptly remitted by employers to the Inland Revenue Department. The chance of losing revenue is obviously much greater.

"Lastly, it deprives taxpayers of the opportunity of profitably utilising the money set aside for paying tax before the tax bill arrives. The Tax Reserve Certificate System is far more satisfactory than the pay-as-you-earn system."

In Hong Kong people liable for tax may purchase these certificates which they can present to the Inland Revenue Department when the bill arrives. These certificates carry interest if they are used for payment of tax.

Turning to the future, Mr. Au-Yeung said the philosophy of keeping taxation simple and inexpensive for both the Government and the taxpayer will be closely adhered to. Under the prevailing economic circumstances and conditions of Hong Kong, it is believed that a comparatively low level of taxation contributes significantly to enlarging the size of the trade sector, generally balances economic prosperity and thus increases revenue yields despite high tax thresholds.

There is no perfect world. People falling into the tax net often complain of the tax burden. Almost without exception, Hong Kong taxpayers join the chorus of complaints about heavy taxation, but perhaps they should count their blessings.

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Singapore's 1982 Budget: A Summary

by Lee Fook Hong*

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COMMENTARY ON THE 1982 BUDGET

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ANNEX

Accelerated depreciation allowance to approved energy-saving equipment in non-industrial enterprises
Summary of new tax concessions in the 1982 budget

On 5 March 1982, the Minister for Trade and Industry, Dr. Tony Tan Keng Yam, presented his 1982 Budget to the Parliament of the Republic of Singapore. This is Dr. Tony Tan's first Budget Speech since taking over in June 1981 from Mr. Goh Chock Tong as Minister for Trade and Industry.

Following established practice, Dr. Tony Tan presented his Budget Statement in three parts. In his first part, he reviewed the progress of the economy in 1981 and the economic policy of the Government. The second part dealt with Main and Development Estimates for the financial year 1982. The Revenue Estimates and tax changes were dealt with in the final part of his Budget Statement.

SECTION I

(1) Singapore's economy in 1981

In his review of the progress of Singapore's economy in 1981, the Minister briefly highlighted the performance and said: "As expected, 1981 was a very difficult year for the world economy. Very low or negative growth rates were recorded in the United States, France, West Germany and Great Britain. The number of people without work in Europe and the United States rose to post-war record levels. In the UK, 3 million people, a number greater than the population of Singapore, were without jobs. In the United States, those jobless numbered 9.5 million. Because of the grim economic conditions in these countries, world trade did not grow at all.

In comparison with the depressing economic conditions in the West, the performance of the Singapore economy in 1981 was an enviable one. Our economy grew at just under 10%, only marginally less than in 1980. We are fortunate that the Asia-Pacific region, with its abundant natural resources and political stability, is one of the growth areas in the world today. The North East Asian developing countries of Hong Kong, Taiwan and South Korea and our ASEAN neighbours, continued to register growth rates of 5-10%. Japan, Australia and New Zealand also did relatively better than other industrialised countries."

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At the end of the review, the Minister pointed out that Singapore's good economic performance had only one unsatisfactory aspect, i.e. a stubborn inflation rate. Mainly because of rising food prices, inflation in 1981 did not subside as much as Singapore would like to see. Consumer prices rose by 8.2%, marginally less than in 1980. However, inflation in Singapore was again lower than the inflation in the industrialised countries and that of her neighbouring countries.

(2) Economic policy

The Minister then proceeded to elaborate on specific areas of economic policy, namely, industrial development, research and development, trade development, financial services, computerisation, tourism, manpower development, enercy development and construction.

(a) Industrial development

On industrial development, the Minister said it was progressing well under the 3-year wage correction policy. Investment commitments (excluding petrochemicals) amounted to S$1.9 billion, a new record.

(b) Research and development (R&D)

On research and development, Dr. Tony Tan reported that considerable success had been achieved in the promotion of R&D activities and that several projects, with significant R&D content, by international firms such as Nestle, Olivetti, Varta and Sord Computer were now in the pipeline. Other firms would also bring in major R&D facilities as part of the investment projects. Further progress was expected to be seen in industrial R&D activities in electronics, computer hardware and software, pharmaceuticals, robotics and automation systems and biotechnology.

(c) Trade development

On trade development, the Minister reported that two overseas trade offices were set up in 1981 in Beijing and Rotterdam and that new offices were planned in Europe and West Asia in 1982. Apart from servicing trade enquiries and coordinating trade fairs and missions, the overseas offices were also active in encouraging multinational companies based in this region to organise missions to source manufactured parts, components and other intermediates for their parent companies at home.

(d) Financial services

Dr. Tony Tan reported that in the last decade, Singapore had laid a sound infrastructure for international financial services. In the next 10 years Singapore will have to develop even more sophisticated services for a larger international clientele. Emphasis was being given in particular to the development of the foreign exchange market, both in the depth and breadth of services provided, and to the loan syndicated market.

Dr. Tony Tan disclosed that in 1981, 11 offshore banks, 4 merchant banks and 5 insurers opened offices in Singapore. He remarked that local banks and financial institutions were becoming increasingly aware of the more computitive domestic and international environment and of the need to be more productive.

Announcing that the Automated Cheque Clearing System would start on 1 January 1982 Dr. Tan said, "This is expected to improve productivity as well as provide better services to bank customers. To increase the spectrum of services provided, new services such as a financial futures market and a US Dollar Clearing system will be investigated. At the same time, efforts will be made to upgrade the quality of services provided by the Gold Exchange of Singapore. Floating rate certificates of deposit denominated in Singapore dollars were issued for the first time last year, giving the public another avenue for investing in medium and long-term instruments."

(e) Computerisation

On computerisation, the Minister said further progress had been made in promoting the wider use of computers in Singapore. The National Computer Board officially came into being on 1 September 1981. It would promote computerisation in the civil service, establish and maintain standards of computer training and develop Singapore into a computer software centre.

(f) Tourism

On tourism, the Minister reported that in 1981, 2.83 million visitors came to Singapore, an increase of 10% despite the more difficult economic conditions in the major tourist-generating countries.

(g) Manpower development

On manpower development, the Minister announced that the Skills Development Fund had widened the scope of its financial assistance under various training schemes. He had plans to upgrade the skills of existing workers on a wider scale through the establishment of an Institute of Continuing Occupational Development.

(h) Energy development

The Minister was very pleased to report that there were indications that Singapore's economy was responding well to the call to conserve energy.

The Minister said that in spite of success, Singapore should continue to encourage energy conservation through persuasion, incentives and disincentives.

It was announced in 1981 that the provision of accelerated depreciation in the Income Tax Act would be extended to cover approved energy saving expenditure incurred by non-industrial enterprises. The guidelines for these incentives had been finalised. (See Annex I.)

(i) Construction

Emphasising the need to promote mechanisation in the construction industry, Dr. Tony Tan announced that the Ministry of National Development and the Ministry of Finance had implemented a loan scheme at concessionary rates of interest to finance the purchase of machinery as well as a scheme for according accelerated depreciation allowances for construction machinery.

To give a further push to the pace of mechanisation in the industry, an investment allowance scheme, similar to that currently applicable to certain manufacturing projects, will be made available to the construction industry.

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Approved fixed investment in machinery and equipment by construction firms from 1 April 1982 to 31 March 1987 will enjoy an investment allowance of up to 50%.

(j) Concluding remarks on economic policy

In his concluding remarks on economic policy, the Minister conveyed the following message to Singaporeans: "We must pull up our socks if we want to avoid being dragged into the quagmire of economic stagnation. The Government will govern firmly and fairly, steering our economic engine with the policies I have just presented and the Budget and tax changes that follow. Barring a major adverse turn of events, and this caveat bears repeating, because we live in a troubled world where economic disasters have become the rule rather than the exception; if we cooperate and work with the same determination as last year, we may hope to pull through 1982 with a respectable rate of economic growth yet again."

SECTION II

The financial year 1982 Budget

In the second part of the Budget Statement, the Minister elaborated on Main and Development Estimates for the financial year 1982.

The Minister outlined to the Parliament the following objectives of the Budget:

- Increase the supply of skilled technical and professional manpower needed to facilitate the restructuring and upgrading of the economy.
- Step up infrastructural, industrial and commercial development so as to sustain economic growth and economic restructuring.
- Moderate the construction programme to meet the rising demand for housing units.

SECTION III

(1) Revenue

On the revenue estimates, the Minister reported as follows:
"Income tax, as always, is the largest single source of revenue. Income tax collections in FY 1982 are expected to be high because of the economic growth in 1981. The total collection is estimated at S$2,930 million, representing an increase of S$330 million or 12.7% over the revised estimates for FY 1981. Corporate income taxes account for 72% of the total collection."

(2) Tax changes

For the financial year 1982, the Minister did not announce any new taxes or increase in the rates of existing taxes. Instead he introduced the following concessions for individuals and companies:

(i) Tax changes for individuals

(a) Tax on PUB bills

With effect from 1 April 1982, the fixed charges in the PUB bill will not be included for the purpose of computing the 10% tax. These changes are sanitary appliance fee, domestic refuse charge, rental for appliances and night soil removal fee. The tax, therefore, will be imposed on only the total of electricity, gas and water charges, and water-borne fee where these charges exceed S$80. The tax will remain at 10% of the amount in excess of S$80.

(b) Contributions to Central Provident Fund (CPF) and approved pension and provident funds

With effect from Year of Assessment 1983, all statutory CPF contributions and contributions to designated approved pension and provident funds will be fully tax deductible. Where such contributions exceed S$5,000, no deductions will be allowed for life insurance premiums and other voluntary contributions to superannuation schemes. Where the statutory contributions do not exceed S$5,000, the maximum amount deductible for all contributions to CPF and approved pension and provident funds and life insurance premiums will be S$5,000.

(c) Aged dependant relief

The Minister said he intended to make two revisions to the aged dependant relief. A taxpayer can currently claim a relief of S$750 for each aged parent or grandparent living with him, subject to a maximum of two. For the relief to be allowed, one of the conditions is that the aged dependant must not have an income of more than S$750 in the year.

With effect from Year of Assessment 1983, the relief will be raised to S$1,000 per aged dependent. As a further relaxation of the conditions for eligibility of the relief, the relief will be allowed so long as the dependant has income no greater than S$1,500 in the year.

(d) Estate duty

On estate duty the Minister said, "On 1 January 1981 the specific exemption for residential properties was raised from S$200,000 to S$600,000. The exemption limit for assets other than residential properties remained at S$100,000.

"As a further concession to promote home ownership, the exemption limit for residential properties will be extended to include the *full* value of any one residential property. In other words, the exemption limit will be S$600,000 or the full value of any one residential property, whichever is the higher.

"In line with income tax deductibility of CPF contributions, exemption will be given on *all* CPF balances of the estate with the Fund. It will not include amounts withdrawn by the deceased during his lifetime under the approved schemes and not refunded to the CPF. Where the CPF balance exceeds S$100,000 no further exemption will be given for other assets, except for those qualifying for the exemption on residential properties. Where the CPF balance does not exceed S$100,000, the exemption limit of S$100,000 for assets other than residential prop-

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erties will apply to all such assets, including the CPF balance.

"This concession will also apply to all approved provident funds which were *in lieu* of CPF.

"To encourage offshore gold transactions as well as to further develop the gold market, gold deposits with bullion companies held by foreigners, who are neither resident nor domiciled in Singapore, will not be liable to estate duty."

The above concessions will take effect from 1 April 1982.

(ii) Tax changes for companies

(a) Stamp duty

Stamp duty on ACU offshore loan agreements was abolished on 1 April 1980. However, loan agreements which were signed outside Singapore will still be subject to ad valorem stamp duty up to a maximum of S$500 when repatriated to Singapore. As a modest concession towards facilitating loan syndication activities in Singapore, the Minister had agreed to allow ACU offshore loan agreements which were signed prior to 1 April 1980 to be repatriated to Singapore without being liable to stamp duty as from *1 April 1982.*

(b) Road tax on SBS and CSS buses

Irrespective of the size or engine capacity of the bus, road tax will be rationalised with effect from 1 April 1982.

(c) Capital allowances for company registered cars

Under the current Income Tax legislation, capital allowances can be claimed on company registered cars. The ceiling of the capital allowances was last raised from S$15,000 to S$25,000 on 1 April 1979. The Minister has decided to increase this ceiling further to S$35,000 to bring it more in line with present prices of cars, with effect from 1 April 1982.

(d) Financial leasing

Various representations had been made by leasing companies and financial institutions for liberalisation of the present tax laws in order to promote financial leasing in Singapore. One of the proposals was that the residual value of the end of the lease period should be nominal or of a minimum acceptable value. The basic tax principle has always been adopted by the Tax Department that if an asset is disposed of, it must be or so deemed to be sold at the open market price.

The Minister has now agreed with the recommendation of the Tax Department to adopt the basis of open market price of determination of the residual value at the end of the lease period.

A balancing charge will be imposed if the open market price is higher than the written-down value at the time of disposal. If the open market price is lower than the written-down value, then a balancing allowance will be given.

The Minister emphasised, "It is important that a distinction should be made between a sale agreement and a lease agreement. For tax purposes, an agreement will not be considered as a genuine lease agreement if it provides for any of the following:

(i) The lessee is given an option to purchase the asset during the lease period or at its expiry;
(ii) Where there is no option to purchase, the lessee during the lease term or upon its expiry acquires the asset at below open market price;
(iii) The rental payments during the initial lease term constitute almost all or at least 90% of the acquisition cost and incidental expenses.
Additionally, either the lease term is shorter than the useful life of the leased asset, or the leased asset is not marketable and is a special purpose property, and the lessor has no intention to recover the asset;
(iv) The original lease agreement provides for extension or renewal of the agreement at less than 15% of the rental in the primary lease agreement; and
(v) The periodic lease payments are uneven and/or exceed the current fair rental value.

"Transactions involving members of a group or related persons which are primarily motivated by tax manipulations will not be treated as genuine lease agreements. However, transactions which are done at arm's length are acceptable. A transaction is not considered to be at arm's length if a member of the lessee group lends to the lessor funds for the acquisition of the asset or guarantees any debt of the lessor incurred in connection with the lease. A transaction will also be disqualified if the leasing company is specially incorporated for the purpose of leasing the assets to the related companies. It is deemed to be so incorporated if, for any of its financial years, the value of its contracts entered with independent persons constitutes less than 50% of the total value of its contracts for that year.

"Sale and lease-back transactions are generally not accepted as genuine lease agreements. They are treated as loans rather than lease agreements. However, the Tax Department will accept sale and lease-back transactions as genuine lease transactions if the equipment is sold to the lessor before it is put to use in the lessee's trade and the sale is made at not more than the acquisition price which the lessee pays to the supplier. The lessee must also not be given capital allowances for the equipment before its sale to the lessor.

"Leveraged leases will be treated on an individual basis, upon application to the Tax Department.

"The Tax Department will give accelerated depreciation to the lessor on equipment leased to a lessee who would be eligible for the accelerate depreciation allowances if the equipment is subsequently leased to another lessee who is also eligible for such allowances. Otherwise the depreciated value of the equipment will be written off on a straight line basis over the remaining statutory life of the equipment. However, the terminal payment paid by the lessee to the lessor as compensation for terminating the lease will be subject to tax."

(3) Pensions

On pensions, the Minister announced, "From 1 April 1982, the Singapore Allowance which will replace the present New Singapore Allowance will be paid to all locally domiciled Government pensioners whose gross pensions (i.e. pensions plus New Singapore allowance) are less than S$850 a month.

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"Those who are drawing pensions, excluding the current new Singapore Allowance, of S$775 per month or less will be paid a Singapore Allowance at the flat rate of S$75 per month. Those drawing pensions of more than S$775 per month but less than S$850 per month will be paid the Allowance on a reducing scale such that the pension plus the Singapore Allowance equals S$850 per month."

(4) Conclusion

In concluding his Budget Statement the Minister said, "This Budget reflects our economy which is on an even steady keel. I have deliberately not introduced any new taxes or raised the rates of existing taxes in order not to increase the tax burden. However, I hope that Singaporeans will not look on this Budget as an occasion for rejoicing but rather as a respite to enable them to consolidate and improve their position.

"To perform better we must upgrade our present skills and seek to acquire new ones. There is no other way and we must not be deflected from this task. We have to work as a team in our homes, in our work places, in our community and as a nation. Other than a favourable location, we have no natural resources. It is only by working harder than others that we can make a future for ourselves and our children.

"In the process of assimilating new technology and modern management methods, we must not forget the traditional values which have served as the bed-rock of our society. We must not abdicate our moral duty to look after those wo are weak, old and infirm. Children must not forsake their parents and grandparents. The aged and the weak need more than material care; they have emotional and spiritual needs which only their children and their family can provide. It is the responsibility of the young to look after the aged. After all, the success of children in later life is built on the sweat and toil of their parents. Children therefore owe it to their parents to enable them to live out the autumn of their lives not only with pride and dignity, but also surrounded by affection and care.

"1982 will be a grim year. The problems of unemployment and protectionism in the industrialised countries will not abate. Indeed we will be lucky if these problems do not escalate. Singapore will, before very long, be buffeted by the turbulence of the international economic storm. We can go under, or we can resolve to ride out the storm. To do this we must keep trim and be prepared to lend each other a hand when the need arises. Then, when the storm subsides we shall surge forward again."

COMMENTARY ON THE 1982 BUDGET

(1) Man in the street

Some Singaporeans feel that the 1982 Budget is reasonable as it caters for both high and low income earners. It shows trends in the right direction especially where helping the poor and the aged is concerned.

However, some feel that the pensioners should get a little more increase in the Singapore Allowance and there should be some increases in personal reliefs such as reliefs for maintaining wife and children and further increases in reliefs for dependants.

Most people welcome the Budget as it has not introduced any new taxes or increases in the rates of taxes. While rejoicing over the tax concessions, some feel that these are on the small and simple things and accordingly they have only marginally impact.

(2) Leaders in commerce and industry

While welcoming the Budget, some leaders in commerce and industry are of the view that more incentives could have been given in the industrial and commercial sectors. In view of the gloomy economic scenario in 1982, more liberal concessions should have been incorporated.

Financial leasing companies express some satisfaction over the liberalisation of tax law to help promote the financial leasing business in Singapore. They are very pleased over the accelerated depreciation concession to be granted on equipment leased to lessees.

Bankers are disappointed that the Minister did not react to Hong Kong's decision to abolish taxes on all foreign currency deposits. They think this will undermine Singapore's competitive position.

Bullion companies do not react very positively to the tax concession that a foreigner's gold deposits will not be liable to estate duty, as they feel such concessions will not have an immediate effect on the daily turnover of the Gold Exchange of Singapore.

Other leaders in commerce and industry feel that the waiver of the stamp duty on ACU offshore loan agreements is but a modest concession. It is unlikely to have any major impact on Singapore's effort to be competitive with other financial centres in the region.

While welcoming the tax changes in relation to ACUs and leasing, some businessmen are surprised that there are no new or additional measures to boost the economy in view of the difficult times ahead. They are disappointed over the following:

(a) no reduction in the 40% corporate tax; and
(b) no reduction in the 2% payroll tax.

On the whole, most people regard the Budget as an acceptable one although they expect the Minister to grant more tax incentives or concessions.

ANNEX

Accelerated depreciation allowance to approved energy-saving equipment in non-industrial enterprises

Accelerated depreciation allowance will be granted to non-industrial enterprises for capital expenditure on two categories of energy equipment:

(A) Replacements for machines and equipment which consume large amounts of energy. The objective is to encourage enterprises to undertake more frequent changes of major energy utilising machines in order that old and energy wasteful machines could be re-

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placed by new energy efficient machines. The incentive is aimed at the major and not the minor energy utilising machines.

(B) Specialised energy-saving equipment and devices which reduce the usage of energy. The objective is to induce enterprises to invest in these specialised energy-saving equipment and devices.

The non-industrial enterprises that can qualify for this accelerated depreciation allowance are as follows:

(a) Hotels
(b) Restaurants
(c) Commercial buildings
(d) Shopping complexes
(e) Hospital buildings
(f) Apartment buildings
(g) Recreation centres
(h) Theatres/cinemas

This list may be modified or updated from time to time.

Under this scheme, the accelerated depreciation allowance will be for a period of three years at an annual rate of 33⅓% in respect of the capital expenditure approved.

Category A

Criteria for Granting Accelerated Depreciation Allowance to Replacement Machines and Equipment

(1) The machine or equipment will have to be in the List of Approved Replacement Machines and Equipment.
(2) A professional engineer will have to certify that energy will be saved by installing the replacement machine or equipment.

List of Approved Replacement Machines and Equipment

(i) Central air-conditioning system excluding ducts and pipes
(ii) Boilers
(iii) Water pumping systems
(iv) Washing/dry-cleaning machine systems
(v) Refrigeration systems
(vi) Lifts and escalators

This list may be modified or updated from time to time.

Category B

Criteria for Granting Accelerated Depreciation Allowance to Energy Saving Equipment and Devices

The equipment or device must be on the List of Approved Energy Saving Equipment and Devices.

List of Approved Energy Saving Equipment and Devices

(i) Solar heating and cooling systems
(ii) Solar energy collection systems
(iii) Heat recovery system
(iv) Power factor controllers
(v) Energy saving devices of approved types

This list may be modified or updated from time to time.

Summary of new tax concessions in the 1982 Budget

For ease of reference, below is a brief summary of new tax concessions announced in the 1982 Budget:

(A) Individuals

1. Lower PUB bills

Fixed charges in PUB bills, such as sanitary appliance fee, domestic refuse charge, rental for appliances and night soil removal fee, will no longer be included in the computation of the 10% tax.

2. No ceiling on CPF exemption

The S$5,000 tax exemption ceiling on CPF contributions will be removed. With effect from the 1983 year of assessment, all statutory CPF contributions and contributions to designated approved pension and provident funds will be fully tax deductible.

3. More relief for aged

The relief in respect of aged dependants will be raised from S$750 to S$1,000, allowable as long as each dependant has an income of no more than S$1,500 in the year.

4. Estate duty

(a) *Home ownership boost*
To promote home ownership, the estate duty exemption limit for one residential property will be raised from the present S$600,000 to the full value of that property and total estate duty exemption will be given on CPF balances.

(b) *Gold deposits*
Gold deposits with bullion companies held by foreigners, who are neither resident nor domiciled in Singapore, will not be liable to estate duty.

(B) Companies

1. Stamp duty

Stamp duty on ACU offshore loan agreements will be abolished with effect from 1 April 1980.

2. Road tax on buses

Road tax on buses irrespective of the size or engine capacity will be harmonised with effect from 1 April 1982.

3. Capital allowances

The ceiling of capital allowances on company registered cars will be raised from S$25,000 to S$35,000 with effect from 1 April 1982.

4. Liberalising of tax laws for leasing industry

Accelerated depreciation will be grated to the lessor on equipment leased to a lessee.

(C) Pensioners

Allowances to government pensioners now receiving gross pensions of less than S$850 a month will be raised.

(D) Non-industrial users of energy

Non-industrial users of energy will now be given accelerated depreciation allowances over 3 years for approved energy saving equipment. Hotels, restaurants, shopping complexes are among those who will qualify.

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Tax Relief for Americans Abroad
~ An Overview ~

by Piroska E. Soos*

I. INTRODUCTION AND BACKGROUND

The general rule that United States citizens, regardless of residence, are subject to U.S. tax on their world-wide income could result in a substantial tax burden on those Americans who work abroad and are subject to foreign taxes. For many years, double taxation of such Americans has been at least partially avoided by providing tax relief in the form of exclusions, deductions or credits. Depending on the legislation in effect for a particular year, an individual could benefit simultaneously from more than one kind of relief, or he had to make an election.

The foreign earned income exclusion was first enacted in 1926 despite the objection that it was unnecessary because of the foreign tax credit available to expatriates, and after initial efforts to change or repeal it, the exclusion remained unmodified and unchallenged for several years.[1] The exclusion was designed to encourage Americans to engage in employment and other business activities abroad, and it was hoped that a greater U.S. presence abroad would increase U.S. exports.[2] As originally enacted, the exclusion was not intended to be a vehicle for reconciling the relative tax burdens of domestic and overseas taxpayers.[3]

At the time of its enactment, the exclusion was unlimited in amount and could be used by any U.S. citizen who had resided in a foreign country for six months or more.[4] The exclusion (based on residence) remained unlimited until 1962, and the changes made between 1926 and 1962 related to the eligibility requirements. In 1942, the six-month requirement was replaced by a bona fide residence test (see Section II), and in 1951, the exclusion was extended to U.S. citizens who did not satisfy the bona fide residence test but who were physically present in the foreign country for 17 out of 18 consecutive months. The reason for this change was to place U.S. citizens working abroad in an equal position with citizens of other countries going abroad who were not taxed by their own countries.[5] However, in 1953, because of abuses, a $20,000 per year limitation was placed on the exclusion for those who claimed it on the basis of the physical presence test.[6]

In 1962, the exclusion for bona fide residents was limited to $20,000 per year and to $35,000 per year for those who had been bona fide residents of a foreign country for at least three uninterrupted years. In 1964, the $35,000 exclusion was reduced to $25,000 per year.[7] At the time that these limits were set, they were high enough so that, for most individuals, all of their income (including allowances) fell within the exclusion.[8]

In addition to the exclusion, Americans abroad benefitted from two other rules. First, they could take the exclusion "from the top" of their gross income (not "exclusion with progression")[9] so that lower marginal rates applied to the income not exempt from U.S. tax. Secondly, foreign taxes paid on the excluded income were creditable against U.S. tax on any foreign income in excess of the exclusion.[10] Both of these rules have undergone changes since the Tax Reform Act of 1976.

Sweeping changes in the rules for the taxation of expatriates were made in 1976 and 1978, and the issue of an exclusion for expatriates was very controversial. The debates were intense, and the arguments for or against the exclusion, or tax relief in gerneral, were not always enlightening. For example, one U.S. Senator characterized U.S. citizens abroad as "mink-swathed Americans" who "spend their waking hours in gambling casinos in Monte Carlo" and as "high-living jetsetters living at the taxpayers' expense".[11]

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1. Slowinski, Walter A. and Williams, John B., "The Formative Years of the Foreign Source Earned Income Exclusion: Section 911", 51 *Taxes* 355, 357 (June 1973). This article is hereinafter cited as *Slowinski*.
2. Maiers, John D., "The Foreign Earned Income Exclusion: Reinventing The Wheel", *The Tax Lawyer*, Vol. 34, No. 3 (Spring 1981) at 692. This article is hereinafter cited as *Maiers*.
3. Bruce, Charles M., "New Rules Taxing Americans Working Abroad", 57 *Taxes* 79 (1979) (hereinafter *Bruce*).
4. *Slowinski*, at 356.
5. Id. at 358-359.
6. Id., at 359. the U.S. House Ways and Means Committee thought that some U.S. citizens were not paying any tax because they were not in any one country long enough to be classified as a resident for tax purposes. The Committee also thought that individuals with large earnings were going abroad to perform services, which they usually performed in the U.S., only to avoid U.S. income tax.
7. Id., at 360-362.
8. *Maiers* at 695.
9. Id., at 696.
10. Joint Committee on Taxation, *General Explanation of the Economic Recovery Tax Act of 1981* (hereinafter *General Explanation*), as reported in 1982 Prentice-Hall Federal Taxes, Report Bulletin 5, Vol. LXIII (Section 2), 14 January 1982, at 41.
11. Comments of Senator William Proxmire (Democrat from Wisconsin), *International Herald Tribune* of 12 December 1977, as reported in *U.S. Expatriate Taxation*, Vol. 2, No. 3 (September 1979) at 26.

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Another opponent of tax relief for expatriates wrote that the "fact that expatriates who lobby for reduced taxation are always the best-dressed and only tanned people in the room may prejudice me".[12] It was also suggested that Americans abroad be required to pay the cost of maintaining consulates abroad; one response to this questioned the fairness of expatriates paying for consular officials whose preferred role is that of oppressors of overseas Americans.[13]

The Tax Reform Act of 1976[14] made substantial changes in the foreign earned income exclusion and in other aspects of expatriate taxation. The exclusion was reduced to $15,000 per year, although a $20,000 per year exclusion was permitted for employees of certain qualifying U.S. charitable organizations. In addition, foreign income taxes attributable to the excluded income were no longer eligible as a credit against U.S. tax. Finally, the 1976 Act introduced a rule that required that the exclusion come "off the bottom" ("exclusion with progression") of the taxpayer's gross income so that the top part was taxed at the marginal rate that would apply had there been no exclusion.[15]

As a result of angry protests by U.S. citizens working abroad, the effective date of the 1976 amendments was postponed until 1 January 1977, and later, it was postponed again until 1978 because of the inability of Members of Congress to reach agreement on the changes regarding the exclusion.[16] As a result of these postponements, the amendments made by the 1976 Act never went into general effect, although taxpayers could, for 1978, elect to be taxed under the provisions of either the 1976 Act or the Foreign Earned Income Act of 1978.[17]

This article will discuss the provisions of the Foreign Earned Income Act of 1978 and other provisions applicable to expatriates[18] just before the 1981 changes, which are effective for taxable years beginning after 31 December 1981. This article will also discuss the reasons for the 1981 changes and consider the revenue and other effects anticipated as a result of the new rules.

It should be noted that this discussion is limited to the provisions unilaterally provided by the U.S. and does not consider the numerous double taxation treaties, to which the U.S. is a party, that could affect a taxpayer's liability for either U.S. tax or foreign tax. It should further be noted, however, that U.S. citizens often do not benefit from treaties signed by the U.S. since many treaties contain a "savings clause" in which the U.S. reserves the right to tax its citizens and residents on the basis of all items of income taxable under its own revenue laws as though the treaty did not exist.[19]

II. THE FOREIGN EARNED INCOME EXCLUSION

A. Before the Economic Recovery Tax Act of 1981

The Foreign Earned Income Act of 1978 ("1978 Act")[20] virtually abolished the exclusion for most Americans working abroad and replaced it with a deduction for excess foreign living costs (see Section III). The 1978 Act did, however, retain a $20,000 annual exclusion for a small group of individuals, namely, those who resided in a camp located in a hardship area or who performed qualified charitable services in a lesser developed country.[21] Such individuals could elect the exclusion if they satisfied either the bona fide residence or physical presence test. If they satisfied either test for only part of the tax year, the $20,000 limit had to be prorated based on the number of days that the person satisfied the test relied upon. Individuals who elected the exclusion were not allowed the deduction for excess foreign living costs or the foreign tax credit (or deduction) for the taxes paid or accrued with regard to the excluded amount.[22]

For purposes of the exclusion, "camp" meant substandard housing which was (a) provided by or on behalf of the employer for the convenience of the employer because the place at which the individual rendered services was in a remote area where satisfactory housing was not available on the open market, (b) located, as near as practicable, in the vicinity of the place at which such an individual rendered services, and (c) furnished in a common area, or enclave, which was not available to the public and which normally accommodated 10 or more employees.[23] A hardship area meant any foreign place designated by the U.S. Secretary of State as a hardship post where extraordinarily difficult living conditions, notably unhealthful conditions, or excessive physical hardships existed, and for which a post differential of 15% or more would be provided to U.S. government employees.[24] The 1978 Act also defined "lesser developed countries" and "qualified charitable services".[25]

The hardship area camp exclusion was designed to alleviate some of the problems of American construction companies operating overseas. However, because of the restrictive definition of "camp", the exclusion had a very narrow application.[26] Independent contractors or self-employed persons could not qualify for the exclusion since the "camp" had to be provided by the employer.

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12. Kingston, Charles I., "A Somewhat Different View", *The Tax Lawyer*, Vol. 34, No. 3 (Spring 1981) at 739.
13. Kaplan, Philip T., "U.S.: Taxation of Americans Working Abroad", *Intertax* (September 1981/9) at 338, 339, n. 4.
14. Public Law No. 94-455.
15. Tax Reform Act of 1976, Section 1011(b)(3), adding I.R.C. Section 911(d).
16. *Maiers*, at 700-701.
17. *General Explanation*, at 41.
18. This article does not consider the rules applicable to resident aliens in the U.S. or the taxation of foreign-source income derived by legal entities, such as corporations, partnerships, etc.
19. For example, see Article XIX of the Netherlands-U.S. Income Tax Treaty of 29 April 1948, as amended by Supplementary Convention of 30 December 1965; Article 22 of the France-U.S. Income Tax Treaty of 28 July 1967, as amended by the Protocols of 12 October 1970 and 24 November 1978; Article XV of the Income Tax Treaty between the Federal Republic of Germany of 22 July 1954, as amended by the Protocol of 17 September 1965.
20. Public Law No. 95--615.
21. U.S. Internal Revenue Code (hereinafter I.R.C.), Section 911(a), (c). Unless otherwise indicated, references to I.R.C., Sections 911 or 913 are references to those sections just prior to the amendments made by the Economic Tax Recovery Act of 1981.
22. I.R.C., Section 911(a).
23. I.R.C., Section 911(c)(1)(B).
24. I.R.C., Section 913(h).
25. I.R.C., Section 911(c)(1)(E) (lesser developed country); I.R.C., Section 911(c)(1)(D) (qualified charitable services).
26. *Maiers*, at 711.

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An individual satisfied the bona fide residence test if he established to the satisfaction of the tax authorities that he had been a bona fide resident of a foreign country (or countries) for an uninterrupted period which included an entire taxable year.[27] Only a U.S. citizen could claim the exclusion on the basis of the bona fide residence test. Determination of bona fide residence was to be made by applying the principles of I.R.C., Section 871 (tax on non-resident alien individuals) and the regulations thereunder.[28] I.R.C., Regulation 1.871-2(b) defines "residence" as

> An alien actually present in the United States who is not a mere transient or sojourner is a resident of the United States for purposes of the income tax. Whether he is a transient is determined by his intentions with regard to the length and nature of his stay. A mere floating intention, indefinite as to time, to return to another country is not sufficient to constitute him a transient. If he lives in the United States and has no definite intention as to his stay, he is a resident. One who comes to the United States for a definite purpose which in its nature may be promptly accomplished is a transient; but, if his purpose is of such a nature that an extended stay may be necessary for its accomplishment, and to that end the alien makes his home temporarily in the United States, he becomes a resident, though it may be his intention at all times to return to his domicile abroad when the purpose for which he came has been consummated or abandoned. An alien whose stay in the United States is limited to a definite period by the immigration laws is not a resident of the United States within the meaning of this section, in the absence of exceptional circumstances.

The bona fide residence test was not satisfied if the individual gave a statement to the foreign authorities that he was not a resident of that country for purposes of the income tax of that country and he was held not subject, as a resident of that foreign country, to the income tax imposed by that country.[29] In Revenue Ruling 78-254,[30] the U.S. Internal Revenue Service ("I.R.S.") considered whether the taxpayers had made a "disqualifying" statement by filing non-resident tax returns in Belgium. The I.R.S. concluded that they had not, since the taxpayers had not made statements to the Belgian authorities that they were not "residents" of Belgium, as that term is defined for U.S. tax purposes.

The physical presence test could be used by both U.S. citizens and non-U.S. citizens to qualify for the exclusion, and the test required an individual to be present in a foreign country (or countries) for 510 days (approximately 17 months) out of a period of 18 consecutive months.[31] This test was objective and did not consider factors such as the kind of residence established, the nature and purpose of the individual's stay, or his intentions about returning to the foreign country. The test was concerned only with how long an individual was in one or more foreign countries. However, the requirement of 510 days within an 18 month period was unconditional (except as indicated below). An individual fell short of the requirement even if he was forced to leave the foreign country before satisfying the text because of illness or because he was ordered to leave.

As an exception, the 1978 Act permitted waiver of the bona fide residence test or physical presence test if three conditions were satisfied: (1) the individual was actually present in, or a bona fide resident of, a foreign country, (2) he left the country after 31 August 1978 during a period with respect to which the Treasury Department determined that individuals were required to leave the foreign country because of war, civil unrest, or similar adverse conditions in the foreign country which precluded the normal conduct of business by those individuals, and (3) the individual established to the satisfaction of the tax authorities that he reasonably could have expected to meet the time limitation requirements, but for the war, civil unrest, or similar adverse conditions.[32] If these criteria were met, the taxpayer was considered as having satisfied the bona fide residence test or physical presence test for the time that he was resident or present in the foreign country, and the exclusion was computed accordingly.

The exclusion was limited to the individual's "foreign earned income" derived during the time that satisfied either the bona fide residence test or the physical presence test.[33] For purposes of both the exclusion and the deduction for excess foreign living costs (see Section III), "earned income" meant wages, salaries, professional fees and other amounts received for personal services rendered,[34] and was considered received in the year in which the services were rendered.[35]

"Earned income" did not include amounts received as a pension or annuity[36] or that part of an individual's compensation for personal services rendered to a corporation which represented a distribution of profits rather than a reasonable allowance for compensation for the personal services actually rendered.[37] If an individual was engaged in a business (other than in corporate form) in which both personal services and capital were income-producing factors, "earned income" meant a reasonable allowance (not in excess of 30% of the individual's share of net profits) as compensation for the personal services rendered by the individual.[38]

For individuals who elected the exclusion, the hardship area camp was considered to be part of employer's business premises.[39] This meant that the individual could also exclude from gross income the value of employer provided meals and lodging under I.R.C., Section 119 (meals or lodging furnished for the convenience of the

27. I.R.C., Sections 911(a) and 913(a)(1).
28. I.R.C., Regulation 1.913-2(b).
29. I.R.C., Section 911(c)(6).
30. 1978-1 Cumulative Bulletin 243.
31. I.R.C., Section 913(a)(2).
32. I.R.C., Section 913(j)(4).
33. I.R.C., Section 911(a).
34. I.R.C., Section 911(b).
35. I.R.C., Section 911(c)(2). However, if the amount was received after the close of the taxable year following the taxable year in which the services (to which the amounts were attributable) were performed, the amount could not be excluded from gross income. I.R.C., Section 911(c)(4). This rule also applies to taxable years beginning after 31 December 1981. See New I.R.C., Section 911(b)(1)(B)(iv). "New I.R.C." refers to the provisions of the 1981 Act.
36. I.R.C., Section 911(c)(5).
37. I.R.C., Section 911(b).
38. Id.; I.R.C., Regulation 1.911-2(b).
39. I.R.C., Section 911(c)(7).

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employer) if the other requirements of Section 119 were satisfied.[40]

B. Exclusions under the Economic Recovery Tax Act of 1981

The Economic Recovery Tax Act of 1981 ("1981 Act")[41] dramatically changed the exclusions available to Americans working abroad. The 1981 Act abolished the exclusions under the 1978 Act and established a new exclusion for foreign earned income. The 1981 Act also provided, on top of the foreign earned income exclusion, an exclusion for the "housing cost amount". For 1982, the maximum annual foreign earned income exclusion is $75,000 and this amount is increased by $5,000 per year until 1986, when the maximum annual exclusion will be $95,000.[42] The dollar limit was placed on the exclusion in order to prevent abuse by highly paid entertainers or athletes who might otherwise move abroad to avoid U.S. tax on their income.[43] The earned income exclusion is computed on a daily basis for each day within the period of bona fide residence or physical presence in the foreign country and in case of a married couple, the exclusion is computed separately for each qualifying individual.[44] Significantly, the 1981 Act does not contain an "exclusion with progression" rule, so that the U.S. tax on non-excluded income is computed from the bottom of the U.S. rate scale.[45]

The exclusions are available on an optional basis, and an individual may elect either or both of them. The election may be made by individuals whose "tax home" is in a foreign country and who satisfy either the bona fide residence test or physical presence test.[46] "Tax home" is the individual's regular or principal place of business, employment, or post of duty regardless of where he has his residence; if the individual does not have a regular or principal place of business, his tax home is the place in which he regularly lives.[47] An individual is not considered to have a tax home in a foreign country for any period for which his abode is in the U.S.[48] Thus, an individual who lives in the U.S. but commutes daily to work in Canada has his tax home in the U.S.

The bona fide residence test is the same as it was under prior law and may be used only by U.S. citizens. The requirements for the physical presence test have been relaxed: an individual satisfies the test if he is physically present in one or more foreign countries for at least 330 days in a period of 12 consecutive months.[49] These tests may be waived, and the conditions for waiver are the same as under the 1978 Act.[50]

Other features of the prior law remained unchanged. The definition of "earned income" is the same as before,[51] and the income is taken into account in the taxable year in which the services to which the amounts are attributable are performed.[52] As under prior legislation, "double benefits" are denied: no deduction, exclusion from gross income or credit against tax (including the credit for foreign taxes) is allowed to the extent that the deduction, exclusion or credit is properly allocable to or chargeable against amounts excluded pursuant to the foreign earned income or housing exclusions.[53]

The housing exclusion permits an individual to exclude from gross income his "housing cost amount" which is equal to the excess of his "housing expenses" over the "base housing amount,"[54] and a qualifying individual may elect the housing exclusion whether or not he elects the foreign earned income exclusion. The housing exclusion applies to amounts "paid or incurred on behalf of the individual by the individual's employer which is foreign earned income included in the individual's gross income for the taxable year".[55] Individuals whose housing expenses are not "employer provided amounts" may take a deduction for their "housing cost amount". See Section III.B.

"Housing expenses" have the same definition as under the 1978 Act and include reasonable expenses (not lavish or extravagant under the circumstances) attributable to housing, such as rent, utilities, real and personal property insurance, local telephone charges, furniture rental, and parking fees.[56] "Housing expenses" do not include amounts deductible as interest or taxes, the cost of a home purchase, improvements or furniture purchases, domestic labor, principal mortgage payments or depreciation.[57] The "base housing amount" is 16% of the salary of a U.S. employee whose salary grade is step 1 of GS-14. Since that salary is currently $39,689 per year, the "base housing" amount is $6,350 per year.[58]

If an expatriate maintains more than one foreign household, only the one closest to his tax home is eligible for the housing exclusion. As an exception, the housing expenses of a second foreign household are also excludable if the individual's spouse and dependents live at the second household because of dangerous, unhealthful or otherwise adverse living conditions at the individual's residence.[59]

If an individual elects both the foreign earned income exclusion and the housing exclusion, the total amount of the two exclusions may not exceed the individual's

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40. The other requirements for exclusion under Section 119 are that (1) the meals and lodging be provided for the employer's convenience, and (2) lodging be accepted by the taxpayer as a condition of his employment.
41. Public Law No. 97-34.
42. New I.R.C., Section 911(b).
43. *General Explanation*, at 43.
44. Id., at 44.
45. *Intertax*, at 341.
46. New I.R.C., Section 911(a), (d).
47. New I.R.C., Section 911(d); *Commissioner* v. *Flowers*, 326 U.S. 265 (1946).
48. I.R.C., Regulation 1.913-3(a). Although this regulation was promulgated under prior law, it is currently relevant because the definition of "tax home" is the same for purposes of the 1978 Act and the 1981 Act.
49. New I.R.C., Section 911(d).
50. New I.R.C., Section 911(d)(4).
51. *General Explanation*, at 44.
52. New I.R.C., Section 911(b)(2)(B).
53. New I.R.C., Section 911(d)(6).
54. New I.R.C., Section 911(c).
55. New I.R.C., Section 911(c)(3)(D).
56. See I.R.C Regulations 1.913-6(a) and (b) which provide more details as to what constitute "housing expenses".
57. Id.
58. *General Explanation*, at 45.
59. New I.R.C., Section 911(c). I.R.C., Regulation 1.913-3(b)(2) provides that adverse living conditions include a state of warfare or civil insurrection in the general area of the individual's tax home.

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foreign earned income for the year.[60] For example, if an individual has, for 1982, a salary of $68,000 and the value of the employer provided housing is $10,000 for the year, his total earned income is $78,000 and his housing exclusion is $3,650 ($10,000 less $6,350). The first $75,000 of earned income may be excluded under the earned income exclusion, but only $3,000 of the housing exclusion may be used since the maximum exclusion is $78,000. If the individual's salary in this example were $70,000 per year, his total earned income would be $80,000. He would exclude $78,650 ($75,000 earned income exclusion plus $3,650 housing exclusion).

Once an individual elects the earned income exclusion or the housing exclusion, the election remains in effect for that year and all future years. Either election may be revoked with or without the consent of the I.R.S. However, if the election is revoked without such consent, the individual may not make another election until the sixth taxable year following the taxable year for which the revocation was made.[61]

The 1981 Act retained the rule that, for an individual who is furnished lodging in a camp located in a foreign country by his employer, the camp is considered to be part of the employer's business premises. The definition of "qualifying" camp was relaxed: it is no longer required that the camp be in a hardship area or that it constitute substandard lodging. Although the 1981 Act abolished the hardship area camp exclusion, this provision is important because it may enable individuals to exclude from gross income the value of employer provided meals and lodging under I.R.C., Section 119.

III. DEDUCTIONS FOR FOREIGN EXPENSES

A. Deductions under the 1978 Act

The 1978 Act replaced the exclusion available under prior legislation with a deduction from gross income for excess foreign living costs. The deduction was available to individuals who satisfied either the bona fide residence test or the physical presence test. The tests could be waived under certain circumstances (see Section II).

The maximum allowable deduction was the individual's "net foreign-source earned income", which was defined as the individual's earned income from sources outside the U.S. for that part of the taxable year in which his tax home was in a foreign country, reduced by (1) any foreign-source earned income which was excluded from gross income under I.R.C., Section 119 and (2) deductions (except for the deduction for excess foreign living costs) properly allocable to or chargeable against the foreign-source earned income for the part of the year during which the individual's tax home was in a foreign country.[62] This limitation precluded an individual from using his excess foreign living expenses to reduce taxable income from domestic sources or passive income from foreign sources. For purposes of the excess foreign living cost deduction, "tax home" had the same definition as it has for purposes of the exclusion under the 1981 Act.

For qualifying individuals, the deduction consisted of five separate items: (1) cost of living differential, (2) housing expenses, (3) schooling expenses, (4) home leave travel and (5) hardship area amount.[63] The cost of living differential was generally the amount by which the cost of living in the individual's foreign tax home exceeded the cost of living in the highest cost metropolitan area in the continental U.S., other than Alaska. The I.R.S. prepared tables for individuals to use to compute their cost of living differential, which was to be determined on a daily basis for the period during which the individual's tax home was in a foreign country. If an individual had more than one foreign tax home during the taxable year, he had to compute a separate cost of living differential for each foreign country.[64] An individual could not claim a cost of living differential for any day that the value of his meals and lodging were excluded from gross income under I.R.C., Section 119.[65]

Housing expenses were the excess of the individual's reasonable housing costs (see Section II.B.) over the "base housing amount" which was generally one-sixth of his net earned income.[66] The expenses to be taken into account were only those attributable to housing during periods for which the individual's tax home was in a foreign country and the value of his housing was not excluded under I.R.C., Section 119. Housing expenses also included the expenses for a qualified second household (for an individual's spouse or dependents) if the individual's tax home was in a hardship area camp or if the living conditions at his tax home were adverse. However, special rules applied for the computation of the deduction for excess living costs, including housing expenses, if the individual had a qualified second household.[67]

Schooling expenses consisted of the expenses incurred for the education of the taxpayer's dependents at elementary and secondary levels (equivalent to education from kindergarten through the 12th grade in a U.S.-type school). Expenses included the cost of tuition, books and local transportation; expenses also included the cost of room, board and travel if an adequate U.S.-type school[68] was not available within a reasonable commuting distance of the individual's tax home. Schooling expenses were deductible only if they were attributable to education for a period during which the individual's tax home was in a foreign country.[69]

The home leave travel expense included the cost of one round trip for the individual, his spouse, and dependents from his tax home outside the U.S. to his principal domestic residence. Only one round trip per person for each continuous period of 12 months for which the indi-

60. *General Explanation*, at 45-46.
61. New I.R.C., Section 911(e).
62. I.R.C., Section 913(c).
63. See I.R.C., Section 913(d), (e), (f), (g) and (h).
64. I.R.C., Regulation 1.913-5(c).
65. I.R.C., Section 913(d)(1)(E).
66. *General Explanation*, at 43. The method for calculating the "base housing amount" is set forth in I.R.C., Section 913(d).
67. See I.R.C., Section 913(i) and I.R.C., Regulations 1.913-5(e), 1.913-6(d), 1.913-7(f).
68. I.R.C., Regulation 1.913-7(e) provides that a U.S.-type is a school which offers a curriculum which is taught in English, is comparable to that offered by accredited schools in the U.S., and would qualify the student for graduation if he were to transfer to a U.S. school.
69. I.R.C., Section 913(f).

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vidual's tax home was in a foreign country could be deducted.[70]

The hardship area deduction was $5,000 per year and available to those who lived in a hardship area (see Section II.A.). The amount available as a deduction was to be computed on a daily basis for each day that the individual's tax home was in a hardship area.[71]

An individual who claimed the deduction for excess foreign living costs could also claim the foreign tax credit (see Section IV). However, an individual could not claim the deduction if he elected the exclusion for income earned in a hardship area camp or from qualified charitable services or if his spouse claimed the exclusion, unless the spouse maintained a separate abode which was not within a reasonable commuting distance from the taxpayer's abode.[72]

B. Deductions under the 1981 Act

The 1981 Act repealed the excess foreign living cost deduction, and as a result, there are only two deductions specifically for Americans working abroad. However, Americans abroad may claim any deduction that is generally allowed to resident taxpayers, such as deductions for medical expenses, charitable contributions, and personal exemptions.

An expatriate may elect the housing deduction, introduced by the 1981 Act, which may be used for housing costs which are not attributable to employer provided amounts. The deduction is limited to the excess of the individual's foreign earned income for the taxable year over the amount excluded under the foreign earned income exclusion. There is a one year carryover (to the succeeding tax year) of housing costs not allowed as a deduction because of this limitation.[73]

The second deduction for Americans working abroad is the deduction for foreign taxes paid or accrued. With regard to some kinds of taxes, an individual may elect between a credit or deduction (see Section IV). However, some foreign taxes, such as foreign real property taxes,[74] do not qualify for the credit and may be taken only as a deduction.

IV. CREDIT FOR FOREIGN TAXES

The 1981 Act did not make any changes in the rules applicable to the credit for foreign taxes available to Americans working abroad. Nonetheless, the primary features of the credit will be briefly discussed because the credit is an important tool for reducing the tax burden of expatriates. The credit, which was first enacted in 1918,[75] is available whether or not the individual satisfies the bona fide residence test or physical presence test. In addition, the credit may be used in conjunction with the exclusions or deductions to the extent that the rule against "double benefits" is not violated.

The individual may choose between a credit or deduction for "income, war profits and excess profits" taxes[76] paid or accrued to a foreign country, or taxes paid or accrued in lieu thereof.[77] If the individual elects the credit, he must do so with all "qualifying" taxes; he may not use part of them as a credit and the balance as a deduction.[78] Taxes that do not qualify for the credit may be taken as a deduction. Some taxes, such as the value added tax, qualify for neither the credit nor the deduction.[79]

There is a limit to the amount of the foreign tax credit. It may not exceed the same proportion of the U.S. tax (against which the credit is taken) that the individual's taxable income from foreign sources (but not in excess of the individual's total taxable income) bears to his entire taxable income for the same year. In other words, the credit may not exceed the following fraction:

$$\text{Maximum credit} = \frac{\text{foreign taxable income}}{\text{total taxable income}} \times \text{U.S. tax liability.}$$

For purposes of this computation, "foreign taxable income" means the total foreign-source income reduced by deductions directly attributable to such income, as employee business expenses or (under the 1978 Act) the excess foreign living costs deduction.[80] This amount is further reduced by a portion of other deductions that are not directly attributable to foreign-source income, such as medical expenses and the standard deductrion (now called "zero bracket amount"). The total amount of these "indirect" deductions is multiplied by a fraction, the numerator of which is the total foreign-source income and the denominator of which is gross income from all sources. This amount is subtracted from foreign-source income, and the result is "foreign taxable income".

"Total taxable income" means "taxable income" as determined under U.S. tax laws, with certain adjustments. For U.S. tax purposes, "taxable income" is the individual's "adjusted gross income" less (1) the itemized deductions in excess of the standard deduction ("zero bracket amount") and (2) the amount deductible as personal exemptions.[81] For purposes of the foreign tax credit, "total taxable income" means "taxable income" reduced by the "zero bracket amount" but not by the personal exemptions.[82] Special rules apply for the treatment of capital gains[83] and for recapture of foreign losses.[84]

These rules ensure that U.S. citizens will always be liable for U.S. tax on their U.S. source income, regardless of the amount of foreign taxes paid. If the foreign taxes exceed the maximum allowable, the taxpayer may carry back the excess to the two prior taxable years and then carry forward the unused credit to the following five tax-

70. I.R.C., Section 913(g).
71. I.R.C., Section 913(h).
72. I.R.C., Regulation 1.913-2(a).
73. New I.R.C., Section 911(c)(3).
74. I.R.C., Section 164.
75. Williams, Thomas J., "The Creditability of Foreign Income Taxes: An Overview", 58 *Taxes* 699 (October 1980) at 700.
76. I.R.C., Section 901(b).
77. I.R.C., Section 903.
78. I.R.C., Regulation 1.901-1(c).
79. See I.R.C., Section 164(a)(4) and *Intertax*, at 341, n. 11.
80. I.R.C., Regulation 1.913-1(b).
81. I.R.C., Section 63.
82. I.R.C., Section 904.
83. I.R.C., Section 904(b).
84. I.R.C., Section 904(f).

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able years. However, the excess foreign taxes may be used in other years only to the extent that, in that other year, the taxpayer had an unused foreign tax credit allowance, i.e. the "qualifying" taxes for that year were less than the maximum allowable as a credit. An unused credit may not be taken as a deduction in other years.[85]

A major problem with the foreign tax credit has been the confusion regarding the meaning of "income tax". Although the I.R.S. has issued regulations defining the term,[86] the matter is not resolved, and the complexity and difficulty of this area is indicated, among other things, by the fact that the regulations contain over seventy examples illustrating the various standards for creditability. The U.S. Government's awareness of this problem is indicated by a recent letter to Senator Charles H. Percy, Chairman of the U.S. Foreign Relations Committee, in which Senate Finance Committee Chairman Robert Dole wrote that:

> *The question of what foreign taxes are creditable against U.S. tax has, for several years now, been the subject of substantial controversy. Several versions of the section 901 regulations that have been proposed have been subjected to substantial criticism by affected taxpayers.*
>
> *Some taxpayers maintain that the regulations adopt an overly restrictive interpretation of the statute so that the credit issue may be preserved for treaty negotiations. Taxpayers also complain that requests for IRS rulings receive no action and suspect similar motives to explain the IRS inaction.*
>
> *I am sympathetic with the plight of taxpayers who do not know whether the foreign tax they pay is creditable . . . .*[87]

The foreign tax credit may not be used to offset certain U.S. taxes,[88] and the amount of foreign taxes that qualify for the credit may be decreased if the taxpayer participates in or cooperates with an international boycott.[89]

V. REASONS FOR CHANGE AND ANTICIPATED EFFECTS

The primary reason for the 1981 changes had to do with U.S. economic and trade policy and the concern over continuing deficits by the U.S.[90] Generally, it is more expensive for U.S. companies to utilize Americans rather than nationals in their foreign operations, since the companies commonly have "tax equalization" plans and provide special allowances to their overseas employees. A tax executive of a N.Y. corporation said that the current cost of supporting an American with an annual salary of $30,000 in a foreign country was about $120,000, including salary, housing, education, home leave and taxes.[91]

The extra cost of employing Americans overseas resulted in either (1) higher prices to the customer or (2) replacement of Americans by foreign nationals, or both. To the extent that U.S. businesses charged higher prices, they became less competitive, and this led to non-competitive bids in intensely competitive industries such as construction.[92] One survey indicated that the cost of maintaining American workers overseas added 2 to 10%, depending on the industry, to the cost of U.S. goods and services, and construction firms included in the survey reported that they lost at least 1.2 billion in sales in 1979 because of the increased tax burden on overseas employment.[93]

As to the replacement of Americans by foreign nationals, an executive of a U.S. company estimated that the number of Americans working overseas in such highly skilled professions as construction, architecture, and design declined by about 50% in 1979.[94] The replacement of Americans by foreign nationals was considered to have an adverse effect on U.S. exports. Foreign nationals often ordered parts and equipment from their own countries[95] because they were more familiar with the products and standards of their own country and because they considered the maintenance of business contacts with their home countries as being in their individual interests. It was estimated that U.S. exports in 1980 were 5% below what they could have been because of the decrease in the number of Americans working abroad.[96] A U.S. government study indicated that a 1% decrease in the number of Americans abroad results in a 0.5% decline in the value of U.S. exports.[97]

The 1981 changes are designed to reverse this situation by making it less expensive to employ Americans abroad. U.S. companies generally agree that the lower cost will increase U.S. competitiveness for foreign contracts and indirectly increase U.S. exports.[98]

However, there is disagreement as to the effect of the 1981 Act on the employment of Americans abroad. Some indications are that the lower cost of supporting Americans abroad will be translated into more overseas jobs being filled by Americans.[99] Others disagree. U.S. companies started substituting foreign nationals because of the burdensome tax law changes in 1976 and 1978. But the shift to foreign nationals made sense for other reasons – they know the language, market conditions, and economy better than someone brought in from the outside.[100]

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85. I.R.C., Regulation 1.904-2(a).
86. I.R.C., Regulation 4.901-2).
87. The text of the letter was reproduced in *Tax Notes*, Vol. XIII, No. 17, 26 October 1981, at 1005-1007.
88. The foreign tax credit may not be used against the tax imposed by Section 56 (minimum tax for tax preferences), by Section 72(m)(5)(B) (10% tax on premature distributions to owner-employees), by Section 402(e) (tax on lump sum distributions), by Section 408(f) (additional tax on income from certain retirement accounts), by Section 531 (tax on accumulated earnings), by Section 1351 (recoveries of foreign expropriation losses) or by Section 541 (personal holding company tax). See I.R.C., Section 901.
89. I.R.C., Section 908.
90. *General Explanation*, at 43.
91. "Gains for Americans Who Work Abroad", *New York Times*, 28 August 1981 (hereinafter *New York Times*).
92. *General Explanation*, at 43.
93. *Maiers*, at 720.
94. "Tax Break Not Seen Causing Rush of Americans Overseas", *Asian Wall Street Journal*, 27 August 1981 (hereinafter *Asian Wall Street Journal*).
95. *General Explanation*, at 43.
96. *Asian Wall Street Journal*.
97. *Bruce*, at 80.
98. *Asian Wall Street Journal*.
99. *New York Times*.
100. *Asian Wall Street Journal*.

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As to the other effects of the 1981 changes, it is expected that the new provisions will eliminate the U.S. tax liability for about 90% of U.S. citizens working abroad.[101] However, since most major U.S. companies pay for the extra tax burden, they will benefit from the new provisions. A Citibank executive noted that the bank had picked up the tax burden and will also pick up the benefit.[102] A U.S. expatriate working for Arabian American Oil Company made the same observation: because of the company's policies, the 1981 Act would have no effect on his net income.[103]

As a result of the 1981 Act, the U.S. Government expects the fiscal year tax receipts to decrease by $299 million in 1982, by $544 million in 1983, by $563 million in 1984, by $618 million in 1985, and by $696 million in 1986.[104]

101. "Reagan Signs Bill on Taxes Abroad", *International Herald Tribune,* 14 August 1981.
102. *New York Times.*
103. *Tax Notes,* Vol. XIV, No. 3, 18 January 1982.
104. *General Explanation,* at 48.

Conference Diary

JUNE 1982

Shang York SA: Doing business with the People's Republic of China (including: past experience; present industrial policy; recent tax laws and regulations concerning foreign investment). Geneva (Switzerland), June 14 (English).

Oyez International Business Communications Limited: International Tax (including: U.K. law and double taxation; elements of international tax planning; common provisions in U.K. treaties; the practical use of tax conventions) followed by a choice of specialised half day programmes on U.S.A., France, Germany, Italy, Switzerland, the Netherlands and Norway. London (United Kingdom), June 14-16 (English).

European Study Conferences Group and Convention Services: International Tax Planning: Maximising Protection of Investments and Assets (including: tax pitfalls and opportunities of emergency measures). Miami (U.S.A.), June 15 and 16 (English).

European Study Conferences Group and Convention Services: International Oil and Gas Taxation Conference (including: Oil and gas taxation in China, Denmark, U.K. Norway, Canada and the U.S.A. Houston (U.S.A.), June 17 and 18 (English).

Practising Law Institute: Real estate syndications (including: Special problems of foreign investors; The non-resident alien individual partner). New York City (U.S.A.), June 17-18 (English).

Georgetown University Law Center: The Fourth Annual Institute on Multinational Taxation (including: Current developments in international tax rules outside the U.S.; Tax treaties – the changing landscape). Washington, D.C., (U.S.A.), June 24-25 (English).

JULY 1982

Practising Law Institue: International estate planning (including: Taxation of non-resident alien in the U.S.; The use of foreign situs trusts). New York City (U.S.A.), July 22-23 (English).

SEPTEMBER 1982

36th Annual Congress of I.F.A.: I. The tax treatment of interest in international economic transactions. II. Taxation of payments to non-residents for independent personal services. Montreal (Canada), September 12-16 (English, French, German, Spanish).

Confédération Fiscale Européenne (C.F.E.): Third European Congress of Tax Consultants (including: State of tax harmonisation in Europe; The application of wealth taxes and taxes arising on death to foreign assets and liabilities; The practical application of international tax provisions (working groups)). Aachen (Germany), September 30 to October 2 (English, French, German).

OCTOBER 1983

37th Annual Congress of I.F.A.: I. Tax avoidance/tax evasion. II. International problems in the field of turnover taxation. Venice (Italy), October 10-15 (English, French, German, Spanish).

FOR FURTHER INFORMATION PLEASE WRITE TO:

Confédération Fiscale Européenne (C.F.E.): Secrétariat Général, Postfach 1340, Dechenstrasse 14, D-5300 Bonn 1 (Federal Republic of Germany).

European Study Conferences Group and Convention Services: 2616 South Loop West, Suite 330, Houston, Texas 77054 (U.S.A.).

Georgetown University Law Center: 600 New Jersey Avenue, N.W. Washington, D.C. 20001 (U.S.A.).

International Fiscal Association (I.F.A.): General Secretariat, Woudenstein, Burgemeester Oudlaan 50, P.O. Box 1738, 3000 DR Rotterdam (the Netherlands).

Oyez International Business Communications Limited: Norwich House, Norwich Street, London EC4A IAB (United Kingdom).

Practising Law Institute: 810 Seventh Avenue, New York, N.Y. 10019. (U.S.A.).

Shang York S.A.: 56 rue du Stand, CH-1204 Geneva (Switzerland).

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UNITED STATES:

EXCHANGE OF INFORMATION*

Disclosure to Foreign Countries Pursuant to Tax Treaties

(25)10 (2-12-82)

GENERAL

(1) The United States has entered into tax treaties with foreign countries primarily to alleviate double taxation and to help identify fraud and tax evasion through exchange of information. Although the majority of treaties cover exchange of information concerning income taxes, there are also treaties covering the exchange of information concerning estate and gift taxes.

(2) IRC 6103(k)(4) of the Internal Revenue Code provides for disclosure of information with foreign countries. This subsection provides that: "A return or return information may be disclosed to a competent authority of a foreign government which has an income tax or gift and estate tax convention or other convention relating to the exchange of tax information, with the United States but only to the extent provided in, and subject to the terms and conditions of, such convention."

(3) Tax treaties generally provide for exchange of information between the IRS and foreign tax authorities. Individuals referred to as "Competent Authorities" are designated by each country to make written requests for information and to receive information.

(4) The U.S. "Competent Authority" is the Assistant Commissioner (Compliance). However, under Compliance Order 14, the authority to act as U.S. Competent Authority was redelegated to the:

(a) Director, Examination Division, for administering the Simultaneous Examination Program, Spontaneous Exchanges of Information, and Industrywide Exchanges of Information, under the exchange of information provisions of the Income Tax Treaties to which the United States is a partner; and
(b) Director of International Operations, for administering the Programs for Routine and Specific Exchanges of Information and the Program for Mutual Assistance in Collection, under the Income Tax Treaties and Estate/Gift Tax Treaties to which the United States is a partner.

(5) Although the purpose of the redelegation is to allow routine competent authority correspondence to be signed at the Division level, the Assistance Commissioner (Compliance) will sign all correspondence involving sensitive or substantive policy matters.

(6) Copies of competent authority correspondence generated by the Examination function with respect to programs it is responsible for will be furnished to the Director of International Operations.

(25)20 (2-12-82)

INFORMATION RECEIVED FROM FOREIGN TAX AUTHORITIES

(1) If the IRS[1] needs information from a country with which the United States has a tax treaty, a request is submitted through channels for necessary action. Generally, OIO[2] reviews the request and, as appropriate, prepares a letter of request for the signature of the Director, OIO to be sent to the foreign tax authority.

(2) For U.S. requests pertaining to the Simultaneous Examination Program or an Industrywide Exchange of Information, the Director, Examination Division, will forward the request to the treaty partner competent authority upon receipt from the field.

(3) For Spontaneous Exchanges of Information, the Director, Examination Division, will forward foreign-initiated exchanges to the Assistant Regional Commissioner (Examination) for transmittal to the applicable District Director.

(4) Information which is received by the IRS from a foreign tax authority is subject to secrecy clauses contained in the specific tax treaty. In general, these secrecy clauses provide that information received by the IRS cannot be disclosed to any persons other than those (including courts and administrative bodies) concerned with the assessment, collection, enforcement or prosecution with respect to the taxes, which are the subject of the respective tax treaties. Additionally, to the extent the information relates to the liability or possible liability for tax of a United States taxpayer or otherwise falls within the definition of return information in IRC 6103(b)(2), it is return information subject to the restrictions on disclosure imposed by IRC 6103 as well as the restrictions contained in the treaty clauses.

(5) Because of the secrecy clauses, tax treaty information may not be disclosed to State tax agencies under IRC 6103(d), the Department of Justice or other Federal agencies under IRC 6103(i), or under any other provision of IRC 6103 permitting disclosure for non-Federal tax administration purposes.

(6) Disclosure Officers should ensure that information disclosed for non-Federal tax administration purposes is reviewed and tax treaty information is removed prior to

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* Chapter (25)00: "Disclosure to Foreign Countries pursuant to tax treaties" from the *Disclosure of Information Handbook*.

1. Internal Revenue Service.
2. Office of International Operations.

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disclosure. Information obtained under a tax treaty is often stamped to indicate that it is tax treaty information.

(7) Generally, tax treaty information obtained from a foreign tax authority may be disclosed to the United States taxpayer to whom it relates in accordance with IRC 6103(e). In this situation, the taxpayer is considered to be concerned with assessment, collection, enforcement or prosecution with respect to the taxes which are the subject of the tax treaty. However, disclosure will not be made to the taxpayer if the IRS or the foreign tax authority providing the information objects to disclosure or if disclosure would seriously impair Federal tax administration. (See IRC 6103(e)(7).)

(8) If a Freedom of Information Act request for tax treaty information is received, the procedure in text (13)46 of this Handbook should be followed.

(25)30 (2-12-82)

DISCLOSURE OF INFORMATION TO FOREIGN TAX AUTHORITIES

(1) If information is needed by a foreign country with which the United States has a tax treaty, a request is submitted by the Competent Authority to the U.S. Competent Authority. Exchanges of information by the IRS with foreign tax authorities are authorized in the National Office by the Director, OIO or Director, Examination Division, or the Assistant Commissioner (Compliance) for sensitive cases. Certain automatic or "routine" exchanges (such as transmission of reports of taxes withheld from income paid to non-resident aliens) are accomplished at the Philadelphia Service Center.

(2) The Director, OIO generally forwards requests for information to the appropriate IRS offices. When the requested information is received from the IRS offices, OIO prepares a response for the signature of the Director, OIO transmitting the information to the foreign Competent Authority.

(3) For treaty partner requests pertaining to the Simultaneous Examination Program or Industrywide Exchange of Information, the Director, Examination Division, or the Assistant Commissioner (Compliance) in sensitive cases, will:

(a) forward the request to the District Director for action; and
(b) when the information is received, transmit it to the treaty partner competent authority.

(4) For Spontaneous Exchanges of Information, the Director, Examination Division, or the Assistant Commissioner (Compliance) in sensitive cases, will forward a U.S.-initiated exchange to the treaty partner competent authority.

(5) Generally, returns are not furnished to foreign tax authorities pursuant to tax treaties.

(6) If it should become necessary to issue a summons to obtain the requested information, the summons should be prepared and forwarded to District Counsel, OIO for review prior to issuance.

(7) Return information which could identify or tend to identify a confidential informant, or seriously impair an IRS tax investigation is generally not disclosed to foreign tax authorities.

(8) Information which would reveal business or trade secrets is excepted from the exchange of information provisions of the treaties.

(9) Disclosures to foreign tax authorities made pursuant to tax treaties must be accounted for in accordance with IRC 6103(p)(3) and the Privacy Act of 1974. See Chapter (38)00 of this Handbook for further information.

(25)40 (2-12-82)

NONTREATY DISCLOSURES TO FOREIGN COUNTRIES

(1) Although IRC 6103(k)(4) is generally the authority for disclosure of return information to foreign tax authorities, other provisions of IRC 6103 permit limited disclosures to foreign countries or individuals of foreign countries in certain situations. These disclosures can be made regardless of whether the United States has a tax treaty with the country. However, when a tax treaty is in effect, we exchange information under the treaty to the extent possible.

(2) Return information may be disclosed by IRS employees to individuals of foreign countries in accordance with IRC 6103(k)(6). See chapter (21)00 of this Handbook.

(3) Returns and return information may also be disclosed to individuals of foreign countries designated in writing by a United States taxpayer to receive such information in accordance with IRC 6103(c) and (e). For example, pursuant to a written taxpayer request and consent for disclosure, IRS may certify to a tax treaty country that taxes were paid in the United States to enable the taxpayer to receive credit for the taxes on a foreign return.

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TAXATION OF FOREIGN BUSINESS ACTIVITIES IN AUSTRIA

by Prof. Dr. Wolfgang Gassner*
and Geoffrey C. Pink**

INTRODUCTION

Geographical convenience has resulted in Austria's importance as one of the foremost financial centres for East-West trade, and commercial transactions with Eastern bloc countries frequently begin and end in Austria. Accordingly, many firms have established branches or subsidiary companies there in order to do business with the Comecon, Yugoslavia and Albania; the activities would typically include marketing and maintenance of products sold in those countries, or perhaps a simple representative office. In either case the implications of Austrian tax are important when contemplating commercial contracts, and the following brief survey discusses aspects of the Austrian tax system which are relevant for foreign companies embarking on business relations with Austria.

I. THE AUSTRIAN TAXATION SYSTEM

1. Corporation tax on income of foreign companies from permanent establishments

Although the corporation tax is chargeable on income of all companies, those which are incorporated abroad and have their effective management outside Austria are only subject to limited taxation on certain income derived from Austrian sources. This limited tax liability applies above all to income from business for which a "permanent establishment" exists in Austria; this concept is defined in the Federal Tax Code (Bundesabgabenordnung) and resembles the OECD model treaty definition. A permanent establishment is any fixed place of business, and in particular a branch or a factory. The extent of liability may be reduced if the foreign company is resident in a country which has concluded a double taxation convention with Austria.

Corporation tax is charged on the income attributed to a permanent establishment for each calendar year. In arriving at this income, normal overheads are deductible, together with a number of investment incentives; for example, the accelerated depreciation can be made use of at annually varying rates from the costs of depreciable fixed assets. An accelerated depreciation is possible in the year of purchase in addition to the normal depreciation. Alternatively, an investment allowance of 10 to 20% of the cost of depreciable assets may be given in which case the total allowances are increased to 110 - 120% of the cost. A reasonable proportion of head office expenses may be charged to the permanent establishment and transactions between head office and the Austrian branch are generally to be treated on an arm's length basis.

Income from the permanent establishment is subject to corporation tax at the following tax rates:

Income (AS)	*Rate*
to 200,000	30%
200,100 - 250,000	30% + 50% on excess over 200,100
250,100 - 400,000	40%
400,100 - 500,000	40% + 50% on excess over 400,000
500,100 - 1,000,000	50%
1,000,100 - 1,142,800	50% + 40% on excess over 1,000,000
over 1,142,800	55%

Note: These rates are applied not to individual income brackets, but to total income.

2. Corporation tax of foreign companies on other source income

Apart from the income derived from an Austrian permanent establishment, other Austrian source income of foreign companies is subject to limited corporation tax. This tax as a rule is levied in the form of a 20% withholding tax, which may be reduced or omitted under the respective tax treaty. The following source income has to fall within this category:

(a) dividends of Austrian companies;
(b) compensation received by the company for the services of writers, speakers, artists, architects, athletes or entertainers of all kinds becoming active in Austria;
(c) royalty payments;
(d) compensation for consulting activities performed in Austria in the field of business administration or technology and for the supply of gangs for work in Austria.

3. Corporation tax of Austrian companies

If, however, a foreign company is doing business in Austria through a company incorporated in Austria, or having its management there, the latter is subject to unlimited corporation tax liability on its world-wide income. Business transactions with the parent company should be carried out on an arm's length basis in order to avoid hidden distributions of profit, which may entail considerable tax burdens. The taxable income of Austrian subsidiaries is assessed according to the same principles as that of permanent establishments set out above. However, the rates of tax on distributed profits are reduced by half by virtue of the "split corporation tax rate" that is in force in Austria. A 20% withholding tax is levied on dividends and royalty payments to the non-resident parent company, although this may be reduced under the respective tax treaty.

* Binder Dijker Otto & Co., BDO, Vienna.
** Binder Dijker Otto & Co., BDO, London.

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4. Net wealth taxes, business taxes

Both Austrian branches and subsidiaries of non-resident companies are furthermore subject to net wealth tax. The tax of 1% is levied on the value of the Austrian assets of a branch or on the world-wide assets of an Austrian subsidiary, although the relevant tax treaty may mitigate this. In addition, there is a surtax of 0.5% (inheritance tax equivalent). If and insofar as individuals participate in the company this surtax may be eliminated under double tax treaties.

A business tax is also payable by Austrian permanent establishments of domestic or foreign companies. This is a three-part tax based on business profits, business capital and payroll. The business profit tax is levied together with the business capital tax, and amounts to approximately 14.5% of the business profit prior to deduction of the business profit tax as a business expense. The computation of the business profit is based on the profit determined for corporation tax purposes subject to certain additions and deductions. The most important addition is interest on long-term loans, while the most important deductions include 3% of the value of real estate, and profits from participations. The business capital tax amounts to approximately 0.35% of the business capital value adjusted by additions and deductions. The business tax on the payroll amounts to approximately 2% of the salaries and wages.

5. VAT

VAT is levied on goods and other services, as well as the self-consumption by companies, and the import of goods. The tax rates are 18% (standard rate), 8% (reduced rate), 13% (rate for energy) and 30% (rate for luxuries). The reduced rate of 8% is in particular applied to turnovers of basic foodstuffs, to the leasing of real estate, and to services from certain professional activities (medical doctors, lawyers, accountants, architects, etc.). The 13% tax rate relates to coal, fuel oil, gas, electricity and heat. A 30% VAT is, above all, levied on motor vehicles and on other luxury articles. In a series of businesses the turnover tax is of a purely transitory nature since input VAT can be claimed as a credit. Such a deduction of previously paid VAT is, however, not permissible in the case of private motor vehicles.

Foreign enterprises with neither their domicile or usual place of abode, nor seat or a permanent establishment in Austria, may claim tax exemption for their turnover and not apply VAT as long as they do not make use of the tax credit. In the case of delivery and installation of goods by a foreign enterprise, the material components may be accounted for separately. With regard to the VAT on imports, the credit for VAT may be claimed by the recipient of goods or services, but in all other cases of sales by foreign companies the VAT is withheld by the recipient of goods or services and paid to the tax office, where refunds of VAT may also be claimed by foreign enterprises under certain conditions.

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6. Fees

A special peculiarity of the Austrian tax legislation are the fees according to the Fees Law (Gebührengesetz). Under the Fees Law certain documents and legal transactions and, in particular, requests to authorities are subject to fees payable in the form of inland tax stamps. Furthermore, a tax is payable on various legal transactions, such as lease or loan contracts, mortgage or credit contracts and cessions, if they are attested by a written document. As a rule the fee ranges between 0.8% and 2% of the value. The fee on legal transactions is usually exempted whenever a foreign company with no permanent establishment in Austria takes part in the transaction and, moreover, the contract is drawn up abroad and also remains there. The Fees Law is quite formalistic in nature and particularly complicated if foreigners are involved.

II. MAJOR CONTRACTS

Following this brief survey of the Austrian tax system, let us discuss the tax aspects of certain contracts that are important for foreign companies.

1. Supplier contracts

With respect to supplier contracts of foreign companies questions of taxation rarely arise. The foreign supplier is not liable to taxation in Austria as long as he does not maintain a permanent establishment there.

If he delivers the goods from local warehouses, these are not considered as permanent establishments according to the tax treaties. Under such circumstances, however, the foreign supplier becomes liable to pay VAT. VAT must be charged on sales and paid to the tax office and offset by previously paid VAT, in particular, for imports. In the sales contract it should be laid down that the VAT, which is to be shown separately in the invoices, increases the price. Without such specific mention any price agreed upon is understood as the gross price including VAT according to court rulings, so that the supplier receives an amount less VAT.

If an agent is used, care has to be taken that he does not constitute a permanent establishment of the foreign company in Austria. According to the tax treaties a dependent agent generally gives rise to a permanent establishment only if he is given power to conclude contracts. An independent agent may also bring into existence a permanent establishment of the foreign company, if his activities exceed the usual scope. The avoidance of a permanent establishment is important since it entails tax liabilities of the foreign company for the activities of the agent in Austria. The remuneration of an agent for the foreign company is not subject to the Austrian VAT.

2. Supplier, production and service contracts of branches

Supplier contracts carried out via an Austrian branch of the foreign company will normally give rise to a perma-

nent establishment. The same applies to production and services undertaken by Austrian branches. As mentioned earlier, the creation of a permanent establishment entails limited tax liability for taxes on income and net wealth, as well as business tax liability. The profits of the permanent establishment from its business activities in Austria are therefore subject to corporation tax at the full rate and to business tax on the business profit. Where profits exceed 1,142,800 AS the tax burden amounts to approximately 62%. In addition, the assets of the branch are subjected to net wealth tax, the inheritance tax equivalent and the business capital tax amounting to a total of approximately up to 1.9%, and the salaries and wages are subjected to the payroll tax of 2%.

Contracts between the branch and third parties are under the unlimited jurisdiction of the Fees Law. Thus, in particular, loan contracts with banks or lease contracts for buildings or equipment and machinery are subject to fees. However, contracts between the branch and parent company are not liable to fees, since the branch is not itself a legal entity.

3. Formation of subsidiaries, partnerships and acquisition of participations

The formation of subsidiaries attracts a 2% company tax on the paid-in capital. In addition, court and notarial fees become payable. The company is subject to unlimited corporation and property taxes as well as to inheritance tax equivalent and business tax liability. For distributed profits the corporation tax is reduced by one half as already mentioned. The 20% withholding tax on the dividends is, as a rule, considerably reduced under the tax treaties and is credited against the foreign taxes of the parent company. For this reason, a tax advantage may sometimes be achieved by the organisation of subsidiaries instead of branches. The conversion of branches into subsidiaries is tax exempt by virtue of the Business Structure Improvement Law. With respect to fees, however, it should be noted that contracts between the parent company and the subsidiary (in contrast to those between headquarters and branch) may result in fees for legal transactions. This holds true, in particular, for loans by the parent company.

The formation of partnerships, with an Austrian partner, leads to a 2% legal transaction fee on the capital. A foreign company with a share in the partnership is subject to limited taxation like a permanent establishment according to the Corporation Tax Law, the Net Wealth Law and the Inheritance Tax Equivalent Law, and the profit shares are subject to business tax as in the case of a permanent establishment. As regards fees, the same regulations as for a subsidiary apply.

The acquisition of participations in limited liability companies attracts a 2% legal transaction fee and 0.5% stock exchange tax which may, however, be avoided or considerably reduced by a complicated make-up of the contracts.

For participations in stock companies, opnly a negligible stock exchange tax is payable. Participations in partnerships give rise to a 2% legal transaction fee. A revaluation of the tax depreciation basis in Austria is only undertaken in the event of acquisition of a participation in a partnership or the acquisition of a business, but not on the acquisition of participations in a company.

4. Building and construction contracts

Building and construction activities carried out in Austria by a foreign company lead to a permanent establishment only after a certain period of time; as a rule this period amounts to 12 months according to the tax treaties. In the case of shorter periods, generally only VAT becomes payable for which, however, exemption may be claimed, unless considerable VAT has accumulated, making the payment of the VAT and claim of the credit advisable. If the 12-month period is exceeded and a permanent establishment is brought into being, liability for corporation tax, net wealth tax, inheritance tax equivalent and business tax results, as in the case of a branch.

These principles also apply to the employment of subcontractors on the construction site. If the time limit is exceeded, each foreign sub-contractor separately gives rise to a permanent establishment and is individually liable to taxation. The general contractor employing subcontractors becomes liable to taxation as a permanent establishment only if his personal engagement on the construction site goes beyond mere supervisory functions of the sub-contractors. Where the building and construction activities are carried out by a consortium, the latter is treated as a partnership, if the consortium as such enters into contracts. The foreign partner of this consortium is subject to limited taxation in Austria on his share in the profit and the assets. If, however, the consortium only applies to the internal relationship of the partners and the commission is proportionally distributed among the partners, the foreign partner is only liable to limited taxation in respect of the profit and assets of his own permanent establishment.

5. Transfer prices, royalties, cost allocation

In all contracts with Austrian subsidiaries and permanent establishments the principles of dealing at arm's length have to be observed. For this reason the transfer prices for goods and services between the Austrian company or permanent establishment and the parent company or headquarters respectively have to be fixed at an adequate level, as between unrelated parties. This applies, in particular, to goods and services of the Austrian company or permanent establishment, since a hidden distribution of profits may be assumed otherwise.

Royalties are permitted for patents, trade marks and know-how. The amount accepted for tax purposes depends on their value to the Austrian enterprise. In various industries certain rates have in practice evolved from experience; in important cases it is advisable to seek agreement with the tax authorities. From the royalty payments of an Austrian subsidiary or partnership a 20% tax is withheld at source which may, however, be considerably reduced under the tax treaties and for which a foreign tax credit is granted in most cases. In concluding

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a contract it should be recognised that a 1% legal transaction fee may become payable, if the contract is concluded in Austria.

Cost allocations are permissible, if certain prerequisites are met: the costs have to be correctly ascertained at the parent company or the head office; the respective flow of products or services to the Austrian subsidiary or permanent establishment has to be proven; an adequate allocation basis has to be chosen, and an accounting control has to be installed. The opinion of a foreign accountant is accepted as a rule and the cost allocation itself may be negotiated with the tax authority.

6. Cost-plus contracts with East-West trading companies

As mentioned earlier, many foreign-owned subsidiaries have been set up in Austria for the purpose of doing business with East European countries and for serving the maintenance or marketing of products in those countries. Frequently representative offices in the Eastern countries are also maintained by these companies in order to benefit from the treaties of Austria with these countries and at the same time avoid their tax burdens.

Cost-plus contracts, which are basically accepted by the fiscal authorities, have become popular for such companies for reasons of simplification of the tax computation and for eliminating taxation of the full profit margins of the foreign companies in Austria. The Austrian subsidiary performs the representation, maintenance or marketing activities for the foreign parent company in return for remuneration in the amount of its expenses plus a small mark-up. These cost-plus contracts represent a major financial impetus for foreign companies to set up subsidiaries in Austria for doing business with the Eastern European countries.

REPUBLIC OF IRELAND:

Budget 1982

Extracts from the Budget Speech pronounced on 26 March 1982 by the Tanaiste and Minister for Finance Mr. MacSharry

It is unusual, to say the least, for two Budgets to be introduced in Dail Eireann within two months of each other. This fact alone makes it inescapable that this Budget will, in many respects, be similar to that which was presented on January 27th last. In the fortnight available to me, however, I have tried to ensure that while the principal objectives of that Budget – to reduce the current Budget deficit and the overall Exchequer borrowing requirement – will be met, my budget will help those least able to bear hardship and will achieve its aims in a far less disruptive way. Some of my excise taxation proposals have already been implemented and I shall be asking the Dail to confirm these today.

. . .

Tax proposals

I now turn to the question of taxation. I propose to implement the tax proposals put forward in January, subject to certain changes which I will shortly outline. It would not be practicable at this late stage to prepare an alternative tax package for 1982. Before indicating the details of the tax measures, however, I think it necessary to emphasise that our present taxation structure places severe constraints on the freedom of manoeuvre of any Minister for Finance.

Our heavy reliance on indirect taxation for revenue purposes, for example, can cause problems for the industries affected because of its impact on the volume of sales. From the Exchequer's viewpoint, if higher taxes lead to diminishing returns, then they simply defeat the purpose for which they are introduced.

Heavier direct taxes in the future

This reliance on indirect taxation is, however, the result of past policies which have deliberately exempted or relieved whole sectors of the economy – and many individuals – from the rates of taxation normal in other countries, in the interests of economic development. The limits of this policy are now being approached and it must be accepted that in future the tax net will have to be widened significantly and a higher proportion of tax revenue will have to come from direct taxation. It follows that we must also reassess critically the generous reliefs and allowances which are available at present.

The Government are looking forward to the views of the Commission on Taxation on these matters; I understand that a report will be available shortly.

The corollary of widening the tax base is the obligation to develop a more equitable tax system. There is considerable public dissatisfaction with present arrangement and there is general agreement that we need to achieve a fairer distribution of the burden of taxation. A commitment to equity also demands further progress in combating tax avoidance and tax evasion. There is still a considerable loss of revenue because of these practices and the result is that the honest taxpayer has to contribute substantially more than his fair share.

No switch to tax credits

The Government have decided against changing the present structure of income tax in order to apply tax credits. A switch to tax credits for the next income year at this stage would merely give rise to enormous administrative confusion, with little result to show for it.

It is intended, therefore, to continue with the present structure of tax bands and allowances, but changes are being made in order to achieve broadly the same effect for individual taxpayers as under the earlier proposals. As the House is aware the Social Welfare Bill provides for the implementation in full of the improved social welfare children's allowances. The £9.60 weekly payment for spouses who work in the home will not, however, be implemented. The response to this scheme has illustrated clearly that the general public saw no merit in cumbersome and complex scheme which merely transferred money from one spouse, via the Revenue Commissioners, to the other.

That scheme included a family income supplement estimated to cost £4 million this year. This supplement cannot be operated outside a tax credit system and, as I have already mentioned, I am allocating the money instead to social welfare. This, the whole amount set aside in January for income tax improvements is being provided again in this Budget and is being applied to achieve substantially the same re-distributive effects for lower and middle income groups.

While continuing the present income tax structure, I propose to increase the personal allowance from £1,115 to £1,450 for single persons and from £2,230 to £2,900 in the case of married couples. This represents an in-

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crease of 30%. The bands of income taxable at 35% will be reduced to £3,000 in the case of single and widowed persons and to £6,000 in the case of married couples.

With these changes, it is possible to achieve substantially the same effect as the tax credit proposals of January 27th, but without any of the complexity which they would have entailed.

The allowance for widowed persons will be increased to £1,950. An additional allowance for one-parent families was introduced in 1979 and now stands at £650. While this allowance has provided valuable relief to these families, I believe that further assistance is necessary. I am, therefore, providing an increase of £300 in the case of a widowed person and an increase of £800 for other single parents. As a result of these changes, widowed parents and single parents will now be in receipt of allowances equivalent to the married allowance. Widows will continue to qualify for the married allowance in the year of bereavement.

I am also improving the exemption limits for those on low incomes. The limit for single and widowed persons will be increased from £2,000 to £2,200 and from [£4,000 to] £4,400 for married couples. Marginal relief will continue for those whose income does not greatly exceed these amounts. These changes will remove about 24,000 low-income taxpayers from liability.

The elderly are a specially-deserving section of the community and I propose to provide income tax relief for them in several ways. In addition to the increase in the age allowance and the tax allowance for rent on private tenancies proposed on January 27th, I am also improving the age exemption limits by £200 for single and widowed persons and by £400 for married couples.

The changes in allowances, exemption limits and rate bands will cost £39 million in 1982 and £61 million in a full year.

As a consequence of the change in the income tax reliefs for personal loan interest announced on January 27th, some amendments may also be necessary in the provisions relating to tax relief for preferential loan interest. I am looking at this matter in the context of the Finance Bill.

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Social welfare not subject to tax

The Government will not go ahead with the earlier proposal to tax short-term social welfare benefits. Such a tax would impose an unfair burden on many who are unfortunate enough to fall ill [and] are to be made redundant and in any event it would be extremely difficult to administer the tax properly. I have no doubt that there are many cases where the existing provisions encourage absenteeism and reduce the incentive to work, but this does not warrant the general imposition of a tax on those who are in reduced circumstances and have no choice in the matter. The question of reforming the current arrangements will, however, be pursued in other ways.

Blow to private car usage

A number of changes were proposed on January 27th designed to bring about a more rational approach to the taxation and use of motor-cars. One of these concerned the arrangement under which a director or employee has the private use of a company car. At present, this benefit is completely undervalued for income tax so that what is, in effect, substantial additional remuneration escapes taxation.

The exploitation of this tax advantage has become widespread among employees who have little, if any, business travel to do and it is an observable fact that the cars so supplied are bigger and more expensive than the average. Every car, every spare part and every drop of fuel has to be imported and I see no justification for providing unnecessary encouragement to this form of motoring at a time when our balance of payments deficit is giving much cause for concern.

It was proposed in the January Budget, as an interim measure, to increase the annual valuation of the use of a motor-car from 12.5% to 20% of the cost of the car to the employer. I have taken a fresh look at the problem and I am satisfied that a new approach, based on the value of the benefit of the car to the employee, should be taken. In future, the taxable benefit will be based on a sliding scale related directly to the original market value of the car and varying according to whether the costs involved are borne partially or totally by the employer.

I appreciate that it might be unduly disruptive to make this change in a single step. I propose, therefore, to move in two stages to this new basis. For 1982-83, the taxable benefit will be calculated at half the full rates proposed, while the full rates will come into operation in 1983-84. Since most of these cars are replaced at two or three-year intervals this gives ample time to those concerned to decide their own priorities in the matter.

The details of the scales of charge are set out in the "Principal Features". These are designed to ensure that those with a substantial business mileage will be fairly treated. In particular, those with a very high business mileage, such as commercial travellers, will be given further relief, which will in effect exempt them from this charge. The yield from this change is expected to be about £2 million in 1982.

Road tax

I am proposing that the changes in road tax announced in the January Budget will be implemented with effect from May 1st, 1982. The details are set out in the "Principal Fea-

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tures". The extra yield is estimated at £10.5 millions in 1982 and £15.9 millions in a full year.

Insurance levy

It is proposed also to impose a levy on certain insurance transactions with effect from August 1st. The levy will be at a rate equivalent to 1% and will be imposed on premium income from domestic business excluding medical insurance. It is intended that the levy will be collected as a stamp duty on the basis of quarterly returns from the insurance companies. The yield in 1982 will be £2.25 million and the full year yield will be about £9 million.

Bank levy

The levy on the banking sector for 1982 will be £20 million. The details will be published later.

I see these levies as a temporary arrangement and I will be considering in due course proposals for the introduction of a new permanent system of taxation of financial institutions when the recommendations of the Commission on Taxation become available.

Corporation tax: payment dates

The due dates for payment of both first and second instalments of corporation tax will be brought forward by three months. In addition, the grace period before interest is charged on tax overdue will be reduced from two months to one. The combined effect will be that the first instalment will be payable not later than seven months after the end of the accounting period and the second instalment 7 to 16, rather than the present 11 to 20 months after the end of the accounting period.

These changes will bring an additional revenue of £36 million into 1982.

Capital taxes

I have looked at the proposals for capital taxation made on January 27th and I have decided to make some changes.

First, the commencement date for all the capital gains tax proposals will be March 26th instead of January 28th.

Second, the tax treatment of all short-term capital gains will be altered. These gains are akin to income and should be taxed at higher rates than gains made in the longer term. I am proposing, therefore, that gains realised within one year of acquisition will be charged at 60% and gains realised within two or three years of acquisition at 50%.

Third, I am increasing the rate of taxation on gains from disposals of development land. In January, it was proposed that such gains, including gains made by companies, would be liable to a special capital gains tax at a rate of 45%, with certain restrictions on the application of indexation relief, roll-over relief and the right to set off losses. I intend to implement these proposals but I will provide that the normal rate will now be 50% instead of 45%. Gains within one year of acquisition will be liable at the new 60% rate for such short-term gains. There will be no change in the proposed 40% rate for compulsory acquisition cases save where the new proposals for taxing short-term gains apply.

The January 27th Budget also proposed a special capital acquisitions tax on discretionary trusts. I have considered this approach and have concluded that this would be an insensitive and over-simplified approach to the problem. I am, therefore, asking the Commission on Taxation to make a special examination of this area and to recommend measures.

The delay in implementation of the new capital gains tax proposals together with the deferral of the proposed tax on discretionary trusts will reduce the additional yield from capital taxation for this year from £6.5 million to £2.7 million. This new package, however, will bring in over £11 million extra next year.

Excise duties

A number of excise duty changes were introduced from March 13th, 1982, by Government Order under the Imposition of Duties Act, 1957, as amended. This mechanism was used to minimise the revenue lost by the delay in implementing the Budget and its use was entirely consistent with legislation passed without opposition by the Oireachtas. The main duties involved are alcoholic drinks, tobacco and cars over 16 horsepower. The yield from these changes is estimated at £51.4 million in 1982 and £71.3 million in a full year. The House will today have the opportunity to debate a motion noting these changes.

I also propose to implement the other exise duty changes which were put before the House on January 27th, including a duty-based tax increase of 8p per gallon on petrol, road diesel and liquid petroleum gas used in road vehicles, which will have immediate effect. These changes will yield £21.1 million in 1982 and £24.7 million in a full year.

The excise duty increase on petrol, road diesel and LPG will take effect from midnight tonight, but increases in the price of petrol must await a new maximum prices order. This will be made by the Minister for Trade, Commerce and Tourism, who will determine the implementation date. However, if oil prices decline further during this year, it is my intention to look again at the whole question of the appropriate level of taxation on petrol and other hydrocarbon products.

VAT

There will be no VAT imposed on clothing and footwear.

The other VAT changes in the 27th January proposals will be implemented, though the date of implementation of the new 18% and 30% VAT rates will now be May 1st, 1982, and the extension of VAT to certain services which are at present exempt will now take place on September 1st, 1982. Certain professional services provided to farmers and fees on the sale of agricultural land will, however, attract the special low effective VAT rate of 3%. These changes will yield additional revenue of £71.3 million in 1982 and £147.7 million in a full year.

These are, however, two additional changes which I propose. I have been concerned for some time about the application of VAT to books, especially school books. The proposed new rate of 18% would be particularly severe in this area, so I propose to move all books to the zero rate of VAT from May 1st, 1982. This will cost £2.5 million in 1982 and £4.9 million in a full year.

Imports

As was stated in our policy document, VAT is to be imposed on imports at the point of entry. VAT-registered firms may at present, in general, import goods without payment of VAT and account for it subsequently in their normal VAT returns. I propose to change this system to require VAT to be paid at the end of the normal customs duty deferment period, that is on the 15th day of the month following importation. This change will remove the advantage which imports are seen to have over purchases of domestically-produced goods. The change will take effect from September 1, 1982. Details of how it will operate will be included in the Finance Bill.

This change will result in a gain of about £140 million for the Exchequer in 1982, since it will involve earlier payment of VAT. This includes some extra revenue from reducing evasion of VAT on imports and reducing tax losses arising from taxes unpaid in insolvencies. There will also be some gain from a reduction in arrears of VAT. If the change in relation to VAT on imports gives rise to financing difficulties for some firms, then I will look at the possibility of arranging that the Industrial Credit Company could make loan finance available.

Given the desirability of reducing the current budget deficit, the Government had little option but to apply this VAT charge to all imports. Taxation on the "old reliables" has been pushed to the limit and the two main VAT rates are already being increased substantially. The only alternative source of substantial immediate revenue would be income tax increases, which would have borne heavily on the PAYE worker and would be unacceptable to this Government at this time.

No foreign travel tax

The proposal by the previous Government to impose a £20 charge on each person leaving the State on a chartered aircraft will not be implemented. This would have discriminated against one form of foreign travel and, in particular, would have had a significant effect on certain disadvantaged groups.

It is proposed instead to spread the tax over all travellers, by applying a charge, at the rate of £3 per passenger for air and international sea routes, and £2 for cross-Channel sea routes, on all air and sea passengers who pur-

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chase their ticket in Ireland. Accordingly the tax will not apply to most foreign tourists and business persons visiting the State. The tax will apply from September 1, 1982 and is estimated to yield some £1 million in 1982.

Dating of budget changes

A number of the income and capital taxation measures announced on January 27th were to take immediate effect. Where these measures are incorporated in today's Budget, there will now take effect from a current date. It would be inappropriate to backdate their introduction as this would, in effect, correspond to retrospective taxation. The delay in bringing these measures into effect will result in a revenue loss of approximately £2.5 million.

. . .

Deficit and borrowing

The current budget deficit planned in the January 27th Budget was £715 million. I have today added £110 million to the expenditure side of the Budget. On the revenue side of the Budget, the net increase is £146 million, which, taking account of the net increase in expenditure of £110 million, results in a current budget deficit of £679 million or 5.6% of GNP. This compares with an outturn for 1981 of £802 million, or 7.9% of GNP.

The overall Exchequer borrowing requirement emerges at £1,683 million as compared with £1,661 million planned in January. This marginal increase in the borrowing requirement is more than justified by the impact on the economy of the additional expenditure involved. At £1,683 million, or 13.9% of GNP, this requirement compares more than favourably with the 1981 outturn of £1,722 million or 16.9% of GNP.

The planned current Budget deficit and borrowing requirement represent a significant real improvement on the 1981 outturn and are an earnest of this Government's commitment to bring the public finances under control on a phased basis, having regard to the needs of the economy. The improvements in the economy which the Budget will allow should generate a sound basis for further progress in this area in the years ahead. The maintenance of progress will, however, require a sustained, businesslike approach across the broad sweep of public policies and the Government intend to apply this.

I should like to emphasise that the Government will have to take an extremely restrictive line on all requests for additional expenditure or for further taxation reliefs. The scope for any relaxation of financial discipline simply does not exist.

Conclusion

As compared with the proposals of January 27, today's Budget will have a decidedly favourable impact on employment. The removal of VAT from clothing and footwear, the imposition of VAT at the point of import and the maintenance of food subsidies will sustain purchasing power and protect the position of home industries. The increased capital allocations, particularly those for the building industry and local authorities, will give a positive stimulus to employment which will also be helped by the Employment Incentive scheme. Employment will be a central element in the medium – term plan which is being prepared.

The increases in prices as a result of today's Budget will be considerably less than those planned in the January Budget. The CPI effect is estimated at 2.75% compared with the 4.75% increase in prices which would have resulted from the January proposals. This will help to lessen inflation and encourage moderation in pay expectations. The balance of payments will also be improved through better export performance and all – round competitiveness. I estimate that, taking into account the budget changes, GDP growth this year will be higher than last year.

This Budget represents a fair balance between controlling the public finances and giving a stimulus to economic activity and employment. The extra taxation is distributed as equitably as possible, with the greater burden being imposed on those who are best able to pay. The generous social welfare changes provide considerable improvements for those who need help most. The Budget is, therefore, a sensible response to the present difficult situation. It will create more confidence in this country, both at home and abroad, and it will provide a strong imputus for greater and more stable economic progress.

The immediate task facing the Government is to nurse the economy through the present difficult economic period. While we cannot expect dramatic improvements in the short term, we have every reason to feel confident about the future. Our economy is fundamentally sound and it has the capacity to grow steadily. We have assets such as a young, growing and educated labour force which are the envy of many other countries. We must, however, go forward prudently and we must acknowledge that the correction of our public finances has to be a high priority in the immediate future whether we like it or not. This will require acceptance of the fact that we cannot sustain continuing increases in living standards, irrespective of our national output or productivity. It is on this basis, and not either on false hopes or on exaggerated pessimism, that we can advance with justified confidence in our own abilities to secure a better future for all.

Budget Highlights

Indirect taxes

- The 15% basic rate of VAT will be increased to 18% starting from 1 May 1982
- The 25% rate of VAT on "luxuries" will be increased to 30% starting from 1 May 1982
- Certain professional services (solicitors, barristers, accountants, actuaries) will become subject to 18% VAT starting from 1 September 1982
- The 25% rate of VAT on certain furniture and furnishings will be reduced to 18% starting from 1 May 1982
- VAT on books will be abolished
- Imports will become liable to VAT starting from 1 September 1982
- Excise duty on petrol (gasoline) will be increased by 8p per gallon
- Foreign air travel tax will be £ 3 per passenger (£ 2 for cross Channel transportation)
- Road tax on cars, motorcycles and taxis will be increased
- Excise duty on beer, spirits, wine and cigarettes has been increased starting from 12 March 1982

Income tax

- Personal allowances (deductions) will be increased to £ 1,450 for single persons, £ 2,900 for married taxpayers and £ 1,950 for widowed persons
- The child deduction will be *reduced* from £ 195 to £ 100
- The band taxed at the standard rate of 35% will be reduced
- The relief for mortgage interest will be restricted to a maximum of 35% and will only be granted with respect to the borrower's main residence
- The relief for interest on personal loans will be abolished
- The deduction of business expenses for entertainment will be abolished
- The rate of Corporation Tax will be increased from 45% to 50%
- The effective tax payment days will be advanced by four months
- A levy on banks will be introduced as well as a levy of 1% on insurance premiums

Capital gains tax

- Tapering relief will be abolished
- The 30% standard rate will be increased to 40%
- Short term gains in the year of acquisition will subject to a 60% rate instead of 50%
- A special land development tax will be introduced at a normal rate of 50%; in some case the tax may be increased to 60% or reduced to 40%

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The Taxation of Petroleum Products

Opinion of the Commission of the European Communities

On 11 September 1981 the Commission of the European Communities submitted the following communication to the Council (COM (81) final)

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1. INTRODUCTION

1.1 At the same time that the impact of the second major increase in oil prices has made structural adjustments in the economy necessary everywhere to meet the changed circumstances regarding energy, the role of prices and taxation as an instrument both of energy policy and of economic policy has been increasingly recognized. In a Council resolution of 9 June 1980 the Ministers said that energy pricing should be based on the following principles:

- "consumer prices should reflect representative conditions on the world market, taking account of long-term trends;
- one of the factors determining consumer prices should be the cost of replacing and developing energy sources;
- energy prices on the market should be characterized by the greatest possible degree of transparency."[1]

1.2 In October 1980 in its communication on energy and economic policy,[2] the Commission:

- stressed the need to keep the trend of petroleum product prices as constantly consistent as possible with the general direction of energy policy;
- hoped that the Member States, insofar as they had an influence on the formation of prices, would try to avoid developments at the level of the final consumer which would discourage energy saving and diversification, that is, energy investment.

It is proposed as an objective:

- attaining a hierarchy of prices which would serve the aims of reducing dependence on external sources of oil and would act both as a deterrent (oil) and as an incentive (other sources of energy), reflecting both these two aspects of energy policy;
- preventing excessive differences in price structures as between Member States - which can be traced back, to a large extent, to the way in which different energy products are taxed - which, given their similarity of situation and the fact that all belong to the same market, cannot be justified.

1.3 It seemed desirable to take taxation, the subject of this paper, as a starting point for analysing the main factors which determine the levels, trends and reasons for differences in the prices of energy resources, the questions of pre-tax price formation for the different forms of energy, transparency and pricing itself being treated in a separate paper to follow.

2. ENERGY AND ECONOMIC POLICY

2.1 The medium-term Community strategy proposed in the Fifth Economic Policy Programme makes the reduction of reliance on external sources, that is to say of consumption of imported energy and especially oil, a major goal, whose attainment is dependent on two variables which ar economic in nature: energy investments and energy prices. This is the reason why the Commission has asked that increases should be passed on immediately and in full to the final consumer and on the other hand that any ensuing secondary inflationist effects should be as far as possible reduced to a minimum. In connection with this, in its communication on the principles of indexation in the Community,[3] the Commission tries to reconcile the economic concern of the moment - reducing the rate of inflation - and the longer-term objective - increasing energy indepence - and recommends exclusion from indexation of: "the impact of any changes in indirect taxes and certain public service prices" and "the rise in prices attributable to a deterioration in the terms of trade due, for example, to a rise in important raw material prices".

2.2 Having regard to the direction to be followed in energy matters, a price policy should be developed which made it possible both to:

- ensure *"true prices"*, which would mean that consumer prices fully reflected the costs of production, transport and distribution, and the investment costs of developing future sources, and to
- give the consumer as clear and stable a picture as possible of *price trends* so that both industry and households would be able to make rational investment decisions which would contribute to restructuring energy supply and demand.

In pursuing these objectives, however, account must also be taken of others, such as those laid down for energy saving, combatting inflation, tax revenue, social policy and the constraints experienced by energy producers (balancing, the budget, commercial policy, etc.).

2.3 Although a single general principle could be used to analyse price formation for the various forms of energy, it is obvious that since for each of them production follows its own individual course each form must be analysed separately (see the paper: Energy Prices: Policy and Transparency, to be transmitted to the Council). In the case of crude oil and refined products their prices are extremely unstable, and the fact that oil products dominate a large part of the energy market means that this instability is passed on to the other forms of energy.

2.4 Nonetheless, in the long term the price of oil will be mainly determined by the price of alternative forms of energy. For some uses, particularly as fuel and in the petro-chemical industry, there are hardly any substitutes for hydrocarbons, and alternatives to conventional oil could only come from oil shale, tar sands or coals. But for other pur-

1. Official Journal of the European Communities (hereinafter "OJ") No. C 149/4, 18 June 1980.
2. COM(80) 583, 15 October 1980.
3. COM(81) 457, 23 July 1981.

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poses, in particular heat and electricity production, more economical alternatives already exist and the use of oil should be discouraged here.

2.5 Out of the range of energy products, those whose consumption absolutely must be reduced, petroleum products, are also those whose prices are most subject to control by the Member States in the form of taxation. Oil taxes are generally heaviest on those products for which there are few substitutes (see findings below). If in the medium term the price mechanism should have a role to play, taxation too should be used in such a way as to reinforce its effects. Also, many countries are faced with the need to limit or reduce their public deficits, which leads them to accord particular importance in their economic policies to analysing and controlling the sources of tax revenue.

2.6 The manner in which petroleum products are taxed must contribute to diminishing generally these clashes between objectives, provided the line followed here is consistent with macro-economic and energy policy. Action to achieve this is already both feasible and desirable at Community level.

3. OIL TAXES: FINDINGS AND EFFECTS

3.1 Unlike other forms of energy (coal, gas and electricity) on which there are vitually no taxes other than VAT (which is charged only on final consumption), on petroleum products there are specific charges (excise duty on mineral oils) which can be quite heavy. A detailed analysis of oil taxes, both the origin of and justification for the general arrangements and the exceptions, is given in the Annex, the main conclusions being the following:

- because of their yield in tax revenue, excise duties are heaviest on motor fuel (petrol and diesel) and quite light on furnace fuel;
- the adaptation of the rates of excise duties to general price trends has tended to be very irregular and belated in most countries;
- there are very substantial differences in the rates of excise duty applied in the different countries, particularly in the case of diesel fuel;
- the structure of excise duties varies from one member State to another;
- in all Member States there are different arrangements for exemptions or subsidies the economic justification for which in many cases is not obvious. The Commission proposes that the Council adopts as a principle their progressive elimination on the basis of a joint study with national administrations. Particular attention should be paid to air and inland waterways transport, agriculture and oil consumption within certain industrial sectors (e.g. refineries, petro-chemicals).
- with regard to VAT, the normal rates are usually applied (with the customary differences between countries), but some countries apply reduced or zero rates for certain products.

3.2 From these summary findings certain conclusions should be drawn as regards economic and energy objectives:[4]

- the products that are most heavily taxed are not those that offer the greatest opportunities for saving or the use of substitute products;
- the irregular timing of adjustments in excise duties has not generally contributed to smoothing price changes for oil products, which have been masked by sudden sharp movements in pre-tax prices;
- the delays in adapting excise duties to general price trends over the period 1973-81 has in many cases produced a substantial loss in potential tax revenue;
- the absence at European level of any concerted oil tax policy, both for the direction to be followed and the structure of taxation, has made users less aware of the absolute necessity of reducing oil consumption;
- lastly, certain differences in rates of taxation have provoked distortion of competition and have impeded the proper allocation of resources.

3.3 In practice it may prove difficult to make the changes needed to adapt oil taxation; at all events it will be necessary to spread the changes out over a certain period if economic activity is not to be disrupted, as the present systems of taxation affect both sectoral and regional economic structures. In addition the effect of such changes on the competitivity of firms could be important, at least in the short term, in sectors where oil prices form a major part of production costs. Time will also be needed on the supply side for refining structures to be altered. Furthermore, the complexity of tax structures, the interaction between the rates and the products covered by excise duties, the existence of other forms of taxation (on demand for but also on supply of petroleum products) and the multiplicity of objectives do not lend themselves readily to any single solution.

3.4 If the arrangements decided on led to an increase in public revenue, naturally, inflationist effects would have to be kept under control and deflationist effects averted. To this end, appropriate compensations should be sought in line with the budget situations of the individual Member States, so as to reduce the charges borne by Community undertakings, to increase the budget funds devoted to energy adjustment and to assist low-income categories of society directly affected by the rise in prices for certain petroleum products or the abolition of certain exemptions or reductions in the rate of taxation.

4. OIL TAXES: A JOINT EFFORT

4.1 The considerations set out above enable priorities to be defined for selecting the options that will give a system of oil taxation more in keeping with Community objectives. Ideally, oil taxes should:

- contribute to a more regular adjustment of oil prices, while maintaining a constant and substantial flow of tax revenue;
- encourage the adaptation of the structure of energy prices as a whole and the introduction of a price hierarchy for petroleum products which reflects energy objectives and thus prompts the realization of the major potential for saving and the use of substitute products that exists in the Community;
- reduce the differences in the tax structures and charges within the Community, particularly by keeping special arrangements (exemptions, subsidies) to a strict minium.

4.2 Obviously it would be desirable if oil taxation as a whole, or failing this, the structure of excise duties on mineral oils,[5] could be harmonized, and this would contribute to solving most of the problems, but would take a long time. Without waiting for this work to be terminated, and concurrently with it, objectives should be set that are in line with the general approach and will enable rapid progress to be made. These would include the following five practical goals:

- agreement that sizes for the tax burden to be applied in target areas should be set for each major category of product (i.e. the minimum and maximum incidence in relation to the prices net of tax for all excise duties and VAT), so as to have a direct impact on their price structures and bring them more in line with energy objectives;
- a joint decision of the rate of progression of the overall tax burden (excise duties + VAT) towards the target areas and on the proper balance between excise duties and VAT. Watch must be kept to ensure that changes in the tax burden remain at all times in line with target areas;
- a joint agreement on the need to adapt excise duties regularly, without however revising the level more than once a year;
- adoption of the principle of the gradual abolition, following a timetable jointly agreed, of exemptions, subsidies and reductions of the rate of taxation for particular uses where there is no longer any valid reason for keeping them;
- a decision that the Council should review the trends in energy and particularly oil taxes (both structures and rates) annually, to assess to what extent they contribute to achieving the objectives of economic and energy policy.

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4. A detailed analysis of the effects of oil taxes on competitiveness, tax revenue and demand for petroleum products (particularly from the point of view of possible substitution effects) is annexed.

5. The Commission has already presented a proposal for a directive on the harmonization of excise duties on mineral oils (OJ No. C 92, 31 October 1973) which could provide a basis for any fresh discussion of the subject.

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ANNEX

A. TAXATION OF OIL PRODUCTS - SITUATION*

A.1 The tax burden on oil products is made up of specific charges (excise duties) and value added tax, which is levied on the sum of the excise duties and the price exclusive of tax. Table 1 gives the different levels of excise duty expressed in EUA and their incidence as a percentage of the price exclusive of tax, the rates of VAT and the total tax burden (excise duties + VAT as a percentage of the price exclusive of tax) as at 1 January 1973 and 15 July 1981.

A.2 However, discussion of the main features, with their effects, of the taxation of oil products must take account of two factors that impinge on the inferences to be drawn from the information set out below:

- in most countries, there are other ancillary tax measures that, to differing degrees, have a direct impact on the size of the overall tax burden on the use of certain oil products (e.g. axle tax in France, road taxes, taxes on the purchase of motor vehicles);
- the share of oil in energy consumption differs very significantly between some countries, particularly in energy-intensive sectors, whether as a result of policy decisions or as a result of the straightforward operation of the law of comparative advantages (see Table 2).

A.3 Excise duties

A.3.1 Since the taxation of mineral oils used as motor fuels was a potentially valuable source of tax revenue, Member States initially imposed high excise duties on them for the purpose of ensuring a steady and substantial flow of tax revenue. The subsequent increases in the duties on motor fuels were justified on several counts, e.g. the need to finance the infrastructure costs of private and commercial road transport, enviromental problems and, of course, energy conservation. As a result, excise duties were also levied on a variety of other oil products the use of which does not generally give rise to transport infrastructure costs.

In many cases, the aim of taxing these other uses of oil products was to protect indigenous energy resources, especially coal. Consequently, oil products are now taxed for purposes that differ not only from country to country but also from one oil product to another and even from one use to another of the same product. Taking the Community as a whole, the Member States' tax systems exhibit marked differences in both the rates and the application of excise duties for the entire range of oil products; and different arrangements governing exemptions and reductions for particular uses have come into being.

A.3.2 The level and trend of excise duties in the Nine as at 1 January of each year from 1973 to 1981 are given in Graphs A1 to A4. It will be seen that:

- as a rule, motor fuels (petrol and diesel oil) are much more heavily taxed than heating fuels (heating oil and heavy fuel oil);
- although all the nine countries have adjusted the levels of their excise duties during the period 1973-81, these still differ appreciably from one country to another; most important, owing to the impact of inflation, they have very seldom held their real value throughout the period: this applies particularly to motor fuels. Even though in many cases recent adjustments have restored the real value of excise duties at 15 July 1981 to levels near or higher than their value at 1 January 1973, they have nonetheless been substantially eroded over the period; this emerges clearly from Tables 4 and 6 and Graphs B1 to B4;
- in the case of motor fuels, excise duties on diesel oil show the greatest disparity between countries. They are identical to the excise duties on heating oil in Denmark and Italy (in the latter they are very low at only 4% of the duty on petrol), while in the United Kingdom they are the same as the duty on petrol (i.e. they are around 20 times higher than in Italy);
- generally speaking, excise duties on heating oil are low but there are quite appreciable differences between countries: expressed as a percentage of the price exclusive of tax, they range from 0 in Belgium to 16.1% in Denmark (where, however, the duty is refunded to persons subject to VAT if VAT on the purchase of oil products is deductible);
- in the case of heavy fuel oils, which for the most part are used in industry, the tax treatment of excise duties differs a great deal and this has an obvious bearing on competition. They are exempt in France and Belgium, but subject to excise duties amounting to 11.5% of the price exclusive of tax in Ireland, 7.1% in the United Kingdom (although there are exemptions for the oil industry) and as much as 24.5% in Denmark (where, however, the duty is refunded in the same way as that on heating oil);
- in the case of lubricants, the rates range from zero in a number of Member States to 211 EUA per tonne in Germany.

A.4 Value added tax

A.4.1 As regards value added tax, it has to be borne in mind that the practical effect of the system of deducting VAT in all Member States (except France, where VAT levied on oils other than heavy fuel oil is not deductible) is to exempt oil products used in industry, with the result that the entire burden of the tax is shifted to private consumption.

A.4.2 Since 1973, VAT rates have been raised in all Member States except Belgium (where the standard rate was cut from 18% to 16% in 1979, while most of the products chargeable at the reduced rate of 14% are now taxed at the standard rate of 16% and certain products are taxed at the increased rate of 25%) and France (where the rates have remained unchanged). Although these adjustments have applied across the board in that more often than not they have taken the form of a change in the standard rate, they have contributed to increases in the prices of oil products at final consumption and, primarily because VAT is an ad valorem tax, they have boosted tax revenue, thereby making up to some extent for the fact that excise duties had lagged behind the trend in the general price level.

A.4.3 Generally speaking, oil products are chargeable at the standard VAT rate, which ranges from 10% in Luxembourg to 22% in Denmark; but some member States apply different rates for different products:

(i) motor fuels are taxed at the reduced rate in Ireland (15%, with effect from 1 September 1981) and Luxembourg (5%), and at the increased rate in Belgium (25%);
(ii) heating fuels (heating oil and heavy fuel oil) are zero rated in Ireland and the United Kingdom, and taxed at the reduced rate of 5% in Luxembourg;
(iii) the reduced rate of 4% that was applied to diesel oil and heating fuels in the Netherlands was replaced in 1979 by the standard rate of 18%.

A.5 The structure of the taxation of oil products in the Community can thus be broadly summarized as follows:
VAT: falls on the final private consumer. Rates on motor fuels for road transport range from 5% to 25%; rates on other oil products range from 0% to 22%.
Excise duties: 90% or more of the excise duties levied affect motor fuels for road transport, which account for about 30% of all oil products consumed (see Table 3).

The range of rates of tax on petrol is fairly narrow, but there are wide differences between the rates applied to petrol and those applied to diesel oil, and the latter vary considerably from one country to another. Other oil products are for the most part taxed at fairly low rates or completely exempt. Differences in rates of tax on heavy fuel oil may be a direct cause of distortion of competition between industries.

A.6 In many cases, the aggregate revenue from the taxation of oil products was declining in real terms over fairly long periods between 1 January 1973 and 15 July 1981. It is clear that, in view of the enormous rise in prices net of tax (a five-fold increase over the period), the total tax burden (excise duties plus VAT as a percentage of prices net of tax) has declined considerably in all countries and, with a few rare execptions, for all products (see Table 2).

A.7 Exemptions and subsidies

A.7.1 As well as this wide variety of arrangements, which makes it difficult to assess the system as a whole, there are a number of exemptions, rebate schemes or reduced rates for specific uses. These special

* Graphs to which the Annex refers have not been reproduced.

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provisions are the subject of a Commission staff working paper entitled "Subsidies and tax exemption for energy consumption"[6] and are listed in tabular form in the document "Excise and VAT exemptions and reductions in favour of certain groups of mineral oil consumers"[7]; this conspectus is reproduced here as Table 7. It shows the special arrangements in force in the Member States for nine types of use:

(i) aviation: in most countries, consumption by commercial traffic is exempt from excise duties and usually from VAT as well (although VAT, when applied, is deductible except in France); consumption by executive aircraft is exempt from excise duties, and in general only consumption by private aircraft is taxed, although sometimes at reduced rates;
(ii) navigation in territorial waters: consumption is largely exempt in all countries for inshore navigation, fisheries and transport, while consumption by pleasure boats is normally subject to the standard rate;
(iii) agriculture and horticulture: consumption is usually exempt from excise duties or taxed at a reduced rate (the reduced rates in force for heating oil are often applied to motor fuels);
(iv) own use of oil products by refineries and the petrochemical sector is exempt everywhere;
(v) public transport: oil products used by the railways are either exempt (Germany and Italy), eligible for tax rebates (Denmark) or taxed at a reduced rate (Belgium, France, the UK, Ireland, Luxembourg and the Netherlands); only Germany refunds excise duties on consumption by public bus services, and it is to discontinue these arrangements by 1983; in the other countries, the standard rate on diesel oil is applied, except in Ireland and Italy;
(vi) consumption by diplomatic missions, international organisations and the armed forces of a foreign state is totally exempt everywhere;
(vii) reclaimed oils are subject to the standard rate of excise duty on lubricants only in Germany and Luxembourg, while Italy applies a reduced rate and other countries grant exemption.

A.7.2 Most countries, then, grant substantial tax reductions for most of these types of consumption. The justification for the reductions is not always obvious, for their origins are diverse: historical reasons such as international agreements, social reasons, technical reasons such as own use, tax reasons or even energy policy reasons. The Commission, in collaboration with national government departments, should carry out a detailed study of the implications and effects of abolishing certain exemptions, rebates or reduced rates, and the arguments for doing so, so that practical proposals may be presented along with a timetable for applying them.

Although each of the special schemes must be investigated in the light of all the reasons for its existence, certain situations should be given special attention. For example, energy considerations may well justify special treatment for consumption for the purposes of inland waterway transport or public transport (particularly by rail), or for own use, which often means the use of by-products with little productive potential that might be replaced by something less suitable if taxed.

B. THE TAXATION OF OIL PRODUCTS: EFFECTS

B.1 From the situation described above, a number of conclusions can be drawn about the effects of the taxation of oil products, or rather the effects of specific taxes in the form of excise duties, the main source of difficulties. We are concerned with the repercussions in three areas: competitiveness, tax revenue and the demand for oil products.

B.2 Competitiveness

Except in a few specific sectors, energy costs usually account only for a small part of aggregate production costs. However, it is clear that the impact of the price trend of oil products on production costs varies widely as a result not only of different structures of energy consumption, but also of differences in tax treatment, and this distorts relative price competitiveness. For example, the share of oil products in the total volume of energy consumed by manufacturing industry in 1979 varied from 22% in the Netherlands and Belgium to about 70% in Ireland and Denmark; the share in Germany was slightly over 30%, and the share in France, Italy and the United Kingdom about 40%. A comparable range of figures is observed in the residential/tertiary sector, although the ranking by countries is different. The Member States' different systems for taxing oil products, described above, frequently do not offset the effects of consumption structures, thereby amplifying differences in the competititve positions of European firms.

If certain excise duties were increased and periodically adjusted, there should be no major repercussions on the international competitiveness of most European exports: in fact, this might act as an additional incentive for investment to rationalize industry, which would improve competitiveness in general in the medium term. However, the sectors that are still heavily dependent on oil, or in which oil products account for a very large share of production costs (steel, man-made fibres, etc.) might find it extremely difficult to remain competitive.

B.3 Tax revenue

B.3.1 In none of the Member States is the policy governing the changes in excise duty rates amenable to logical analysis, in so far as it is based neither on the general movement in prices nor on the requirements of energy policy, whether in the direct measures to discourage consumption of mineral oils or in the indirect measures for manipulating the prices of products that can be substituted for mineral oils.

Many Member States have allowed the specific rates of the excise duties on mineral oils, or at least some of them, to lag behind the general trend in prices. In so doing, they have generally lost sight of the primary objective of excise duties, which is to raise revenue for the State. An illustration is provided by Table 4, which clearly shows that revenue from the excise duties on mineral oils expressed as a precentage of GDP has fallen in many countries, whereas consumption of motor fuels - which account for the major proportion of excise duties - has increased in all countries.

B.3.2 Table 6 gives an estimate of the revenue forgone owing to the failure to adapt excise duty rates in line with the general movement in prices. Thus, if excise duties had been increased each year from 1973 to 1979[8] in step with the overall rise in prices, several countries would have collected appreciably higher revenue each year: aggregated over the period from 1973 to 1979, this "extra" revenue, calculated at current prices, would in some cases have nearly amounted to their total revenue for a single year. The figures also show up differences of approach: some countries have adapted excise duties comparatively frequently; others, some years after the first oil shock, have suddenly increased the rates in an effort to catch up; and in others again, the rates have constantly lagged behind the general movement in prices.

B.3.3 However, this finding must be qualified by the fact that, since VAT is an ad valorem tax and oil prices net of tax have been rising steeply, VAT revenue has increased substantially, thereby offsetting the effects on tax revenue of the slow increase in excise duties.

B.4 Demand for oil products

B.4.1 A distinction must be made between the very different markets for oil products. These markets reflect a clear division between private consumption, that of the tertiary sector and that of the productive sector - with its own economic impact.

B.4.2 *Motor fuels:* in this market, there is practically no substitute for oil in the short or medium term. However, consumption could certainly be made more efficient: recent studies suggest that the price elasticity of demand is generally greater than has hitherto been assumed (ranging form approximately -0.2 to -0.4 in the short term and from -0.4 to -0.9 in the long term).

Even leaving aside additional ways of taxing consumption (e.g. road tax), the present level of taxation of motor fuels is very high compared with that of other products. However, a distinction must be made between petrol and diesel oil. Excise duties on petrol are high, but had their real value been maintained from 1973 to 1980 they would in many cases have been much higher by now and the revenue to the State correspondingly larger, without making an excessive impact on the price inclusive of all taxes (see Table 5). In five countries, the price

6. SEC(81)939 of 10 June 1981.
7. SEC(81)1314 of 31 August 1981.
8. At this point the calculations cannot be taken beyond the year 1979. The 1980 figures will probably be available in the autumn.

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of petrol would have been approximately 15% higher on average in 1980, which, in view of the price elasticities of demand, might well have led to appreciable savings. In all the countries, diesel oil is taxed at lower levels than petrol, often much lower. Whereas in the past diesel oil was used by and large only in the commercial and productive sectors, the proportion of moter vehicles using it is now increasing rapidly. As the present levels of excise duty on this product in many countries do not encourage energy savings, it would be desirable for taxation on motor fuels to be aligned, i.e. the lowest levels of excise duty on diesel oil should be increased. Steps should also be taken to ensure that the structure of excise duties does not encourage substitution by other forms of energy such as liquified petroleum gas which offer few or no advantage from the viewpoint of energy policy.

B.4.3 *Heating oil:* this product is used mainly in the tertiary and residential sectors for heating. The most attractive substitutes are natural gas, district heating and electricity in the form of electric heat pumps. In all countries, there is considerable potential for conserving energy and for rationalizing consumption through house insulation, inspection and maintenance measures, etc. The current level of taxation (excise duties and VAT) is generally low, although it varies greatly according to country. There are therefore grounds for increasing the level of taxation where it is at present particularly low. Here again, however, one must guard against encouraging a massive switch to the single alternative of natural gas.

B.4.4 *Heavy fuel oil:* the prospects of using substitutes for this product are good, because it is consumed by industry where electricity, coal and gas offer satisfactory alternatives. The level of excise duties is generally low, but there are substantial differences between countries. Besides the problem of competitiveness which arises from this situation, there is little encouragement to conserve energy and adopt alternative processes. For both reasons, the excise duty rates in the Community should be brought up to a common level.

B.4.5 *Non-energy consumption:* in addition to the uses described, oil is also used as a feedstock, particularly in the form of naphtha (chemically similar to petrol). No tax is currently imposed on this use. Since there is as yet no possibility of substitution and since the potential for making savings is limited, there is little reason to introduce significant levels of excise duty.

TABLE 1

	Belgium				Denmark				FR Germany				France			
	PGP	D	HO	HFO	PGP	D	HO	HFO	PGP	D	HO	HFO	PGP	D	HO	HFO
1 January 1973																
a) Excise duties in EUA[1]	153.1	61.5	10.8	2.4	103.9	0	0	0	174.5	163.4	3.3	5.9	105.9	59.1	3.1	0
b) Excise duty rates as % of price exclusive of tax	241.9	109.9	24.4	11.8	170.3	0	0	0	190.7	198.5	7.0	21.1	174.6	119.8	9.4	0
c) VAT rate	18	18	14	14	15	15	15	15	11	11	11	11	17.6	17.6	17.6	17.6
d) Total impact (excise duties + VAT as % of price exclusive of tax	303.4	147.7	41.8	22.5	210.8	15	15	15	227.7	231.3	18.8	34.4	222.9	158.5	28.7	17.6
15 July 1981																
e) Excise duties in EUA[1]	203.5	83.6	0	0	243.3	45.6	45.6	5.20	202.4	177.4	6.7	5.9	235.9	124.5	23.1	0
f) Excise duty rates as % of price exclusive of tax	54.0	26.7	0	0	69.9	14.7	16.1	24.5	60.3	59.6	2.5	3.2	70.8	41.9	8.1	0
g) Index of real value of excise duties (1973 = 100)[2]	72.3	74.0	–	–	104.6	–	–	–	77.6	72.7	135.6	67.7	95.5	90.4	324.1	–
h) VAT rate	25	25	16	16	22	22	22	22	13	13	13	13	17.6	17.6	17.6	17.6
i) Total impact (excise duties + VAT as % of price exclusive of tax)	92.5	58.4	16	16	107.3	39.9	41.7	51.8	81.1	80.4	15.8	16.4	100.8	66.9	27.1	17.6

TABLE 1 (cont.)

	Ireland				Italy				Netherlands				United Kingdom			
	PGP	D	HO	HFO	PGP	D	HO	HFO	PGP	D	HO	HFO	PGP	D	HO	HFO
1 January 1973																
a) Excise duties in EUA[1]	57.6	52.6	0	0	79.0	34.3	2.3	0.6	150.2	60.1	11.6	5.0	89.8	89.9	4.1	4.2
b) Excise duty rates as % of price exclusive of tax	163.5	157.7	0	0	237.1	152.6	14.4	5.6	196.0	91.2	24.1	25.0	178.0	195.7	10.7	22.1
c) VAT rate	5.26	5.26	5.26	5.26	12	12	12	12	16	4	4	4	0	0	0	0
d) Total impact (excise duties + VAT as % of price exclusive of tax	177.4	171.1	5.26	5.26	277.6	182.9	28.1	18.3	243.4	98.8	29.1	30.0	178.0	195.7	10.7	22.3
15 July 1981																
e) Excise duties in EUA[1]	239.3	157.5	25.9	27.0	316.6	13.0	13.0	0.8	190.1	65.8	11.6	5.0	250.0	215.5	13.8	14.5
f) Excise duty rates as % of price exclusive of tax	65.5	45.6	8.8	11.5	101.4	4.8	5.1	0.4	53.9	22.6	4.3	2.6	74.3	69.0	4.5	7.1
g) Index of real value of excise duties (1973 = 100)[2]	113.5	87.2	–	–	107.9	10.7	158.2	33.7	69.8	60.4	55.2	55.2	83.9	72.3	105.1	104.7
h) VAT rate	10	10	0	0	18	15	15	15	18	18	18	18	15	15	0	0
i) Total impact (excise duties + VAT as % of price exclusive of tax)	82.1	60.1	8.1	11.5	137.7	20.6	20.8	15.5	81.6	44.6	23.8	21.0	100.4	94.4	4.9	7.1

PGP = premium grade petrol; D = diesel oil; HO = heating oil; HFO = heavy fuel oil.
(1) Per 1,000 l for premium grade petrol, diesel oil and heating oil; per tonne for heavy fuel oil.
(2) Excise duties deflated by GDP prices and expressed as an index (1973 = 100).

* 15% as from 1 September 1981.
Source: Commission departments.

TABLE 2

Share of oil products in the final energy consumption of the three sectors

		B	DK	D	F	IRL	I	NL	UK
Share of oil products in the final energy consumption of:									
1975	Industry	26.2	70.7	34.6	49.6	83.0	45.5	15.0	39.2
	Transport	98.4	99.7	96.9	97.8	100.0	96.5	98.9	98.9
	Residential/tertiary	59.5	79.1	60.4	63.4	44.6	67.2	22.7	21.2
	Total	51.7	81.9	58.1	66.1	73.3	64.8	34.4	45.3
1979	Industry	22.0	67.2	30.7	44.4	70.0	40.1	21.8	38.3
	Transport	98.6	99.7	97.6	98.0	100.0	97.4	99.0	98.8
	Residential/tertiary	55.8	76.6	59.1	58.2	38.6	60.4	16.6	21.1
	Total	49.5	79.4	57.2	62.8	65.8	62.2	33.4	45.3

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TABLE 3

Part of consumption (A) and of excise revenue on hydrocarbon oils (B) for the main products groups 1973

Products		EUR %	B %	DK %	D %	F %	IRL %	I %	L %	NL %	UK %
Motor spirit	A	19.3	16.2	13.0	19.0	18.7	24.3	16.8	18.0	16.0	25.9
	B	72.2	75.2	82.8	67.2	70.8	79.5	80.8	81.4	78.8	67.8
Diesel road fuel	A	8.7	7.5	4.7	7.3	8.9	9.1	12.9	6.1	8.6	8.3
	B	15.6	11.2	0.3	21.6	15.5	10.9	4.5	6.4	14.5	22.6
Gas-oil for heating	A	32.3	42.4	43.6	44.0	36.1	24.2	22.2	35.5	14.3	18.1
	B	5.7	10.3	10.7	2.6	9.7	3.2	5.7	9.8	4.2	3.5
Heavy fuel oil	A	18.2	17.4	25.7	12.7	17.9	24.6	27.5	30.9	6.5	22.0
	B	1.6	0.8	0.4	2.9	0	2.9	0.3	2.3	0.7	3.7

TABLE 4

Tax revenue from excise duties on mineral oils, expressed as % of GDP

	B	DK	D	F	IRL	I	NL	UK
1970	1.8	1.2	1.7	1.7	2.9	2.4	1.5	2.7
1971	1.8	1.2	1.6	1.7	2.7	2.7	1.4	2.3
1972	1.7	1.1	1.7	1.6	2.4	2.5	1.5	2.4
1973	1.8	1.0	1.8	1.6	2.1	2.2	1.4	2.2
1974	1.5	0.9	1.6	1.5	2.0	2.1	1.3	1.9
1975	1.6	0.9	1.7	1.4	2.5	2.6	1.3	1.5
1976	1.5	0.9	1.6	1.3	2.8	2.2	1.2	1.6
1977	1.5	1.0	1.6	1.5	2.6	2.4	1.2	1.7
1978	1.4	1.0	1.6	1.7	2.5	2.3	1.2	1.5
1979	1.4	–	1.5	1.9	–	2.1	1.1	1.5

TABLE 5

Price of premium grade petrol in EUA per 1,000 litres

	B	DK	D	F	IRL	I	NL	UK
a) 1973	223.8	202.3	210.3	221.3	157.7	226.1	217.6	153.9
b) 1980	574.6	590.7	469.6	583.0	486.7	602.7	526.9	473.6
c) 1980 notional	660.6	560.1	541.1	549.5	510.4	540.2	586.9	606.6
$d = \frac{c \times 100}{b}$	115.0	94.8	115.2	94.3	104.9	89.6	111.4	128.1

TABLE 6

Comparison between actual excise duty revenuefrom mineral oils and the excise duty revenue which would have been collected if the rate had been adjusted in line with the general movement in prices[1]

	In million BFR BELGIUM			In million DM GERMANY			In million FF FRANCE		
	Actual revenue	Notional revenue	Gain or loss	Actual revenue	Notional revenue	Gain or loss	Actual revenue	Notional revenue	Gain or loss
1973	31692	31692	–	16589	16589	–	17777	17777	–
1974	29891	33704	+3813	16052	17177	+1125	18920	22481	+3561
1975	37451	46914	+9463	17121	19416	+2295	20270	25448	+5178
1976	39330	52713	+14383	18121	21418	+3297	21419	28799	+7380
1977	40445	53644	+13199	19184	23248	+4064	28070	31827	+3757
1978	42571	57446	+14875	20462	25401	+4939	35815	34764	-1051
1979	44558	61376	+17318	21114	26987	+5847	46517	40294	-6223
			+73051			+21567			+12602

TABLE 6 (cont.)

	In '000 million LIT ITALY			In million HFL NETHERLANDS			In million £ UNITED KINGDOM		
	Actual revenue	Notional revenue	Gain or loss	Actual revenue	Notional revenue	Gain or loss	Actual revenue	Notional revenue	Gain or loss
1973	1959	1959	–	2370	2370	–	1618	1618	–
1974	2291	2039	-253	2500	2530	+30	1556	1805	+249
1975	3230	2966	-264	2730	3034	+304	1521	2192	+671
1976	3468	2980	-487	2880	3381	+501	1941	2639	+698
1977	4537	3622	-915	3070	3841	+771	2377	3133	+756
1978	4989	4490	-499	3270	4268	+998	2465	3523	+1058
1979	5691	5923	+232	3340	4562	+1222	2777	4210	+1433
			-2186			+3826			+4365

(1) All other things being equal, i.e. assuming unchanged quantities, which makes for an over-estimate of the notional revenue. It is assumed that the purpose of adjusting excise duties is to maintain the real value of excise duties at the 1973 level.

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TABLE 7 *

Excise and VAT exemptions and reductions in favour of certain groups of mineral oil consumers (Sit. 15/7/81)

A. Normal rates	BELGIUM Excise (ECU/hl)	BELGIUM VAT %	W.GERMANY Excise (ECU/hl)	W.GERMANY VAT %	DENMARK Excise (ECU/hl)	DENMARK VAT %	FRANCE Excise (ECU/hl)	FRANCE VAT %	UNITED KINGDOM Excise (ECU/hl)	UNITED KINGDOM VAT %
01 Rates generally applied for road fuels:										
a) petrol	20.35	25(17)	20.24	13	24.33	22	22.14-23.59	17.6[2]	25.00	15
b) DERV	8.36	25(17)	17.74	13	4.56[1]	22	12.45	17.6[2]	21.55	15
c) LPG	4.84	25(17)	15.71	13	3.04[1]	22	6.31	17.6[2]	12.50	15
02 Rates generally applied for heating fuels:										
a) heavy fuel oil	0	17	0.59/100 kg	13	5.20/[1] 100 kg	22	0	17.6	1.45/100 kg	0(15)
b) heating gas-oil	0	17	0.67	13	4.56[1]	22	2.31	17.6[2]	1.39	0(15)
c) light oil	0[3]/20.35	17	0[3]/20.24	13	0	22	0[3]/22.14	17.6	1.39[3]/25.00	0(15)
d) LPG	0	17	0	13	3.08[1]	22	0	17.6	0	0(15)
03 Rates generally applied for use in motors other than those of road-vehicles:										
a) petrol	20.35	25(17)	20.24	13	0	22	22.14-23.59	17.6[2]	25.00	15
b) gas oil	0	17	17.74	13	4.56[1]	22	2.31	17.6[2]	1.39	15
04 Rates generally applied for non-energetic use:										
a) raw material, solvent etc.	0	17	0	13	0	22	0	17.6	0	15
b) lubricants	0	17	21.13/100 kg	13	0	22	0	17.6[2]	1.55/100 kg	15

A. Normal rates (cont.)

	GREECE Excise (ECU/hl)	GREECE VAT %	IRELAND Excise (ECU/hl)	IRELAND VAT %	ITALY Excise (ECU/hl)	ITALY VAT %	LUXEMBOURG Excise (ECU/hl)	LUXEMBOURG VAT %	NETHERLANDS Excise (ECU/hl)	NETHERLANDS VAT %
01 Rates generally applied for road fuels:										
a) petrol	16.23-18.86	?	23.93	10[4](25)	31.66	18(15)	16.86	5(10)	19.01	18
b) DERV	1.12	?	15.75	10[4](25)	1.30	15	4.84	5(10)	6.58	18
c) LPG	0	?	12.74	10[4](25)	19.04	18(15)	2.18	5(10)	0	18
02 Rates generally applied for heating fuels:										
a) heavy fuel oil	0	?	2.70/100 kg	0(25)	0.08/100 kg	15	0.24/100 kg	5(10)	0.50/100 kg	18
b) heating gas-oil	1.12	?	2.59	0(25)	1.30	15	0.60-0.92	5(10)	1.16	18
c) light oil	?	?	0[3]/23.93	0(25)	0[3]/31.66	15	0[3]/16.86	5(10)	0[3]/19.01	18
d) LPG	0	?	2.59	0(25)	0.90	15	0	5(10)	0	18
03 Rates generally applied for use in motors other than those of road-vehicles:										
a) petrol	16.32-18.86		23.93	10[4](25)	31.66	18(15)	16.86		19.01	18
b) gas oil	1.12		2.59	10[4](25)	1.30	15	0.60-0.92	5(10)	1.16	18
04 Rates generally applied for non-energetic use:										
a) raw material, solvent etc.	0		0	10[4](25)	0	15	0	5(10)	0	18
b) lubricants	12.99/100 kg		2.89/100 kg	10[4](25)	14.34-15.93/100 kg	15	0.24/100 kg		0	18

* *Editor's note:* (a) Unlike the official EEC document where international codes are used, here full country names are given.
(b) For footnotes to this table, see at the end of Table 7.

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TABLE 7 (cont.)

B. Reductions or exemptions of excise and/or VAT granted to certain consumer groups

	BELGIUM		W.GERMANY		DENMARK		FRANCE		UNITED KINGDOM	
Consumer groups	*Excise (ECU/hl)*	*VAT %*	*Excise (ECU/hl)*	*VAT %*	*Excise (ECU/hl)*	*VAT %*	*Excise (ECU/hl)*	*VAT %*	*Excise (ECU/hl)*	*VAT %*
1 Aviation										
a) commercial international flights	ex.	ex.	ex.	ex.[6]	ex.	ex.	ex.	ex.[5]	ex.[7,8]	ex.
b) commercial domestic flights	ex.[7]	ex.[7]	ex.	ex.[6]	ex.	22	ex.[7]	ex.[5]	ex.[7,8] or 1.39/25	ex. 0/15
c) military aircraft and aircraft of public authorities	ex.	ex.	ex.	13	ex.	22	ex.	17.6[2]	1.39/25	0/15
d) business aviation	ex.[7]	ex.[7]	ex.	ex.[6] 13	ex.	22	ex. or **	17.6[2]	ex.[7,8] 1.39/25	ex. 0/15
e) private aircraft	ex.[7] or 20.35	25 (17)	20.24	13	ex.	22	0.76/15.57	17.6[2]	1.39/25	0/15
2 Navigation in home waters										
a) coastal	0	ex.	ex.	ex.	4.56[1]	ex.	ex.	ex.	0[8]	0
b) fishery	0	ex.	ex.	ex.	4.56[1]	22	ex.	ex.	0[8]	0
c) professional transport	0	25	ex.	ex.[9] 13	4.56[1]	22	ex. 2.31	ex. 17.6[2]	0[8]	0
d) pleasure boats (d = petrol/gas-oil)	20.35[11]/0	25	20.24/ 17.74	13	24.33/ 4.56[1]	22	22.14/ 12.45	17.6[2]	25.00[11]/ 1.39	15/0
3 Agriculture (gas-oil)										
a) in general	0	17	0[8,10]/0.67	13	ex.	22	2.31	17.6	1.39	0/15
b) horticulture	0	17	0[8,10]/0.67	13	ex.	22	2.31	17.6	ex.[8]	0/15
4 Auto-consumption										
a) refineries	ex.	—	ex.	—	ex.	—	ex.	—	ex.	—
b) petrochemical plants	ex.	—	ex.	—		—	ex.	—	ex.[12]	—
5 Public transport (gas-oil)										
a) railroad	0	17	ex.[8,13]	13	4.56[1]	22	2.31	17.6[2]	1.39	0
b) buses	8.36	25	ex.[8,13]	13	4.56[1]	22	12.45	17.6[2]	21.55	0
6 Diplomatic missions and consulates	ex.	ex.	ex.	ex.	ex.	ex.	ex.[14]	ex.[14]	ex.	ex.
7 International organisations	ex.	ex.	ex.	ex.	ex.	ex.	ex.	ex.	ex.	
8 Armed forces of another State	ex.	ex.	ex.	ex.	ex.	ex.	ex.	ex.	ex.	
9 Re-refined waste oils	0	17	21.13/ 100 kg	13	0	22	0	17.6	ex.	15

** *Editor's note:* In the EEC document no alternative figure is mentioned.

1. Complete drawback granted to professional consumers authorized to deduct VAT on these products.
2. Final consumers, even if normally entitled to deduct input VAT, may not deduct VAT charged on these products.
3. The preferential excise duty arrangements for light oils used as furnace fuel are subject to special authorization.
4. 15% as from 1 September 1981.
5. On condition that more than 80% of the company's activity takes place abroad or in the FOD.
6. On condition that the VAT-registered person's activity consists predominantly in international flights.
7. For flights to or from other countries.
8. Drawback.

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TABLE 7 (cont.)

B. Reductions or exemptions of excise and/or VAT granted to certain consumer groups (cont.)

	GREECE		IRELAND		ITALY		LUXEMBOURG		NETHERLANDS	
Consumer groups	*Excise (ECU/hl)*	*VAT %*	*Excise (ECU/hl)*	*VAT %*	*Excise (ECU/hl)*	*VAT %*	*Excise (ECU/hl)*	*VAT %*	*Excise (ECU/hl)*	*VAT %*
1 Aviation										
a) commercial international flights	ex.		ex.	ex.	ex.	ex.	ex.	ex.	ex.	ex.
b) commercial domestic flights	ex.		ex.[7,8] or 2.59/23.93	ex. 0/10	ex.	18	ex.[7]	ex.[7]	ex.[7,8] or 1.16/19.01	ex. 18
c) military aircraft and aircraft of public authorities	ex.		2.59/23.93	0/10	ex. or 3.16/31.66	18	ex.	ex.	1.16/19.01	ex. 18
d) business aviation	?		ex.[7,8] or 2.59/23.93	ex. 0/10	ex. or 31.66	18	ex.[7]	ex.[7]	ex.[7,8] or 1.16/19.01	ex. 18
e) private aircraft	?		2.59/23.93	0/10	31.66	18	ex.[7] or 16.86	5(10)	ex.[7,8] or 1.16/19.01	ex. 18
2 Navigation in home waters										
a) coastal			0[8]	0	ex.	ex.	—	—	ex.	ex.
b) fishery			0[8]	0	ex.	ex.	0.60-0.92	5(10)	ex.	ex.
c) professional transport			0[8]	0	1.30	15	0.60-0.92	5(10)	ex.	18
d) pleasure boats (d = petrol/gas-oil)			23.93[11]/12.59	10/0	31.66/1.30	18/15	16.86/0.60-0.92	5(10)	19.01[11]/1.16	18
3 Agriculture (gas-oil)										
a) in general	1.12		2.59	0/10	ex.	6	0.61-0.92	5(10)	1.16	4
b) horticulture	1.12		ex.[8]	0/10	ex.	6	0.61-0.92	5(10)	1.16	3
4 Auto-consumption										
a) refineries		—	ex.	—	ex.	—	—	—	ex.	—
b) petrochemical plants		—		—	ex.	—	—	—	ex.	—
5 Public transport (gas-oil)										
a) railroad	—		2.59	0	ex.	15	0.60-0.92	5(10)	1.16	18
b) buses	—		2.59	0	1.30	15	4.84	5(10)	6.58	18
6 Diplomatic missions and consulates	ex.	ex.	ex.	ex.	ex.	ex.	ex.	ex.	ex.	ex.
7 International organisations			ex.		ex.		ex.		ex.	
8 Armed forces of another State			ex.		ex.		ex.		ex.	
9 Re-refined waste oils			ex.	10[4]	3.58	15	0.24	5	0	18

9. For passenger transport.
10. As motor fuel for tractors.
11. Exemption for vessels proceeding to destinations abroad.
12. If the energy is predominantly used for producing and processing mineral oils.
13. Exemption (drawback) wil be abolished in three steps up to 1983.
14. Subject to a quota.
15. Passenger transport is exempted. (*Editor's note:* In the EEC document there is no reference to this footnote in the text.)

French or German versions of Table 7 are available upon request.

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UNICE and Taxation of Petroleum Products

On 2 February 1982 UNICE gave its opinion on document COM(81) 511 final of 9 September 1981, "Taxation of Petroleum Products" (Commission Communication to the Council)

1. SUMMARY OF THE COMMUNICATION TO THE COUNCIL

The Communication of the Commission is an argument in favour of joint efforts as regards taxes on oil. Although the Commission is concerned with economic policy, energy policy and public finances, the energy aspects are given as the main basis for the proposals made. The Commission sets out its views on various energy problems, especially as regards energy saving and substitution. The present incentives and achievements in the matter of energy saving and substitution are regarded as inadequate. In this connection the Commission argues that the level of prices of oil products should be raised by means of taxes, especially on heating oil and heavy fuel oil so as to accelerate the adjustment processes necessary.

2. ASSESSMENT OF THE COMMISSION'S PROPOSALS

The points made below refer essentially to energy policy, since this is the issue which looms largest in the Commission document. More attention and weight is naturally given here to industrial production and use aspects than to private consumption. Account is also taken of general economic policy considerations.

2.1. View of the Commission's diagnosis of energy problems

UNICE does not at all go along with the Commission thesis that petroleum product prices are not high enough to encourage saving and substitution and should therefore be raised by means of taxes.

The need for investment to cope with energy constraints is fully recognised by business and industry, which act accordingly wherever possible. The price mechanism has clearly played an effective part. A few figures, chosen among many others, illustrate this:

- whereas at the end of the 70s about 80% of the boilers ordered by German Industry were fuel burning, the figure had fallen to 40% (i.e. by half) by 1980. (The new trend being in the direction of (1) fuel/gas boilers using interruptable supplies of gas, and (2) boilers using residual heat or heat from waste);
- in German Industry the yearly consumption of heating oil (light and heavy fuels) dropped from 40 million TCE in 1973 to 25 million TCE in 1980. A further fall of 4 million TCE is expected in 1981, bringing down consumption to 21 million. These figures are a good reflection of Community figures as a whole.

Hence, even before considering the technical details of the Commission's proposals, there is the serious question of deciding whether the proposals are desirable and necessary at all.

2.2. Economic, technical and political problems created by the fiscal measures recommended

Irrespective of the issue whether the public authorities really need to add other general incentives to the price mechanism, one must admit that resort to taxation, at any rate, is not necessarily an effective way of coping with energy constraints.

This can be shown as follows:

a) as mentioned above, there may be serious technical obstacles to investment. For instance, many big firms which would be interested in converting to coal do not always have the extra space necessary for handling this sort of fuel. SMEs, on the other hand, might have financial problems. Account must also be taken of the procedures for obtaining authorisation, which can be long drawn out.

   Increasing fiscal pressure does not help here. All it does is to erode the financial resources of consuming firms. Moreover, in the case of administered prices, tax increases often diminish the flexibility of pretax prices, with adverse effects on the financial situation of enterprises.

b) A deliberate increase in the price of oil products could, in times of supply difficulties, encourage the OPEC to hasten the upward movement in the price of crude oil.

c) The principle of a gradual elimination of fiscal exemptions enjoyed by oil refineries and petro-chemical concerns throughout the Community in respect of oil products used in production can be objected to on three counts:
   - first of all, the oil and petro-chemical sectors are definitely among those which for 10 years have been making consistent efforts to save energy, and have obtained good results. No further incentive is needed here; far from encouraging investment, the use of taxes would hinder it, by diminishing the financial resources which could be devoted to investment in rational use of energy. Furthermore, this would penalize the use of residual petroleum products as a source of process heat, which is precisely a good example of rational use of energy;
   - the elimination of the exemption would only exacerbate the competitive disadvantage suffered by the EEC relative to oil producing countries which are increasingly interested in on-the-spot refining. This would mean creating additional difficulties for a sector which already has serious adjustment problems;
   - the general exemption situation at the moment has the advantage of providing perfect fiscal harmonisation at Community level.

d) In addition to this specific matter, it is obvious that the measures proposed would be detrimental to the competitiveness of European Industry as a whole compared with its international rivals, especially as regards chemicals. Further difficulties would be created on the employment level. The remedies proposed therefore are the carriers of even more serious diseases.

e) Quite apart from these outside considerations it must be said, too, that the views of the Commission on replacing petroleum products are not always very clear.

   As regards heavy fuel, it must be remembered that electricity cannot be regarded as a good substitute if it is produced from oil products or natural gas.

   Replacing heavy fuel by natural gas often is not the best solution either, especially in Member Countries that do not have natural gas deposits. There is a danger that one might replace dependence on oil by an equally harmful dependence on natural gas.

   Furthermore, one cannot see the logic of introducing a hierarchy of energy prices so as to encourage substitution. In paragraph 2.4 it is stated that "more economical alternatives (than oil) already exist, and the use of oil should be discouraged here (production of power and heat)". If oil substitutes are more economical to use, and are offered in sufficient quantities, it is odd that it should be necessary to discourage firms from using oil. If, on the other hand, the oil substitutes are not yet offered in sufficient quantities, it would be dangerous to aim at increasing the price of oil so as to discourage its use as energy, since this would mean pushing up industrial production costs before the more economical factors were available.

   It would be pointless, and dangerous, therefore, to try to reduce dependence on oil and to encourage the use of other energy sources before ensuring the necessary supplies of the substitute.

Among many sectors where the taxation envisaged would only add to production costs, one could quote inland waterway transport, where the possibilities of finding a substitute for diesel engines are practically nil. It is unthinkable that sectors hit by depression, such as the steel industry, should be saddled with extra costs for the transport of raw materials and finished products. This applies, of course, to other industrial sectors too.

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2.3. Taxation as a means of smoothing price changes

The Commission considers that price policy should provide consumers with indications, as clear and as far-sighted as possible, as to future price developments, and that, in this context, taxes on petroleum could help to ensure more regular adjustments in oil product prices.

UNICE does not find this argument very convincing. The regular tax adjustment proposed would imply clear and reliable forecasts as to the quantities of petroleum available, movements in the price of other energies, the shape of demand, political factors and technical progress. A great deal has been written to show the fallibility of energy forecasting and it would be dangerous for the economy to be dependent on guidelines provided by a central forecasting body.

The Commission suggests that tax adjustments should aim at preventing temporary falls in price, possibly through the building up of financial reserves in time of price falls, which could be used to delay the next rise, or spread it over time. Industry does not wish to lose the benefit of any fall in price that might occur. Furthermore, as to the question whether price movements should be carefully evened out, the point could be made that the instability of the petroleum market is a strong argument for dropping this source of energy, wherever this is technically possible.

2.4. Conclusion: Which tax harmonisation strategy?

The general discussion about tax harmonisation in the Community is not new, and UNICE has, on several occasions, expressed support for moves in this direction, so long as the approach was across the board and neutral.

In this conection UNICE would like to make a few suggestions which, necessarily modest, call for more thorough studies with public authorities.

a) Motor fuel taxation should be studied in the context of the overall taxation of vehicles, which includes a series of taxes (VAT on purchase, road taxes, etc.), which must also be taken into account for achieving real harmonisation.

b) If one wishes to make progress in the matter of harmonising taxes on heating fuels (gas-oil and fuel), one must firmly keep in mind the fact that taxes on heating oil constitute only a small proportion of taxes on oil products generally (7.3% of receipts). The tax effect on the selling price of these products is limited too. It might therefore be simplest to limit taxation to motor fuels, leaving industrial fuels exempt througout the Community, which would mean harmonisation.

c) This zero level tax harmonisation as regards industrial fuels would only make sense if all energy products used by industry were looked at from the angle of fiscal harmonisation. The fact is that, in a given country, users may find a favourable tax situation as regards some energy products, and an unfavourable one as regards others. Altering the tax situation of one energy source could upset the prevailing pattern and balance. In general, it must be realised that intra-Community differences as regards taxes on energy can have a compensatory effect by off-setting other intra-Community differences in the matter of productivity, interest rates, wages costs, etc.

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Federal Taxation of Foreign Governments, International Organizations, and Their Employees in the United States

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I. INTRODUCTION

Citizens and residents of the United States, and certain non-resident aliens as well, are subject to a bewildering variety of U.S. taxes imposed at the federal, state, and local levels. The federal government imposes taxes on income, gifts, transfers by reason of death, and certain other items not considered in this article. All states impose taxes on income or sales or both. Most cities and counties tax the ownership of real and even personal property and some, such as New York City, impose an income tax as well. The many outposts of foreign governments in the United States and the numerous international organizations that are located there, and of course the employees of both, are naturally interested in the extent to which they are subject to this complicated tax regime. Because the federal taxes are usually the highest, and because the state and local rules often follow the federal treatment, the focus of the potential taxpayer's concerns and of this article is on taxation at the federal level.

A decade ago this *Bulletin* published an article that thoroughly explored the historical background of U.S. income taxation of foreign governments, international organizations, and their employees and described the state of the law at the time.[1] Since then, new regulations have been issued concerning the income taxation of official foreign entities, while legislative, judicial, and administrative developments have taken place that will have a significant impact on the income tax status of their employees. An updated review of these topics therefore appeared to be in order. In addition, due to expanding investment by alien individuals in U.S. property, attention to estate and gift taxation of international organization and foreign government employees is also timely.

II. TAXATION OF FOREIGN GOVERNMENTS AND INTERNATIONAL ORGANIZATIONS

Section 892 of the U.S. Internal Revenue Code provides that the investment income of "foreign governments or international organizations" from United States sources shall be exempt from United States income taxation. In contrast, income derived from "commercial activities" within the United States is not exempt.[2] Accordingly, whether a foreign entity is taxable on its income from United States sources will be determined by (1) whether the entity falls within the statutory definition of "foreign government" or "international organization" and (2) whether the income from United States sources is derived from "commercial activities" or from investment.

A. Foreign governments

The term "foreign government" is not defined by the Internal Revenue Code, but is defined in the regulations under section 892. The regulations state that the term "foreign government" applies to all "integral parts or controlled entities of a foreign sovereign".[3] The terms "integral part" and "controlled entity" are then separately defined.

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1. Rendel, *United States Income Taxation of Foreign Governments, International Organizations and their Employees*, 26 Bull. Int'l Fiscal Doc. 448 (1972).
2. Treas. Reg. § 1.892-1(a)(3)(i).
3. Id. § 1.892-1(b)(1).

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An "integral part" of a "foreign sovereign" is defined in the regulations as any body, however designated, that constitutes a governing authority of a foreign country.[4] Prior to issuance of the regulations, the Chilean *Corporación de Fomento de la Producción* had been held by the U.S. Tax Court to be an "integral part" of the Chilean government.[5] In addition, numerous foreign cultural organizations have received rulings from the Internal Revenue Service that they qualify as "integral parts" of a foreign sovereign.[6]

A "controlled entity" of a foreign sovereign is defined as an entity juridically separate from a foreign sovereign that meets all of the following requirements: (1) it is wholly owned and controlled by a foreign sovereign, directly or through other "controlled entities"; (2) it is organized under the laws of the foreign sovereign that owns it; (3) its net earnings are credited to its own account or to other accounts of the foreign sovereign without inuring to the benefit of any private person; and (4) its assets vest in the foreign sovereign upon dissolution.[7] Examples of entities that have been found by the Internal Revenue Service to be "controlled entities" are certain foreign central banks of issue,[8] the Foreign Currency Board of an unnamed country,[9] an export-import loan authority,[10] a government-owned hospital,[11] an orchestra association,[12] and a tourist board.[13] The regulations specifically provide that a pension trust for foreign government employees is a "controlled entity" if the trustees are appointed by the foreign government and the pension plan provides for definitely determinable benefits.[14] Favorable rulings have been issued to several such trusts.[15] Even if they do not fall within the special pension trust provisions of the regulations, government sponsored welfare benefit programs may qualify as "integral parts" or "controlled entities" of a foreign sovereign. An example is the favorable ruling issued in 1979 to a foreign "fund" providing "sickness, injury, bereavement and old age" benefits, not limited to government employees.[16]

Entities owned and controlled by more than one foreign sovereign are not considered "controlled entities",[17] and the East Caribbean Currency Authority and an unnamed "fund" were each ruled not to be a "controlled entity" on this basis.[18] A number of governments may, however, collectively constitute a "foreign government".[19] The test is whether the group as such is empowered to exercise, independently, substantial governmental powers binding the member governments.[20] Under this test the European Economic Community, the European Coal and Steel Community, and the European Atomic Energy Community were held to be "foreign governments".[21]

B. International organizations

The term "international organization", unlike the term "foreign government", is defined in the Internal Revenue Code. Section 7701(a)(18) of the Code defines "international organization" as any "public international organization" afforded the privileges of the International Organizations Immunities Act. The latter Act is codified at sections 288 to 288i of Title 22 of the U.S. Code. Under section 288 the entities afforded the privileges of the Act are "public international organizations" (1) in which the United States participates pursuant to any treaty, or otherwise under the authority of Congress, and (2) which shall have been designated by the President as qualifying for such privileges through an Executive Order. The forty-six organizations that have to date been so designated are listed in the appendix to this article.

C. Commercial activities

As noted above, neither "foreign governments" nor "international organizations" are exempt from tax on their income derived from "commercial activities". Any activity conducted in the United States of the sort ordinarily conducted with a view towards production of income is a "commercial activity" unless the regulations under section 892 specifically provide otherwise.[22] The following activities are listed in the regulations as not constituting "commercial activities": investing in corporate shares, even though they represent a controlling interest; investments in bonds, other securities, loans, net leases, or unproductive land; holding bank deposits; presenting amateur athletic exhibitions; giving cultural performances; purchasing goods for use of the foreign sovereign; engaging in activities not constituting a trade or business in the United States; and engaging in activities not customarily carried on for profit.[23]

III. REMUNERATION FROM A FOREIGN GOVERNMENT OR AN INTERNATIONAL ORGANIZATION

Section 893 of the Internal Revenue Code provides that the wages, fees, or salary of any alien employee of a "foreign government" or "international organization" received as compensation for services to such government or organization is exempt from United States taxation. If the alien is employed by a foreign government, the character of the services performed must be similar to those provided by employees of the U.S. government outside the United States, and the foreign government must grant an equivalent exemption to employees of the U.S. government.[24] Although the law requires that the

4. Id. § 1.892-1(b)(2).
5. *Vial v. Commissioner*, 15 T.C. 403 (1950).
6. Letter Ruls. 8037112, 8012078, 7934045, 7849014, 7806073, 7806072.
7. Treas. Reg. § 1.892-1(b)(3).
8. Rev. Rul. 75-298, 1975-2 C.B. 290; Letter Ruls. 7837006, 7833050.
9. Rev. Rul. 76-329, 1976-2 C.B. 223.
10. Letter Rul. 8101060.
11. Letter Rul. 8038032.
12. Letter Rul. 7934119.
13. Letter Rul. 7811023.
14. Treas. Reg. § 1.892-(b)(4).
15. Letter Ruls. 8020139, 7841076, 7804046.
16. Letter Rul. 7951046.
17. Treas. Reg. § 1.892-1(b)(3).
18. Rev. Rul. 77-482, 1977-2 C.B. 242; Letter Rul. 7826098.
19. Rev. Rul. 68-309, 1968-1 C.B. 338.
20. Rev. Rul. 77-41, 1977-1 C.B. 226.
21. Rev. Rul. 68-309, 1968-1 C.B. 338.
22. Treas. Reg. § 1.892-1(c)(1).
23. Id. § 1.892-1(c)(2).
24. I.R.C. § 893(a)(2), (3).

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State Department shall certify to the Treasury that these two requirements have been met in the case of each foreign government,[25] we are aware of only two cases in which an alien employee of a foreign government was taxed because no such certification was issued with respect to his government.[26]

For purposes of section 893, consular or other officers, as well as non-diplomatic representatives, are treated as foreign government employees.[27] However, former employees of foreign governments and international organizations are not protected by section 893.[28] For example, the Internal Revenue Service has ruled that a former employee of a foreign government was taxable on his pension from that government.[29]

An alien employeee of a foreign government or international organization that wishes to obtain or retain U.S. immigrant status must file a waiver of any exemptions under the law deriving from his occupational status.[30] In most cases, the filing of such a waiver will void the application of section 893 to the alien, and he will become taxable on remuneration from his foreign government or international organization employer.[31] The waiver, however, will not eliminate the exemption if it is based upon a treaty with the foreign government or the articles of agreement of the international organization.[32]

The term "foreign government" is not defined in section 893 or the regulations thereunder, but the regulations under section 892 provide that the term "foreign government" has the same meaning for purposes of section 893 as it does for purposes of section 892.[33] Thus, the principles, discussed in the preceding section, that determine whether an entity itself qualifies for tax exemption as a "foreign government" should also determine whether wages, fees, and salaries paid by the entity to its alien employees are also exempt from taxation. In the case of "international organizations", the regulations again make clear that the same criteria apply for purposes of both sections 892 and 893.[34]

IV. THE DETERMINATION OF RESIDENCY STATUS

The taxation of income which is unrelated to a foreign government or international organization employee's official duties will depend upon whether the employee is a resident or non-resident of the United States. If the employee is a non-resident alien, he will be taxed on fixed and determinable income from U.S. sources, such as rent from U.S. property and dividends and interest from U.S. corporations, at the rate of 30% of the gross amount of such income.[35] In addition, he will be subject to tax at the rate of 30% on net U.S. capital gains, other than gains from the sale of U.S. real estate, if he is present in the U.S. for 183 days or more during the taxable year in which such gains are realized.[36] Capital gains realized from the sale of U.S. real estate (or the sale of stock in a corporation primarily holding U.S. real estate) are subject to tax on essentially the same basis as they are to a U.S. resident, except that a minimum amount of tax, generally equal to 20% of the gain, must be paid.[37]

If the employee is a resident alien, he will be subject to U.S. income tax, according to the progressive schedule of rates applicable to U.S. citizens, on all of his worldwide income (except for wages, fees, and salaries from his foreign government or international organization employer). Foreign income tax paid with respect to foreign source income is usually creditable against the U.S income tax on such income.[38]

Under the income tax regulations, all aliens are presumed to be non-resident aliens for income tax purposes.[39] The regulations also provide, however, that this presumption may be rebutted by acts showing an intention to acquire residence or by a stay of such an extended nature as to constitute the alien a resident.[40] A definite intention to acquire residence is apparently manifested by the absence of any definite intention concerning the length and nature of the alien's stay in the United States,[41] and a stay of one year is of "such an extended nature" to create the presumption of residence.[42] In short, the alien is a resident unless he has a definite intention to leave after accomplishing a purpose that does not require an extended stay. If he stays more than one year the burden of proving his intention shifts from the Internal Revenue Service to the alien.

The determination of the alien's intentions is based solely on objective manifestations of such intentions. No statement made to the immigration authorities, nor any document issued by a foreign government evidencing the establishment of residence abroad, can guarantee that an individual will be accorded non-resident status. Instead, such factors as the length of his stay in the United States; the nature, extent, and reasons for his temporary absence from a foreign home; his visa classification; the size and nature of his physical dwelling in the United States; and the extent of his integration into U.S. society will determine whether an alien is a U.S. resident.

An alien whose stay in the United States is limited to a "definite period" by the immigration laws is considered under the income tax regulations to be a non-resident "in the absence of unusual circumstances".[43] In practical terms, therefore, visa classification should usually be the most significant factor in determining residence, al-

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25. Id. § 893(b); Treas. Reg. § 1.892-1(b).
26. *Ratarra v. Commissioner*, 40 T.C.M. 1119 (1980) (Thailand); Letter Rul. 7929044 (Rhodesia).
27. Treas. Reg. § 1.893-1(a).
28. Rev. Rul. 56-44, 1956-1 C.B. 319.
29. Id. However, under a number of income tax treaties currently in force, foreign government pensions are not subject to U.S. taxation.
30. 8 U.S.C. § 1257(b)(19).
21. Treas. Reg. § 1.893-1(a)(5), (b)(4).
32. Id. § 1.893-1(c); Rev. Rul. 75-425, 1975-2 C.B. 291; Letter Rul. 7935001.
33. Treas. Reg. § 1.892-1(f)(1).
34. Id. §§ 1.892-2(a); 1.893-1(b)(3).
35. I.R.C. §§ 871(a)(1)(A), 861(a)(1), (2), (4). The 30% tax on corporate dividends and interest is not payable if less than 20% of the corporation's gross income is from U.S. sources. Id. § 861(a)(1)(B), (2)(A).
36. Id. § 871(a)(2).
37. Id § 897(a).
38. See I.R.C. § 901(a).
39. Treas. Reg. § 1.871-4(b).
40. Id. § 1.871-4(c)(2)(iii).
41. Id. § 1.871-2(b).
42. Rev. Rul. 69-611, 1969-2 C.B. 150.
43. Treas. Reg. § 1.871-2(b).

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though it is not entirely clear what the regulations mean by a "definite period". D-1 (alien crewman) visas have been held to limit residence to a "definite period" within the meaning of the regulations,[44] but there is otherwise no authoritative guidance. In our view, visas such as B (visitor), J (exchange student or scholar), and L (intracompany transferee) visas, which limit the holders' stay to 12 months or less,[45] are probably "definite period" visas. Visas such as F (student) visas and most G (international organization employee) visas, which limit the holders' stays only to the time they continue pursuing the activities on which their status is based,[46] may not be "definite period" visas.

An alien seeking to retain his non-resident status should also consider the following possibilities: leasing accommodations in the U.S. for short periods of time rather than purchasing them; continuing to own and occupy his home abroad; maintaining an office and substantial business operations abroad; not owning a car in the U.S. and not applying for a U.S. driver's license; not belonging to clubs and churches in the U.S., but continuing affiliations with and contributions to such groups abroad; not maintaining substantial savings or checking accounts in the United States; using traveler's checks and international credit cards rather than local charge accounts for purchases in the U.S.; and continuing to designate a foreign place of residence or domicile in legal documents and in formal correspondence. Although it is not necessary for an alien to comply with all of these recommendations in order to qualify as a non-resident, the more closely they are followed, the stronger will be his case for treatment as a non-resident. Unfortunately, the Internal Revenue Service will not rule in advance on the resident status of an alien if the determination depends on facts that cannot be confirmed prior to the end of the taxable year.[47]

V. ESTATE AND GIFT TAXES

Residents of the United States are taxable on the transfer of property by gift or bequest. However, a $10,000 per-donee, per-annum exclusion from the gift tax,[48] combined with a lifetime gift and estate tax credit of $62,800,[49] means that substantial amounts of property must be transferred before any gift or estate tax is actually payable. Resident aliens are taxable on gifts and bequests of property wherever situated within or without the United States. Non-resident aliens, by comparison, are taxable only on gifts and bequests of property situated within the United States.[50] Generally, for both gift and estate tax purposes, stock in U.S. corporations and the debt obligations of U.S. persons are deemed to be situated within the United States, while stock in foreign corporations and the debt of foreign persons are deemed to be situated without the United States.[51]

The test of residence for estate tax purposes is whether the individual is "domiciled" in the United States at the time of death.[52] In the United States the term "domicile" connotes a more permanent attachment than the term "residence". It is determined, not by length of stay, but by whether one has a "definite present intention" to depart at a later date.[53] Employees of foreign governments and international organizations who wish to avoid U.S. estate and gift tax on their overseas property must take care to preserve their foreign domiciles because the Internal Revenue Service has recently ruled that holding a G-4 or A-1 visa is *not* conclusive evidence that a U.S. domicile has not been established.[54] A number of countries have Estate and Gift Tax Treaties with the United States that may bear on a particular individual's liability for these taxes.[55] Nationals of these countries contemplating large gifts or bequests should examine the pertinent provisions of applicable treaties to ascertain their rights.

VI. SALE OF PERSONAL RESIDENCE

Because of the possibility for substantial appreciation and the very generous deductions allowed homeowners against otherwise taxable income, many U.S.-based employees of foreign governments and international organizations will purchase one or more personal residences during their stay in the United States. In our experience the consequences arising from the sale of their personal residences is the tax question most commonly faced by such employees.

As noted above in Part IV, a non-resident is taxable on essentially the same basis as a resident on gain from the sale of real estate, and this rule also applies to the sale of a personal residence. Gain from the sale of a personal residence is "capital gain" rather than "ordinary income". This is principally significant if the residence has been owned for more than one year, in which case the gain is "long-term capital gain". In computing his taxable income, an individual may deduct 60% of any long-term capital gain.[56]

The tax laws provide relief to an individual who sells his personal residence and purchases a new residence during the 24-month period preceding, or the 24-month period following, the sale of the old residence.[57] If the individual buys a new residence within the prescribed period, he is

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44. See *Sanford v. Commissioner*, 27 T.C.M. 266 (1968); Tech. Adv. Mem. 8135028.
45. See 8 C.F.R. § 214.2(b), (j)(1), (l)(1), (3)(17).
46. See id. § 214.2(f)(2), (g)(1).
47. Rev. Proc. 80-38, 1980-2 C.B. 771.
48. I.R.C. § 2503(b).
49. Id. § 2010(a). This credit will be increased in phases after 1982 until it reaches $155,800 in 1986. Id. § 2010(b). The effect of a $155,800 credit is that $600,000 of assets may be gratuitously transferred free of estate and gift tax.
50. Id. §§ 2103, 2501. The rules concerning estate and gift taxation of non-resident aliens have recently been outlined in detail in Schlinkert, "Estate Planning for the Nonresident Alien", Tax Management Int'l J., Aug., 1981, at 3. Another recent article on the subject, focusing on real estate investment, is Mene, "Estate Planning for Nonresident Aliens", 59 Taxes 617 (1981).
51. I.R.C. §§ 2104(a)(c), 2511(b); Treas. Reg. § 25.2511-3(b).
52. Treas. Reg. § 20.0-1(b)(1).
53. Id.
54. Rev. Rul. 80-363, 1980-2 C.B. 249 (G-4 visa); Tech. Adv. Mem. 8137027 (A-1 visa).
55. Countries with which the United States has Estate Tax Treaties are: Australia, Belgium, Canada, Finland, France Greece, Ireland, Italy, Japan, the Netherlands, Norway, South Africa, Switzerland and the United Kingdom. The treaties with Australia, France, Japan and the United Kingdom also extend to gift taxes.
56. I.R.C. § 1202(a).
57. Id. § 1034(a).

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taxable on gain from the sale of his old residence only to the extent the "amount realized" from the sale of his old residence exceeds the "cost" of his new residence. For this purpose, the "amount realized" from selling the old residence is reduced by sales commissions, legal fees, and other costs incident to selling the old residence, including certain expenses for work performed on the old residence to assist in its sale.[58] Conversely, the "cost" of the new residence includes fees, commissions, and other expenses incurred in acquiring it, unless they are deducted for U.S. income tax purposes.[59] Mortgage "points", for example, may qualify as interest and, if they do, are deductible in computing taxable income.[60]

This relief from tax on the sale of a personal residence appears to be available even if the individual acquires his new residence outside the United States, provided he was a resident alien at the time he sold his old residence.[61] Indeed, if the alien moves outside the United States, the period during which he must acquire his new residence is extended from two to four years.[62] If, however, the alien was a non-resident at the time he sold his old residence in the United States, relief from taxation is not available unless the new residence is also located in the United States.[63]

Another form of tax relief for homeowners is an exclusion from income of up to $125,000 of gain from the sale of a personal residence if the homeowner is at least 55 years old at the time of sale.[64] A taxpayer may elect this exlusion with respect to only one sale in his lifetime.[65]

VII. U.S. INCOME TAX RETURN FILING REQUIREMENTS

A non-resident alien is required to file a return on Form 104NR if he was engaged in a trade or business in the United States at any time during the taxable year,[66] he has elected to report income from real property on a net basis,[67] or there was underwithholding from U.S. source fixed or determinable annual or periodical income, such as interest or dividends.[68] Employment in the United States with a foreign government or international organization presumably constitutes a U.S. trade or business, and employees of these organizations should therefore file a return unless their gross income, exclusive of exempt wages, is less than $1,000.[69]

A non-resident alien married to a U.S. citizen or resident may elect to be taxed as a resident alien in order to file a joint return with a citizen or resident spouse and thereby qualify for the generally lower rates applicable to individuals filing joint returns.[70] An alien employee of a foreign government or international organization would not subject his remuneration to taxation by electing to be taxed as a resident, because the exemption of such income from tax under section 893 is based on citizenship rather than residence.[71] Under regulations recently proposed by the Internal Revenue Service, a non-resident alien who makes the election in order to file a joint return may not claim to be a non-resident for purposes of any U.S income tax treaty.[72] Although the election may later be revoked, once revoked it may never be made again between the same individuals.[73] The election should not, therefore, be made without careful consideration of the couple's future tax planning needs.

If an alien changes his status from resident to non-resident during the taxable year, he may be taxed "as though his taxable year were comprised of two separate periods", and the tax liability for each period will be computed under its own set of rules.[74] In determining a dual-status taxpayer's tax rate for the year, however, all income must be taken into account, including any part earned during the period of non-residence.[75] A dual-status taxpayer's exemptions for himself, his spouse and dependents may not exceed the taxable income for the period he is a resident alien.[76] If the dual-status taxpayer is a resident alien at the end of the taxable year, he may elect to be taxed as a resident alien for the entire year.

To file as a dual-status taxpayer, the employee should file Form 1040 and write across the top of the return "Dual-Status Return". A separate schedule must be attached to his return to show the income for the part of the year he was a non-resident. Form 1040NR may be used as a separate schedule, but the employee should mark "Statement" across the top thereof.[77]

If the U.S. residency is established after the commencement of a calendar year and the individual does not want to subject to U.S. taxation income from U.S. sources earned during the portion of the year he was a non-resident, he may adopt a fiscal year. If he has not previously filed as a non-resident on a calendar year basis, he may adopt a fiscal year without obtaining the perior approval of the Internal Revenue Service so long as he maintains books and records that "reflect income adequately and clearly on the basis of an annual accounting period".[78] The establishment and maintenance of adequate books and records may not be delayed beyond the end of the first fiscal year.[79]

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58. Treas. Reg. § 1.1034-1(b)(4).
59. Id. § 1.1034-1(b)(7).
60. Rev. Rul. 69-188, 1969-1 C.B. 54; see also I.R.C. § 461(g)(2) (year of deduction).
61. Rev. Rul. 71-495, 1971-2 C.B. 311.
62. I.R.C. § 1034(k).
63. Id. § 897(a).
64. Id. § 212(a), (b).
65. Id. § 121(b)(2).
66. Treas. Reg. § 1.6012-1(6)(1)(i).
67. Id. § 1.6012-1(b)(2).
68. Id.
69. Section 1.6012-1(b)(1)(i) of the regulations states that if a non-resident alien has no gross income for the taxable year, he is not required to complete the return schedules but must attach a statement to the return indicating the nature of any exclusions claimed and the amount of such exclusions to the extent such amounts are readily determinable. The Code, however, clearly provides that an income tax return need not be filed by an individual, including a non-resident alien, whose gross income is less than $1,000. See I.R.C. § 6012(a)(1).
70. I.R.C. § 6013(g).
71. Id. § 893(a)(1); Leter Rul. 7839026.
72. Prop. Treas. Reg. § 1.6013-6(a)(2)(v).
73. I.R.C. § 6013(g)(4)(A), (6).
74. Treas. Reg. § 1.871-13(a).
75. Id.
76. Treas. Reg. § 1.871-13(d)(2).
77. I.R.S. Publication 519 at 6.
78. I.R.C. § 441(g); Treas. Reg. § 1.441-1(g)(3); Rev. Rul. 80-352, 1980-2 C.B. 160; *Godson v. Commissioner*, 5 T.C.M. 648 (1946). Cf. *MacLean v. Commissioner*, 73 T.C. 1045 (1980) (taxpayer required to use calendar tax year because he did not keep adequate books and records for fiscal tax year filing as required by I.R.C. § 441(g)).
79. *Freudman v. Commissioner*, 10 T.C. 775 (1948).

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From a tax standpoint, adoption of a fiscal year appears very desirable. The practical problems of this approach, however, may outweigh the tax benefits. The employee's adoption of a fiscal year may result in greater scrutiny by the Internal Revenue Service than if the employee adopted a calendar taxable year. In addition, the filing of a return on a fiscal basis will require greater efforts by the employee since certain information statements, customarily available at the end of a calendar year, may be unavailable during the year.

APPENDIX

African Development Fund.
Asian Development Bank.
Caribbean Organization.
Customs Cooperation Council.
Food and Agriculture Organization.
Great Lakes Fishery Commission.
Inter-American Defense Board.
Inter-American Development bank.
Inter-American Institute of Agricultural Sciences.
Inter-American Statistical Institute.
Inter-American Tropical Tuna Commission.
Intergovernmental Maritime Consultive Organization.
Interntional Atomic Energy Agency.
International Bank for Reconstruction and Development.
International Centre for Settlement of Investment Disputes.
International Civil Aviation Organization.
International Coffee Organization.
International Cotton Advisory Committee.
International Cotton Institute.
International Development Association.
International Fertilizer Development Center.
International Finance Corporation.
International Hydrographic Bureau.
International Joint Commission – United States and Canada.
International Labor Organization.
International Maritime Satellite Commission.
International Monetary Fund.
International Pacific Halibut Commission.
International Secretariat for Volunteer Service.
International Telecommunication Union.
International Wheat Advisory Committee (International Wheat Council).
Lake Ontario Claims Tribunal.
Organization of African Unity (OAU).
Organization of American States (including Pan American Union).
Pan American Health Organization.
South Pacific Commission.
United International Bureaux for the Protection of Intellectual Property (BIRPI).
United Nations.
United Nations Educational, Scientific, and Cultural Organization.
Universal Postal Union.
World Health Organization.
World Intellectual Property Organization (WIPO).
World Meteorological Organization.

Conference Diary

JULY 1982

Practising Law Institue: International estate planning (including: Taxation of non-resident alien in the U.S.; The use of foreign situs trusts). New York City (U.S.A.), July 22-23 (English).

SEPTEMBER 1982

36th Annual Congress of I.F.A.: I. The tax treatment of interest in international economic transactions. II. Taxation of payments to non-residents for independent personal services. Montreal (Canada), September 12-16 (English, French, German, Spanish).

Confédération Fiscale Européenne (C.F.E.): Third European Congress of Tax Consultants (including: State of tax harmonisation in Europe; The application of wealth taxes and taxes arising on death to foreign assets and liabilities; The practical application of international tax provisions (working groups)). Aachen (Germany), September 30 to October 2 (English, French, German, Spanish).

OCTOBER 1982

Management Centre Europe: International Tax Management (including: Inter-company pricing of goods; inter-company licensing; service fees; inter-company loans; handling of disputes between tax administrations) (Seminar). Nice (France), October 11-12 (English).

Management Centre Europe: Taxation of International Group Companies and Branches (including: Taxation of branches and subsidiaries; taxation of shareholders; domestic and tax treaty "anti-avoidance" measures) (Seminar). Brussels (Belgium), December 2-3 (English).

OCTOBER 1983

37th Annual Congress of I.F.A.: I. Tax avoidance/tax evasion. II. International problems in the field of turnover taxation. Venice (Italy), October 10-15 (English, French, German, Spanish).

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The Dynamics of Property Tax Delinquency in the Philippines – A Case Study –

by Milwida M. Guevara *

Evasion is a serious problem in the collection of property tax in the Philippines. From 1974 to 1979, local authorities were only able to collect an average of 51% of the rates due.[1] This situation has precluded the property tax from becoming a buoyant source of revenue for local governments.

In accounting for this problem, local authorities blamed their non-use of legal sanctions in the collection of delinquent taxes on the lack of adequate personnel in the office of the treasurer and the poverty of the taxpayers (NTRC 1974; NTRC 1980).

Another angle was brought up in a study of the same problem by a team from Syracuse University, United States. They noted instances where a land parcel in a local unit in the Philippines was listed as belonging to more than one owner. Apparently this was caused by the failure of assessors to monitor land transfers.

These findings notwithstanding, there is reason to believe that evasion is not a mere product of a weak tax administration. Other studies substantiate the fact that evasion is multi-dimensional in character.

In analyzing delinquency in property tax in Pittsburgh, Pennsylvania (U.S.A.), Sternlieb and Lake (1976) found out that a number of the delinquent taxpayers were old, retired and with incomes below the median income in Pittsburgh 6 years before their study. They also tended to be clustered in the lower-status labourer and service occupation categories.

Vogel (1974), Spicer and Lundstedt (1976) and Lewis (1979), on the other hand, all deal with the importance of attitude in tax compliance.

Vogel (1974) investigated the variables related to attitudes favourable to tax evasion. Education, for example, was found to have an inverse relationship to the predisposition to tax evasion while the awareness of illegal opportunities exerted a positive influence on the said tendency.

In the same vein, Spicer and Lundstedt (1976) found that tax resistance is more likely when a taxpayer perceives that his terms of trade with the government are inequitable and if he personally knows many tax evaders. Their study gave no strong support to the theory of a relationship between tax resistance and the perceived severity of sanctions.

Lewis (1979), in his study of 200 male taxpayers in Bath, England, concluded that income and the amount of tax a person pays have a significant influence on his views of taxation. For example, he found out that people with incomes above £6,000 a year felt that tax avoidance is fair while people with incomes below that level felt otherwise.

Considering the above findings, our intention was to investigate the nature, extent and causes of property tax delinquency in a typical local authority in the Philippines. The study was anchored on the framework that property tax delinquency is affected by several variables as shown in the following model:

$$Y = F(X_1, X_2, X_3, X_4, X_5)$$

where:

Y = property tax delinquency index

X_1 to X_5 = characteristics of the delinquent taxpayer as follows:

- X_1 = income
- X_2 = educational attainment
- X_3 = tax ethics
- X_4 = perception of equity in the property tax system
- X_5 = perception of the probability of detection of delinquency in the property tax payment.

The length of delinquency in terms of the number of years was taken as the index of property tax delinquency. Actual data were used for income and educational attainment while the attitude of the taxpayer towards his tax obligation was measured by his score on a Likert-type attitude scale constructed for the purpose.

Prior to the survey, the researcher went over the 7,652 tax declarations in Obando,[2] Philippines by hand. Some

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1. *Editor's note:* "Rates is the British term for local taxes.

2. Obando is a municipality in the province of Bulacan. A municipality is the second smallest form of local government in the Philippines. Several barangays make up a municipality. A number of municipalities comprise a province. Provinces and cities make up the country.

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1,603 taxpayers were identified as delinquent. From these, a 5% tapering sample was chosen through systematic random sampling. Preliminary interviews were conducted with delinquent taxpayers in order to construct the attitude scale which was subjected to an item analysis. The questionnaires were administered using an interview by a team of 6, including the researcher, for 4 days. The data were analyzed using the multiple regression scheme. The variables with very small estimated coefficients were eliminated in the final model which was used. Variables which because of their related nature may exert the same effect on income, such as income and level of education, were tested for auto-correlation. To measure the significance of the independent variables, the t-statistic was computed for each estimated coefficient.

Results of the study

After reorganizing the data from the survey of delinquent taxpayers, the following profile emerged:

Over half (64%) have incomes less than ₱1,000[3] which is below the 1980 national per capita income. Among other reasons, this is because about 40% of the people questioned lack regular employment.

A quarter of the respondents have only finished elementary education. A significant number thus have had only 6 years or less of schooling.

The majority of the respondents (57%) are 50 years and above. A number of them are retired employees and cases of sick and physically handicapped taxpayers were noted.

Most of the delinquent properties are residential in nature and have assessed values from ₱1,000 to less than ₱5,000. Delinquency in commercial lands is concentrated on properties with an assessed value of over ₱5,000 while the core of the delinquency problem in agricultural lands is in properties which have assessed values of less than ₱1,000. The average length of delinquency is 4 years.

A preliminary analysis of the completed questionnaires tended to show great variability in the responses of the different samples. To minimize this, the responses were analyzed by land-use of the property owned by the delinquent taxpayer. The estimated coefficient for income was found to be so small that it was dropped from the final equation that was used. The apparent inference – that income does not exert any significant influence on property tax delinquency – should, however, be made with caution as the study acknowledges a limitation on the income data. Respondents were directly asked the amount of their income, including non-cash income. Considering the reluctance of Filipinos to reveal their true income, it is probable that the data on income were inaccurate.

To check the existence of multi-colinearity among the attitude indices, the coefficient of correlation (r) was computed. The relationship between equity and tax ethics was found significant at the .05 level so that they were not put together in one equation. Two equations were thus used:

$$Y_1 = a + bx_2 + bx_3$$

$$Y_2 = a + bx_2 + bx_4 + bx_5$$

The estimated coefficients of the regression equations are shown below. Some significant coefficients are noted in the estimated relationships for the behaviour of landowners of commercial and industrial properties and employed landowners of residential and agricultural land.

Multiple regression results

Variables/Land-use	*Industrial*	*Agricultural*	*Residential*
Education (b_2)	– .9768 *	–.7340 *	–.3079
Ethics (b_3)	– .2197 *	–.0169	–.0924
Equity (b_4)	–1.193 *	.2128	–.2866 *
Probability of detection (b_5)	.5966 *	–.1489	–.1821
R^2	.8876	.2068	.4262
R	.9421	.4546	.6529
SE	.5512	1.924	1.622

* Significant at the .05 level of confidence.

For delinquent taxpayers owning commercial and industrial properties, an inverse relationship was noted between education and property tax delinquency; tax ethics and delinquency; and the perception of equity and delinquency. This means that delinquency is more likely when taxpayers are less educated and when they are less disposed towards tax compliance. Likewise, delinquency is associated with the perception that the tax system is inequitable. The feeling of inequity was determined by the strong agreement of the taxpayer with the following statements:

1. From what I have heard, there are more property tax evaders among the rich.
2. There is no reason to pay as property tax collections are not properly spent.
3. Taxpayers who have strong political backing can evade payment easily.

A paradoxical observation is the direct relationship between the perception of the probability of detection and property tax delinquency. It appears that among landowners of commercial and industrial lands, delinquency is more probable if they expect to be caught. This finding is contrary to expectations. The attitude of the respondents towards the equity of the tax system can be used to resolve the paradox. Since the taxpayers feel that influential tax evaders enjoy the protection of certain local officials, they are confident that they can enjoy the same protection if and when they are caught. This confidence dispels the fear of penal consequences should they be caught. The fact that Obando (and a large majority of the localities throughout the Philippines) have failed to prosecute tax evaders bolsters this confidence. Among landowners of commercial properties, being caught does not matter as they can get away with it. It is likely that their financial capability to pay the penalties for property tax

3. Rate of exchange US$1 = ₱8.50.

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delinquency lessens their fear of being detected. When they are asked, in fact, of their attitudes towards the fine for delinquency, the majority of them considered it light. Under the law, delinquency is fined at 2% of the tax for every month of delinquency but the maximum penalty that can be imposed is 24% of the delinquent tax. It will thus be advantageous for the taxpayer to cumulate his tax payments instead of paying his delinquency after a year. After all, the penalty is the same whether he is delinquent for one year or for 10 years.

Among employed residential land owners, the variable which is linked with delinquency is the perception of the inequity in the property tax system. However, the t-statistic of the coefficient (–1.7369) did not reach the .05 level which is conventionally acceptable. Using the 10% level of acceptability, it can be inferred that taxpayers are more probable to be delinquent if they have the view that the property tax system is inequitable.

Among the unemployed residential landowners, a pattern of relationship was also evident between the level of education and delinquency and the perception of the probability of detection and delinquency although the t-statistic is too low for any confidence to be placed in this finding.

Variable	Coefficient	t-statistic
Education	.7494	1.158
Perception	.2572	– 1.024

Delinquency moves directly with education and inversely with the probability of detection index. This implies that among unemployed residential landowners, delinquency is associated with those who have had more schooling and who think that evasion is difficult to detect. These inferences cannot be used as generalizations because of the lack of statistical significance of the coefficient of the noted observations.

The variable which tends to influence delinquency among employed owners of agricultural land is education. The level of education of taxpayers was found to be inversely related to delinquency. Like owners of commercial properties, landowners of agricultural lands tend to be delinquent if they have not attained a high level of education.

No variable in the model appears to influence delinquency among the unemployed. To account for the cause of their delinquency one can only fall back on a qualitative analysis of the reasons given by the respondents themselves. As cited earlier, most of them pointed to their poverty as the main reason for delinquency. This is quite credible as most of them realize that payment of taxes is important. When asked to identify the 3 most important reasons why they have to pay taxes, the following were cited:

1. It is the duty of every citizen to pay taxes.
2. Taxes finance the expenditures of the government.
3. It is an honor to pay taxes.

Only the minority (4% of the respondents) related payment of taxes to fear of the government and the lack of alternative except to pay taxes.

From the interviews with respondents, it can also be observed that lack of knowledge on property taxation could be one of the contributory causes of delinquency. Both the employed and unemployed respondents showed little knowledge of the importance of the property tax. When asked, for example, which level of government spends the proceeds from the property tax, 46% admitted they did not know; 33% said that the tax accrued to the national government and only 21% knew that the tax goes to the coffers of local government. Likewise, 36% of the respondents did not know the basis of the property tax. Some said the income of the taxpayer is the tax base (7%); others thought that the tax was based on the location of the land (11%) and others flatly admitted that they did not know the tax base (14%).

Another factor which may predispose taxpayers to evasion is disagreement with the property valuation. Over half the respondents disagreed with the assessor's valuation. Disagreement came mostly from owners of residential buildings (67%) who claimed that they do not know how the buildings they owned were valued. They were puzzled that despite the age of the buildings the valuation had not gone down significantly. This confusion is caused, among other things, by the failure to understand that buildings are valued through the replacement cost approach. This misunderstanding, which is caused by the taxpayers' lack of familiarity with the property tax system, should be an area of concern in Obando and possibly in other municipalities.

The final cause of delinquency in property tax payment is defective tax administration machinery. To date, the municipality of Obando has not actively used the following remedies provided by the law to collect delinquent taxes:

- distraint of personal property, including the crops on the land of the delinquent taxpayers;
- sale of delinquent real property tax at public auction;
- collection of the real property tax through the courts.

The non-use of legal remedies is not peculiar to Obando alone as only 3 out of 10 local units in the Philippines make use of the above powers (NTRC, 1980). When asked to account for the reasons behind the failure to enforce the penal provisions of the tax laws, the treasurers cited their preference for less strong measures, such as sending letters notifying the taxpayers of their delinquent accounts. This reaction is hardly surprising. The treasurer needs not only courage but also the full support of the executive and legislative branches of the local government to enforce collection of taxes on delinquent properties. In many instances, these may be lacking.

Summary and recommendations

The findings of this study suggest that evasion of the property tax is not a simple problem. In analyzing the causes of delinquency of all the sample taxpayers, no variable stood out as clearly significant. It was only when the analysis was carried out by land use that the study was able to relate delinquency to certain independent variables as follows:

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- For owners of commercial and industrial real properties, delinquency is inversely related to education, tax ethics and the perception of equity. On the other hand, delinquency is directly related to the perception of the probability of detection.
- Among employed residential landowners, delinquency is more probable among those who think that the property tax system is inequitable.
- With employed owners of agricultural lands, delinquency is linked to a low level of education.

This changing list of factors influencing delinquency of taxpayers is quite complicated and the solutions suggested below must be qualified in certain instances. However, there are improvements in the tax administration machinery which can be generally prescribed.

Considering legal remedies first, the findings suggest that all delinquent taxes cannot be collected merely by threatening the taxpayers with civil action in court or by distraint of their personal property. A substantial number of delinquent taxpayers (40%) is employed and 64% have incomes less than ₱1,000. Bringing them to court would only create more problems for the local government. It seems clear that the enforcement of legal remedies can only be successfully applied to property with high assessed values (in this particular study, this pertains to those with assessed values above ₱5,000), especially properties which are commercial and industrial in nature. In this connection, increased vigor in the enforcement of legal remedies is called for. There is a general belief among delinquent taxpayers that the property tax system is quite inequitous. Moreover, delinquency among industrial landowners is associated with a certainty of being detected. Yet, because detection and punishment do not go together, the same taxpayers have the courage to evade the tax. They have to be convinced that the government is determined in future to collect all the taxes due. To encourage this spirit, granting a tax amnesty on delinquent property taxes is worth considering to give all property owners the chance to "make amends". As a basis for the proposed tax amnesty scheme, the government can draw the guidelines from the successful tax amnesty program on untaxed wealth and income which was implemented in 1972. After providing taxpayers with the chance to start with a clean slate, the local government can start the prosecution of evaders who have refused to cooperate.

It is also timely for the government to consider the revision of fines for delinquency. As discussed earlier, the limitation on the maximum amount of penalty to 24% of the delinquency encourages taxpayers to cumulate their delinquent accounts instead of pressuring them to pay after one year. This limitation should be lifted by allowing a 2% monthly surcharge on the amount of delinquency.

With respect to the delinquency of landowners owning residential lands, the national government should study the feasibility of granting an exemption to landowners who are incapable of payment. Although the basis of the tax is the assessed value of the property, the government should look into the possibility of using the income of the taxpayers as the basis of the exemption as residential properties on their own do not produce any income. To simplify administration, residential landowners who are exempt from payment of the income tax can also be exempt from payment of rates.

The second area which requires attention after the enforcement of legal remedies is the familiarization of taxpayers with the property tax system and its importance to local governments. Findings here suggest that the taxpayers do not know that the local governments depend heavily on the property tax to finance publicly provided goods and services. This lack of appreciation breeds indifference to payment of the tax. This is further aggravated by the failure to understand the nature of the property tax, its base and the method of its assessment. An information campaign should be launched by the municipality and two of its most effective media are the barangay officials and the teachers in the public schools. Orientation meetings on this tax with the two groups in attendance should be organized.

An increased familiarization of the taxpayers with the functions of their own local government is also favourable to the improvement of their tax ethics or their attitude towards tax compliance. Survey findings indicate a fairly low level of tax ethics. Although taxpayers feel that they have a duty to pay taxes to the national government, they cannot relate the same duty to the local government. This may be due to the lack of awareness of projects which are funded by the local government. It is surprising that residents in a particular locality like Obando are more informed of the activities and problems of the national government than those of their own local government. A publicity program, to improve this lack of communication must be designed by the municipality.

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Overseas Indians and the Finance Bill 1982

by Parimal M. Parikh*

Mr. Pranab Mukherjee, the Finance Minister of India, while introducing the Budget in the Parliament on 27 February 1982, anmnounced certain fresh incentives for Indians abroad who invest in India, which will go down as a major policy decision in the economic history of India.

It is therefore possible to strengthen the economic base of the country by augmenting foreign exchange resources and embarking upon industrial ventures where technical skills and the experience of operating in international markets are required.

More than 6 million people of Indian origin have settled abroad and their number is steadily increasing. Indians abroad, with their skill, ability and sheer hard work, have consolidated their economic position. Their cultural and economic links with India are intact. Some economists have estimated the wealth of persons of Indian origin residing abroad to be of the order of Rs. 115,000 crores (1 crore = 10,000,000), i.e. more than three fourths of India's annual gross national product.

In one way or another, they have always passed on part of their prosperity to the motherland. However, it is the feeling of many Indians abroad that the attitude of the government towards them has generally been lukewarm.

Some very important provisions with far-reaching consequences have been introduced in the Finance Bill 1982 in response to a long standing desire of Indians abroad.

An attempt is made hereunder to analyse and understand the proposed provisions and their implications.

I. DEFINITION OF "RESIDENCE"

In India the scope of total income of an assessee is determined on the basis of residential status. For this purpose assessees are divided into the following two categories:

- resident; and
- non-resident.

The individual "resident" in India is further classified as:

- ordinarily resident; and
- not ordinarily resident.

A person who is *ordinarily resident* is liable to tax on all income:

(a) which is received or is deemed to be received in India by or on behalf of such person;
(b) which accrues or arises or is deemed to accrue or arise to him in India; and
(c) which accrues or arises to him outside India.

A person who is *not ordinarily resident* is liable to tax in the same manner as a person who is "ordinarily resident", *except* that the income which accrues or arises to him *outside* India is not includible in his other income unless it is derived from a business controlled in or a profession set up in India.

A person who is a *non-resident* is liable to tax in respect of all income from whatever source derived which is received or deemed to be received in India by or on behalf of such person or which accrues or arises or is deemed to accrue or arise to him in India. He is *not liable* in respect of income accruing or arising *outside India* even if it is remitted to India.

Thus, the liability to pay income tax in India is dependent on the residential status of an assessee.

Under the existing provisions (Section 6 of the Income-tax Act (ITA), 1961) an individual is considered to be "resident" in India in any year if:

(a) he is in India in that year for a period or periods amounting in all to 182 days or more; or
(b) he maintains or causes to be maintained for him a dwelling place in India for a period or periods amounting in all to 182 days or more in that year *and* has been in India for 30 days or more in that year; or
(c) having within the 4 years preceding that year been in India for a period or periods amounting in all to 365 days or more, is in India for a period or periods amounting in all to 60 days or more in that year.

The Finance Act 1978, with effect from 1 April 1979, inserted an Explanation to Section 6(1) to secure that in the case of an Indian citizen rendering services outside India, and who is or has been in India on leave or vacation in the previous year, the 30 and 60-day periods respectively referred to in (b) and (c) above are extended to 90 days. The effect of this provision is that an Indian citizen *employed* outside India is able to stay on leave or vacation in India for 89 days in a previous year without becoming resident in India in that year.

With a view to avoiding hardship in the case of Indian citizens who are employed or engaged in other vocations outside India, the Finance Bill 1982 seeks to make certain modifications in the tests of "residence" in India.

One of the conditions for being treated as a "resident" is dependent upon maintenance of a dwelling place for more than 182 days *and* stay in India in a given year for 30 days or more. This condition was causing hardship to In-

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dians going abroad in the middle of a year to take up employment outside India inasmuch as they were being treated as "residents" in the year of their departure, with the consequence that their income *outside* India also suffered Indian taxation. As we have seen above, under the Income-tax Law, "residents" have to pay tax in India on their total *world* income, while "non-residents" pay tax only on their *Indian* income. This condition of dwelling place is being removed with effect from 1 April 1983, that is, the assessment year 1983-84.

Yet another condition causing hardship was in relation to a person in India for 60 days or more in a year and who was in India for 365 days or more in the preceding 4 years. For such persons also, a stay up to 182 days in a year does not make them "residents" with the resultant taxation in India of their foreign income. No doubt this benefit of 182 days is available only for the first year of their departure for the purpose of taking up *employment* outside India. A further amendment appears to indicate that the benefit of stay up to 182 days is not available to persons not taking up employment but becoming *self-employed* or otherwise. Self-employed persons will be governed by the test of stay of 90 days or more, as provided in the explanation to Section 6(1) of the Income-tax Act, 1961.

II. REMITTANCE OF FUNDS TO INDIA

The next amendment is to be found is Section 10 of the Income-tax Act, 1961, first in respect of Section 10(4A) which exempts from tax income from interest on moneys standing to the credit of a "non-resident" in a non-resident (external) account in any bank in India in accordance with the Foreign Exchange Regulation Act, 1973 (FERA).

According to FERA, Indian nationals and persons of India origin holding foreign passports residing abroad can freely remit funds to India through banking channels and keep them in their accounts with banks authorised to deal in foreign exchange ("authorised dealers"). The following facilities are available for these persons for remittance of funds to India and for making investments in India.

1. Non-resident (external) accounts designated in Indian rupees (NR(E) accounts)

The funds must be transferred to India through banking channels from the country of residence or from any other country in the External Account group other than Bulgaria, Czechoslovakia, German Democratic Republic, Hungary North Korea, Poland, Romania and the U.S.S.R. The facility is also available to government servants posted abroad on duty with Indian Missions and similar agencies set up abroad by the Government of India where the officials draw their salaries out of Central Government resources, Government servants deputed abroad on assignments with foreign government or regional/international agencies like the World Bank, IMF, WHO, ESCAP, and officials of a State Government and public sector undertakings deputed abroad on temporary assignments or posted to branches of their offices abroad.

The advantages of opening the above type of account are:

- The income accruing on the balances in the accounts is free of Indian income tax (Section 10 (4A) of ITA).
- The account holders have the freedom to repatriate the balances, along with the interest accrued thereon, outside India at any time without reference to the Reserve Bank of India.
- Interest accruing on the accounts may be credited to the accounts freely by authorised dealers.
- Debits to the accounts for local disbursements are freely permissible.
- Purchase of units of the Unit Trust of India, Government securities and National Plan Certificates or National Savings Certificates from the balances in these accounts may be made freely.
- Dividends or interest on and sale or maturity proceeds or repurchase price of the units, securities or certificates may be credited to the external accounts, on application to the Reserve Bank of India.

2. Non-resident (external) accounts designated in foreign currencies (FCNR accounts)

In order to provide account holders a cover against the risk of any loss arising from fluctuations in the exchange rate of currencies, a new scheme for opening non-resident (external) accounts designated in special foreign currencies (pounds sterling and U.S. dollars) has been introduced. The accounts are maintained in the currencies in which the remittances are received and the funds are also to be repaid to the account holder, or transferred elsewhere in India under his instructions, in the same currency. The interest is paid in the currency in which the account is maintained. This interest is also free of Indian income tax (Section 10 (4A) of ITA).

Thus, the exchange risk in respect of both the funds remitted to India by the account holders and the interest accruing on the funds is not to be borne by the non-resident depositors. To start with, the accounts are maintained in the form of fixed deposits for periods of 91 days and above, but not exceeding 61 months at a time. This period of 61 months can be further extended.

The present condition for exemption under Section 10 of ITA is that the person should be a "non-resident" under ITA. The tests for being treated as "non-resident" under FERA and under ITA are entirely different. The amendment seeks to exempt such income of "non-residents" under FERA.

To determine the residential status of a person under FERA, the following questions must be answered:

- Is he an Indian citizen or not?
- If he is an Indian citizen, has he been staying in or outside India and for what purpose?
- If he or she is a foreigner staying in India, what is the purpose of his or her stay, whether his or her wife or husband is a person resident in India, and what is the duration of his or her stay here?

Section 2(p) of FERA lays down specific norms for determining the residential status of person as follows:

(a) If an Indian citizen has been staying in India at any

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time after 25 March 1947, he is regarded as a person resident in India.

(b) If an Indian citizen has gone out of India:
  (i) for employment, business, or vocation outside India; or
  (ii) for any other purpose with the intention of staying outside India for an indefinite period,
  he is regarded as a person not resident in India.
  Even though the word "profession" is not mentioned in Section 2(p), if an Indian citizen leaves India to carry on his profession outside India, he will become a person resident outside India.
  If an Indian citizen has gone abroad for his studies, a pleasure trip, medical treatment, a business trip, visiting friends or relatives, and other purposes where the intention is not to stay abroad for an indefinite period, he will be regarded as a person resident in India during his stay abroad.

(c) An Indian citizen who was abroad and was regarded as a person resident outside India under the preceding provisions will be regarded as a person resident in India when he returns to India for employment, business, or vocation in India. Similarly, if he returns to India for any other purpose with an intention to stay in India for an indefinite period, he will be regarded as a person resident in India.

(d) An Indian citizen who has not stayed in India at any time after 25 March 1947 coming to India for employment, business, or vocation, staying with his or her spouse who is resident in India, or for any other purpose, with an intention to stay for an indefinite period, will be regarded as a person resident in India.

(e) A foreign citizen who has come to stay in India for employment, business or vocation in India will be regarded as a person resident in India. Similarly, if a foreign citizen stays in India with his or her wife or husband who is resident in India, the foreigner will be regarded as a person resident in India during his or her stay in India even if the stay of the foreigner is temporary.
  If a foreigner stays in India for any other purpose and his stay is for an indefinite period he will be regarded as a person resident in India. If, however, a foreign citizen has become a person resident in India for the reasons stated in the preceding paragraph, he will become a non-resident during the period he is outside India even though that period is of short duration.
  For example, if an Indian after becoming a British citizen comes to India for employment, business or vocation in India, he will be regarded as a person resident in India. But during his temporary stay abroad, his status will change and he will be treated as a non-resident.

(f) The residential status of a person does not depend upon that of his or her husband, wife or parents. For example, if a married Indian citizen has gone abroad for employment, he will become a non-resident. If his spouse, who is otherwise treated as a person resident in India, goes abroad to stay with him for a temporary period, she will continue to be a person resident in India.

Thus it may be observed that the definitions of "resident" and "non-resident" are totally different under FERA and ITA.

It is possible that a person may be *non-resident* under FERA but *resident* under ITA. Such a person would be denied this exemption.

With a view to removing this anomaly it is proposed to provide that the exemption from income tax in respect of interest on non-resident (external) accounts shall be available in the case of a "person resident outside India" as defined in Section 2(q) of FERA.

Similarly, the balance standing to the credit of such non-resident (external) accounts is exempt under Section 6(ii) of the Wealth Tax Act, 1957.

The Finance Bill 1982 also seeks to exempt gifts made by non-resident Indian citizens and foreign nationals of Indian origin out of the moneys to their credit in non-resident (external) accounts in India.

However, balances held in non-resident (external) accounts are not exempt from Estate Duty (i.e. death duty).

A recent announcement made by the Reserve Bank of India (RBI) permits overseas companies, firms, societies and trusts to invest freely in units of the Unit Trust of India, securities (other than bearer securities) of Central and State Governments and national savings certificates from the funds held in their NR(E) accounts and FCNR accounts or by sending remittances directly from abroad. Such investments enjoy the benefits of repatriation of capital as well as income earned.

Overseas companies, partnership firms, societies and other corporate bodies which are owned to the extent of at least 60% by Indian nationals or persons of Indian origin residing abroad, as well as overseas trusts in which at least 60% of the beneficial interest is irrevocably held by such persons, can now open with any bank authorised to deal in foreign exchange in India NR(E) Rupee Accounts and FCNR Accounts in U.S. dollars or pound sterling out of the funds transferred by them to India. Hitherto, only Indian nationals and persons of Indian origin residing abroad were given this facility. All authorised dealers have been permitted to freely open such accounts out of the funds received from any country in the External Account Group other than Bulgaria, Czechoslovakia, German Democratic Republic, Hungary, North Korea, Poland, Romania and the U.S.S.R.

To open such accounts, the concerned party will, however, have to produce to authorised dealers a certificate from an overseas auditor, chartered accountant, or certified public accountant in a precribed form to the effect that the ownership/beneficial interest in these entities is held to the extent of at least 60% by Indian nationals or persons of Indian origin residing abroad.

III. NATIONAL SAVINGS CERTIFICATES

With a view to encouraging the remittance of foreign exchange into the country, a new sub-section (4B) is proposed to be inserted with effect from 1 April 1983, that is, from assessment year 1983-84, to provide an exemption from income-tax for interest in 12% 6-year National Savings Certificates to be issued hereafter by the Central Government. The exemption will be available to *"non-resident" Indians* or to foreign nationals of *Indian origin* provided that the subscription to the certificates is in

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foreign currency in accordance with the provisions of FERA. Thus, this exemption shall be available only to initial subscribers of these 6% National Savings Certificates.

A corresponding exemption from wealth tax is also provided by Section 5(1) (xvi c) of the Wealth Tax Act, 1957 whereby non-resident Indian citizens and foreign nationals of Indian origin can avail themselves of this exemption provided that the subscription to the certificate is in foreign currency in accordance with the provisions of FERA.

Similarly, Section 5(1) (ii d) of the Gift Tax Act, 1958 seeks to grant exemption from gift tax to gifts of such Savings Certificates by non-residents to their *relatives* who are "residents" in India. For this purpose, "relative" is defined by Section 2(21) of the Income Tax Act, 1961 as including husband, wife, brother, sister or any lineal ascendant or descendant of that individual.

IV. INVESTMENT IN SHARES

The recent announcement made by the RBI liberalises the policy governing investment in Indian companies by Indian nationals or persons of Indian origin residing abroad.

RBI has also simplified the procedural formalities in this regard to facilitate a higher inflow of non-resident investment. According to an RBI notification, the facilities are available to all Indian nationals or persons of Indian origin residing abroad.

The facilities extended include permission to invest in shares without any limit on the quantum or value of the investment, permission to make portfolio investments in shares with full benefits of repatriation of capital invested and income earned, and expeditious sale and transfer of shares by such persons.

Under the liberalised facilities, such persons can invest in shares through stock exchanges in India without any limit on the quantum and value of investment, either by fresh remittances from abroad or out of their NR(E), or FCNR or Non-resident Ordinary accounts. Repatriation of capital invested and income earned thereon will not, however, be allowed.

In order to avoid references, for specific approval of each transaction, the RBI will grant permission to banks in India authorised to deal in foreign exchange for purchasing and selling shares on behalf of their clients.

They can also invest in new issues of public or private companies engaged in any business activity (except real estate business) up to 100% of the issued capital without any obligation to associate resident Indian participation in equity capital at any time.

They can also make portfolio investments in shares in India with full benefit of repatriation of capital invested and income earned thereon, provided:

- the shares are purchased through a stock exchange;
- the purchase of shares in any one company does not exceed 100,000 Rupees in face value or 1% of the paid-up equity capital of the company, whichever is lower; and
- payment for such investment is made either by fresh remittances from abroad or out of the funds held in the NR(E) or FCNR account with a bank in India.

As in the case of investment in shares without repatriation benefits, the RBI will grant permission to banks to purchase shares through stock exchanges on behalf of their non-resident customers, subject to the limit and conditions mentioned above.

They can make investment in the new issues of new or existing companies in India (other than a FERA company) up to 40% of total new capital with full benefits of repatriation of capital invested and income accruing thereon. They can also make investment with full repatriation benefits in the capital raised by any company other than through issue of prospectus up to 40% of total new capital subject to a ceiling of 4 million Rupees. Such investments can be made in any industry including those in the "negative" list of industries (which has been withdrawn), as well as in the hotel industry.

If subscriptions or portions thereof are refunded by companies, banks may allow the amounts to be re-credited to the applicants' accounts from which they had been withdrawn earlier. Similarly, where subscriptions to new issues were remitted from abroad by such persons to companies in India or to bankers to the issues, banks may remit the refunds of excess subscriptions to the concerned beneficiaries.

The facility of equity investment with full repatriation benefit under the 74% scheme continues, with a further relaxation that the investment can now also be made in the hotel industry, apart from the priority industries.

To facilitate the expeditious sale and transfer of shares by such persons through stock exchanges, a consolidated application furnishing full particulars of their holdings in quoted shares may be made to the RBI. The bank will grant permission for the sale of these holdings, initially with a one-year validity period, renewable for further periods subsequently. These shares can then be sold at any time within the validity period.

Such person can freely invest in Six-year National Savings Certificates. Such investments will be free from wealth tax, income-tax and gift tax and they enjoy the same facilities as are available for repatriation of maturity proceeds of other Government securities or credit thereof to non-resident accounts of the beneficiary.

All the facilities of direct and portfolio investments outlined above have been extended to overseas companies partnership firms, societies and other corporate bodies, which are owned to the extent of at least 60% by Indian nationals or persons of Indian origin residing abroad as well as overseas trusts in which at least 60% of the beneficial interest is irrevocably held by such persons.

V. EXEMPT GIFTS

Section 5(1) (ii c) of the Gift Tax Act 1958 seeks to grant exemption from gift tax of gifts to *relatives* of any amount of foreign currency or other foreign exchange remitted from a country outside India by *non-resident Indians* or foreign nationals of *Indian origin*.

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THE 1982 INCOME TAX CHANGES IN THE REPUBLIC OF SOUTH AFRICA

by Dr. Erwin Spiro

Presenting the 1982 Budget on the 24th March, 1982, the Minister of Finance, Prof. Owen Horwood, confessed to aspiring to comply with three minimum requirements: first, to restrict the increase in government spending as much as possible without disrupting the provision of essential services; second, in order to assist in curbing monetary demand and to prevent undue upward pressure on interest rates, to reduce the 'deficit before borrowing' as a percentage of gross domestic product to well below its average of 3.4% over the past 22 years and, third, to finance this deficit in such a manner that not only the Exchequer, but also the government sector as a whole, including the extra-budgetary funds, were able to avoid a net recourse to bank credit. It is against this background that the following income tax changes must be understood.

I. STRUCTURAL INCOME TAX REFORMS

Fringe benefits

The recommendations of the Parliamentary Commission in respect of fringe benefits arising from employment or from the holding of an office will, upon receipt, be considered by the government without delay and, if found to be acceptable, be notified to employer and employee organizations in good time so that any legislation which may be required can be introduced early in the next year in order to ensure that the recommendations take effect as from 1 March 1983 (that is for the 1983/1984 tax year).

Final PAYE deduction system

As announced in the 1981 Budget speech, persons whose taxable incomes (that is net salary (wage) after deduction of medical expenses, pension and retirement annuity fund contributions and the allowance of the earnings of a spouse), do not exceed R7,000, will, with effect from 1 March 1982, no longer be required to submit annual returns of income. In the present budget the Minister of Finance made it quite clear that the new measure would not be applicable to persons who received substantial investment income not taxed at source or to those whose income was received in a form other than fixed salaries, wages or pensions.

II. ONGOING TAX REFORMS

Exemptions

The first R100 of the aggregate income derived from interest and dividends will be exempt from tax, such exemption being granted to all taxpayers irrespective of their income.

Rebates

The primary rebates have been increased by R120.

Deductions

Married women. It has still not been possible to formulate a preferable alternative to the present system whereby the incomes of married persons are aggregated for taxation urposes. However, the deduction allowed from the earnings of a married woman is increased from the R1,200 applicable in the 1980/1981 tax year to R1,400 in the 1981/1982 tax year and to R1,600 in the 1982/1983 tax year.

Housing. Investors who plan to erect housing accommodation for rent will be granted the annual depreciation allowance of 2% at present applicable to new industrial buildings. This will apply to all new housing projects which offer not less than five family housing units for rent, provided the erection commences on or after 1 April 1982:

In addition an initial allowance of 10% of the cost of the project will be allowed as a deduction from income in the year in which the project is completed and the accommodation is first let to tenants.

If the developer of the housing project should dispose of such property either by means of an outright sale of the whole project or through sectional little selling of individual units, or in any other way, the allowances previously granted will be recouped and included in his taxable income.

Taxable income of long-term insurance companies

In view of the enormous growth of the long-term insurance industry, the percentage of gross investment income used as a yardstick for measuring taxable income is to be increased from 30 to 40%.

Loan levy on individuals

A 5% loan levy will be imposed on income tax payable by individuals, the following taxpayers being exempted therefrom:

(a) persons of all age groups whose incomes are R7,000 or less. Falling as they do, at least most of them, under the Final PAYE Deduction System (supra), they will be taxed at a fixed rate, and it would not be fair to impose upon them the further loan levy.

(b) other persons, whose basic normal income tax before the addition of loan levy amounts to R150 or less;

(c) persons who are 70 years of age and older and whose taxable incomes exceed R7,000, but do not exceed R15,000 per annum (they, of course remain liable for normal tax).

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The levy is a compulsory loan, repayable within a maximum period of 7 years at simple tax-free interest, its rate being raised from 5 to 8%.

Company tax

Ordinary companies. The present 5% surcharge is to be incorporated in the basic rate, thus becoming 42%, and a further surcharge of 10% is to be levied on such new basic rate.

This applies to all companies excluding gold and diamond mining companies.

Gold and diamond mining companies. The basic rate is not increased. But the present surcharge of 5% is increased to 15%. That change serves the purpose, inter alia, to meet the increased demands which will be made on the Exchequer in the form of assistance to the marginal gold mines.

III. RATES OF (NORMAL) INCOME TAX

Persons other than companies

Persons other than companies are, in respect of the taxable income derived in the year of assessment ending 28 February 1983 or 30 June 1983, whichever is applicable, subject to (normal) income tax at the rates contained in the TABLE attached, with a maximum basic marginal rate of 50% and with the addition, in the case of unmarried persons, of a 20% surcharge on the tax. The maximum rate is reached where the taxable income exceeds R40,000 in the case of married persons and R28,000 in the case of unmarried persons.

If the taxable income is greater than R7,000 and the tax is not less than R150, the loan levy of 5%, mentioned above, must be added to such tax.

Companies

Companies are, in respect of taxable income derived in respect of every year of assessment ending during the period of twelve months ending on 31 March 1983, subject to the following rates of (normal) income tax:

(i) on each R of the taxable income (excluding taxable income derived from mining operation and taxable income referred to in (ii)(c)) 42 cents plus a surcharge equal to 10% of the tax;

(ii) in respect of taxable income derived from gold mining:

(a) in the case of any mine other than a post-1966 gold mine an amount determined in accordance

INCOME TAX TABLE REFERRED TO IN III. ABOVE
for persons other than companies

Taxable income	Rates of tax
Where the taxable income –	
does not exceed R7,000	10% of each R1 of the taxable income;
exceeds R 7,000 but does not exceed R 8,000	R 700 plus 12% of the amount by which the taxable income exceeds R 7,000
exceeds R 8,000 but does not exceed R 9,000	R 820 plus 14% of the amount by which the taxable income exceeds R 8,000;
exceeds R 9,000 but does not exceed R10,000	R 960 plus 16% of the amount by which the taxable income exceeds R 9,000;
exceeds R10,000 but does not exceed R11,000	R 1,120 plus 18% of the amount by which the taxable income exceeds R10,000;
exceeds R11,000 but does not exceed R12,000	R 1,300 plus 20% of the amount by which the taxable income exceeds R11,000;
exceeds R12,000 but does not exceed R13,000	R 1,500 plus 22% of the amount by which the taxable income exceeds R12,000;
exceeds R13,000 but does not exceed R14,000	R 1,720 plus 24% of the amount by which the taxable income exceeds R13,000;
exceeds R14,000 but does not exceed R15,000	R 1,960 plus 26% of the amount by which the taxable income exceeds R14,000;
exceeds R15,000 but does not exceed R16,000	R 2,220 plus 28% of the amount by which the taxable income exceeds R15,000;
exceeds R16,000 but does not exceed R18,000	R 2,500 plus 30% of the amount by which the taxable income exceeds R16,000;
exceeds R18,000 but does not exceed R20,000	R 3,100 plus 32% of the amount by which the taxable income exceeds R18,000;
exceeds R20,000 but does not exceed R22,000	R 3,740 plus 34% of the amount by which the taxable income exceeds R20,000;
exceeds R22,000 but does not exceed R24,000	R 4,420 plus 36% of the amount by which the taxable income exceeds R22,000;
exceeds R24,000 but does not exceed R26,000	R 5,140 plus 38% of the amount by which the taxable income exceeds R24,000;
exceeds R26,000 but does not exceed R28,000	R 5,900 plus 40% of the amount by which the taxable income exceeds R26,000;
exceeds R28,000 but does not exceed R30,000	R 6,700 plus 42% of the amount by which the taxable income exceeds R28,000;
exceeds R30,000 but does not exceed R32,000	R 7,540 plus 44% of the amount by which the taxable income exceeds R30,000;
exceeds R32,000 but does not exceed R34,000	R 8,420 plus 46% of the amount by which the taxable income exceeds R32,000;
exceeds R34,000 but does not exceed R36,000	R 9,340 plus 47% of the amount by which the taxable income exceeds R34,000;
exceeds R36,000 but does not exceed R38,000	R10,280 plus 48% of the amount by which the taxable income exceeds R36,000;
exceeds R38,000 but does not exceed R40,000	R11,240 plus 49% of the amount by which the taxable income exceeds R38,000;
exceeds R40,000	R12,220 plus 50% of the amount by which the taxable income exceeds R40,000.

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with one of the formulae laid down plus a surcharge which is not payable in respect of certain assisted gold mines equal to 15% of the said amount;

(b) in the case of post-1966 gold mines an amount determined in accordance with one of the formulae laid down plus a surcharge of 15% of the said amount;

(c) in the form of excess recoupments over capital expenditure accruing to companies which are or have been gold mining companies the average rate of tax as determined in accordance with the Act or 35 cents per R1, whichever is higher;

(iii) in the case of companies mining for diamonds 45 cents per R1 of the taxable income plus a surcharge of 15% of such amount;

(iv) in the case of companies mining, but not for gold or diamonds, the position is the same as in the case of a non-mining company (see (i) above).

Taxpayers carrying on long-term insurance business

The taxable income derived from the carrying on of long-term insurance business by any taxpayer who carries on such business in the Republic (whether on mutual principles or otherwise) is deemed to be an amount equivalent to 40% of the gross income derived from investments.

IV. RATES OF OTHER TAXES CONTAINED IN THE INCOME TAX ACT

Non-resident shareholders' tax

The non-resident shareholders' tax is 15% of the amount of the dividend or interim dividend in question.

Undistributed profits tax

The undistributed profits tax is 33⅓ cents on every R1 by which the 'distributable income' as defined exceeds the amount of dividends distributed during the 'specified period' as defined.

Non-residents' tax on interest

The non-residents' tax on interest is 10% on the amount of the interest in question.

Donations tax

The donations tax is at progressive block rates, the block exceeding R90,000 being taxable at the rate of 25%.

SOUTH AFRICA:

Budget 1982

Extracts from the Budget Speech pronounced by Professor Owen Horwood, Minister of Finance, on 24 March 1982.

World economic recession

This year's Budget is being presented against the background of a serious and long-lasting world recession. In the United States the rate of real economic growth was actually negative in 1980, less than 2% in 1981 and, according to the latest forecasts of the Organization for Economic Co-operation and Development, will be negative again in 1982. In the United Kingdom, the real economic growth rate was minus 1.7% in 1980, minus 2% in 1981 and is now expected to recover to a small positive figure in 1982. In West Germany a growth rate of minus 1% in 1981 is expected to be transformed into a positive rate of just over 1% in 1982. In addition, the countries behind the Iron Curtain and a number of important oil-producing states have been experiencing serious economic difficulties, which have forced some of them to sell large quantities of gold on world markets. At the same time, the economic plight of most Third World countries has reached critical proportions.

Revenue 1982-'83

Estimated total revenue on the current basis of taxation amounts to R15 417 million, which is 7.9% higher than the revised 1981-'82 estimate of R14 290 million. Receipts both from Inland Revenue and from Customs and Excise are expected to increase – Inland Revenue by R912 milion and Customs and Excise by R215 million. These estimates already include the increased proceeds to be collected from the one percentage point increase in general sales tax and the 10% import surcharge announced last month.

The additional revenue from these two sources, now estimated to amount to about R1 235 million, will in itself only partly offset the decrease in the collections from income tax on gold mines and gold mining leases. Estimated receipts from the gold mining industry during 1982-'83 most probably will amount to no more than R900 million, compared with R2 171 million in 1981-'82 – a reduction of nearly R1 300 million in one year. This huge loss in revenue is the direct result of the adverse effect that the drop in the gold price and cost escalations are expected to have on the operating results of the gold mines.

Uncertainty regarding the future behaviour of the gold price makes it extremely difficult, if not virtually impossible, to predict with any degree of accuracy Exchequer revenues from this source. While I am certainly not pessimistic on the longer term outlook for gold – anything but – it would only be prudent to assume that the average gold price for the year 1982-'83 will be significantly below the average realized during the current financial year, and I have framed my estimates accordingly.

To sum up, on the current basis of taxation, total tax revenues of R15 417 million are available to finance total expenditures of R18 238 million. The deficit before borrowing at his stage thus amounts to R2 821 million.

Despite the financing problems we are faced with now, I wish to announce the following concessions.

Final PAYE deduction system

In my Budget speech last year I announced that, with effect from the tax year which commenced at the beginning of this month, persons in the lower income categories who derive their income entirely, or almost entirely, from salaries, wages or pensions, will no longer be required to submit annual returns of income. In the majority of such cases the PAYE, which will be deducted in terms of the new deduction tables which came into operation on the first of this month, will represent a final settlement of their tax liability. A substantive amendment was included in last year's Income Tax Act to make this possible.

Persons affected by this measure are those whose taxable incomes, that is, net salary after deduction of medical expenses, pension and retirement annuity fund contributions, and the allowance in respect of the earnings of a spouse, do not exceed R7 000.

The new measure cannot, of course, be applied to persons who receive substantial investment income not taxed at source, or to

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...illion in 1975 to R0.9 million in 1980, ...doubt mainly due to the advent of television.

The Standing Commission has recommended that the tax be abolished. I am in agreement with this recommendation and, in the interest of more efficient administration, accordingly propose that the tax be abolished with effect from 1 April 1982. The loss of revenue will amount to some R1 million.

The total of the concessions I have just outlined amount to R34 million and will reduce receipts from Inland Revenue from the printed figure of R13 198 million to R13 164 million.

Before turning to certain proposals for relief from excise duties, there are two further inland revenue matters to which I should like to refer.

Fringe benefits

The taxation of fringe benefits arising from employment or from the holding of an office, which has been part of our income tax law ever since its inception, has in principle been reaffirmed by the Government. The question in regard to the uniform valuation of such benefits is, however, one which should be approached very circumspectly.

Certain proposals were first put forward by the Franzsen Commission in 1970. The matter was subsequently investigated by Inland Revenue and the Standing Commission on Taxation Policy. After protracted and wide-ranging discussions, it was decided that the Standing Commission's valuation proposals should form the basis of an in-depth inquiry by a Parliamentary Commission.

Although reports have appeared in the Press to the effect that the proposals for the taxation of fringe benefits have been shelved, I wish to give the assurance that this is not the case. The recommendation of the Parliamentary Commission, will, upon receipt, be considered by Government without delay and, if found to be acceptable, will be notified to employer and employee organizations in good time so that any legislation which may be required can be introduced early in the next year in order to ensure that the recommendations take affect as from 1 March 1983, that is for the 1983-'84 tax year.

Fiscal incentive measures

In my Budget Speech on 26 March 1980 I indicated that I had directed the Standing Commission on Taxation Policy to investigate the initial and investment allowances accruing to manufacturers and to make recommendations to me in this regard. The matter is one of extreme complexity and, as I previously said, caution is needed before any change is made to the *status quo*. I am informed that the Standing Commission has made good progress in its task and am hopeful that it will be possible for the Commission to submit its recommendations to me within the next few months. It appears unlikely, however, that any consequential legislation will be introduced during the current session of Parliament.

I wish now to propose two concessions in regard to excise duties.

Excise duty concessions

Natural wines

The agricultural industry in the Western Cape is one of the main supports of the regional economy and provides an important impetus to development and growth. It is also true that agriculture in this region is much dependent upon the weal and woe of the products of the vine.

At the same time wine provides the State with not inconsiderable excise revenues and in this way assists in financing necessary expenditures. Yet it is also true that in the case of natural wines, notwithstanding a slight, albeit consistent upturn in demand, consumption *per capita* today is still below the 1975 level and this despite an annual average producers' price rise of less than 9% during this period.

I wish to propose, therefore, that the full excise duty of 3 cents per litre on natural wines be abolished. Though the incidence of this duty may be small, I am told the concession will bring South Africa into line with other wine-producing countries such as West Germany, Italy, Austria, Switzerland and Australia.

The loss of revenue is calculated to amount to R6 million in 1982-'83.

In the case of natural fermented apple, pear and orange beverages I propose that the excise duty be similarly withdrawn. The loss of revenue in this case will be minimal.

Natural fruit juices are, of course, not subject to any excise duty.

Non-alcoholic beverages

This industry has had to cope in recent times with substantial increases in input costs, one of the latest examples being an increase in the price of sugar of some 13%. Any tax concessions will grant a measure of relief not only to the producer and the consumer but will also, I understand, tend to be helpful to the small businessman in the rural areas. I wish to propose, therefore, that the excise duty on non-alcoholic beverages be reduced by 1 cent per litre. This will mean an estimated loss of revenue in 1982-'83 of some R10 million.

Government notices to give effect to these proposals will appear tomorrow.

The total cost of these two concessions will amount to R16 million and will reduce the income from customs and excise duties in the printed Estimates of Revenue to R2 203 million.

Financing of deficit

The estimate of total revenue is now R15 637 million, which leaves me with a deficit before borrowing of R2 871 million at this stage.

After adding to the deficit an amount of R1 246 million to provide for loan redemptions and other loan expenditures – the latter figure is very substantially lower than total redemptions for the 1981-'82 financial year – the total financing requirement will amount to R4 117 million.

I propose that this amount be financed as follows:

	R million
Public Debt Commissioners	1 290
Reinvestment of maturing stock	614
New stock issues	800
Non-marketable securities	550
Foreign loans	250
Surplus carried forward from 1981-'82	16
	R3 520

This still leaves me with a shortfall of R597 million.

National Defence Bonds and Defence Bonus Bonds

I should explain that the non-marketable securities I have just mentioned comprise tax-free Treasury Bonds, tax-free Defence Bonus Bonds and taxable National Defence Bonds.

Recently in my Part Appropriation speech I announced an increase in the interest rate on Treasury Bonds and indicated that I would also deal with improvements in the terms of issue of National Defence Bonds and Defence Bonus Bonds in due course.

It has now been decided that the interest rate payable on fully taxable National Defence Bonds – which have a minimum currency of twelve months – be raised from 11% to 14% with effect from 1 April 1982 to make them more attractive in the market.

From the same date the method of calculating interest on the tax-free Defence Bonus Bonds will also be changed from the current 5% simple interest basis to a 5% monthly compounded basis, which will yield an effective 5.66% per annum over a five-year term. This compound rate of interest will also apply to all existing unredeemed investments made since the inception of the scheme provided that the Bonds are not redeemed before 1 April 1983. Interest on redemptions made before that date will continue to be calculated at the existing simple interest rate. These adjustments should at least ensure a positive flow of investment funds into these two investment media.

The loan programme set out above presupposes that funds be obtained in the domestic market in a non-inflationary manner at realistic market-related rates and care will therefore be taken to limit the individual stock issues to smaller amounts obtainable without undue difficulty and without placing undue pressures on the money and capital markets and thus on interest rates. Smaller stock issues will also ensure a more even distribution of cash flows to the Treasury throughout the year.

I also believe that the Exchequer should approach the markets for its loan requirements on a more regular basis than hitherto. The success of the Treasury's first tender issue has been most heartening considering the difficult conditions pertaining in the market at the time, and this method will again be used

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those whose income is received in a form other than fixed salaries, wages or pensions.

It is gratifying to note that even at the relatively low income levels, many persons are still able and willing to save, and in order to encourage savings and not to deprive them of the benefits of the new system, I furthermore propose that the first R100 of their aggregate income derived from interest and dividends be exempt from tax. This exemption will, in fairness, be granted to all taxpayers irrespective of their income, and I estimate the concomitant loss of revenue to the Fiscus for the 1982-'83 financial year at R13 million.

Although taxpayers in the category I have mentioned will not in future be required, as a matter of course, to submit returns of income for assessment purposes, I realize that factors, such as the birth of a child or abnormally high medical expenses may result in over-deductions of PAYE. In such cases, taxpayers will still be entitled to ask for an assessment and a refund of tax overpaid.

There is a point which I would like to stress in regard to the new system, and that is it does not affect the year of assessment which ended on 28 February this year. Income tax returns in respect of that year were recently mailed and must still be completed by all taxpayers. The Commissioner for Inland Revenue will in due course advise all those taxpayers who will not in future be required to complete returns of income.

The adjustments and simplifications which I have referred to will make the tax collection system that much more cost-effective and is a further positive step in our overall tax reform programme.

Primary rebate

It is apparent from the new normal tax rate table which will be tabled today, that the rate of tax applicable to the first R7 000 of an individual's taxable income is 10%. Previously the rate of tax for the first R6 000 was 8% and from R6 001 to R7 000 it was 10%. The proposed new rate results in an additional R120 gross tax payable, before the deduction of rebates. The increase in the rate is not intended to be an additional impost on taxpayers but has been decided upon as part of the scheme for the elimination of unnecessary income tax assessments in the case of salary earners whose taxable incomes do not exceed R7 000, as explained. To neutralize the increase in the gross rates, an additional rebate of R120 was provided for in last year's Income Tax Act as part of the scheme to put into operation the PAYE final deduction system as from 1 March 1982.

The sacrifice of revenue, which is confined to the R0 - R7 000 income sector, is estimated at R40 million and has also already been taken into account in the printed Estimates of Revenue.

The increase in the primary rebate, taken together with the standard deductions for medical and certain other expenses and the standard insurance rebate provided for in last year's Income Tax Act, will have the effect of raising the tax thresholds of individuals without children or dependants as follows:

	Present threshold	Proposed threshold
Married person		
– under 60	R2 500	3 800
– 60 but under 70	R4 000	R5 000
– 70 and over	R5 000	R5 800
Unmarried person		
– under 60	R1 500	R2 850
– 60 but under 70	R3 000	R4 050
– 70 and over	R4 000	R4 850

Married women

Honoré de Balzac once said that "women are always afraid of thing which have to be divided". This does not seem to be the case with the vexed question of the taxation of the income of married women, a matter which continues to enjoy the attention of the Department and the Standing Commission on Taxation Policy.

It has still not been possible to formulate a preferable alternative to the present system whereby the incomes of married persons are aggregated for taxation purposes. However, as I announced during my 1981-'82 Budget Speech, one of the consequential adjustments which would be necessary to facilitate the introduction of the Final PAYE Deduction System referred to, is that the deduction allowed from the earnings of a married woman would need to be increased in two stages, from the R1 200 applicable in the 1980-'81 tax year, to R1 400 in 1981-'82, and to R1 600 in 1982-'83.

I trust that this concession will further reduce the real tax burden of women engaged in gainful employment or in a trade or profession. The loss of revenue for the 1982-'83 financial year is estimated to amount to R19 million.

I may add that the total loss of revenue as a result of the introduction of the Final PAYE Deduction System, including amounts already accounted for in the printed Estimates of Revenue, will aggregate no less than R109 million in a full year.

The effect of the final deduction system with its inbuilt standard deductions and rebates and increased deduction from a married woman's earned income, can best be illustrated by an example. Take the case of a married couple under the age of 60 years with no children, where the husband earns R4 000 and the wife R2 500 per year, a total of R6 500. In the tax year which ended on 28 February 1982, tax amounting to some R210 had been deducted in their case. In the present tax year ending 28 February 1983, total tax deductible will only amount to R109, and no further tax returns or adjusting assessments will be issued. I regard this to be a very meaningful concession to the lower income groups in South Africa.

Housing

As indicated earlier, the provision of adequate and sufficient housing remains a problem which enjoys a very high priority with the Government. Not only have substantial public funds been allocated over the years for the provision of housing, but employers have also been encouraged by means of tax concessions to assist employees in either acquiring their own homes or in obtaining rented accommodation.

The provision of adequate financial resources, particularly for housing for the lower income groups, is at present being studied in depth by an expert committee representing the private and public sectors under the chairmanship of the Deputy Minister of Finance.

The private sector will be called upon to make a much more substantial contribution towards solving this problem, but in the meantime I feel it appropriate for the Government to offer further tax concessions specifically to encourage the construction of new accommodation for rent, at present at a premium throughout the country.

Various schemes and suggestions have been researched, but most were found to be either impracticable, too open to abuse, or even in conflict with sound taxation principles.

I am prepared, nevertheless, to offer the following concessions to investors who plan on erecting accommodation for rent: The annual depreciation allowance of 2% at present applicable to new industrial buildings will be extended to include all new housing projects which offer not less than 5 family housing units for rent. This will apply to all qualifying housing projects the erection of which commences on or after 1 April 1982.

In addition I wish to propose that an initial allowance of 10% of the cost of the project be allowed as a deduction from income in the year in which the project is completed and the accommodation is first let to tenants.

If the developer of the housing project should dispose ofsuch property either by means of an outright sale of the whole project or through sectional title selling of individual units, or in any other way, the allowances previously granted will be recouped and included in his taxable income. Details of the allowances will be contained in the Income Tax Bill which will be presented to Parliament later in the session.

I am confident that these concessions will stimulate the provision of accommodation for rent for the benefit of those dependent on such accommodation, and will assist investors materially with their cash flow prolems and return on investment.

It is estimated that the loss of revenue which this concession will entail in 1982-'83 will not exceed R1 million, but it could amount to approximately R500 000 for each R10 million invested in such projects in a full year.

Cinematograph films tax

The cinematograph films tax has been in operation in its present form since 1960. It is imposed at the rate of 3 cents on admission tickets of more than 35 cents, and has remained unchanged over the years. The tax has never been a substantial contributor to the State coffers and, in fact, the yield has declined dramatically over the last five years; from

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for the April issue and probably for further issues during the year.

It is imperative that the shortfall of R597 million be financed in a non-inflationary manner, most suitably by way of taxation. Various options are open to me in this respect, but considering all the positive and negative effects of the various taxes, a choice had to be made as to the most desirable package under present-day and expected conditions.

I wish to turn, then, to the additional taxation proposals. As Henry Ward Beecher so aptly states it: "In this world it is not what we take up, but what we give up, that makes us rich". Let us not give up grudgingly for the rewards will be plentiful.

Ad valorem excise duties

In 1978 certain *ad valorem* duties were imposed on less essential goods such as jewellery, photographic equipment, furs and the like. I feel it essential for these items to make a further contribution to the State coffers and wish to propose that the present *ad valorem* duties on certain locally produced gods as well as their imported equivalents be raised from 20% and 25% to 25% and 30%, respectively.

This proposal is expected to yield additional revenue of some R28 million in the 1982-'83 financial year and should also assist in curbing consumer demand. The increased duties will become effective as from 25 March 1982 and will be applicable to all imported goods concerned which have not been cleared for home consumption before that date and to all similar locally manufactured goods which by tomorrow have not been removed from the premises of manufactures and owners of warehouses licensed by the Commissioner for Customs and Excise.

Advertising

General sales tax

General sales tax is levied on a wide variety of commercial and industrial services, for example repair services, the services of tailors, hairdressers, launderers, photographers, signwriters and printers, to mention only a few. The omission from this list of advertising services is somewhat anomalous and I feel that the taxation of such services for the purpose of producing revenue is fully justified and will not prove to be unduly burdensome.

It is, therefore, proposed to amend the Sales Tax Act to bring advertising services within the ambit of the Act as from 1 August 1982. There may be certain practical problems in this regard and I have, therefore, instructed the Commissioner for Inland Revenue to liaise with the advertising industry and media in order to iron out these problems before the legislation is drafted.

The additional revenue from this source is estimated at R31 million for a full year and at R20 million for the current financial year.

Company tax

During 11 of the last 14 years a surcharge ranging from 2.5% to 10% was imposed on the income tax payable by companies. In addition, in most of these years a loan levy was also applied. The present surcharge on the basic rate of 40% amounts to 5%, which makes the effective rate of tax on all companies excluding gold and diamond mining companies – 42%.

This is a low rate by world standards. In view of the fact that basic company tax rates have remained unchanged since 1970, I propose that the present 5% surcharge be incorporated in the basic rate. I propose, further, that a surcharge of 10% be levied on the new basic rate for all companies excluding gold and diamond mining companies.

The additional tax that will be collected by the increase in the effective rate from 40 to 42% and the 10% surcharge is estimated at R400 million for a full year and at R300 million for the 1982-'83 financial year.

I do not propose to increase the basic rate of tax applicable to gold or diamond mining companies. Gold mining companies pay tax according to a formula which varies with profitability, and to which is added a 5% surcharge, while the tax on diamond mines is 45% plus a 5% surcharge, an effective rate of 47.25%.

In the circumstances prevailing, however, I consider it is not inappropriate to increase the surcharge in the case of the gold mining as well as the diamond mining companies by 10%, that is, from 5% to 15%, to provide in this way much needed additional revenue from which to meet, *inter alia*, the increased demands which will be made on the Exchequer in the form of assistance to the marginal gold mines. In this way the more profitable mines will contribute partly to the strengthening of the total mining industry.

The yield from the additional surcharge on gold and diamond mining companies is estimated to amount to R115 million in a full year and R105 million in the 1982-'83 fiscal year.

Long-term insurance companies

The taxable income of companies carrying on long-term insurance business cannot, because of the nature of their business, be determined according to normal accounting principles and it has always been neccessary to provide special rules for this purpose. Since 1959 the basic measure for the determination of taxable income from life insurers has been 30% of gross income derived from investments.

Over the years the long-term insurance industry has grown enormously and I feel it is only fair that it should make a greater contribution to the Exchequer. I propose, therefore, that the percentage of gross investment income used as a yardstick for measuring taxable income be increased from 30 to 40%.

The taxation position of the long-term life insurance industry is a matter which requires further investigation and I have instructed the Standing Commission on Taxation Policy and the Commissioner for Inland Revenue to consider the matter in depth during the recess in consultation with the whole industry and to report as soon as practicable.

The additional revenue to be collected during the current financial year as a result of this proposal is estimated to amount to R38 million.

Loan levy on individuals

The additional tax that can be collected based on the proposals I have just made amounts to R491 milion which still leaves me with a deficit of R106 million.

Few will differ from Thomas Jefferson when he remarked: "The purse of the people is the real seat of sensibility. Let it be drawn upon largely, and they will listen to truths which could not excite them through any other organ."

I wish thus to propose, finally, the imposition of a 5% loan levy on income tax payable by individuals, but subject to exempting the following taxpayers:

(a) Persons of all age groups whose incomes are R7 000 or less. These taxpayers, the majority of whom will fall under the Final PAYE Deduction System to which I referred earlier on, will be taxed at a fixed rate. I do feel that no further loan levy should be added to their tax;
(b) Persons, other than those I have just mentioned, whose basic normal income tax before the addition of loan levy amounts to R150 or less; and
(c) in the Year of the Aged, persons who are 70 years of age and older and whose taxable incomes exceed R7 000 but do not exceed R15 000 per annum, though remaining liable for normal income tax, will not be liable for loan levy.

Not only will the levy yield the revenue required to leave me with a small surplus for the 1982-'83 financial year, but it should also contribute, albeit moderately, to curb consumer demand by reducing personal disposable incomes and thus help in the fight against inflation. Additionally, it has the advantage that it does not presuppose an increase in the marginal rates of tax which I have striven so hard to bring down to, and keep at, lower and more realistic levels.

The levy is a compulsory loan to be repaid within a maximum period of 7 years, at simple, tax-free interest. Up to now the rate of interest has been 5% per annum, but I now propose that this rate be raised to 8%.

The yield expected from the loan levy in the 1982-'83 financial year will amount to around R115 million and R157 million for a full financial year.

After all these revenue proposals have been taken into account, there will remain a small surplus of R9 million.

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Developments in Latin America

PERU: NEW TAX AMENDMENTS

By Pedro Massone *

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1. IN GENERAL

Law No. 23,337 of 14 December 1981, published in the Official Journal *El Peruano* on 15 December 1981, introduced tax amendments affecting the recent tax reform discussed in my recent article, "The Peruvian Tax Reform (1981)", in this *Bulletin*.[1]

The changes refer to the tax code, income tax, property tax, general tax on sales, excise tax, mining taxation, customs duties and some other subjects. The principal changes are discussed in the following sections.

2. INCOME TAX JURISDICTION

Persons (individuals or legal entities) that under the provisions of the income tax law are domiciled in Peru are taxed on their world-wide income. The nationality of individuals, the place where entities are organized and the income-producing source are in this respect irrelevant. Persons not domiciled in Peru and their branches, agencies or permanent establishments in Peru are taxed on their Peruvian-source income only.

The foreign income tax paid abroad on foreign-source income is creditable against the liability to Peruvian income tax. The credit is limited to: (a) the tax actually paid abroad; and (b) the Peruvian tax which would result if the average (effective) rate applicable to world-wide income were applied to foreign-source income only.

For income tax purposes, legal entities include branches, agencies and *any other permanent establishment* in Peru belonging to sole proprietorships, companies or entities of any kind established outside Peru.

3. DEDUCTION OF LOSSES

Taxpayers domiciled in Peru can set off Peruvian-source losses against Peruvian-source income. They can also set off foreign-source losses against foreign-source income. They cannot, however, set off their foreign-source loss against Peruvian-source income. Only Peruvian-source losses can be set off against income arising in subsequent periods (carry over).

4. MINING TAXATION

The Mining Law is amended in order to specify that concessionaires are subject to the following taxes and duties:

- surface and registration duties;
- the income tax;[2]
- the tax on goods and services for the period during which it was in force (i.e. up to 31 October 1981);
- the general tax on sales as far as transactions subject to this tax are performed;[3]
- the "special tax" levied on exports of traditional products in place of the tax on goods and services;
- the tax on considerations for the rendering of personal services;
- the additional tax on sales levied on exports of minerals listed by the law, which was established in Legislative Decree No. 33 of 21 February 1981;
- the 2% surtax on behalf of the *Fondo de Compensación Nutricional* except where the taxpayer has concluded a contract with the government by means of which a guarantee has been granted that taxation rules will remain unchanged for a certain period of time;
- the taxes levied on behalf of the National Fund for Housing;
- social security contributions; and
- the tax on the distribution of electric power and running water, which was established in Legislative Decree No. 163 of 12 June 1981.

Concessionaires are exempt from taxes other than those listed above.

5. TAXATION OF CAPITAL GAINS

Taxable capital gains include gains arising from the transfer of property belonging to legal entities organized in Peru or to permanent establishments of enterprises organized abroad that perform in Peru activities that produce third category income. Other rules on the taxation of capital gains continue in force.

6. TAXATION OF INCOME DERIVED BY NON-DOMICILIARIES

Dividends paid to beneficiaries not domiciled in Peru are

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1. 36 *Bulletin* No. 4 (1982) at 148.
2. The income tax is levied, as regards mining activities, under ordinary rules of the Income Tax Law, with several deviations therefrom, as explained in "The Peruvian Tax Reform (1981)", Section III. B.
3. Most minerals are specifically exempt from the general tax on sales.

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subject to a 40% withholding tax which is a final tax (was 30%).

For income taxation purposes, it is presumed that loans expressed in foreign currency produce an interest of not less than the average "Libor" rate for 6-month deposits, for the second semester of the preceding year. This rule does not apply in those cases already excluded from the presumption of interest under the income tax law enacted in June 1981.[4]

Royalties paid to beneficiaries not domiciled in Peru are subject to a 55% withholding tax which is final (was 25%).

7. PROPERTY TAXATION

The property tax on non-business real estate due for the year 1982 shall be calculated on the basis of the amount due for the year 1981, increased by 40%. This rule does not apply to dwellings the rent of which is frozen.

8. SALES TAXATION

The coverage of the general tax on sales is extended to include production services.

For purposes of the excise tax *(Impuesto Selectivo al Consumo)*, enterprises are deemed to be economically connected, in addition to instances specified in previous legislation, if more than 30% of the capital of two or more enterprises belong to persons who are common partners of said enterprises.

9. CUSTOMS DUTIES

The Executive Branch is vested with the power to revise the customs tariff. Moreover, imports of goods carried out during 1982 are subject to a surcharge representing 15% of the old customs tariff. Imports made by the government are exempt from the surcharge.

10. ADJUSTMENT FOR INFLATION

The capitalization of the net appreciation resulting from the revaluation of fixed assets carried out under the law (partial adjustment for inflation) is subject to a tax of 5% of the capitalized sum. This tax is paid by the company concerned. The capitalization shall be carried out during the first semester of every year as regards the revaluation made at the end ot the preceding year.

The capitalization to be carried out in 1982 shall include any appreciation resulting from prior revaluations, which has not been capitalized yet.

11. TAX INCENTIVE MEASURES

The Executive Branch shall prepare a bill containing a revised statute for tax incentives which shall preserve the system of tax credits currently in force.

While the approval of the new statute for incentives is pending, some of the current benefits are reduced, i.e.;

- indexes of selectivity included in Decree Law No. 22,401 are reduced;
- the capitalization of reinvested profits shall be subject to income tax at a 5% rate unless a higher tax is due under previous legislation;
- exemptions from the tax on business net worth granted by old laws are reduced to 50%. This reduction does not affect benefits granted in Decree Law No. 2 of 17 November 1980 to agriculture and activities that are allowed to conclude contracts with the government by means of which a guarantee is granted that taxation rules will remain unchanged for a certain period.

4. E.g. the presumption does not apply to loans granted by non-domiciliaries from abroad.

IFA NEWS

FINNISH BRANCH

The Board of the Finnish Branch of IFA met on 5 March 1982. The Board discussed, among other things, applications for membership and resignations. On 1 January 1982 the Finnish Branch had 52 individual members, which number did not change during the first two months of 1982. The Board decided to send the Resolutions of the Berlin Congress[1] to the Ministry of Finance and the National Board of Taxes for their information. It was also decided that a report of this Congress, to be prepared by the Secretary, would be submitted for publication in the Taxation magazine.

The Annual Meeting was held on 20 April 1982. Professor Andersson and Mr. Pallonen who were appointed as national reporters for the Montreal Congress discussed their reports.

The Finnish Branch of IFA will attempt to organize a group trip to Montreal in September.

1. See for the text of these resolutions 35 *Bulletin for International Fiscal Documentation* No. 12 (1982) at 544-546.

[continued on page 274]

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UNITED STATES:

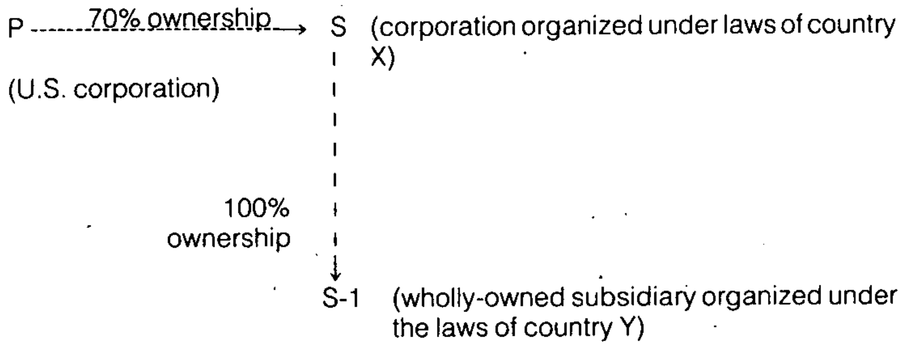
Income of Foreign Corporations Subject to Tax in the U.S.

by Piroska E. Soos*

In Revenue Ruling 82-16,[1] the United States Internal Revenue Service ("I.R.S.") applied the provisions of Subpart F (Sections 951-964) of the U.S. Internal Revenue Code ("I.R.C.") which is designed to prevent tax avoidance by U.S. persons (individuals and entities) that seek to reduce their U.S. tax liability by conducting part or all of their business operations through foreign subsidiaries. I.R.C., Section 951(a) provides, inter alia, that if a person is a U.S. shareholder of a "controlled foreign corporation" and owns stock in the corporation on the last day (in a taxable year during which a foreign corporation is a controlled foreign corporation for an uninterrupted period of 30 days or more) on which the corporation is a controlled foreign corporation, such person must include in his gross income his pro rata share of the corporation's "Subpart F income".

I.R.C., Section 957(a) defines a "controlled foreign corporation" as any foreign corporation of which more than 50% of the total combined voting power of all the classes of stock entitled to vote is owned directly or indirectly by U.S. shareholders on any day during the taxable year of such foreign corporation. "Subpart F income" is defined in I.R.C., Section 952 and includes, among other things, certain sales income and certain dividends, interest and royalty income.

Revenue Ruling 82-16 involved a U.S. corporation, P, and two foreign corporations, S and S-1. Under the rules of direct and indirect ownership in I.R.C., Section 958(a), P was deemed to own 70% of S and 70% of S-1. The following diagram illustrates the relationship among the corporations.



During its tax year ending on 30 September 1980, S-1 had "Subpart F income" of 100x dollars and other income of 50x dollars. S-1 also had accumulated earnings and profits in excess of 250x dollars, none of which was attributable to amounts previously included in P's gross income under I.R.C., Section 951(a). On 30 September 1980, S-1 distributed 200x dollars in cash to S, all of which was "Subpart F income" in the hands of S.

Under I.R.C., Section 951(a), P must include in its gross income for U.S. tax purposes its pro rata share of the "Subpart F income" of both S and S-1. However, in the absence of a specific provision stating otherwise, P would be taxed twice on its pro rata share of 100x dollars since the same 100x dollars was "Subpart F income" for both S and S-1. I.R.C., Section 959(b) prevents this result by providing that, for purposes of Section 951(a) the earnings and profits of a controlled foreign corporation attributable to amounts that are, or have been, included in the gross income of a U.S. shareholder under Section 951(a) shall not, when distributed through a chain of ownership described under Section 958(a), also be included in the gross income of another foreign corporation in the chain for purposes of applying Section 951(a) to the other controlled foreign corporation with respect to the U.S. shareholder.

The issue in the Revenue Ruling related to the words "amounts that are, or have been, included in the gross income of a U.S. shareholder" in I.R.C., Section 959. Does the phrase apply to exclude 70x dollars (P's pro rata share of S-1's income included in P's income) from S's gross income? Or, does the phrase exclude the entire 100x dollars of S-1's earnings and profits that are attributable to the 70x dollars included in P's gross income?

The I.R.S. held that, under the facts in this case, 100x dollars of the dividends received by S from S-1 are excluded from S's "Subpart F income" for purposes of applying I.R.C., Section 951(a) to P, its U.S. shareholder. The I.R.S. said that the exclusionary language of I.R.C., Section 959(b) looks at the total amount of earnings and profits of the controlled foreign corporation that caused the U.S. shareholder to be in receipt of gross income under I.R.C., Section 951(a). In this case, it was 100x dollars of S-1's earnings and profits that caused P to be in receipt of 70x dollars of gross income.

The I.R.S. found that if the exclusion of I.R.C., Section 959(b) were limited to 70x dollars, P would in fact have to include more than its pro rata share of S-1's income. If only 70x dollars were excluded, the remaining 30x dollars would be included in S's "Subpart F income", and P would have to include in its gross income its pro rata share of 30x dollars, i.e. 21x dollars (70% × 30x dollars). Thus, the total amount includible in P's gross income as a result of the 100x dollars would be 91x dollars (70x + 21x dollars).

The I.R.S. noted that I.R.C., Section 959(b) was enacted for the specific purpose of preventing the income of a controlled foreign corporation, which income had once been included in the gross income of a U.S. shareholder, from being included in the gross income of the U.S. shareholder a second time when the income is distributed to another controlled foreign corporation. This purpose could be achieved only by excluding 100x dollars from S's "Subpart F income".

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1. Published in *Internal Revenue Bulletin* No. 1982-5 of 1 February 1982 at 12.

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INDIA:

How Progressive are the Direct Taxes?

by G. Thimmaiah*

1. INTRODUCTION

In India taxation has been used to promote multiple objectives: increase the rate of domestic savings, reduce inequalities of income and wealth and maintain price stability. The first objective was attempted through "widening and deepening of the Indian tax system" so as to mobilise additional revenue for the purpose of investment in the public sector. Additional taxation measures were mainly intended to increase public sector saving by diverting increased income in the private sector (from conspicuous consumption) to public sector saving and investment. But in the 1970s empirical studies have shown that this has not actually happened in India.[1] In fact, both direct and circumstantial evidence go to prove that additional taxation has encouraged the government to increase its consumption expenditure much more than government savings.

In the case of price stability, taxation was justified on the basis of Keynesian macro-economic logic, namely, that taxation would reduce disposable income and hence effective demand and thus bring down prices. But here again, some empirical studies have shown that taxation, particularly indirect taxation,[2] instead of reducing demand, has simply added to the tax-pushed price rise; consequently the additional tax measures in the past 10 years or so have only added to price instability in the country.

In regard to the equity objective, the role of taxation in reducing inequalities of income and wealth has been rather overemphasised. During the Second Five Year Plan period, the big-push strategy of industrialisation emphasised the objectives of growth and equity. Growth was attempted through rapid industrial development, particularly by starting capital goods industries, and equity was supposed to be achieved through fiscal policy tools, particularly by levying steeply progressive rates of tax on income and wealth. Accordingly, for the first time a group of direct taxes was introduced based on the recommendations of Nicholas Kaldor which came to be known as the "integrated direct tax system". In addition to the then existing income tax and capital gains tax, wealth tax, estate duty, gift tax and expenditure tax were introduced during the Second Five Year Plan period. Since then, these taxes have continued to operate with various modifications and only expenditure tax has been removed.

Nicholas Kaldor provided a very appealing rationale for the equity objective of taxation in the following way:

> An effective system of progressive direct taxation is vital to the survival of democratic institutions in India. The need for this arises not merely on financial grounds – to raise adequate resources for purposes of accelerated economic development – but in order to bring about the degree of social cohesion and co-operation that is essential for the successful functioning of a democratic system. In a community where there is such a wide gap between the position of a privileged minority of well-to-do and the vast majority who live in dire poverty, social cohesion can only be achieved if economic inequality is effectively lessened and the tendency towards increasing concentration of wealth is effectively counteracted. This can only be done through the instrument of taxation. It is in any case inevitable that heavy burdens should be laid on the broad masses of the population if India is to attain a satisfactory rate of development in the coming decades. it will not be possible to carry through the programme successfully with the consent and co-operation of the people if the privileged minority of the well-to-do are not made to bear a fair share of this burden. Moreover, in matters of taxation, like in the administration of the law, it is not enough that justice should be done – it must also be seen to be done. If owing to defects in the tax laws, or in their administration, highly progressive taxes of wealth and income have no visible effect on the prevailing economic inequality, or in the standards of living of the rich, the mere enactment of advanced tax legislation will prove fruitless.[3]

The Government of India took this advice very seriously and relied too much on direct taxes to reduce inequalities of income and wealth in the country. What is more, by introducing many direct taxes together, the Government of India tried to convince the majority of the vast masses that the richer people were bearing a very high burden of taxation and therefore the masses should also contribute, to whatever extent possible, through indirect taxation for the development effort of the country. This led to an enormous increase in the rates and coverage of indirect taxation. Such an unprecedented increase in indirect taxation also gave a lever to the private sector, which has been protected from foreign competition, to increase the profit through pushing up prices. While the Government was lulled to complacency on the assumption that increased taxation would reduce consumption and bring down the price level and also that the system of integrated direct taxes would prevent evasion of direct taxation and reduce inequalities of income and wealth, in actual practice prices went on rising as and when taxes were increased and the really rich self-employed income earners went on evading direct taxes. This is the story of postwar tax policy in India. After a period of two decades it has come to be realised that inequalities of income have increased and mass poverty has only spread. Several explanations are given for these not so unexpected economic

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1. See for details G. Thimmaiah, *Studies in Indian Public Finance* (New Delhi, Kalyani Publishers, 1979).
2. Ibid.
3. Nicholas Kaldor, "Tax Reform in India", in R.M. Bird and O. Oldman (eds.), *Readings on Taxation in Developing Countries* (Baltimore, The Johns Hopkins Press, 1972), p. 272.

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consequences. Recognising this fact, the Fourth Five Year Plan emphasised restructuring the plan priorities and also the composition of the goods produced in the country with a view to achieving growth with equity. The Fourth Plan also started some anti-poverty programmes which have been continued even in the Fifth and Sixth plans.

While the effect of indirect taxes and the overall additional tax measures on public sector saving and the price level have been examined elsewhere, an attempt is made here to assess the effect of direct taxes on the inequalities of income and wealth in India. This is done by measuring the progressivity of direct taxes in India.

2. MEASUREMENT OF PROGRESSIVITY

For the purpose of judging the progressivity of tax, the average rate and marginal rates are traditionally used. Thus, over a given range of ascending income levels, if the average rate and marginal rates are equal, the tax is considered proportional; if the marginal rate is greater than the average rate, it is progressive; and if the average legal rate is greater than the marginal rate, it is regressive. However these refer only to legal rates which exist in law, but which in actual operation may not satisfy these conditions. In other words, what is important from the point of view of judging the progressivity of direct taxes is the comparison of average effective and marginal effective rates. These rates are obtained on the basis of actual amount of revenue collected from the taxpayers at different income levels. Though the progressivity of taxation is measured in terms of average progressivity, marginal rate progressivity, and tax liability progressivity, in order to know the effect of direct taxes on the inequality of income and wealth, we need to have some summary measure which has some relation to the popularly used measure of inequality, namely, the Lorenz curve. R.A. Musgrave[4] has suggested a measure in which the inequalities of pre-tax and post-tax incomes are compared and the effect of a tax system on the inequality of income is measured. Recently, D.B. Suits[5] and N.C. Kakwani[6] have also developed similar summary measures to know the impact of the tax structure on inequality of income. In this paper we have used Musgrave's measure as it will not only give us the impact of direct taxes on the degree of inequality, but also takes into account the impact of the statutory rate structure, the level of tax yield and the distribution of income.

Progressivity of direct taxes is measured with reference to their distributional effect. Following R.A. Musgrave, the incidence of taxation has come to be defined in terms of its distributional consequences. Accordingly, progressivity is supposed to reduce the inequality of post-tax income distribution. No doubt, for the purpose of knowing the progressivity and the impact of distribution of income, not merely the incidence of the overall tax structure but also the incidence of public expenditure should be considered. Only such a complete budget incidence will give the true picture of the distributional consequences of a government budget. However, it is also necessary to examine the impact of specific direct taxes on the distribution of income from the point of view of tax reform. The taxes which are traditionally considered as direct taxes – such as income tax, estate duty, capital gains tax, gift tax, wealth tax, etc. – are supposed to fall on those people on whom legal liability is indicated and established. It may be noted that the effectiveness of these taxes in reducing the inequality of income depends upon the nature of the progressive structure of the tax rates. In the case of Musgrave's measure, first the gini-coefficient of income distribution before tax, (G), is estimated. Then the gini-coefficient of post-tax income distribution, (G*), is estimated and the ratio of the latter to the former, (G*/G), will give the overall progressivity of the tax. The ratio (G-G*/G), which may be called the coefficient of equalisation, will give us the effect of direct taxation on the distribution of income. If the ratio of the Gini coefficient of post-tax income distribution, (G*), to the Gini coefficient of pre-tax income distribution, (G), is greater than 1, the overall effect of a tax is progressive. If it is equal to 1 it is proportional, and if it is less than 1 it is regressive. Further, the higher the value of the coefficient of equalisation, (G-G*/G), the higher the redistributive effect of taxation.

3. PROGRESSIVITY OF DIRECT TAXES IN INDIA

Table 1 shows the changing composition of direct taxes in India. It may be observed that the income tax, which contributed almost 75% of the revenue from direct taxes, gradually declined in its importance to 18%. Correspondingly, the revenue importance of corporation tax has increased from 23% in 1950-51 to 71% in 1981-82. Of the remaining direct taxes, the revenue from wealth tax has been increasing in both absolute and relative terms. Even so, the revenue importance of direct taxes on individuals has been declining. This would suggest that direct taxes on individual income and wealth are declining as compared to direct tax on corporate income, thereby making them ineffective in achieving the equity objective.

Table 2 presents the summary measure of progressivity and the redistributive effect of direct taxes in India. The summary measure of progressivity is the one suggested by R.A. Musgrave which indicates that all direct taxes have been regressive as the values are less than 1. Perhaps wealth tax, estate duty, gift tax and capital gains tax can be considered to be proportional in view of the values of their progressivity measures being nearer unity. But in the case of individual income tax, it is definitely regressive as it is less than 1. What is more, the coefficient of equalisation which is presented in Table 2 shows that the income tax, though it had a more equalising effect than other direct taxes, is still greatly inadequate to reduce the inequality of income distribution among direct tax assessees. In the case of wealth tax, the equalising effect is almost absent. And in the case of other direct taxes it is negligible. This suggests that direct taxes did not have a significant equalising effect to reduce inequalities of income distribution among the assessees to direct taxes in India.

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4. *The Theory of Public Finance* (Tokyo, McGraw Hill Co., 1959).
5. "Measurement of Tax Progressivity", *American Economic Review*, September 1973.
6. *Income Inequality and Poverty: Methods of Estimation and Policy Applications* (New York, Oxford University Press, 1980).

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Table 1
Composition of direct taxes in India

(Rs. crores)

Year	*Income tax*	*Corporation tax*	*Estate duty*	*Wealth tax*	*Gift tax*	*Other direct taxes*	*Total direct taxes*
1950-51	132.73 (74.97)	40.49 (22.87)	–	–	–	3.81 (2.16)	177.03 (100.00)
1951-52	146.19 (76.71)	41.41 (21.73)	–	–	–	2.97 (1.56)	190.57 (100.00)
1955-56	131.35 (76.01)	37.04 (21.44)	1.81 (1.05)	–	–	2.60 (1.50)	172.80 (100.00)
1960-61	167.38 (56.60)	111.05 (37.55)	3.09 (1.04)	8.15 (2.76)	0.89 (0.30)	5.18 (1.75)	295.74 (100.00)
1965-66	271.80 (45.02)	304.84 (50.50)	6.66 (1.10)	12.05 (2.00)	2.27 (0.38)	6.06 (1.00)	603.68 (100.00)
1970-71	473.20 (53.97)	370.50 (42.26)	7.90 (0.91)	15.30 (1.74)	2.40 (0.27)	7.50 (0.85)	876.80 (100.00)
1975-76	1214.40 (54.65)	861.70 (38.78)	11.70 (0.53)	53.70 (2.42)	5.10 (0.23)	75.40 (3.39)	2222.00 (100.00)
1980-81	504.42 (25.32)	1310.79 (65.79)	3.93 (0.20)	67.43 (3.38)	6.51 (0.33)	99.34 (4.98)	1992.42 (100.00)
1981-82 RE	503.12 (18.24)	1962.00 (71.12)	(0.02)	75.00 (2.72)	6.75 (0.24)	211.18 (7.66)	2758.55 (100.00)

Notes:
1. 1 crore = 10,000,000.
2. Figures in brackets refer to percentages.
3. Other direct taxes include stamps and registration, land revenue, interest tax and expenditure tax.

Source: RBI Bulletins and *Reports on Currency and Finance.*

Table 2
Progressivity and redistributive effect of direct taxes in India

Year	*Income tax*		*Wealth tax*		*Estate duty*		*Gifts tax*		*Capital gains tax*	
	$\frac{G^*}{G}$	$\frac{G-G^*}{G}$	$\frac{G^*}{G}$	$\frac{G-G^*}{G}$	$\frac{G^*}{G}$	$\frac{G-G^*}{G}$	$\frac{G^*}{G}$	$\frac{G-G^*}{G}$	$\frac{G^*}{G}$	$\frac{G-G^*}{G}$
1957-58	.07844	0.2156	–	–	–	–	–	–	0.9525	0.0475
1958-59	0.9242	0.0758	–	–	–	–	–	–	0.9518	0.0482
1959-60	0.8492	0.1508	–	–	–	–	–	–	0.9504	0.0496
1960-61	0.8248	0.1751	–	–	–	–	–	–	0.9696	0.0303
1961-62	0.8467	0.1533	0.9968	0.0033	0.9379	0.0621	0.9768	0.0232	0.9521	0.0479
1962-63	0.8392	0.1608	0.9961	0.0039	0.9371	0.0629	0.9721	0.0279	0.9638	0.0362
1963-64	0.8397	0.1603	0.9952	0.0047	0.9236	0.0764	0.9816	0.0184	0.9701	0.0299
1964-65	0.8452	0.1548	0.9959	0.0041	0.9436	0.0564	0.9432	0.0567	NA	NA
1965-66	0.8424	0.1476	0.9964	0.0035	0.9427	0.0573	0.9279	0.0721	0.9457	0.0543
1966-67	0.8400	0.1599	0.9960	0.0040	0.9142	0.0858	0.9318	0.0682	0.9551	0.0449
1967-68	0.8318	0.1682	0.9956	0.0046	0.8837	0.1163	0.9510	0.0489	0.9670	0.0329
1968-69	0.8591	0.1409	0.9962	0.0040	0.9221	0.0779	0.9319	0.0680	0.9607	0.0393
1969-70	0.8304	0.1696	0.9959	0.0041	0.8881	0.1119	0.9422	0.0578	0.9642	0.0358
1970-71	NA	NA	0.9960	0.0040	0.9105	0.0895	0.9712	0.0288	NA	NA
1971-72	0.7607	0.2393	0.9951	0.0049	0.9191	0.0809	0.9427	0.0573	0.9646	0.0354
1972-73	0.7860	0.2140	0.9966	0.0034	0.9113	0.0887	0.9383	0.0617	0.9145	0.0855
1973-74	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
1974-75	0.7098	0.2092	0.9955	0.0046	0.9159	0.0841	0.8964	0.1036	0.8922	0.1078
1975-76	0.7909	0.2091	0.9957	0.0043	0.9085	0.0915	0.9277	0.0723	0.8953	0.1047
1976-77	0.8008	0.1992	0.9970	0.0031	0.9272	0.0728	0.9224	0.0776	0.8872	0.1128
1977-78	0.7009	0.2991	0.9944	0.0054	0.9259	0.0741	0.9224	0.0776	0.6935	0.3065
1978-79	0.8102	0.1898	NA	–	NA	NA	NA	NA	0.8887	0.1113

Notes:
1. NA: Data are not readily available for these years and hence the relevant measures are not estimated.
2. $\frac{G^*}{G}$: is the summary measure of progressivity suggested by R.A. Musgrave.
3. $\frac{G-G^*}{G}$: is the equalisation coefficient as proposed by Hiromitsu Ishi.

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We have also examined average rate – marginal rate progressivity. (However the results are not presented here as they run into several pages.) There also we find evidence of regressivity. In other words, though the summary measure of progressivity indicates the overall progressivity over the entire range of income levels, even the marginal rate progressivity does not clearly indicate progressivity at different ranges of income levels. It is quite possible that a tax may be progressive at different levels of income but may not be progressive over the entire range of income levels. However, both the summary measure of progressivity and the average – marginal rate progressivity indicate that all the direct taxes in India have not been progressive so as to reduce inequalities of income and wealth.

It should, however, be noted that these direct taxes have been operating in a situation of rising prices. Rising prices themselves operate as some sort of regressive tax, and in order to know the true nature of the progressivity we have to eliminate the impact of inflation on the progressivity of these taxes. However, we have not been able to separate the regressivity of inflation from the regressivity of direct taxes. Even so, one would expect from the tax rate structure that some sort of progressivity would prevail. But the average effective rates and the marginal effective rates indicate that the effective rate progressivity has been regressive in India.

4. EXPLANATIONS FOR THE ABSENCE OF PROGRESSIVITY

After establishing he negligible equalising effect of direct taxes in India, it is necessary to search for the reasons for such absence of progressivity. Three reasons may be given to explain this phenomenon:

(1) Though the legal rates have been steeply progressive, the effective rates have been made regressive owing to various exemptions, allowances, deductions and so on. In other words, "tax expenditure measures" which are built into the direct tax system have distorted the legal rate structure and made them regressive.

(2) Tax evasion seems to be evident as the marginal and average effective rates become lower at the higher levels of income and wealth.

(3) The extent of tax avoidance under legal protection and the ever increasing arrears of assessment and of collection (as is evident from Tables 3 and 4) do indicate that, at the higher levels of income and wealth, people resort to legal remedies because of defective assessment and, as a result, the actual tax liability becomes far less than the expected legal liability. Consequently, the originally designed tax loses its progressivity element over time, apart from the government losing the revenue.

Thus a combination of these factors have been operative in the country to make the direct taxes ineffective in their equalising effect. The policy implication of the foregoing findings is simple, namely, to recognise the reality of the situation. It is better to admit the fact that the direct taxes in the country cannot be used to reduce inequalities of income and wealth, rather than to proclaim repeatedly that they are intended for that. This is mainly because the coverage of these taxes is so small that it is meaningless to think of using such taxes – which cover a small proportion of the active population in the country – to reduce the inequalities of income in the country as a whole. The actual operation of the tax laws has shown that the average and marginal effective rates have been quite different from the legal rates and as a result the expected equity even among those whose income and wealth are assessed for direct taxes is not achieved. It would be better to recognise the fact that these direct taxes cannot reduce inequalities of income and wealth in this country, and, therefore, to justify these taxes only from the point of view of raising revenue. Otherwise, great hopes will be raised, and in fact such hopes have been raised in the past, in the minds of the people in the name of achieving equity through steeply progressive taxation, which in fact has not been achieved. Hence, instead of raising expectations and dashing them to the ground without achieving the intended objective, it would be better to admit the fact that direct taxes in the Indian situation cannot achieve the objective of reducing inequalities of income in the country.

Alternatively, one might argue that we should reform the direct tax structure in such a way as to cover more people, to plug legal loopholes not only to prevent evasion of tax payment but also to reduce tax avoidance through tax planning. We would consider such arguments as merely academic in the Indian politico-economic institutional setting.

Table 3 (Number of assessments)
Arrears of assessment of direct taxes in India

Year	*Income tax*	*Wealth tax*	*Estate tax*	*Gifts tax*
1950-51	528,070	–	–	–
1955-56	539,832	–	–	–
1961-62	712,402	15,499	4,210	2,117
1966-67	2,346,531	74,232	9,798	6,872
1971-72	1,123,705	172,044	11,945	13,825
1972-73	1,392,665	198,677	13,408	16,986
1973-74	1,719,597	238,732	14,969	21,106
1974-75	1,677,481	244,224	20,084	26,305
1975-76	1,726,683	255,810	25,470	30,438
1976-77	1,741,838	288,949	27,256	22,580
1977-78	1,537,542	314,224	28,287	22,925
1978-79	1,925,564	331,561	27,802	21,807
1979-80	2,299,265	432,988	34,891	27,403

Note: Wealth tax, estate duty and gifts tax were not in operation in 1950-51 and 1955-56.
Source: Anil Kumar Jain, "Central Direct Taxation: Administrative Problems", *Eastern Economist*, 12 February 1982.

Table 4 (Rs.crores)
Arrears of collection of direct taxes in India

Year	*Income tax*	*Wealth tax*	*Estate tax*	*Gifts tax*
1970-71	738.77	12.01	15.71	2.38
1972-73	790.02	25.46	15.29	3.61
1973-74	815.60	29.03	15.75	3.60
1974-75	935.96	75.56	13.86	5.01
1975-76	993.79	82.38	15.31	5.22
1976-77	873.56	52.75	15.56	5.90
1977-78	989.87	56.51	17.52	6.97
1978-79	910.65	184.08	17.11	17.72
1979-80	1011.85	180.53	17.23	15.77

Source: Anil Kumar Jain, op.cit.

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HONG KONG:

Budget 1982-83

Extracts from the Budget Speech pronounced by the Financial Secretary, Mr. John Bremridge, on 24 February 1982

A detailed discussion of Hong Kong's tax system appears in the International Bureau of Fiscal Documentation's publication: TAXES AND INVESTMENT IN ASIA AND THE PACIFIC

1. I begin my first budget speech by acknowledging my debt to my predecessor who has left me a clean slate on which to draw. I am also grateful to my new colleagues in Government who have worked so hard on the budget, and have loyally pointed me in approximately the right direction, though the choice of paths is mine – even in a budget which naturally reflects governmental not personal policy. I cannot name them all, but they particularly include officers in Finance, Economic Services, Monetary Affairs, and Inland Revenue.

2. My speech deals with three main issues – where Hong Kong has been and why; the current state of the Government's accounts and my proposed estimates and tax concessions; and where Hong Kong then seems likely to go in 1982. It is supported by the accompanying cross referenced 1981 Economic Background and 1982 Economic Prospects, plus footnotes and appendices bound with the printed version.[1]

. . .

TAX PROPOSALS

74. I come now to my proposals on taxation. The estimated surplus for 1982-83 is $6.3 billion as against the revised estimate of $7.7 billion for 1981-82. Our reserves are now larger at $23 billion.

75. While there are several sources of increased or additional revenue fairly open, with tobacco and alcohol only among the more obvious, I do not believe that it is ordinarily appropriate for the Government to raise taxation when it clearly does not need the money either for its immediate expenditure requirements or in order further to strengthen prudent reserves. While for years it has been argued in Hong Kong that in normal circumstances taxation should be fiscal in nature there may have to be exceptions. Higher taxes on motor vehicles and duties on petrol are possible examples. There are others. Common sense in such cases may indicate that the Government should consider not only its fiscal requirements but also the potential of taxation as a supplementary means of achieving other policy ends.

76. I believe that the new Capital Works Reserve Fund is a businesslike way of spreading unpredictable and often lumpy capital revenue from year to year against a current Public Works Programme four-year overhang of some $23 billion. In fact annuality (except as an important control concept) does not really play a part in major capital programmes, for we are not likely to stop large capital schemes in mid-stream unless in extraordinary circumstances.

77. With the C.W.R.F. established and initially funded, the surplus is estimated to drop to $3.7 billion in 1982-83. This presupposes that members will accept my recommendation that $11 billion should be appropriated in 1982-83 for the fund. While the creation of the C.W.R.F. has seemingly diminished the overall surplus on General Revenue Account, we should not allow ourselves to be seduced by this budgetary innovation into inconsistent fiscal behaviour.

78. I make no apology for referring frequently in this speech to the need for consistency in Government policies – and particularly taxation policies. While simultaneously observing our accepted guidelines it is reasonably consistent that I should propose to abate taxation in 1982-83 by some $1.37 billion, which compares with the figure of $1.25 billion a year ago. You will note that I do not use the irritating phrase 'give back', which presuppose that private monies are all at Government's beck and call.

79. My major concerns for 1982-83 include the need for appropriate monetary and fiscal counter-inflationary policies, the problems of industry, the continued development of Hong Kong as a major financial centre, and the less privileged. I also acknowledge the burdens of Mr Lobo's sandwiched society – the middle class who in Hong Kong as elsewhere tend to be a mainstay of the community. Finally I am well aware that capital revenue yield from future land sales is as enigmatic as it ever has been.

80. I thus propose ten tax concessions in four areas, which I believe reflect these concerns. They otherwise are mainly neutral in effect, and will promote our general economic well-being. In that state of well-being I include a sense of fair play, for good budgets must surely have some satisfying emotional content.

BUSINESS TAXATION

81. My first two concessions offer incentives for investment to the business sector of our economy and in particular to our manufacturers, who I believe should be further encouraged to expand their investment in new capital equipment. This is essential if our industry is to remain flexible and competitive. I am anyway well aware of the difficulties currently being experienced for example by many in the spinning, weaving, dyeing and finishing sectors. Members will recall that in order to encourage manufacturers to re-equip and upgrade their plant and equipment, Government last year introduced both improved annual depreciation rates and an increased initial allowance, which was raised from 25% to 35% in respect of expenditure incurred on the provision of plant and machinery.[2] Some have said that we did not go far enough and that we should permit a full 100% write-off in the year of acquisition as indeed is the practice in some other places. This would, however, be an expensive concession, which could not be contemplated in one single bound. Furthermore, bearing in mind Hong Kong's unusually low rates of tax fiscal relief alone will probably never be a conclusive incentive to incur expenditure on plant and equipment; other considerations such as a desire for improved production capacity, increased productivity, and particularly enhanced profitability are more likely to be the deciding factors. Nonetheless I accept that tax considerations play their part in the decision-making process; and our manufacturers still represent the backbone of our economy. Accordingly my first proposal is that the initial allowance should be further increased from 35% to 55% for expenditure incurred on the provision of qualifying plant and equipment.[3] The new initial allowance will apply to both final profits tax assessments for 1981-82 and provisional profits tax for 1982-83. The cost to the revenue of this increased allowance will be $354 million in 1982-83 and $180 million in a "full" year.

82. My second concession, which concerns the industrial buildings allowance, will benefit both manufacturers and those who invest in industrial property for rental income purposes. For just as it is important that our manufacturers should be encouraged to re-equip and upgrade their plant and equipment, so it is desirable that new plant and equipment, and particularly the workers who operate the machines, should be accommodated in modern and efficient factory premises.

83. The present legislation provides for the grant of industrial buildings allowances by reference to the cost of construction only: no account is taken of the profit element included in the price which the property developer charges to the purchaser for his new building. I propose therefore, that where a person carrying on a trade, which consists wholly or partly of the construction of buildings or structures with a view to their sale, sells a qualifying building in the course of that trade, before it is used, then the initial and annual allowances will be computed by reference to the net price paid by the purchaser and not by reference to the actual cost of construction.[4] The cost to the revenue of this concession will be $66 million in 1982-83 and $34 million in a "full" year; and the concession

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1. Not reproduced here.
2. B.S. 1981, paragraph 243.
3. Thus, for example, an item of weaving or spinning machinery already ranking for the annual rate of allowance of 30% will qualify for a write-off for profits tax purposes (initial and annual allowances taken together) of 68.5% in the year of acquisition.
4. Thus, assuming a factory building is constructed by a property developer at a cost of $8 million and sold to a corporate manufacturer for, say, $10 million (which could be a comparatively modest mark-up), then the tax saving to the manufacturer in the year of acquisition as a result of this concession would be $79,200 (i.e. tax at 16.5% on initial and annual allowances granted on the developer's profit of $2 million).

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will again apply to both final profits tax assessments for 1981-82 and provisional profits tax for 1982-83.

INTEREST TAX

84. I turn now to the controversial issue of interest tax. When presenting his 1981-82 Budget Sir Philip made reference to the taxation treatment of foreign currency deposits and told this Council that an examination was in hand.[5]

85. In the course of our subsequent deliberations we once again concluded that for a variety of reasons there was no present case for the total abolition of interest tax; and that the case for the exemption of foreign currency deposits taken in Hong Kong was not clearcut, because it could lead to switching of funds from Hong Kong dollar deposits to foreign currencies with consequential pressure on the exchange value of the Hong Kong dollar. I have since received two reports prepared by the Hong Kong Association of Banks. The second of these gave information obtained from a survey of member banks, the general consensus of which was (hardly surprisingly) strongly in favour of a tax exemption for foreign currency deposits. These submissions acknowledged the probable fiscal consequences of repeal, but took the view that in the context of our total budgetary situation we could afford the loss in yields from interest tax. They also argued that the monetary and economic advantages, in particular the enhancement of Hong Kong's position as an international financial centre, could well outweigh the fiscal losses; and that such losses would in part at least be offset by increased profits tax yields from financial institutions. After long internal debate and much heartsearching we have come to the conclusion that the arguments for a partial repeal of the interest tax on pragmatic and economic grounds outweigh the fiscal arguments for its retention. The Government considers that the continuing growth of Hong Kong as an international financial centre is worthy of encouragement.

86. I therefore propose to exempt foreign currency deposits placed with licensed banks and registered and licensed deposit-taking companies from interest tax; and it follows that those institutions will no longer be under any withholding obligations in respect of such deposits. The original terms of reference for the examination envisaged that exemption would only be available for deposits of a minimum size, and would apply only to deposits placed with licensed banks and licensed deposit-taking companies. We have now come to the view, however, that it would best serve Hong Kong's interests if the exemption were extended to registered deposit-taking companies as well, thus giving to international investors who wish to use our services a wider range of choices. By the same token I have decided not to impose a minimum level of deposit. Any such limitation would necessarily have had to be arbitrary: if set too high it would have vitiated the objectives of the exemption; and if set too low could have been readily circumvented, for instance by groups of depositors joining together to meet the stipulated minimum. Furthermore a minimum level of deposit which was pitched high would be open to criticism on grounds of equity – helping only the rich investor at the expense of the man in the street. Consequently the exemption will apply to all foreign currency deposits placed with licensed banks and licensed or registered deposit-taking companies. And, I should add, not only is the charge to interest tax removed but also it is intended to provide a corresponding exemption from profits tax in respect of interest accruing on foreign currency deposits placed with these institutions by persons, whether corporate or non-corporate, carrying on a trade, profession or business in Hong Kong (other than the business of 'financial institution' as defined in the Inland Revenue Ordinance).[6] I must stress that the profits tax exemption will not apply to 'financial institutions' – for obvious reasons. The borrowing and lending of money at interest with a view to profit is the very essence of their business activities, and there is clearly no case for excluding those profits from charge.

87. Having thus decided to exempt interest on foreign currency deposits, there remained the problem to which I have already referred; that is the evident dangers for the Hong Kong dollar if depositors began significantly to move across the exchanges out of Hong Kong dollar deposits ino foreign currency deposits. It is also now a relatively simple matter for an investor to minimise his exchange risks at small cost by entering into what is known in the trade as a "swap" transaction – that is the coincidental purchase and resale of the foreign currency deposit. This practice moreover is clearly mushrooming.

88. Bearing in mind, however, that there is a cost element in minimising exchange risk exposure, we believe that it is possible to discourage widespread switching from Hong Kong dollar to foreign currency deposits; and this I propose to do by reducing the rate of interest tax on Hong Kong dollar deposits with licensed banks and registered and licensed deposit-taking companies from 15% to 10%. At this level the tax advantages of moving into foreign currency deposits will usually be small; indeed a switch could well be disadvantageous when measured against the costs of covering exchange risks. Much will depend, however, upon the relative movements of Hong Kong dollar and other interest rates. I do not incidentally propose to introduce a differential rate for profits tax on Hong Kong dollar deposit interest accruing to business depositors. The practical complications would be considerable and, in my view, not justified. Again it will be appreciated that the concessions now proposed apply only to deposits with banks and deposit-taking companies. Interest on other forms of indebtedness such as mortgages and private loans will continue to attract liability to tax at the standard rate of 15%, or 16.5% in the case of the profits of corporations who receive such interest as part of their trading profits.

89. The cost to revenue of exempting foreign currency deposits and of reducing the interest tax rate on Hong Kong dollar deposits to 10% is estimated to be $400 million in 1982-83, subject always to the influences which variations in interest rates from time to time and in the volumes of deposit business transacted might have on revenue yields.

90. It would be appropriate administratively to introduce these interest tax proposals with effect from 1st April 1982, that is at the commencement of the next fiscal year. As however there could be something of a hiccup in the financial sector in the intervening weeks, I have decided that it will be more intelligent to introduce the new exemption for foreign currency deposits and the reduced rate of 10% forthwith. To this end Your Excellency this morning signed an Order under the Public Revenue Protection Ordinance which will bring these proposals into force so as to apply to interest paid or credited on or after tomorrow, Thursday, 25th February 1982. It is my hope that the clamourings of the interest tax abolitionist lobby will now subside. But whether they do or not, we shall watch carefully the effects of the reliefs now to be introduced. Whatever the monetary and economic advantages may be, we realise that these reliefs introduce a new, untried and somewhat untidy dimension to the well tested fiscal balance of our tax system. If the imbalance which these new reliefs impart to the system is unduly exploited – for example by way of sophisticated gearing devices designed to eliminate or reduce substantially the profits tax liabilities of ordinary trading concerns – we shall have to consider whether the loss to revenue is still justified, or whether we have begun to pay too high a price for the economic advantages gained. It will also be a matter of experience whether 10% is an appropriate level.

PERSONAL TAXATION

91. Last year substantial increases were introduced in the level of allowances granted to those liable to salaries tax and to those who elect for personal assessment. I propose this year to introduce further concessions in the field of personal taxation because, as Sir Philip aptly put it last year, we have an ongoing commitment 'to review the system of personal taxation periodically, having regard to our current budgetary situation and to the need to maintain equity as between different income groups at a time when the growth of money incomes is leading to fiscal drag'.[7] If at some future time our revenue needs dictate an increase in the levels of taxation, I shall not hesitate so to address this Council. For the moment, however, I am satisfied that we can afford this year to review again the levels of our personal taxation allowances and to revise upwards the tax thresholds, that is the

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5. B.S. 1981-82, paras. 295-296 . . . . . to consider the implications of the proposition 'that interest payable on deposits denominated in foreign currencies above a certain minimum size, accepted by institutions of a certain status (say, licensed banks and the proposed new category of merchant banks), be made exempt from tax and consequently, that the institutions concerned be made exempt from any withholding obligations'.

6. This profits tax exemption is a logical consequence of the decision to exempt foreign currency deposits from interest tax, and also recognises that business proprietors could with comparative ease remove surplus funds temporarily from their businesses thus legitimately avoiding the charge to profits tax whilst at the same time enjoying the interest tax exemption.

7. B.S. 1981, paragraph 223.

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levels of the entry points into the tax net. Such concessions will ensure that those who would otherwise be brought into the tax net because of the effects of inflation on money incomes are kept out: they will pass on to some of those already in the tax net some of the benefits of our satisfactory budgetary situation: they will also mean that some are no longer liable to tax at all.

92. Firstly, I propose an increase in the level of personal allowances from $15,000 to $20,500 for single persons and from $30,000 to $41,000 for married persons. The present supplementary personal allowances of $7,500 for a single person and $15,000 for a married person will remain unchanged, and the available claw-back mechanism will continue to be zero rated. Thus taken together the basic personal allowance plus supplementary allowance will total $28,000 for a single person and $56,000 for a married couple; below these income levels there will be no liability to tax. The new allowances will be, therefore, very nearly 25% higher than the present levels fixed a year ago, and thus considerably in excess of the rate of inflation.

93. Secondly, I propose an increase in the child allowances from $7,000 to $8,000 (or by 14.3%) for the first child and from $5,000 to $5,500 (or by 10%) for the second child. I do not propose increases in the present allowances for the third to ninth children, which I consider remain appropriate.

94. Thirdly, I propose an increase in the dependent parent allowance from $7,000 to $8,000 (or by 14.3%), as before pitching this allowance at the same level as that for the first child. I do not propose to vary the criteria for the granting of this allowance.[8] I shall give further thought to the important social question of persuading children to support their ageing parents, of whom I am one.

95. If approved, my proposals for personal taxation allowances will be applicable to final salaries tax assessments (and for personal assessments also) for 1981-82 and to provisional salaries tax for 1982-83. The cost to the revenue in 1982-83, after allowing for the two-instalment system for the payment of provisional salaries tax, will be $509 million, equivalent to a substantial proportion (22%) of the estimated revenue from personal taxation. The cost in a "full" year is estimated to be $316 million at present levels of chargeable income.[9] I do not propose to dwell on the figures, but I suggest that close examination will demonstrate again that our system of personal taxation is extraordinarily modest in its impact. Indeed there can be few other places in the world which have both tax thresholds so high that the majority of the economically active are excluded from charge to tax, and a system which is so efficiently revenue productive (and, I might add, at an extremely low cost by world standards).

ESTATE DUTY

96. Finally I have three concessions relating to Estate Duty. But first I intend to use this opportunity to comment on certain criticisms of Estate Duty at large, which will also enable me to range more widely. It has been suggested that the Estate Duty legislation ought to be repealed because it is cumbersome and complex, its impact is easily avoided, it produces little revenue, and is difficult and expensive to administer.

97. The facts however are that the legislation is well understood by those who have to deal with it professionally, and by the officers of the department who administer it. As regards avoidance, all our direct taxes are susceptible to avoidance, based as they are on our limited territorial source criterion. On the whole because of our modest rates the majority of our entrepreneurs and others who use Hong Kong's excellent infrastructure of services, communications facilities and so on do not conduct their tax affairs as cynically as their counterparts in other places where high levels of taxation prevail. But I am bound to say that, if ever our taxation system ceases to be as revenue productive as it is now, we shall have to think seriously about plugging the leaks even if that means paddling into the muddy waters of highly complex fiscal legislation, which we have always avoided in favour of our simpler system.

98. In the year ended 31st March 1982 estimated estate duty collections are expected to be $294 million, which though not a significant sum measured against our total revenue yields, is a useful contribution to our total budgetary needs. Nor must we ever commit the cardinal error of being mesmerized by billions: it is an accumulation of small sums that matters, as every man and woman in the street knows. The cost of collection is under 1%, which is hardly an expensive operation. Finally, so the Commissioner informs me, the Estate Duty Office provides an excellent source of information on those who during their lifetime made little or no contribution to the Exchequer – because they evaded or cheated on taxes they ought to have paid. This final opportunity to seek and obtain some restitution from the estates of such people would in itself be justification for the retention of the estate duty, even if the yield from the duty itself were insignificant – which it is not.

99. But to return to my three concessions. Members will recall that last year we raised the estate duty exemption limit to $1 million in recognition of rising asset values. This year I propose firstly further to raise the exemption limit to $2 million: that is to say no duty will be payable on the estates of deceased persons who die possessed of net assets of a value below that figure. This increase may at first sight seem somewhat generous, but it recognises that asset values have continued to rise and is consistent with our low tax philosophy.

100. Secondly, one of the effects of successive increases in the exemption limit in recent years has been to make the initial impact of the estate duty rather more significant than it should be, and therefore inconsistent with our low tax philosophy. If my proposal to increase the exemption limit to $2 million is approved, the rate of duty applicable to estates between $2 million and $3 million under the present schedule (and subject, of course, to marginal relief) would be 17%. Therefore in order to reinstate the concept of graduality I propose to replace the present schedule of rates with a new schedule scaled from 10% on estates between $2 and $2.5 million to 18% above $4 million.[10]

101. Thirdly, I propose to exempt from duty altogether the principal matrimonial home of the deceased, where the deceased leaves a surviving spouse. This relief acknowledges the claim that sometimes there can be hardship for the surviving spouse because the home is subject to duty. While I know of no case where a widow has been obliged to sell the home in order to pay the duty, it seems logical in the context of our low tax philosophy to exclude it from charge.[11]

102. The cost to the revenue of these three proposals will be approximately $42 million in 1982-83 and an estimated $52 million in the following year.

OTHER MATTERS

103. Before I leave the subject of taxation I wish to comment on other matters on which I have received representations. (My office is of course always open to criticism or to new ideas.)

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8. At certain income levels those who contribute only the minimum qualifying annual contribution of $1,200 to a dependent parent can gain a tax advantage in excess of that sum; the majority of claimants probably make a rather larger contribution to the maintenance of their dependent parents.

9. These increased allowances will benefit an estimated 92,000 persons; 52,000 taxpayers who were previously liable and who will now be exempt, and a further 40,000 who would have become liable in 1982-83 but who will now be kept out of the tax net. This means that in 1982-83 there will be an estimated 218,000 salaried taxpayers, compared with some 310,000 who would have been liable without these new concessions. Furthermore, of those remaining in the tax net some 205,000 will benefit by way of reduced liability. About 13,000, or 6% of the total number in the tax net, will receive to benefit from these concessions and will continue to bear tax on their chargeable incomes at the standard rate of 15%. *This high income group continues to contribute well over half of the total yield from salaries tax.* Additionally an estimated further 55,000 persons who elect for the advantages of personal assessment will also benefit through reduced liability. Examples of the effects of these new allowances for persons at various income levels and in various personal circumstances are contained in Appendix E to the printed version of this speech; and at Appendix F there appears a table showing examples of the present and future effective rates of tax at different income levels for persons in various personal circumstances. Appendix G shows the income levels at which persons in various personal circumstances will become liable at the standard rate in future.

10. On estates between –

$2,000,001 and $2,500,000	10%
$2,500,001 and $3,000,000	12%
$3,000,001 and $3,500,000	14%
$3,500,001 and $4,000,000	16%
$4,000,001 and above	18%

11. The exemption will be administered by reference to rules which broadly follow the Property Tax owner-occupier exemption; and where there is more than one matrimonial home the estate's legal personal representative will be permitted to designate which property is to be the principal matrimonial home. But for the purposes of determining the appropriate rate of duty to be applied to the remainder of the estate, the matrimonial home will first be aggregated with the other dutiable assets and only thereafter excluded from charge.

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104. They include allegations that our profits tax legislation enables the Commissioner to charge capital gains to tax. I am advised that this is not so; and the Commissioner assures me that he has never done so and has not the slightest intention of trying to do so. He does concede that there are occasions when he seeks to tax as income what the taxpayer prefers to think of as a capital profit. But there are remedies through the appeal process, if the Commissioner's view in such a case seems incorrect. It has also been represented that executors of deceaseds' estates are in some jeopardy in that the Commissioner could successfully recover from the personal assets of the executor taxes owed by the deceased. Again I am advised that this is not a correct interpretation of the law, and the department does not seek to recover taxes in default in this way. I have also been told that in certain circumstances dividends could be chargeable to profits tax. Once more, that is not a view to which the Commissioner subscribes. These, and other miscellaneous matters which have been placed before me, are not in any respect what could be described as burning issues. However, I have taken due note of them; if at some convenient time in the future it is thought that any of them has merit, or that there is indeed some legal doubt as to the proper interpretation of the existing legislation, steps will be takenm to put matters right.

105. The one proposition which has caused me sleepless nights is the contentious issue of separate taxation for married women. I have of course noted Sir Philip's concluding comments in the last year's debate.[12]

106. I am fortified by two other considerations. Firstly, the cost to revenue of separate taxation for married women would be about $200 million per annum. It would not be prudent to add this considerable sum to this year's total tax cuts, and it would therefore be necessary to sacrifice others of my proposals to make room for benefits for married women. I do not think it sensible that my overall reliefs should thus be distorted.

107. Secondly and fortuitously, the Commissioner for Inland Revenue has told me that because of the considerable changes proposed this year and the computer software problems inherent in a system of separate assessment his department simply could not cope with such a change. On pragmatic grounds, therefore, further tax changes this year are not possible.

108. Perhaps I protest too much. I will admit under pressure that as history moves on the arguments for and against separate taxation for women seem more evenly balanced, while deeply felt emotion rightly or wrongly can be as persuasive as logic. In fact the argument is not simple, for there are great practical problems involved. Nevertheless a dispassionate and pragmatic man should be able now to see which way the tide is running both in Hong Kong and elsewhere. Whether it should so run is another matter; but Canute proved the fallacy of relying on this sort of argument.

109. If, therefore, women members of this Council and some 50% of the population will bear with me this year, without of course making any promises or commitments and absolutely dependent on the situation as it then exists I hope to be able to have another look at this proposition next year with a view to some movement. I do trust that this olive branch will be accepted, and that I am not forced in subsequent debate to erect defensive battlements. This can be done, but I would like to avoid the necessity, which indeed I think could be counterproductive.

110. The cost to the revenue of my tax concessions is $1.37 billion, and the estimate of total revenue thus becomes $37.8 billion. The difference between this and the estimate of total expenditure of $35.5 billion is $2.3 billion, which is the surplus we are budgetting for on General Revenue Account in 1982-83.[13]

111. These concessions produce satisfactory results as far as the balance of the fiscal system[14] and the budgetary guidelines are concerned.[15]

112. But I must again draw attention particularly to the growth and relative size of the public sector in 1982-83. On Consolidated Account total expenditure will be no less than $37.7 billion. This is an increase in money terms of $6.8 billion, or 22% over the revised estimate for 1981-82. In real terms it represents an increase of 10.7%. The growth rate of 10.7% envisaged for 1982-83 though large thus represents a significant slowing down in the growth rate of the public sector, but it will still be higher than the forecast growth rate of G.D.P. of 8%.

113. As a result, the relative size of the public sector will again increase from 22.9% in 1981-82 to about 24% in 1982-83. We clearly must not relax in our efforts to ensure that the growth rate of expenditure on Consolidated Account has due regard to the growth rate of the economy.

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12. "Is there really any valid reason why one family with an income of, say, $100,000 should pay less tax than another family with a similar income, simply because in the first case the $100,000 is produced by the husband and wife, whereas in the second case the husband (or wife) alone contributes to the support of the family."

13.

Revenue:	*$mn*	*$mn*
Recurrent	25,308	
Capital	12,518	37,826
Expenditure:		
Recurrent	19,466	
Capital	16,034	35,500
Surplus on recurrent account		5,842
Deficit on capital account		3,516
Overall surplus		2,326

(Including the surplus in the C.W.R.F. the total overall surplus is $4,954 million).

14. Ratio between direct and indirect taxes – 67 : 33.
Ratio between direct and indirect taxes taken together and all other recurrent revenue – 66 : 34.

15.

Guideline	*Ratio*	*1982-83*
Recurrent revenue / Total expenditure	At least 77%	77%
Recurrent expenditure / Recurrent revenue	No more than 85%	77%
Surplus on recurrent account / Capital expenditure	At least 33%	44%
Recurrent expenditure / Total expenditure	No more than 65%	59%
Capital revenue / Capital expenditure	At least 20%	93%

(The percentages for 1982-83 are calculated to include the Capital Works Reserve Fund.)

IFA NEWS

[continued from page 265]

JAPANESE BRANCH

The Japanese Branch held its 1982 annual conference in Tokyo on 1 May 1982.

At the conference, the following subjects were reported on:

(1) Recent Trends of Japanese Tax Treaties, by Mr. Yasuyuki Kawahara, Director of the International Tax Affairs Division, Tax Bureau, Ministry of Finance.
(2) Aussensteuergesetz of West Germany, by Professor Tadashi Murai, Professor of Law, Kansai University.
(3) Unitary Tax in the United States of America, by Mr. Toshio Miyatake, attorney-at-law.

SWISS BRANCH

The Swiss Branch of IFA will meet on 25 June 1982 in Zurich. The agenda shows the following important topics of discussion:

1. The presenting of the 1981 annual report and the 1981 financial statements;
2. The resignation of a number of members of the Board and the Board's proposal for the (re)appointing of (new) Board members;
3. Dr. Vögeli will speak on the tax aspects of international competition with respect to Swiss banks.

The next meeting of the Swiss Branch will be held on 5 November 1982 in Bern.

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Customs Co-operation Council *

Since the beginning of the century, attempts have been made to simplify and standardize Customs formalities in international trade. The first substantial proposals for simplification were sponsored by International Congresses of European Trades and brought forward by the International Chamber of Commerce for consideration by the League of Nations. Inter-governmental actions taken under the aegis of the League resulted in the drafting of the international Convention for the simplification of Customs and other formalties. This Convention, dated 3 November 1923, was the first concrete result obtained.

Several subsequent international conferences also studied this question but achieved no appreciable results.

After the end of the second World War the United Nations Conference on Trade and Labour resumed the examination of the problem at international level. Several provisions relating to Customs questions were included in the draft for the establishment of an International Trade Organization (Havana Charter) and in the "General Agreement on Tariffs and Trade" (GATT).

Nevertheless, there was still no international organization specializing in the comparative study of Customs technique, which was regarded merely as an aspect of economic policy and had been given close consideration only at national level and in very few countries.

THE EUROPEAN CUSTOMS UNION STUDY GROUP:

In a joint declaration made in Paris on 12 September, 1947, thirteen Governments represented on the Committee for European Economic Co-operation agreed to give consideration to the possibility of establishing one or more European Customs Unions. With this end in view, it was decided to set up in Brussels a Study Group to examine the problems incidental to the project and the steps necessary for its materialization.

In 1948, this Study Group set up an Economic Committee and a Customs Committee, the latter being assisted by a Permanent Tariff Bureau.

The Study Group subsequently suspended the activities of the Economic Committee, the work of which was tending to overlap with that of the Organization for European Economic Co-operation (OEEC) after the creation of that organization.

It was decided, however, that the Customs Committee, which had been charged with the task of making a comparative study of Customs techniques in the various countries concerned, with a view to their standardization, should pursue this work. This Committee devoted particular attention to the establishment of a common tariff nomenclature and the adoption of a common definition of value for Customs purposes. It also studied other aspects of Customs procedures.

THE CONVENTIONS OF 15TH DECEMBER 1950:

In 1949, the Study Group decided that, irrespective of the progress which might be made with the Customs Union project, the achievements already attained in the fields of Nomenclature and Valuation should be turned to advantage and that similar endeavours should be made in other fields of Customs technique.

This decision was the origin of the three Conventions signed in Brussels on 15th December 1950. Two of these Conventions are concerned with Nomenclature and with Valuation; they represent the culmination of the extensive work undertaken by the Study Group's Customs Committee on these two important subjects. The purpose of the participating countries in setting up – under the third Convention – the Customs Co-operation Council was not only to assemble the executive machinery required for the interpretation and application of the two specialized Conventions in a single international organization but also to entrust that organization with a more general responsibility: "to secure the highest degree of harmony and uniformity in Customs systems and especially to study the problems inherent in the development and improvement of Customs technique and Customs legislation in connection therewith."

ESTABLISHMENT OF THE CUSTOMS CO-OPERATION COUNCIL:

The Convention establishing a Customs Co-operation Council came into force on 4 November 1952, and the Council met for the first time on 26 January 1953. Under the provisions of this Convention, the Customs Co-operation Council is required to:

- make recommendations to ensure the uniform interpretation and application of the two other Conventions (on Nomenclature and Valuation);
- perform such functions as may be expressly assigned to it in those Conventions; and
- act in a conciliatory capacity in any disputes which may arise in this respect.

Apart from these particular functions, the Council has the more general task of:

- studying all questions relating to co-operation in Customs matters which the Contracting Parties agree to promote;
- examining the technical aspects of Customs systems with a view to proposing practical means of attaining the highest possible degree of harmony and uniformity;
- preparing for this purpose draft Conventions and Recommendations;
- circulating information regarding Customs procedures;
- furnishing information or advice to Member States; and
- co-operating with other international organizations.

In order to enable the Council to accomplish this extensive task, Articles V and VI of the Convention provide that it shall establish the two specialized Committees envisaged by the Nomenclature and Valuation Conventions and shall be assisted by a Permanent Technical Committee, in respect of other Customs matters, and by a General Secretariat.

The functions of the Council are thus clearly defined. They in no way duplicate the activities of other international organizations particularly of those essentially concerned with economic policy.

The Council is a technical body and its studies and attempts to resolve Customs problems are based on a purely technical approach. Its purpose is to improve and harmonize Customs operations and thus facilitate the development of international trade, without obliging Member countries to adopt provisions incompatible with their individual economic policies.

Accession to the Council Convention dopes not entail accession to either or both of the two other Conventions on Nomenclature and Valuation, but accession to the Council Convention is obligatory for any country wishing to accede to either of those Conventions.

THE COUNCIL AT WORK:

The Council normally meets once a year. The delegates to the Council are representatives of the Contracting Parties to the Council Convention and those representatives are usually the heads of national Customs administrations.

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* Prepared by Douanes (Pakistan) Custom House, Karachi.

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The first part of each Session is devoted to technical matters. The Council receives reports from the Nomenclature Committee, from the Valuation Committee, from the Permanent Technical Committee, the Harmonized System Committee and, on intersessional developments, from the Secretary General. After discussion of these reports, the Council takes such executive decisions as may be appropriate, for example, by initiating Conventions or Protocols of amendment to Conventions, by making Recommendations to Contracting Parties, and by giving directives to the Committees or to the Secretary General regarding the work in progress or future work to be undertaken.

One or two days at the end of each Session are reserved for current administrative and internal questions which are usually presented in the form of proposals worked out in advance either by the Finance Committee – which meets before each Council Session – or by the Secretary General.

The adoption of these methods enables the work of each Session to be conducted expeditiously.

The official languages of the council are English and French and all documents and publications are issued in these two languages.

THE NOMENCLATURE COMMITTEE:

Under the authority of the Customs Co-operation Council, the Nomenclature Committee supervises the operation of the Convention on Nomenclature for the Classification of Goods in Customs Tariffs.

This Convention, which entered into force on 11 September 1959, has been ratified by several countries. In addition, many countries or territories have based their national tariffs on the Customs Co-operation Council Nomenclature (CCCN), without becoming Contracting Parties to the Convention.

The CCCN is also used by many regional organizations, including the European Communities, the European Free Trade Association (EFTA), the Latin American Free Trade Association (LAFTA), the Common Afro-Mauritian Organization (OCAM), the West African Economic Community (CEAO) and the Central African Customs and Economc Union (UDEAC).

AIMS OF THE NOMENCLATURE CONVENTION:

The essential aims of the Nomenclature Convention are:

(a) to establish a common basis for the classification of goods in national Customs tariffs;
(b) to facilitate comparison of the Customs duties applicable in various countries to all goods entering into international commerce;
(c) to simplify international Customs tariff negotiations;
(d) to facilitate comparison of international trade statistics;
(e) to provide Government and traders alike with a firm guarantee of the maximum uniformity in the classification of goods in national Customs tariffs; and
(f) to facilitate international trade and thus to contribute to its expansion.

CHARACTERISTIC FEATURES OF THE CCC NOMENCLATURE:

The CCCN is systematic. It provides a framework for the classification of goods in Customs tariffs but, since it includes Interpretative Rules and legal Notes, it also constitutes a comprehensive classification system which has been designed to ensure:

(a) maximum simplicity, so that it can be readily understood by the public as well as by experts;
(b) precision, so that the most appropriate heading for a given commodity can be readily identified; and
(c) exactness in application, so that the same commodity will be classified in the same way in the tariffs of the countries using the Nomenclature.

STRUCTURE OF THE CCC NOMENCLATURE:

The CCCN comprises:

(a) the Rules for the interpretation of the Nomenclature which prescribe the general principles governing the classification system;
(b) Section and Chapter Notes, which define the scope and limits of Sections, Chapters and of certain headings. These legal Notes permit the headings to be drafted in concise form without any loss of precision or of exactitude in their interpretation; and
(c) a list of headings, arranged in systematic order, covering all the times in international commerce.

The headings in the Nomenclature are arranged in 99 Chapters which are themselves grouped in 21 Sections. In general, goods are grouped according to the material of which they are made; further, most Chapters are developed "progressively" – that is, starting from raw materials and progressing to finished articles.

ADAPTATION OF THE CCC NOMENCLATURE TO THE ECONOMIC REQUIREMENTS OF INDIVIDUAL STATES:

The Nomenclature Convention leaves the Contracting Parties free, within the framework of the Nomenclature, to make such provisions as they may consider necessary in order to safeguard their own special national interests.

In particular, countries may set up, within the CCCN headings, subheadings covering those products or categories of products to which they propose to apply special treatment. They also remain perfectly free to fix their rates of duty at the levels they consider appropriate, subject to due regard to any bilateral or multilateral commitments they may have entered into with other countries.

SUPPORTING PUBLICATIONS:

The CCCN is supported by several publications designed to facilitate its use and interpretation.

The Explanatory Notes do not form an integral part of the Nomenclature Convention itself, but they do constitute the official interpretation of the Nomenclature as approved by the Council and they are, therefore, an indispensable complementary publication thereto.

In addition to technical information, the four volumes of the Explanatory Notes provide a full commentary on the meaning and scope of the Section and Chapter Notes and on the scope of each heading.

The Alphabetical Index to the Nomenclature and the Explanatory Notes lists all the goods specified in the Nomenclature, with references to the relevant headings or Section or Chapter Notes, and in the Explanatory Notes, with reference to the pages on which the goods are mentioned and, in some cases, described.

The Compendium of Classification Opinions lists, in Nomenclature heading order, all Classification Opinions adopted by the Nomenclature Committee and the Customs Co-operation Council as a result of the study of practical cases submitted to the Council by the administrations.

The English and French versions of the Nomenclature and its complementary publications are equally authentic. They are kept constantly up-to-date, in particular in the light of current technological developments.

THE NOMENCLATURE COMMITTEE AT WORK:

The Nomenclature Committee met for the first time on 23 May 1960, after the entry into force of the Convention, but the Council had set up an Interim Committee from early 1953 and in effect the Committee has been at work since then.

The Committee normally meets twice a year for a fortnight at a time. It is composed of delegates representing Contracting Parties to the Convention. Its Sessions are attended by Observers from many non-Member States and from International Organizations. The Committee is assisted by a Committee of Chemists which also meets, in principle, twice a year.

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The Nomenclature Committee's main tasks are to give decisions on the more declicate classification questions raised by administrations or by International Organizations, to resolve differences of opinion between Customs administrations and, in general, to take all appropriate steps to ensure international uniformity in the interpretation and application of the Nomenclature.

To this end, the Committee:

(a) collates and circulates information concerning the application of the Nomenclature;
(b) studies the procedures and practices of the Contracting Parties in relation to the Classification of goods for Customs purposes;
(c) makes appropriate recommendations to the Contracting Parties to secure uniformity in the interpretation and application of the Nomenclature;
(d) prepares draft amendments to the Nomenclature Convention;
(e) drafts and amends the Explanatory Notes;
(f) issues Classification Opinions; and
(g) takes such other steps as may be necessary to achieve the aims set by the Convention establishing the Customs Co-operation Council and the Convention on Nomenclature.

AMENDMENTS TO THE NOMENCLATURE:

Since 1959 the CCC Nomenclature has undergone three series of amendments, in 1965, 1972 and 1978, in order to keep it abreast of developments in the fields of production and international trade.

The third series of amendments, published in the Recommendation of 18 June 1976, entered into force on 1 January 1978. It includes more than 260 amendments to the 1972 Nomenclature, the main changes being the deletion of some 90 headings which no longer represented a significant volume of international trade and the amendment or creation of other headings.

THE CCN AND INTERNATIONAL TRADE STATISTICS:

It has already been mentioned that one of the aims of the CCCN is also to facilitate comparison of international trade statistics, insofar as these are compiled from data collected on the basis of the national Customs nomenclatures.

In 1950, the United Nation Statistics Office established a Standard International Trade Classification (SITC), to facilitate the systematic study of world trade statistics.

Since the aims in a single area of activity were very much akin, it was necessary to establish a close correlation between the two basic systems of classification.

The first correlation between the CCC Nomenclature and the revised SITC was completed in 1960. A new correlation was concluded in 1974, when the SITC was revised for a second time (SITC/Rev. 2).

The SITC/Rev. 2 was published on 1 January 1975. On the same date, the Council issued a Recommendation proposing that Member States incorporate in their Customs tariffs the 1,087 subheadings which make it possible to collect statistical data on the basis of the CCC Nomenclature and to achieve complete correlation with the SITC/Rev. 2. The complete system (SITC/ Rev. 2 and the new correlation) entered into application in a number of countries on 1 January 1976.

THE FUTURE OF THE CCC NOMENCLATURE:

The future of the Nomenclature is bound up with the work on the Harmonized Commodity Description and Coding System.

THE HARMONIZED SYSTEM COMMITTEE:

In September 1970 the Council set up a Commodity Coding Study Group to explore the feasibility of developing a harmonized commodity description and coding system which could simultaneously meet the needs of Customs, external trade statistics and carriers.

This Study Group reported to the Council in May 1973 that the development of a harmonized commodity description and coding system was not only feasible but was essential in the longer term interests of facilitation on international trade and recommendaded that the Council undertake to carry the project to completion. The Council approved the Study Group's Report, and decided that such a system should be developed.

In preparing the system, the Harmonized System Committee, which was created by the Council to succeed the Study Group, is taking account of some 15 classification systems, chosen as being representative of the requirements of Customs administrations, external trade statistics and carriers.

The system is based on the CCCN and on the SITC/Rev. 2 which will be revised where necessary to achieve the system's general aims.

In some respects, therefore, the Harmonized System will be a development of the revised CCCN elaborated by the introduction of subheadings (structured nomenclature), which will include those already drawn up for the correlation between the CCCN and the SITC/ Rev. 2.

The system also includes "descriptors" for the more important commodities in international trade. These descriptors will provide cross-references to the subdivisions of the structured nomenclature and the SITC/Rev. 2 and will also serve for the compilation of an alphabetical index.

Implementation of the system will be facilitated by Explanatory Notes which will supplement those of the CCCN by providing a guide to classification in the subheadings, and it is hoped that the system will eventually be employed by most, if not all, participants in international trade.

The concern for the harmonization and simplification of the various national and international instruments used in international trade, which brought about the development of the Harmonized System, is felt by many agencies. In particular, the United Nations Statistical Commission, at its 19th Session (November 1976), agreed that the Harmonized System should also play a prominent part in the harmonization of the various statistical classifications concerning transportable goods.

This will be possible if the CCCN and its extension, the Harmonized System, are compatible with the concept of the industrial origin of commodities, and this principle has been approved by the Council.

THE VALUATION COMMITTEE:

Under the authority and in accordance with the directives of the Council, the Valuation Committee supervises the operation of the Convention on the Valuation of Goods for Customs purposes. This Convention entered into force on 28th July 1953. Since then the Brussels Definition of Value which is annexed to the Convention has found a steadily widening field of application. Apart from the Contracting Parties to the Convention many countries have already based their valuation systems for Custom purposes on the Definition.

AIMS OF THE VALUATION CONVENTION:

The essential aims of the Valuation Convention are:

(a) to achieve the maximum uniformity, internationally, in the valuation of goods for Customs purposes;
(b) to simplify international Customs tariff negotiations and the comparison of foreign trade statistics by providing a uniform basis for the valuation of goods; and
(c) in general, to facilitate international trade.

CHARACTERISTIC FEATURES OF THE BRUSSELS DEFINITION OF VALUE:

The Brussels Definition of Value is designed to:

(a) provide for the establishment of Customs values by reference to a single formula to be uniformly applied to all clas-

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ses of importations, thus ensuring equitable treatment as between all imported goods;
(b) conform as closely as possible to commercial practice in open market conditions;
(c) ensure that administrations are safeguarded against evasion;
(d) ensure that honest traders are protected against unfair competition and arbitrary administration; and
(e) meet the needs for commercial simplicity and administrative convenience.

These requirements are met by:
(a) selecting the standard of the price made under a contract of sale concluded:
  (i) in respect of imported goods, and
  (ii) in the open market between a buyer and a seller independent of each other;
(b) giving precision to this standard by specifying the contract of sale to be a contract concluded at a price:
  (i) appropriate to the time when the duty becomes payable, and
  (ii) giving delivery to the buyer at the port.
(c) setting up this standard in the Definition as a notional concept expressed in terms of the price which the goods "would fetch" on a sale conforming, inter alia, to the conditions envisaged at (a)(i), (a)(ii), (b)(i) and (b)(ii) above.

THE VALUATION COMMITTEE AT WORK:

The Valuation Committee normally meets twice a year. It is composed of delegates representing Contracting Parties to the Convention. Its Sessions are attended by Observers from many non-Member States and from International Organizations.

Its task, in general, is to ensure the uniform interpretation and application of the Definition.

To this end the Committee's duties are:
(a) to collate and circulate information concerning the valuation of goods by the Contracting Parties;
(b) to study the domestic laws, procedures and practices of Contracting Parties in relation to the Definition and its Interpretative Notes and to make recommendations to the Council or the Contracting Parties to secure uniformity in the interpretation and application of the Definition and Notes and the adoption of standard procedures and practices;
(c) on its own initiative or on request, to furnish to Contracting Parties information or advice on any maters concerning the valuation of goods;
(d) to submit to the Council proposals for any amendment of the Convention which it may consider desirable; and
(e) to exercise such other powers and functions of the Council in relation to the valuation of goods for Customs purposes as the Council may delegate to it.

RECOMMENDATIONS:

The Valuation Committee has established the following Recommendations:
- Recommendation concerning the treatment of inadvertent errors in the declared value of goods;
- Recommendation concerning the treatment, in the valuation of goods, of the right of reproduction in the country of importation;
- Recommendation concerning the application of the Brussels Definition of Value;
- Recommendation concerning the application of the provisions of Article III of the Definition of Value and of its Interpretative Note 2;
- Recommendation concerning the application of the Definition of Value in regard to trade marks; and Recommendation concerning the interpretation of Article I of the Definition of Value.

EXPLANATORY NOTES:

One of the important tasks completed by the Committee has been the preparation of the Explanatory Notes to the Definition, which were first published in 1960. Further experience gained since 1960 having shown that some revision of, and additions to, the Explanatory Notes were desirable, a new edition was issued in 1971 in three separate volumes (one English, one French and one bilingual).

These Explanatory Notes, which are available to the public as well as to the Customs, expound the theory and practice of valuation under the Brussels Definition both in general terms and with regard to problems of a general nature and, within these generalities, also with regard to particular problems of common occurrence. They give reasons for each conclusion and demonstrate the underlying equality of treatment as between the different methods advocated. As it has been put shortly, they provide the "Why" as well as the "How" of valuation.

Although these Notes do not form part of the Valuation Convention, they constitute the official Commentary on the Brussels Definition of Value.

EXAMPLES TO ILLUSTRATE SELECTED PASSAGES IN THE EXPLANATORY NOTES:

In order to facilitate the practical application of the Explanatory Notes referred to above, the Committee decided to supplement them by suitable Examples indicating how the text they illustrate should be applied to factual cases.

Two loose-leaf volumes, one in English and one in French, containing 34 such Examples were published in 1975, and further Examples are being added as they are prepared and adopted by the Committee.

VALUATION OPINIONS:

In pursuing the general aim of ensuring uniformity in interpretation and application of the Definition, the Committee has issued several Valuation Opinions based on actual cases of doubt submitted by Members.

VALUATION NOTES:

The foregong aim is also achieved by means of a number of Valuation Notes which serve the purpose of clarifying the meaning of certain terms of the Definition which present difficulties in interpretation.

VALUATION STUDIES:

The Committee has made studies on a number of important aspects of valuation, such as Members' domestic legislation; administrative procedures; valuation disputes; the combating of fraud; the treatment of royalties; expenses incurred on advertising and trade marks; the dutiable value of computers and programme media; and the application of the Recommendation concerning the right of reproduction.

Certain of these studies have been published.

COMPENDIUM OF TEXTS CONCERNING VALUATION:

The Valuation Convention, Recommendations, Opinions, Notes and Studies are published together in a Compendium.

THE PERMANENT TECHNICAL COMMITTEE:

As mentioned previously, the Council's functions include not only ensuring the uniform interpretation and application of the Conventions on Nomenclature and Valuation but also the study of all aspects of Customs technique in order to find practical means of attaining the highest possible degree of harmony and uniformity in Customs systems. It is assisted in this latter work by the Permanent Technical Committee.

This Committee, which was established in 1953, is composed of representatives of all Council Members. It meets twice a year and its sessions are attended by both representatives of Member countries and by observers from many non-Member countries and international organizations.

The achievement of a high degree of harmony and uniformity is a long-term project. In this connection a wide-embracing international instrument, the Convention on the simplifica-

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tion and harmonization of Customs procedures is now in force. A number of other Conventions and Recommendations have been prepared on specific subject matters of Customs technique.

Another matter which has occupied the Committee's attention is that of mutual administrative assistance between Customs administrations for the prevention, investigation and repression of Customs offences. The Committee prepared a Recommendation on this topic as early as 1953 and followed up with additional Recommendations in 1971 and 1975. In 1977 the Council adopted a major instrument n this field, the International Convention on mutual administrative assistance for the prevention of Customs offences. Particular emphasis has always been placed on the combating of illicit traffic in narcotic drugs and psychotropic substances.

In addition to technical Conventions and Recommendations, the Permanent Technical Committee has carried out a systematic study of procedures in Member countries on the basis of which International Customs Norms have been drawn up laying down fundamental principles to guide Customs administrations considering amendment or review of Customs legislations or regulations. The Committee has also prepared a Glossary at present containing some 60 terms with definitions in English and French, and which, when complete, will result in a uniform international Customs terminology. The Glossary will be brought up-to-date as required.

In parallel with these activities, the Committee devotes part of each session to the consideration of such maters as the simplification of documentation, postal traffic, and also to questions submitted by Members or by international organizations. These latter, according to circumstances, are either discussed by the Committee or are circulated to Members as requests for information or for written observations.

A Working Party has been established to deal with the practical applications of computers in the Customs field.

CUSTOMS CONVENTIONS:

The Committee has produced eleven Conventions which are open to all Council Members and in most cases to all Members of the United Nations or its specialized agencies.

1. International Convention on the simplification and harmonization of Customs procedures

This Convention, adopted by the Council on 18 May 1973, deals systematically with all the principal Customs rules and procedures. It consists of a central body and separate Annexes, each of which lays down the basic principles applicable to a distinct area of Customs activity. It is anticipated that ultimately the Convention will have some 30 Annexes. The 20 Annexes adopted so far deal with subjects such as Customs warehouses, drawback, temporary admission subject to re-exportation in the same state, clearance for home use, Customs transit, rules of origin, repayment of import duties and taxes, free zones, Customs facilities applicable to travellers, outright exportation and postal traffic.

2. Conventions concerning temporary duty-free importation

(a) The Customs Convention of 6 October 1960 on the Temporary Importation of Packings (entered into force on 15 March 1962).

This Convention meets a wish frequently expressed by representatives of international trade for the extension of temporary duty-free importation procedures to packings. The Contracting Parties undertake to grant temporary admission to packings, subject to the conditions specified in the Convention, and to accept an undertaking to re-export the packings in lieu of security whever the Customs authorities deem this possible.

(b) The Customs Convention of 8 June 1961 on the Temporary Importation of Professional Equipment (entered into force on 1st July 1962).

This Convention is designed to facilitate the international exchange of specialised skills and techniques by the introduction of general rules on the temporary duty-free importation of professional equipment.

It has three Annexes, one relating to equipment for the press or for sound or television broadcasting, one to cinematographic equipment and the third to other professional equipment.

(c) The Customs Convention of 8 June 1961 concerning Customs facilities for the Importation of Goods for display or use at Exhibitions, Fairs, Meetings or Similar Events (entered into force on 13 July 1962).

The purpose of this Convention is to facilitate the display of goods at exhibitions, fairs, meetings or similar events of a commercial, technical, religious, educational, scientific, cultural or charitable nature.

It deals, in particular, with:
- the temporary admission of goods and equipment for display or use at an event;
- the waiving of import duties in respect of certain goods (small samples, printed matter, catalogues, etc.); and
- the simplification of formalities on importation and re-exportation.

(d) The Customs Convention of 1st December 1964 concerning Welfare Material for Seafarers (entered into force on 11 December 1965).

This Convention was drawn up by the Council on the initiative of and in consultation with the International Labour Organization. Its aim is to promote the welfare of seafarers on ships engaged in international maritime traffic.

Contracting Parties undertake to grant facilities in respect of welfare material for use on board foreign ships and, unless a reservation is entered in this respect, to welfare material for use in welfare establishment ashore.

(e) The Customs Convention of 11 June 1968 on the Temporary Importation of Scientific Equipment (entered into force on 5 September 1969).

This Convention helps to materialize the principle of the "free flow of ideas" which has been advocated and promoted by UNESCO for more than twenty years. It removes certain difficulties encountered in the implementation of the 1950 Florence Agreement and supplements, with regard to scientific equipment, the Professional Equipment Convention and the Fairs and Exhibitions Convention which were also drawn up by the Council in co-operation with UNESCO.

The Contracting Parties undertake to grant temporary admission, free of duties and taxes, to instruments, apparatus, mahines or accessories therefor which are to be used for purposes of scientific research or education by "approved institutions" and to reduce the attendant Customs formalities.

(f) The Customs Convention of 8 July 1970 on the Temporary Importation of Pedagogic Material (entered into force on 10 September 1971).

This Convention is designed primarily to supplement, in the field of educational materials, the Scientific Equipment Convention. It rounds off the work done by the Council, in co-operation with UNESCO, in connection with the temporary importation of educational, scientific and cultural materials.

Under the Convention the Contracting Parties undertake to grant and facilitate the temporary admission, free of import duties and taxes, of pedagogic material which complies with the prescribed conditions (and with certain optional conditions which may be imposed by each Contracting Party). A non-limitative list of pedagogic material is annexed to and forms an integral part of the Convention.

3. Conventions introducing international Customs documents:

(a) The Customs Convention of 1st March 1956, regarding ECS Carnets for Commercial Samples (entered into force on 3rd October 1957).

The aim of the Convention was to facilitate the temporary duty-free importation of commercial samples.

(b) In view of the success of the ECS carnet, in 1961, the Permanent Technical Committee established the Customs Convention on the ATA carnet for the Temporary Admission of Goods. This carnet can be used not only for

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commercial samples but also for goods temporarily imported under:

- international conventions concerning temporary admission to which a State is party (e.g. Conventions on Professional Equipment, on Exhibitions, Fairs, etc.);
- national regulations on temporary admission.

The principle of the ATA Convention is the same as for the ECS scheme: it seeks to eliminate the two main difficulties encountered when importing goods temporarily into a country, namely the need to make out a Customs declaration on the national form each time the goods are taken into a country and the necesity of furnishing security for the payment of the Customs duties and other taxes chargeable in case of failure to re-export them.

This double aim is achieved by the ATA carnet which is an international Customs document issued and guaranteed by associations approved by the Customs and affiliated to an international chain.

Some years ago it was decided that the ATA carnet should replace the ECS carnet, in view of the latter's limited scope. This replacement has continued progressively and the point has now been reached when ECS carnets have practically disappeared. In the near future, therefore, there will be only one international document in use for temporary duty-free admission operations. In fact the Council has recommended to Contracting Parties to denounce the ECS Convention and a number of States have already done so.

4. Customs Convention on the international transit of goods (ITI Convention)

This Convention, adopted by the Council on 7 June 1971, was prepared to deal with emerging patterns in international traffic, particularly the widespread use of intermodal freight containers. The basic aim of the Convention is, whilst taking full account of the latest transport techniques, to provide the Customs with the possibility of carrying out their essential controls without creating transport delays, thus permitting transport operators to enjoy fully the advantages of the through-transport concept.

5. International Convention on mutual administrative assistance for the prevention, investigation and repression of Customs offices

The Convention applies to all Customs offences insofar as they involve matters falling within the competence of Customs administrations.

It is dividend into Annexes which can be accepted independently of each other. As is usual in mutual assistance instruments, the Convention is based on the principle of reciprocity, according to which a Contracting Party is required to give assistance to another Contracting Party only if both have accepted the Annexes concerned.

Annexes I to IX cover different aspects of mutual administrative assistance and apply to every kind of goods except those specified in Annexes X and XI, that is to say, narcotic drugs and phychotropic substances (Annex X) and works of art, antiques and other cultural property (Annex XI). It was felt advisable to prepare separate Annexes for these categories of goods because, for many countries, they represent a major problem which often cannot be handled within the usual framework and has aspects not normally associated with the more strictly fiscal or Customs type of offence.

RECOMMENDATIONS:

The Permanent Technical Committee has drawn up some thirty Recommendations, which can be grouped in the following categories:

(a) Recommendations designed to promote co-operation between Customs administrations.
For example:
- Pooling of information concerning Customs fraud.
- Spontaneous exchange of information concerning illicit traffic in narcotic drugs and psychotropic substances.

(b) Recommendations designed to secure uniformity in practice as regards duty-free admission or the repayment or remission of duties.
For example:
- Refund of import duties and taxes on shortages.
- Free admission of removable articles imported on transfer of residence.

(c) Recommentations to facilitate the international transport of goods, and travel and tourism.
For example:
- Simplified Customs control, based on the dual channel system, of passengers arriving by air, and by sea.
- Customs sealing systems in connection with the international transport of goods.

(d) Recommendations relating to the application of certain Conventions.
For example:
- Use of ATA carnets for commercial samples.
- Measures to facilitate the application of the ITI Convention.

(e) Recommendations to simplify and harmonize Customs documents.
For example:
- Lay-out key for Goods declaration (outwards).
- Adoption of a standard form of certificate of origin.

(f) Recommendation to ensure that adequate legal remedies are available to the tax-payer.
For example:
- Right of appeal in Customs matters.

PUBLICATIONS CONCERNING CUSTOMS TECHNIQUE:

A compendium containing the texts of the Recommendations, Resolutions and International Customs Norms relating to Customs technique has been published. It is intended to incorporate the Glossary of international Customs terms in this Compendium in due course.

A Handbook containing the complete texts of the international Convention on the simplification and harmonization of Customs procedures and its Annexes, with a Commentary printed after the relevant provisions, has also been published. The detailed information furnished by Contracting Parties with regard to the implementation of Annexes and other matters (reservations, terms of application, etc.) is also included.

RELATIONS WITH OTHER INTERNATIONAL ORGANIZATIONS:

Under the terms of the Convention by which it was established, one of the Council's functions is to co-operate with other inter-governmental organizations and maintain with them such relations as may facilitate the achievement of its aims. It also co-operates with certain non-governmental organizations dealing with questions within its competence.

Over the years the Council has established close relations with a large number of organizations, either directly or through its Committees or the Secretariat, exchanging observers or co-operating even more directly in the study of questions mutually of concern to those organizations and the Council.

TECHNICAL CO-OPERATION:

The Council has rendered technical assistance in various spheres of Customs work to a large number of Member and non-Member developing countries.

Many countries have been given assistance in transposing their tariffs into the form of the CCC Nomenclature, such being a prime necessity for any country wishing to modernize and rationalize its Customs procedures. Also of great importance is the adoption by countries of the Brussels Definition of Value and a number of countries have been helped in this respect. Further, countries have been advised on means of implementing the wide range of other instruments which have been devised by the Council to improve Customs

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efficiency and to facilitate international trade. In many instances it has been possible to arrange for "on-the-spot" assistance by experts, the selection of the experts being made in co-operation with Member countries of the Council and other international organizations, particularly the United Nations, the United Nations Conference on Trade and Development, the United Nations Development Programme, the International Monetary Fund, the Organization of American States, the United Nations Sttistical Office and the United Nations Regional Economic Commissions.

Considering the importance of training with a view to the establishment of an efficient Customs administration, the Council has published a brochure entitled "Training Facilities for Customs Officials of Developing Countries" which contains full particulars of the training facilities available in Member countries. The facilities described in the brochure consist of participation in the normal training courses designed to meet the needs of some developing countries. Many trainees benefit from the facilities.

The Council also actively participates in the training programmes of other international organizations. It has provided lecturers from the staff of the Secretariat for training programmes of United Nations Regional Commissions and has organized courses in collaboration with the UNDP, UNCTAD and the OAS, some of the lecturers being Secretariat staff members and other being officials supplied by Council Members.

The Council's efforts in technical assistance, especially Customs training, are directed to complement the work being done bilaterally by its Member countries and to co-operate with other international and regional organizations.

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Tax Treaty Shopping

Art. 16 of the Draft U.S. Model Income Tax Treaty

By Michael J. Cooper and Thomas J. Rasmussen *

The purpose of this article is to comment on Article 16 of the draft U.S. Model Income Tax Treaty of 16 June 1981 (Model Treaty) and alternative versions of Article 16 in the Treasury News Release of 23 December 1981. [1]

I. COMMENTS ON U.S. TREATY POLICY

Treasury appears to have made a policy decision to include some form of Article 16 in all new U.S. income tax treaties in an attempt to prevent treaty shopping.[2] We recognize that there is a valid concern underlying such a policy. However, we believe that this policy would also discourage foreign investment in the United States and thus would not be helpful to the American economy. In the past, fostering such investment has been considered more important to the U.S. economy than trying to end all treaty shopping.[3]

Nevertheless, at a public meeting held at Treasury on 14 January 1982 to discuss Article 16, it was suggested that Treasury's policy decision on this matter would not be changed.

We are unaware of any economic studies that have been done by the Treasury which would justify this decision to overturn 42 years of U.S. treaty policy and administrative practice.[4] Therefor, we urge Treasury to re-consider this decision because we believe:

1. Article 16 could significantly reduce new foreign investment in the U.S.

2. Article 16 could cause a flight of already-invested foreign capital from the United States.

3. The effect could be to reduce the capital pool available to U.S. owned business for investment in new plant and equipment.

4. Concern about a possible flight of capital from the U.S. compelled Congress to make permanent in 1976 the temporary exemption from U.S. withholding tax on interest paid to non-resident aliens and foreign corporations on their U.S. bank deposits.[5] If a serious outflow of foreign investment capital would have resulted from ending this exemption for interest, there can be no doubt that declining investment and a similar outflow will result from Article 16's elimination of reduced withholding tax rates on dividend and interest paid with respect to foreign portfolio investments in U.S. businesses.

5. Article 16 will discourage foreign investors from locating manufacturing plants, real estate projects, or other job-producing businesses in the United States. It is counter-productive for the U.S. to use Article 16 to try to collect more tax on dividends or interest when paid by such businesses to its foreign investors if Article 16 deters the business from being located in the U.S. in the first place.[6]

6. By discouraging foreign portfolio and foreign direct investment in the U.S., Article 16 may actually reduce U.S. income tax revenues from such investment in the U.S.

7. Article 16 could have a negative impact on U.S. tax revenues by preventing U.S. corporations from using the favorable treaty network of a U.S. treaty partner to lower the foreign income tax such corporations would otherwise have to pay to a third country. As a result, U.S. corporations (or their foreign subsidiaries) could pay more foreign income tax, which would produce higher foreign tax credits, and thus could further reduce U.S. income tax revenues.

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* Deloitte Haskins & Sells.

1. The U.S. Model Income Tax Treaty serves as the starting point for U.S. negotiators in negotiating an income tax treaty with a foreign country.

2. Treaty shopping involves residents of countries that do not have an income tax treaty with the U.S. (third countries) or that have less favorable income tax treaties with the U.S. These third-country residents organize a corporation in a country that has a favorable treaty. They then use the treaty-country corporation to invest in the U.S. Because of the treaty, the treaty-country corporation receives reduced rates of withholding on any U.S. dividends, interest, rentals and royalties derived from that investment.

3. See, e.g.: Rev. Rul. 75-23, 1975-1 C.B. 290.

4. The only possible exception to this policy is the U.S.–Netherlands Income Tax Treaty, as it applies to the Netherlands Antilles. See: Statement of Treasury Department With Respect to the Protocol of 23 October 1963, in II P-H Tax Treaties: Netherlands 66,169 (1982).

5. See: section 861(a)(1)(A) and (c). The General Explanation of the TRA of 1976, prepared by Staff of Jt. Comm. on Tax., 94th Cong., 2d Sess. 256 (1976), states that

> Congress has concluded that the elimination of the exemption would result in a *significant decline* in the substantial deposits by non-resident aliens and foreign corporations in banks in the United States. Since *a possible shortage of investment capital* presently exists in the United States, Congress concluded further that *it would not be advisable at this time to permit the exemption to expire at the end of 1976 with the resultant outflow in investment capital.*
>
> Moreover, it was decided to retain the exemption on a permanent basis. . . . [Emphasis added.]

6. The location of such businesses in the U.S. in recent years has been increasing. An important economic factor in locating these businesses in the U.S. instead of some competing location is the availability of a favorable bilateral U.S. income tax treaty. A favorable treaty is one that reduces the U.S. rate of withholding tax on U.S.-source dividends, interest, rents, and royalties. Typically, the foreign investor will organize a corporation in a country having a favorable treaty with the U.S. That corporation will then organize a U.S. corporation to which it contributes or loans large amounts of foreign capital to be used to run the U.S. business and hire American workers. The U.S. corporation will pay U.S. income tax on its profits. Because of the favorable income tax treaty, the U.S. will then pay dividends (from those previously taxed profits) and interest to its foreign parent corporation at reduced rates of U.S. withholding tax.

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8. If included in revised U.S. tax treaties, Article 16 will render many existing foreign investments in the U.S. and U.S. investments in treaty countries economically unsound by denying the investors reduced rates of withholding tax. Many of these investments were made on the understanding that such reduced rates of withholding tax would be available.

9. The foreign portfolio investors that will be affected by Article 16 are, for the most part, not consuming U.S. social and governmental services. Consequently, the treaty benefits received by such third-country foreign investors are not unjustified in view of the capital they bring into the U.S.

10. We know of no authoritative economic studies done by Treasury on whether Article 16 will cause a revenue loss to the U.S., a loss in new foreign portfolio investment in the U.S., an outflow of already-invested foreign capital from the U.S., a reduction in the capital pool available to U.S.-owned business, or a reduction in the number of job-producing, foreign-owned businesses located in the U.S.
Therefore, we respectfully recommend that before any Article 16 policy is implemented, such studies be conducted to ensure that such a policy does not produce the investment and other losses discussed above.

II. TECHNICAL COMMENTS ON ARTICLE 16

These comments refer to the two basic versions of Article 16: the "June Draft", published as part of the proposed Model Treaty of 16 June 1981, and the "Discussion Draft", published in a Treasury News Release of 23 December 1981. These drafts currently exist as possible alternative formulations of Article 16 as it might appear in future U.S. income tax treaties.

75% Test (June Draft)

Article 16(1)(a) of the June Draft denies treaty benefits to a corporation of a contracting state unless "more than 75% of the beneficial interest" in the corporation is owned directly or indirectly by persons who are residents of that contracting state (hereinafter "75% test").[7]

This provision causes numerous problems:

Problem No. 1: The June Draft will discriminate against U.S. corporations that are foreign-owned, by denying them treaty benefits available to other U.S. corporations.

For example, suppose that a U.S. corporation, manufacturing automobiles in the U.S. and owned by Japanese residents, makes a loan to a Dutch affiliate. Suppose the 75% ownership test is included in the U.S.–Netherlands Income Tax Treaty. The U.S. corporation will lose its treaty exemption from Dutch withholding tax on interest received from the Dutch borrower, merely because the U.S. corporation is owned by non-residents of the U.S.

Article 16(1)(c) and (2)(e)(ii) of the Discussion Draft might cure this problem, but only if the income subject to treaty benefits is incidental to, or derived in connection with, the above corporation's U.S. business operations.[8] However, even if these tests are met, Article 16(2)(e)(ii) creates only a presumption that a foreign-owned U.S. corporation qualifies for the Treaty benefits. Because this presumption could be challenged by the subjective judgments of the revenue authorities of the other contracting state, it would be difficult to obtain certainty as to the application of this presumption. Moreover, the lack of a definition for the term "incidental" makes it difficult to judge when the presumption would operate in the case of income "incidental to" U.S. business operations.

We recommend that a definition of "incidental" be provided and that the presumption be made a conclusive one.

Article 16(1)(b), as supplemented by Article 16(2)(d) of the Discussion Draft, also might cure the problem in the June Draft, but only if more than 75% of the U.S. corporation is owned directly by resident individuals of a third-country having a U.S. income tax treaty (with relief not less favorable than, for example, the U.S.–Netherlands Treaty discussed above).[9] However, many U.S. corporations are directly owned by foreign corporations, not by foreign individuals. Thus, Article 16(2)(d) is not helpful in those cases.

Moreover, in the case of the Japanese-owned U.S. corporation discussed above, the U.S.–Japan Income Tax Treaty does not provide relief on interest payments as favorable as the U.S.–Netherlands Treaty. Even if it did, Article 16(2)(d) creates only a presumption, not a certainty, that the U.S. corporation qualifies for treaty benefits. We therefore recommend that the "presumption" language be deleted.

The "principal purpose test" in Article 16(2) of the June Draft might also resolve this problem, but again, this Article is too subjective.[10]

Problem No. 2: U.S. corporations are taxed on their world-wide income and thus can claim tax benefits

7. The term "contracting state" refers either to the U.S. or the foreign country with which the U.S. has concluded an income tax treaty.
8. Article 16(1)(c) of the Discussion Draft essentially provides that a corporation will be entitled to treaty benefits if it is established that the principal purpose of the corporation or of the conduct of its business was not to obtain such benefits (hereinafter "principal purpose test").
Article 16(2)(e)(ii) establishes the presumption that the principal purpose test is met if the income subject to treaty benefits is incidental to, or derived in connection with, the corporation's business operations in the contracting state of which it is a resident.
9. Article 16(1)(b) provides essentially that a corporation of a contracting state will be entitled to treaty benefits if it is controlled by residents of that state or U.S. citizens.
Article 16(2)(c) states that a person or persons shall be treated as having control of the corporation claiming treaty benefits if, under the income tax laws of the contracting state where income arises, they could be treated as having direct or indirect control of the corporation for any purpose.
Article 16(2)(d) presumes that the corporation meets this control test if (i) U.S. citizens, (ii) individual residents of the contracting state in which the above corporation is a resident, or (iii) individual residents of a third country having a U.S. income tax treaty (offering relief as favorable as the treaty in question) own directly more than 75% of such corporation. See Discussion below, pp. 294-295.
10. Article 16(2) of the June Draft allows treaty benefits to a corporation if it is determined that the acquisition or maintenance of the corporation and the conduct of its operations did not have as a "principal purpose" obtaining benefits under the treaty. See Discussion below, pp. xxx-xxx, for a more complete treatment of this Article.

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granted by the Code without regard to whether any shares are owned by U.S. residents.[11]

Since the U.S. taxes on the basis of world-wide income without regard to the identity of the shareholders, access to our treaty system should be allowed on an equal basis, regardless of ownership.

Problem No. 3: The 75% ownership test is too high.

If a corporation resident in a contracting state is not a sham and has a good business purpose, apart from the U.S. treaty benefit, for residing there, the fact that less than 75% of its shareholders are non-residents should be irrelevant to its access to treaty benefits.[12]

As just noted, a U.S. corporation is considered to be sufficiently connected to the U.S. for all purposes of the Code, even if none of its shares are owned by U.S. residents and none of its income is derived from the U.S.[13]

In adopting Subpart F and the foreign personal holding company (FPHC) provisions. Congress thought that if U.S. persons owned more than 50% of a foreign corporation, that corporation was sufficiently connected to the U.S. for its income, on a pro rata basis, to be subject to the U.S. taxing jurisdiction.

If more than 50% U.S. ownership is needed for Subpart F and FPHC purposes, and no U.S. ownership is necessary to tax a foreign-owned U.S corporation, a requirement that more than 75% U.S. ownership is necessary to claim treaty benefits is too high.

Problem No. 4: An international finance subsidiary (IFS) is an important vehicle for raising foreign capital for U.S. businesses. The 75% ownership test in the June Draft undercuts the economic viability of an IFS created by a U.S. corporation in, for example, the Netherlands Antilles by denying treaty benefits to that IFS. The reason is that, typically, more than 75% of the beneficial interest in such an IFS is owned by U.S. corporations that are not residents of the Netherlands Antilles.

This problem in the June Draft appears to be cured by Article 16(2)(e)(ii) of the Discussion Draft if the U.S.-source interest income received by the IFS for which the Antilles treaty benefit is claimed can be regarded as derived in connection with, or incidental to, the conduct of business operations by the IFS in the Netherlands Antilles.[14] Thus, we recommend that such income be regarded as derived in, or incidental to, the conduct of such business operations so that this presumption would clearly apply.

If not cured by Article 16(2)(e)(ii), this problem is also not cured by the control test in Article 16(1)(b) or (2)(d)(i) of the Discussion Draft, unless "citizens of the United States" can be interpreted to be the U.S. corporate owners of the IFS, an unlikely interpretation.[15]

Problem No. 5: For the same reasons, the 75% test in the June Draft denies treaty benefits to, and thus undercuts the economic viability of, an IFS created, for example, in the Netherlands by a Canadian corporation to raise funds to loan to its U.S. operating companies.

Interest paid by those U.S. companies to the IFS (because the IFS is Canadian-owned) would lose the exemption from U.S. withholding tax afforded by Article 8 of the U.S.–Netherlands Treaty if the 75% test were included in that treaty.

Article 16(2)(d)(iii) of the Discussion Draft may prevent this problem but only in cases where the shareholders of the IFS are individual residents of countries having income tax treaties with the U.S. and those treaties grant relief as favorable as the relief claimed under the Netherlands Treaty.[16]

The present U.S.–Canada Treaty does not grant relief as favorable as the the Netherlands Treaty.[17] Also, shareholders of an IFS are ordinarily not individuals

Stock Trading and the 75% Test (June Draft)

For purposes of satisfying the 75% ownership test, Article 16(1) of the June Draft also establishes a presumption that a corporation with "substantial trading" in its stock on a recognized exchange in its state of residence is owned by individual residents of such state.

Problem: This provision is of little use since it merely creates a presumption of satisfying the 75% test.

The IRS can overcome the presumption merely by requiring the taxpayer to supply proof that the 75% ownership test is actually met. Because the term "substantial trading " is undefined, the IRS could also contend that certain levels of trading are not substantial.

We believe the stock trading provision in Article 16(1)(a) of the Discussion Draft is preferable to the provision in the June Draft. The former eliminates the presumption and permits a corporation to qualify for treaty benefits if, for example, its stock is listed on an approved stock exchange in its country of residence.

Control Test (Discussion Draft)

Article 16(1)(b) of the Discussion Draft denies treaty benefits on income arising in a contracting state (assume

11. See: sections 11 and 7701(a)(3) and (4).
12. See, e.g.: *Moline Properties, Inc. v. Commissioner,* 319 U.S. 436, 438-439, 30 AFTR 1291, 1293-94 (1943), and *Rothschild v. U.S.*, 407 F. 2d 404, 409-10, 415, 23 AFTR 2d 69-637, 642-43, 648 (Ct. Cl. 1969), which synthesizes the judicial standards for shamming a corporation and shamming a transaction, respectively.
13. See: Treas. Reg. 1.11-1(a).
14. As previously stated, under Article 16(2)(e)(ii) a corporation is presumed to meet the principal purpose test and thus be entitled to treaty benefits if the income in question is incidental to, or derived in connection with, the corporation's business operations in the contracting state of which it is a resident. See note 8.
15. As previously stated, under Article 16(1)(b) a corporation of a contracting state is entitled to treaty benefits if controlled by residents of that state or U.S. citizens. Under Article 16(2)(d)(i) a corporation is presumed to meet the above control test and thus get treaty benefits if more than 75% of the corporation is owned directly by U.S. citizens. See note 9.
16. As previously stated, under Article 16(2)(d)(iii) a corporation is presumed to meet the control test and thus get treaty benefits if individual residents of a third country having a U.S. income tax treaty (offering relief as favorable as the treaty in question) own directly more than 75% of each corporation. See note 9.
17. See Article XI(1) of the Canadian Treaty which imposes a 15% withholding tax on U.S.-source interest.

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U.S.) to a corporation of the other contracting state (assume Netherlands), controlled by persons who are not residents of that other contracting state, unless such persons are U.S. citizens.

Under Article 16(2)(c) a person (or persons) is treated as having control of such corporation for Article 16(1)(b) purposes if under the income tax laws of the contracting state in which income arises (assume U.S.), "the person or persons could be treated as having direct or indirect control of the corporation for any purpose".

Problem No. 1: The definition of "control" in Article 16(2) of the Discussion Draft refers to control "for any purpose" under the tax laws of the contracting state in which the income arises. Suppose a Dutch corporation wants to claim treaty benefits on U.S.-source income. The Dutch corporation could never be sure that it qualified for those benefits unless shareholders residing in the Netherlands owned enough of its shares to meet the maximum ownership test under any provision of the Internal Revenue Code.

This article provides no guidance as to which ownership rules the IRS or Treasury will use. Thus, the IRS or Treasury would be free to choose among the various ownership tests in ways that could not be anticipated by any investors.

Problem No. 2: Another problem with the definition of "control" is that other states might not have constructive ownership rules or might have control provisions that differ significantly from those of the U.S.

For example, suppose that in country X a corporation is considered to be controlled by country X residents if 40% of a corporation's shares are owned by such residents. It is unlikely that country X will agree to a provision that requires country X residents to own, for example, 80% of any country X corporation receiving dividends or interest from the U.S. before that corporation gets treaty benefits, when U.S. investors in country X have to own only 40% of a U.S. corporation for that corporation to get treaty benefits on income from country X.[18]

Problem No. 3: In many cases, Article 16(1)(b) of the Discussion Draft will cause the U.S. Treasury to collect less U.S. income tax than if treaty benefits had not been disallowed by this Article.

For example, suppose that T, a resident of a country (Y) not having an income tax treaty with the U.S., owns a U.S. corporation. The U.S. corporation does not conduct business operations in the U.S. but receives $100,000 of dividends from sources in country X. The U.S. has an income tax treaty with country X which reduces X's withholding tax rate on dividends from 35% to 10%. If Article 16(1)(b) of the Discussion Draft is not included in the country X treaty, the U.S. corporation would only have to pay $10,000 of country X withholding tax (10% of $100,000) on such dividends. However, if Article 16(1)(b) is included, the U.S. corporation will not meet the control test of that Article since it is owned by a resident of country Y.

The loss of the reduced rate means that the U.S. corporation must pay $35,000 of country X withholding tax instead of $10,000. Because of Article 16(1)(b) the U.S. corporation will claim a greater U.S. foreign tax credit and thus pay less U.S. income tax than if the treaty benefits had been available.

This problem is not cured by Article 16(1)(a) of the June Draft (the 75% test) which requires that more than 75% of the U.S. corporation be owned by residents of the U.S.[19]

Exception to Control Test (Discussion Draft)

Under Article 16(2)(d) of the Discussion Draft, a corporation is presumed to meet the "control test" if:

(i) U.S. citizens,

(ii) individual residents of the contracting state (treaty country) where the corporation claiming treaty benefits resides (assume Netherlands), or

(iii) individual residents of third countries having income tax conventions with the contracting state from which relief from taxation is claimed (assume U.S.) providing relief not less favorable than under the convention with the treaty country (assume U.S.–Netherlands Treaty),

own directly more than 75% of the total combined voting power of all classes of voting stock and more than 75% of the shares of each other class of stock of the corporation claiming the treaty benefits.

Problem No. 1: Article 16(2)(d) of the Discussion Draft is unclear on whether a combination of U.S. citizens, Dutch individual residents, or individual residents of states (having an income tax convention with the contracting state from which relief from taxation is claimed), who own together more than 75% of all classes of the corporation's stock, can meet the 75% test. Article 16(2)(d) should be amended to make it clear that such a combination does meet the 75% test.

Problem No. 2: If the section 385 regulations or similar rules are eventually applied to international transactions, they could accidentally cause a corporation to lose treaty benefits guaranteed to it by the 75% test of Article 16(2)(d) of the Discussion Draft.

For example, suppose that a U.S. corporation is owned by a Dutch corporation. Suppose also that 76% of all classes of stock of the Dutch corporation is owned by an individual resident of a third country having a U.S. income tax treaty providing benefits not less favorable than the U.S.–Netherlands Treaty. The other 24% of the Dutch corporation is owned by a Liberian corporation.

On 1 August 1982, the Dutch corporation becomes indebted to its shareholders in the form of interest-bearing, demand loans with a fixed maturity date. At the time of issuance it was felt that the debt-to-equity ratio on these loans was not excessive, even though the 3:1 safe-harbor ratio was not met. Of this debt, 30% is owned by the third-country individual and 70% by the Liberian corporation. The terms of the debt to each shareholder are identical.

In December 1985, the U.S. corporation pays a dividend to the Dutch corporation.

18. The 80% control test in section 368(c) is used here as an example.
19. See Discussion above, pp. 292-293.

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The Dutch corporation claims the reduced rate of withholding granted by Article VII of the U.S.–Netherlands Treaty. In 1986, a determination is made that the shareholder debt-to-equity ratio of the Dutch corporation was excessive. Under Treas. Reg. 1.385-4(c)(1)(i) and 6(a)(2) and (g)(1), the foregoing shareholder debt of the Dutch corporation is reclassified as non-voting preferred stock during 1986, retroactive to its date of issuance.

Until the reclassification, the Dutch corporation appeared to meet the control test of the above Article because 76% of all classes of its stock was owned by an individual resident of a third country having an income treaty as favorable as the U.S.–Netherlands Treaty. However, because of the reclassification of debt to preferred stock, the Liberian corporation owns 70% of one class of the U.S. corporation's non-voting preferred stock. Thus, the Dutch corporation retroactively will not meet the control test of the above Article because the third-country individual does not own more than 75% of the shares of each class of the Dutch corporation's non-voting stock.

Problem No. 3: Other problems with this exception to the "Control Test" are discussed on pages 292 and 293.

Pass-through test (June Draft)

Article 16(1)(b) denies treaty benefits to a corporation of a contracting state (assume Netherlands) whose income is used "in substantial part, directly or indirectly", to pay liabilities, e.g. interest expenses, to persons who are not residents of that state and who are not citizens of the United States. Treaty benefits are lost even if 75% of the beneficial interest in the Dutch corporation is owned by Dutch residents.

Problem No. 1: The pass-through test of Article 16(1)(b) is too severe since it will deny treaty benefits even when no third-country resident is taking advantage of a U.S. income tax treaty.

For example, suppose a Dutch company engaged in business in the Netherlands has a subsidiary in the U.S. The Dutch company is wholly owned by individual residents of the Netherlands. The Dutch company borrows money at low rates in Europe from a Swiss bank, and then loans the money to its U.S. subsidiary in return for an arm's length interest rate. The Dutch company under this Article will lose the benefit of the reduced rate of U.S. withholding tax afforded by the U.S.–Netherlands Treaty, even though more than 75% of the beneficial interest in the Dutch company was owned by individual residents of the Netherlands. The loss occurs because the Dutch company pays interest to a Swiss bank. As presently drafted, Article 16(1)(b) interferes with legitimate business transactions and thus should be deleted. Existing case law is sufficient to deal with any real treaty abuse occasioned by pass-through payments. See *Aiken Industries, Inc. v. Commissioner*, 56 T.C. 925, 933-34 (1971).

Problem No. 2: This provision will deny treaty benefits to, and thus undermine the economic viability of, an international finance subsidiary (IFS) organized by a U.S. corporation in, for example, the Netherlands Antilles to raise capital by selling bonds to European investors.

If an IFS loans the sales proceeds from its bond sales to its U.S. parent, the interest received by the IFS from the parent would be paid to the European investors to meet the interest obligations of the IFS to those investors. Because of this pass-through of interest, the IFS would not be entitled to the reduced rate of U.S. withholding tax on interest received from its parent under Article 16(1)(b). This is a burden for an American business community in need of large amounts of investment capital.

Problem No. 3: Also, Article 16(1)(b) of the June Draft presents various interpretative problems. What is the precise meaning of such phrases as "in substantial part", "to meet liabilities", and "directly or indirectly"?

Because Article 16 of the Discussion Draft does not contain a pass-through provision, we believe it is preferable to the June Draft on this issue.

Principal Purpose Test (June Draft)

Article 16(2) of the June Draft allows treaty benefits to a corporation if it is determined that the acquisition or maintenance of the corporation and the conduct of its operations did not have as "a principal purpose" obtaining benefits under the treaty.

Problem No. 1: Article 16(2) can easily be read to deny treaty benefits to a corporation, even if it meets both the 75% test and the pass-through test of Article 16(1) of the June Draft. If so, treaty benefits will be lost in many cases where there is no imaginable treaty abuse.

At the Treasury meeting of 14 January 1982, however, Treasury personnel responded to this concern by saying that Article 16(2) was intended to grant treaty benefits to a corporation that otherwise failed the pass-through test or the 75% test. In order to conform the language of Article 16(2) to that intent, we recommend that the following words be inserted after the word "apply":

to cause a loss of benefits . . . under the convention

In summary, we believe that the principal purpose test should be used only to permit a corporation to qualify for treaty benefits when it would not otherwise qualify for such benefits under the other tests.

Problem No. 2: The principal purpose test in Article 16(2) makes it easier for the IRS to deny treaty benefits than would otherwise be permitted by existing case law.

Suppose that a resident of a third country has an appreciable business purpose, such as minimizing non-U.S. taxes, for making an investment in the U.S. through a treaty-country corporation, apart from any U.S. treaty benefit. Despite the presence of such a purpose, Article 16(2) allows the IRS to sham the transaction.

If the transaction is shammed, the investment will be treated as having been made directly by the non-resident person, causing a loss of treaty benefits. This results because the IRS only has to show that obtaining treaty benefits was "a principal purpose" for making the investment through the treaty country corporation. It can then

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ignore any appreciable business purpose, apart from the treaty benefit, for the investment.

Existing case law, however, will not permit the IRS to sham the above investment transaction if the third-country resident can show that some appreciable economic advantage or disadvantage (business purpose) flows or was reasonably expected to flow from the transaction.[20] If such a business purpose is present for making the investment through the treaty-country corporation, it is irrelevant that the above resident also knew that U.S. treaty benefits would be available to the treaty-country corporation.[21]

We, therefore, recommend that the principal purpose test in Article 16(2) of the June Draft be amended to conform to the standard of existing case law.

Problem No. 3: If Article 16(2) is administered like similar language in existing treaties, it will be useless to taxpayers in many situations.

Article 16(2) gives the IRS and the Treasury unlimited discretion to determine the intent of taxpayers who enter into investments in the U.S. Such discretion makes it impossible for taxpayers to have any certainty of qualifying for treaty benefits, if the principal purpose test is involved. It is unreasonable to expect prudent businessmen to invest significant amounts of capital in the U.S. without some certainty that treaty benefits will not be withdrawn because of purely subjective determinations by the IRS or the Treasury.

We understand that in the past well-intentioned IRS and Treasury personnel have frequently disagreed over the meaning of language similar to Article 16(2).[22]

Often, the positions of each department have fluctuated with personnel changes. Because of these disagreements, the issuance of rulings has often been delayed. Only a handful of favorable rulings has been issued under Article VII(1) since 1978, mostly under familiar fact patterns. We see no good purpose in continuing such an uncertain situation that is not conducive to investment in the U.S.

We think this is another good reason for adopting the recommendation above. We also recommend that Treasury in Article 16(2) provide a non-exclusive list of business purposes for making an investment in the U.S. through a treaty-country corporation that will prevent the investment transaction from being shammed.

Principal Purpose Test (Discussion Draft)

The principal purpose test in Article 16(1)(c) of the Discussion Draft is essentially the same as the test in the June Draft, except that the Discussion Draft clearly sets forth the test as an alternative to claiming treaty benefits. Thus, the Discussion Draft is preferable on this point, but the other problems we have discussed remain.

Equality of Tax (June Draft)

Article 16(3) of the June Draft denies treaty benefits to a resident of the other contracting state on, for example, U.S.-source dividends and interest, when such income bears a significantly lower tax in that other contracting state than dividends and interest arising in that other contracting state.

Problem No. 1: Many contracting states levy income tax only on income arising within their borders and not on foreign-source (including U.S.-source) income. Thus, Article 16(3) would always disallow treaty benefits to residents of such states because the income they derive from the U.S. would always bear a significantly lower tax than similar income arising within their state of residence.

Clearly, it cannot be the treaty policy of the United States to penalize residents of states with territorial tax systems. We therefore recommend that this Article be deleted.

Problem No. 2: Article 16(3) of the June Draft can easily be read to deny treaty benefits to a corporation, even if it meets the 75% test, the pass-through test, and the principal purpose test of Article 16(1) and (2) of the June Draft.

Equality of Tax (Discussion Draft)

Under Article 16(2)(e)(i) of the Discussion Draft, a treaty country corporation (assume Netherlands) is presumed to meet the principal purpose test if "the reduction in [assume U.S.] tax claimed is not greater than the tax actually imposed by the Contracting State. . ." (assume Netherlands) where such corporation is a resident.

Problem No. 1: It is unclear whether (a) the "reduction" in tax refers to an absolute dollar amount or a percentage rate reduction, or (b) whether "the tax *actually* imposed" refers to the tax rate or the actual tax collected in, for example, the Netherlands. If the reference is to the actual tax collected in the Netherlands, a Dutch corporation may never be able to meet this standard if Netherlands-source net operating losses or other deductions significantly reduce the amount of Dutch tax collected on the U.S.-source income in question.

Problem No. 2: Even if this test is met, Article 16(2)(e)(i) of the Discussion Draft creates only a presumption that the above corporation qualifies for Treaty benefits. If this article is retained, the "presumption language" should be deleted.

Problem No. 3: Article 16(2)(e)(i) relief also may be unavailable to corporations resident in states with territorial tax systems.

20. See *Rothschild v. U.S.*, 407 F. 2d 404, 409, 415, 23 AFTR 2d 69-637, 642, 648 (Ct. Cl. 1969), (and cases cited therein); *Gilbert v. Commissioner*, 248 F. 2d 399, 411, 52 AFTR 634, 646-47 (2d Cir. 1957) (Hand, J., dissenting), *cited approvingly in Knetsch v. Commissioner*, 364 U.S. 361, 366, 6 AFTR 2d 5851, 5853 (1960); *Aiken Industries, Inc. v. Commissioner*, 56 T.C. 925, 934 (1971).

21. See *Fabreeka Products Co. v. Commissioner*, 294 F. 2d 876, 878, 8 AFTR 2d 5554, 5555-56 (1st Cir. 1961); *Bass v. Commissioner*, 50 T.C. 595, 601 (1968); *Gilbert* at 646 stating "when a taxpayer supposes that *the transaction*, in addition to its effect on his tax, *will promote his beneficial interest in the venture*, he will of course secure the desired reduction [in his tax] for it *would be absurd to hold that he must deny himself an economic advantage* unless he pays the tax based on facts that have ceased to exist." (Emphasis added.)

22. See Article VII(1) of the U.S.–Netherlands Treaty, as extended to the Netherlands Antilles.

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Existing Investments

Problem: Article 16 will render many existing foreign investments in the U.S. and U.S. investments in treaty countries economically unsound by denying their investors the reduced rates of withholding tax. This result is unfair because such investments were made on the understanding that such rates would be available. To avoid this inequity, we recommend that the U.S. Model Treaty and all renegotiated U.S. treaties include a provision that existing investors continue to receive the reduced rates of withholding, even if their investment does not meet the requirements of Article 16.

III. RECOMMENDATIONS

It is our view that Article 16, as proposed, should not be included in U.S. tax treaties. Even if, as a matter of policy, it were desirable to include Article 16 in tax treaties, we think the interpretative problems and the impediments to the conduct of international business presented by Article 16 outweigh any arguments in favor of the adoption of such an Article.

JUNE DRAFT

Article 16
Limitation on benefits

1. A person (other than an individual) which is a resident of a Contracting State shall not be entitled under this Convention to relief from taxation in the other Contracting State unless
a) more than 75% of the beneficial interest in such person is owned, directly or indirectly, by one or more individual residents of the first-mentioned Contracting State; and
b) the income of such person is not used in substantial part, directly or indirectly, to meet liabilities (including liabilities for interest or royalties) to persons who are residents of a State other than a Contracting State and who are not citizens of the United States.

For the purposes of subparagraph a), a company that has substantial trading in its stock on a recognized exchange in a Contracting State is presumed to be owned by individual residents of that Contracting State.

2. Paragraph 1 shall not apply if it is determined that the acquisition or maintenance of such person and the conduct of its operations did not have as a principal purpose obtaining benefits under the convention.

3. Any relief from tax provided by a Contracting State to a resident of the other Contracting State under the Convention shall be inapplicable to the extent that, under the law in force in that other State, the income to which the relief relates bears significantly lower tax than similar income arising within that other State derived by residents of that other State.

DECEMBER DRAFT - (Discussion Draft)

Article 16
Investment or holding companies

1. A corporation which is a resident of a Contracting State shall not be entitled under this Convention to relief from taxation in the other Contracting State with respect to an item of income, gains or profits unless the corporation establishes that:
a) its stock of any class is listed on an approved stock exchange in a Contracting State, or that it is wholly owned, directly or through one or more corporations each of which is a resident of a Contracting State, by a corporation the stock of which of any class is so listed; or
b) it is not controlled by a person or persons who are not residents of a Contracting State, other than citizens of the United States; or
c) it was not a principal purpose of the corporation or of the conduct of its business or of the acquisition or maintenance by it of the shareholding or other property from which the income in question is derived to obtain any of such benefits.

2. For the purposes of this Article:
a) an approved stock exchange in _____ means _____;
b) an approved stock exchange in the United States means the NASDAQ System owned by the National Association of Securities Dealers, Inc. and any stock exchange registered with the Securities and Exchange Commission as a national securities exchange for the purposes of the Securities Exchange Act of 1934;
c) a person or persons shall be treated as having control of a corporation if under the income tax laws of the Contracting State in which the income arises the person or persons could be treated as having direct or indirect control of the corporation for any purpose;
d) notwithstanding subparagraph c) of this paragraph, a corporation is presumed to meet the requirements of subparagraph b) of paragraph 1 of this Article if the corporation establishes that individuals who are:
i) citizens of the United States; or
ii) residents of a Contracting State; or
iii) residents of States that have income tax conventions in force with the Contracting State from which relief from taxation is claimed and such conventions provide relief from taxation not less than the relief from taxation claimed under this Convention;

own directly more than 75% of the total combined voting power of all classes of the corporation's stock entitled to vote and more than 75% of the number of shares of each other class of the corporation's stock;

e) a corporation is presumed to meet the requirements of subparagraph c) of paragraph 1 of this Article, in particular, where:
i) the reduction in tax claimed is not greater than the tax actually imposed by the Contracting State of which the corporation is resident;
ii) the corporation is engaged in business operations in the Contracting State of which it is a resident and the relief from taxation claimed from the other Contracting State is with respect to income which is incidental to or derived in connection with such business.

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BELGIUM:

Cutting Taxes on Business and Investment Income

by Frans Vanistendael*

I. GENERAL OUTLINE OF NEW TAX MEASURES

During the spring of 1982 a new set of tax measures was introduced in Belgium in what looks like a determined effort to relieve the country of its bad international reputation for high taxes. The measures are aimed at achieving two goals:

a. a general and permanent improvement in the tax environment by a substantial cut in the tax rate on business and investment income;
b. a boost in investment in physical and financial assets by temporary but substantial tax incentives, that will have an effect over a relatively long period of time.

The legal basis for most of the new measures is the Special Powers Act of 2 February 1982. This act enables the government to take sweeping reform measures by Royal Decree, thereby effectively excluding the vote necessary for a formal Act of Parliament. The special powers are granted on a temporary basis and expire 31 December 1982.

Art. 2 of the act enables the government to amend by simple Royal Decree, any existing tax statute, decree or ruling with respect to specifically listed items. However any amendment so effected by Royal Decree is to be confirmed by a formal Act of Parliament before 1 January 1984. Any amendment by Royal Decree that has not been confirmed before that date will lapse thereafter.

The chance of non-confirmation of the measures seems at present very remote, if only because non-confirmation would bring down instantly a whole tax structure that has been built up very carefully.

Under the Special Powers Act, the following tax decrees have already been issued:

(a) 15 February 1982
- Royal Decree No. 1: Reduction of the V.A.T. rate on new construction from 17% to 6%;
- Royal Decree No. 2: Abolition of the capital gains tax on unimproved land situated in areas earmarked for residential construction;
- Royal Decree No. 6: Tax incentives for taxpayers under 35 who start a new unincorporated business or a new profession;
- Royal Decree No. 7: Deduction of a special reserve for severance pay;
- Royal Decree No. 8: Change (reduction) of the tax base for the application of V.A.T. to sales of works of art, antiques, gold and bullion;
- Royal Decree No. 9: Reduction of V.A.T. rate to 1% on gold bullion;
- Royal Decree No. 10: New system of advance payment for taxpayers filing a joint return.

(b) 19 March 1982
- Royal Decree No. 15: Tax incentives for the subscription of shares in Belgian companies;
- Royal Decree No. 16: Reduction of the corporate income tax rate.

(c) 30 March 1982:
- Royal Decree No. 29: Replacement of the tax deduction by a tax credit for income from social security schemes (retirement pensions, sick- and disability pay, unemployment compensation, etc.).

(d) 2 April 1982
- Royal Decree No. 40: Amendments with respect to interest charged for late payment of taxes;
- Royal Decree No. 41: Amendments with respect to criminal sanctions for tax avoidance.

(e) 5 May 1982
- Royal Decree No. 44: Changing the provisions for aggregating the income of husband and wife.

(f) 22 June 1982:
- Royal Decree No. 48: Replacement of existing tax incentives by an investment deduction and tax exemption for capital gains realized on certain business assets.

Comments will be limited to those Royal Decrees that directly affect business activities, i.e. No. 7 on the special provision for severance pay, No. 15 on the tax incentives for the subscription of Belgian shares, No. 16 on the reduction of corporate income tax, and No. 48 on the investment deduction and the exemption for capital gains on business assets.

Finally it should be added that the temporary solidarity surcharges will not be renewed and that negotiations are under way to create a new legal basis for the privileged tax status of foreign executives and research employees.

Discussion of the above measures will be divided into two parts: those of a permanent nature and those which are temporary.

II. PERMANENT MEASURES

1. Reduction of the corporate tax rate

The maximum corporate tax rate will be reduced from a maximum of 56.8% for fiscal 1982 to a single top rate of 45% for fiscal 1983 (income earned in 1982). This reduction is effectuated in two steps.

The first step is the non-renewal of both temporary solidarity surcharges of 4.8% respectively 4% on so called exceptional profits that were introduced by Art. 43 of the Economic Recovery Act of 30 March 1976, and by Art. 48 of the Budgetary Proposals Act 79 - 80 of 8 August 1980. In order to remain in effect, these surcharges had to be confirmed each year by Act of Parliament. There is a political agreement within the government, not to ask for confirmation of the surcharges, so that they will be repealed automatically as of 1 January 1983.

The second step is a reduction of the general top corpo-

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rate tax rate from 48% to 45%. As of fiscal 1983 the structure of the tax rate is the following:

Income (US$)[1]	*Tax rate*
income ≤ 20,000	31 %
20,000 - 72,000	40 %
72,000 - 288,000	47.5%
income ≥ 288,000	45 %

It follows that for taxable income below US$288,000 the effective tax rate is lower than 45% and may vary from 31% to maximum 45%.

The tax credit for dividends and directors' compensation has been adopted to reflect the changes in the corporate tax rate. The tax credit on net-dividends (after 20% withholding tax) has been reduced from 57.5% to 51% of the net amount received.

The credit on non-deductible directors' compensation has been lowered from 46% to 41%. The relative importance of the tax credit, aimed at reducing the burden of double economic taxation (combination of corporate and personal income tax), remains unchanged. About half the amount of the corporate income tax (22.44 for dividends and 22.55 for directors' compensation) is creditable against personal income tax.

2. Exemption for capital gains on business assets

The exemption for capital gains on business assets has its historical origins in Art. 9 bis and 9 ter of the Royal Decree implementing the Income Tax Code (I.T.C.). These articles provided for exemption of capital gains realized on certain business assets.
The exemption had to be renewed on an annual basis. This annual renewal rule, combined with the fact that renewals were sometimes very late, rendered the exemption ineffective as a tax incentive.

Therefore the exemption was incorporated in Art. 36 I.T.C. as a permanent measure not subject to annual renewal, by Art. 53 of the so called Program Act of 2 July 1981, Art. 2 e.s. of Royal Decree No. 48 of 22 June 1982 confirms this permanent exemption and determines its application.

As a general rule exemption is granted with respect to capital gains realized on business assets, used during more than five years in business or other professional activity, when the total sales price of such assets is reinvested in new assets in Belgium within a period of three years. The exemption is automatic and not subject to preliminary rulings or approval by the Department of the Treasury or the Department of Economic Affairs.

The three years reinvestment period is calculated as of the first day of the calendar year or the financial year during which the capital gain has been realized, until the last day of the second calendar year (31 December), or financial year, following the (calendar or financial) year in which the capital gain has been realized.

If business activities are ceased at an earlier date, the reinvestment period ends simultaneously with the cessation of business activities.

Example I

Company keeps its financial year from 1 July - 30 June. A business asset is sold in October 1982. Start of the three years reinvestment period: 1 July 1982, end of the reinvestment period: 30 June 1985.

The reinvestment has to be made in new business assets to be used in Belgium. However, the following are not considered as reinvestment: the purchase of goods in trade or inventory, bonds or simular securities, time deposits, loans or claims, buildings or land held for resale as well as the repayment of a debt. However, bonds issued or guaranteed by the Belgian State for a period of more than five years, do qualify as a reinvestment, if purchased by fiancial or similar enterprises. The purchase of company shares or stock, title to patents, copyrights or other non-physical assets are considered as qualifying investments.

The exemption for capital gains is not applicable to assets that have benefited from the investment reserve provided for in Art. 58 of the Program Act of 2 July 1981 or the investment deduction introduced by the same Royal Decree No. 48 (see below). The basic idea is to prevent the taxpayer from combining the benefits of two incentives. This means that the taxpayer has to make a choice between an immediate tax benefit in the form of an investment reserve or deduction in the year of investment or a deferred tax benefit on the capital gain in the year in which the assets will be sold. Taxpayers that have already chosen for the investment reserve in 1981, or will choose for the investment deduction, will not be entitled to claim the exemption for capital gains at the time the asset is sold.

New business assets purchased as a reinvestment to obtain the exemption from capital gains tax do qualify however for the investment deduction described below.

Example II

Purchase of research equipment in 1982. Application of the investment deduction of 20%. Equipment sold in 1988, and sales price reinvested in similar but more modern equipment. Capital gain realized in 1988 is taxable (at lower rate of 22.5%), because of investment deduction of 20% claimed in 1982. New equipment purchased in 1988 does qualify however for the investment deduction.

New assets purchased as a reinvestment can be depreciated in accordance with ordinary rules. Although the capital gain, which in theory originated the cash for the new investment is completely tax exempt, the newly acquired assets are subject to full depreciation like any other business asset.

Example III

Equipment with salvage value of US$10,000 is sold for US$50,000 in 1982 and proceeds are reinvested in 1983, in new equipment with a purchase price of US$200,000. Capital gain of US$40,000 is tax exempt. Amount of up to US$200,000 of new assets can be depreciated.

1. Exchange rate at 50 Bfrs. = US$1.

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The exemption applies to all taxpayers engaged in business or professional activities in Belgium: resident individuals and corporations, and Belgian establishments of non-resident taxpayers (individuals and corporations).

3. Investment deduction

The same Royal Decree No. 48 introduces a new investment deduction. The intention of the government was to simplify the complicated structure and the scattered pattern of existing tax incentives, by replacing several existing incentives with one single and simple measure. Removed from the statute books are both of the investment reserves introduced in 1982 (the 5% reserve enacted on 10 February 1981, and the 28 or 30% investment reserve enacted on 2 July 1981), depreciation of research equipment at 110% of acquisition cost and depreciation at will ("ad libitum") of energy saving equipment.

Art. 6 of the Royal Decree provides for a so called "investment deduction" of:
- 25% on energy saving equipment
- 20% on research equipment and new technology
- 5% on furniture and office equipment
- 13% on any other business equipment qualifying under the Royal Decree; i.e. the standard rate of the investment deduction is 13%.

The investment deduction is applied to the acquisition cost of the qualifying assets in addition to ordinary depreciation. It does not decrease the tax base of the assets for the purpose of calculating subsequent capital gains or -losses in case the assets are sold. It follows that the investment deduction is in fact an additional depreciation deduction in excess of the 100% cost base. The investment deduction does not apply to some additional acquisition costs such as taxes, fees, installation- and transportation charges, on which the taxpayer has the option either to deduct such costs as ordinary expenses, or to capitalize such costs and to depreciate them together with the purchase price. If the additional costs are deducted as an expense, the investment deduction does not apply. If however the additional costs are capitalized and depreciated the deduction is applicable.

Example IV

Purchase of equipment at a price of	US$200,000
Packing and transport charges	US$ 10,000
Installation charges	US$ 10,000
Value added tax (V.A.T.)	US$ 37,700

(purchaser is no V.A.T. payer).
If V.A.T. and charges are deducted as an expense, the basis for the investment deduction is US$200,000; if V.A.T. and charges are capitalized and depreciated together with purchase price, the basis for the investment deduction is US$257,700.

In applying the investment deduction the taxpayer has the option either (a) to apply a one time lump sum deduction calculated as a percentage of the acquisition cost of the qualifying asset, or (b) to spread the amount of the deduction over the normal depreciation period of the qualifying asset. In the latter case the amount of the annual investment deduction bears a compounded interest at a rate of 10% per annum to reflect the deferral of the tax saving. It is clear however that in most cases the biggest tax saving (and also the simplest) will be realized by taking the one time deduction for the full amount in the year of investment.

Example V

Purchase of equipment for US$100,000 to be depreciated with the declining balance method over a period of ten years. Depreciation allowance during the first year (at 20%) US$20,000. One time investment deduction: US$13,000. Total deduction during the year of investment: US$33,000, or 33% of acquisition cost.

Example VI

Purchase of vehicle for US$10,000 to be depreciated with declining balance method over five years. Depreciation allowance during the first year (at 40%): US$4,000. One time investment deduction: US$1,300. Total deduction during the year of investment US$5,300, or 53% of acquisition cost.

The investment deduction applies to all taxpayers engaged in business activities (resident individuals and companies), as well as to Belgian establishments of non-resident individuals and companies, including financial and real estate activities that in the past have very often been excluded from the benefit of such tax incentives. Understandably it does not apply to taxpayers that are not assessed on real but on estimated income. For the time being it is not applicable to taxpayers engaged in the professions, but the Decree provides for the possibility to extend the deduction to this category of taxpayers.

The deduction applies to all *new* investment assets used in business activities with the exception of the following categories of assets:
- assets used for mixed purposes (partially business – partially personal);
- assets subject to a depreciation period of less than three years;
- all automobiles and stationwagons used for transport of individuals, except when used solely for taxi- or leasing services (with driver);
- real estate held for sale by taxpayers professionally engaged in real estate activities.

It also applies to assets acquired as a reinvestment within three years of capital gains that are exempt under Art. 36 I.T.C. (see above).

In order to qualify, the assets must be *new*. It follows that land and old buildings (not new construction) do not qualify as well as some intangible assets (such as goodwill) that are generated in the course of business activities, or that already have been partially depreciated. Also excluded are some other assets, because they already benefit from existing tax incentives:
- workmen's housing and other facilities for personnel that benefit from a 50% exemption provided for in Art. 42 I.T.C.
- assets that benefit from the special depreciation at will (Act of 29 November 1977);

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- assets that benefit from the repealed investment reserves introduced in 1981 and 1982 (Acts of 10 February 1981 and 2 July 1981).

Finally the investment deduction does not apply to some acquisitions that are not subject to depreciation and can be deducted as ordinary business expenses (or depreciated at 100%) in the year during which the expenses are incurred (see below).

Example VII

Purchase of a business vehicle for US$20,000, to be depreciated with declining balance method. V.A.T. amounts to US$5,000. Total acquisition cost US$25,000. Deductions in year of investment:
- US$5,000 V.A.T. as business expense if purchaser is no V.A.T. payer
- US$8,000 depreciation allowance for 1st. year
- US$2,600 investment deduction.

Total deduction: US$15,600 or 62.4% of total acquisition cost.

When the amount of the investment deduction exceeds the amount of taxable profits, or when the company realizes a loss, any unused amount of the investment deduction can be carried forward indefinitely. In case of a tax free reorganization the investment deduction is carried over to the surviving company.

4. Depreciation of acquisition cost

In order to determine which items are subject to depreciation and to determine the basis of depreciation, the tax legislation is now harmonized with existing statutes on annual financial statements (Act of 8 October 1976); so that there is no longer any discrepancy between depreciation rules for tax purposes and for accounting purposes. This identity between tax and accounting rules with respect to depreciation has its most important consequence in the field of leasing: henceforth the lessee will be entitled to take depreciation on the leased asset instead of the lessor.

The new Art. 48 § 2 I.T.C. confirms existing administrative practice with respect to expending or capitalizing certain items of acquisition cost. Additional costs of acquisition, or costs of establishment or incorporation of a business can be (a) either capitalized and depreciated together with other assets, (b) or be capitalized and depreciated in accordance with a separate depreciation schedule, (c) or be expended and deducted at once as an ordinary business expense. This rule applies to such additional cost as indirect taxes, local taxes, charges for transportation, packing, installation, fees for experts etc.

5. Provision for severance pay for small business

As is well known in the international business community severance pay in case of firing or lay-off is quite substantial in Belgium, particularly for non-manual employees. Until now, taxpayers were generally not allowed to take any deduction for provisions established for such contingencies as firing or laying-off employees.

Royal Decree No. 7 provides for a tax deductible provision for firing or laying-off employees for small business employing less than 100 employees at the beginning of the calendar year, or financial year (if not identical to the calendar year). The deductible provision amounts to maximum US$800 per additional employee for manual workers and to maximum US$2,400 per additional employee for non-manual workers. The number of additional employees, that have been hired, is calculated by comparison with the average number of employees employed during the preceding (calendar- or financial) year. When the number of employees decreases (because of firing, lay-off, retirement or resignation), previously deducted provisions become taxable in accordance with the category of employees (manual, or non-manual) that has decreased.

6. Tax status of executive and research personnel

The tax status of executive and research personnel of multinational companies has up to 1982 been regulated by administrative circular. This circular in principle expires on 31 December 1982, for employees residing in Belgium before 1 January 1975. Moreover a recent decision of the Supreme Court has cast some doubt on the legal status of these tax privileges. (Cass. 19-11-1981, F.J.F. 1982, 22).

However, the Belgian government has the firm intention of maintaining a special tax status for non-Belgian executive and research personnel, that are hired abroad and transferred to Belgium. Negotiations are under way to find a more solid and more permanent legal basis for this special tax status. At the same time tax benefits would be improved; the main benefits at present being (a) a 30% flat deduction on the first US$100,000 of taxable income for employees of international headquarters and research personnel and of US$30,000 for other employees and (b) the limitation of the tax liability to income from employment earned in Belgium.

III. TEMPORARY TAX INCENTIVES

Royal Decree No. 15 of 9 March 1982 introduced two new tax incentives for the subscription to newly issued or the purchase of existing shares in Belgian companies. The first incentive consists of an exemption from corporate income tax coupled with an exemption from personal income tax for dividends on newly subscribed shares; the second incentive consists of a deduction from personal income of the price of shares purchased in the market. By virtue of its exemption from corporate income tax the first incentives affects Belgian subsidiaries of non-resident parent companies, and non-resident individuals holding shares in Belgian companies. The second incentive affects solely Belgian residents subject to personal income tax.

The new tax incentives replace the old 5% dividend exemption introduced by the law of 29 November 1977 and amended by the laws of 10 February 1981 and 2 July

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1981. The 5% exemption indeed proved to be ineffective as a tax incentive.

1. Exemption from corporate income tax

Art. 2 of Royal Decree No. 15 provides for an exemption from corporate income tax during a five-year period for dividends that have been distributed on shares in Belgian companies and other legal entities that were newly issued during the calendar years 1982 or 1983.

The exemption applies only to shares in companies or other legal entities that are subject to Belgian corporate income tax. Shares in non-resident companies having a permanent establishment in Belgium are excluded. The new shares must be issued at the time of incorporation or increase of statutory capital. The shares must be paid in cash. Payment in kind whether made directly or indirectly by having the company first receive the cash and then purchase the assets from its shareholders, does not qualify. The exemption applies to public as well as to limited issues of shares.

Incorporation or capital increases resulting from splitting, merger or other forms of corporate reorganizations do not qualify. Any decrease of statutory capital during the period 1982 – 1983 is deducted from the amount of capital increase qualifying for the exemption, except when the decrease has been necessary to consolidate accumulated losses. Shares acquired in exchange for convertible bonds issued before the starting date of the exemption period do not qualify either.

The exemption is further subject to the condition that at a minimum 60% of the proceeds of the capital increase is invested either in tangible or intangible fixed assets used for business activities in Belgium, or in shares of companies subject to Belgian corporate income tax. The business investment requirement must be met by the end of the first financial year in which the corporate income tax exemption applies. The Secretary of the Treasury has the power to decrease the 60% investment requirement for companies using the proceeds of the capital increase to repay specific debts, to consolidate accumulated losses or to acquire participations in non-resident companies in order to secure supplies of raw materials or fuel, or to secure foreign outlets for the sale of domestic products. In case the acquired assets are sold or otherwise transferred, the proceeds must be reinvested in qualifying assets within a period of three months.

The exemption applies to dividends distributed on the newly issued shares, not of the newly subscribed capital that has actually been paid in. Any capital surplus paid in excess of the face-value of the shares is also taken into account to determine the basis for the exemption. The exemption is increased to 13% of newly paid in capital if and when the company undertakes the obligation to distribute any supplementary income resulting from the tax saving caused by the corporate income tax exemption, to the newly subscribed shares.

Such obligation can in practice only be undertaken in case of the incorporation of a new business, or in case of a capital increase when all newly subscribed shares can be duly identified.

Example VIII

Capital increase of US$1,000,000 in 1982 with obligation to pass on tax savings.
Dividends distributed of up to US$130,000 per annum are tax exempt from 1983 through 1992 (see below).

The exemption is granted for a period of five financial years following the year in which the capital increase has been effectively paid in. However for companies newly incorporated in 1982 or in 1983, or companies effectuating a capital increase within three years of incorporation the exemption is granted from the third through the seventh financial year following the year of incorporation.

Example IX

Company incorporated in 1960, with financial year coinciding with the calendar year. Capital increase in May 1983. Exemption for dividends distributed from 1 January 1984, through 31 December 1988.

Example X

Company incorporated on 15 May 1983 with financial year coinciding with the calendar year. Exemption for dividends distributed from 1 January 1986 through 31 December 1990.

The exemption period is extended however, when the company undertakes the obligation to distribute the tax benefit to the newly issued shares and the exemption is raised to 13%. The exemption period is raised to ten or nine years depending on whether the capital increase takes place in 1982 or 1983.

The ten or nine-year period takes effect, the first financial year after the year of the capital increase, or the third financial year after the year of a new incorporation, or of a capital increase within three years of incorporation.

Example XI

Incorporation of company on 1 July 1980, financial year coinciding with the calendar year.
Capital increase on 10 October 1982, thus within three years, with obligation to distribute tax savings to newly issued shares.
Exemption for dividends distributed from 1 January 1985 through 31 December 1994.

Companies holding shares in other companies can also benefit from the tax exemption of 13% on dividends distributed to them on newly issued and qualifying shares, to which the holding has subscribed, provided the holding company undertakes the obligation to pass through to its newly issued shares any tax saving from which it may itself benefit on dividends distributed by its subsidiary.

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Example XII

Company A effectuates a capital increase with shares, qualifying for the 13% exemption, to which company B subscribes.
Company B will also benefit from the 13% exemption on dividends distributed on qualifying shares by company A, provided it (company B) undertakes the obligation to pass through to its shareholders any tax saving it may receive on dividends distributed by company A.

The 8% or 13% exemption remains in effect so long as the company meets the investment conditions, and the obligation to pass through any tax savings to the newly issued shares (only 13% exemption).

Together with the annual tax return a company claiming the exemption must submit a list of the qualifying investments still in use in the company. In case of tax free splitting, mergers or other forms of reorganisation the exemption is carried over to the surviving company.

2. Exemption from personal income tax

In addition to the exemption from corporate income tax described above Art. 3 of the Royal Decree No. 15 provides for a total exemption from personal income tax of dividends of shares that were newly subscribed during 1982 or 1983. Whereas the amount of the corporate income tax exemption is limited to the first 8 or 13% of dividends distributed on paid in capital, the exemption for dividends from personal income tax to the shareholders has no limit.

Example XIII

A dividend of 20% on paid in capital will benefit from the corporate income tax exemption up to 8 or 13% while the balance (12 or 7%) will be subject to corporate income tax. However, the total amount of the dividend distribution (20%) will be exempt from personal income tax.

The total dividend exemption is subject to the condition that the shares on which the dividends are distributed do qualify either for the 8% or for the 13% exemption from corporate income tax.

The period of the dividend exemption is also linked to the period of the corporate income tax exemption (e.g. depending on the corporate income tax exemption the personal income tax exemption is granted for a period of 5, 9 or 10 years (see above)).

It is not required that the shareholder claiming the personal income tax exemption be the original subscriber of the shares i.e. the exemption from personal income tax on qualifying shares is carried over to any resident individual purchasing the shares during the period of exemption from corporate income tax (5, 9 or 10 years).

If the company does not meet the 60% investment requirement set for the corporate income tax exemption (see above) this does not entail the loss of the personal income tax exemption to the individual shareholder, except when the shareholder would act in bad faith.

Whereas a capital decrease for another reason than the consolidation of accumulated losses entails only a proportional reduction of the tax benefit in the corporate income tax, it entails a complete loss of such benefit in the personal income tax, even if only part of the face-value is repaid on each share.

The exemption from personal income tax does not entail an exemption from the withholding tax due at the time of the payment of dividends. The withholding tax of 20% is the sole remaining tax on dividend income, i.e. the total income tax burden on dividends distributed on qualifying shares is limited to 20% and the shareholder receives 80% of total corporate profits after tax.

Dividends on qualifying shares do not have to be reported in the shareholder's tax return. Payment of the withholding tax absolves him from any further tax liability.

However for shareholders in low income brackets (average rate below 43.14%), the existing system of crediting withholding tax and the tax credit on dividends (51% of dividend after withholding tax) remains in effect. Such shareholders have the option to report their dividend income from qualifying shares. The credits from withholding tax (20%) and the tax credit on dividends (51% on net dividend) will then result in an even lower tax burden than the single withholding tax at 20%.

Finally, shares qualifying for the personal income tax exemption, do also qualify the holder of such shares to an exemption from inheritance and gift taxes during a period of up to ten years after the subscription if payment takes place in the same calendar year.

3. Deduction of purchase price of shares

Art. 4 of the Royal Decree No. 15 provides that subject to certain conditions, the purchase of shares, or certificates in Belgian investment funds made between 1 January 1982 and 31 December 1985 entitles the purchaser to a deduction from taxable income of the total acquisition price (within certain limits). In order to qualify, shares must have been issued by a corporation subject to the Belgian corporate income tax. When such shares were issued before 1 January 1982 then quotation on a Belgian stock-exchange is necessary. When issued after 31 December 1981, the company must have undertaken the obligation to invest 60% of the actually paid-in capital in fixed assets upon issuing the shares. Certificates in Belgian investments funds qualify only when the fund has been accredited by the Department of the Treasury, approval which is dependent upon the fund investing at least 60% of its assets in Belgian shares.

The deduction is limited to 40,000 Bfrs. for a single individual and to 50,000 Bfrs. for a married couple. It is increased with 10,000 Bfrs. per dependent. Of course, the amount of the deduction may not exceed the purchase price really paid for qualifying shares or certificates during the calendar year.

The deduction is total, i.e. up to the maximum amount mentioned above, in the year of purchase. However, upon transfer of the shares within a period of 5 years, a fraction of the acquisition price is added to the tax base,

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the numerator being the number of months between the transfer and the end of such period and the denominator being 60.

Complete reinvestment of the "resale" price within three months or transfer by reason of death or gift to lineal ascendants or descendants does not entail such partial and deferred taxation.

It is clear that the taxpayers wanting to benefit from the deduction will have to report the dividends from the shares on which they claimed the deduction. The deduction of the purchase price of the shares does not entitle the dividends distributed on such shares to an exemption from personal income tax. The normal rules (withholding tax and tax credit) apply. As stated above there is no additional income tax, because of these credits, if the average tax rate of the shareholder does not exceed 43.14%.

As to shares that qualify both for the deduction as well as the exemption, the shareholder has an option. He is presumed to prefer the exemption unless he expressly and irrevocably opts for the deduction in the personal income tax return related to the taxable year wherein the shares were purchased.

CONCLUSION

This brief review of the latest tax measure makes it clear that the tax climate is definitely changing for the better in Belgium. The measures in the field of taxation are coupled with a whole series of Royal Decrees in the field of social security also aimed at reducing the labor cost to business. The Belgian economy is certainly not back in the golden Sixties, but the new tax measures have been rolling back the tax burden on business enterprise at least to the level of the early Seventies.

In next issues:

Integration of Tax Expenditures into the Government Fiscal Management System
– by *Allan J. MacEachen* (Minister of Finance, Canada)

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– by *H. Heward Stikeman*

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Role of Income Tax Incentives in Industrialization in Pakistan During the Seventies – A Critique

by Ahmad Khan*

A. PHILOSOPHY OF TAX INCENTIVE PROGRAMS

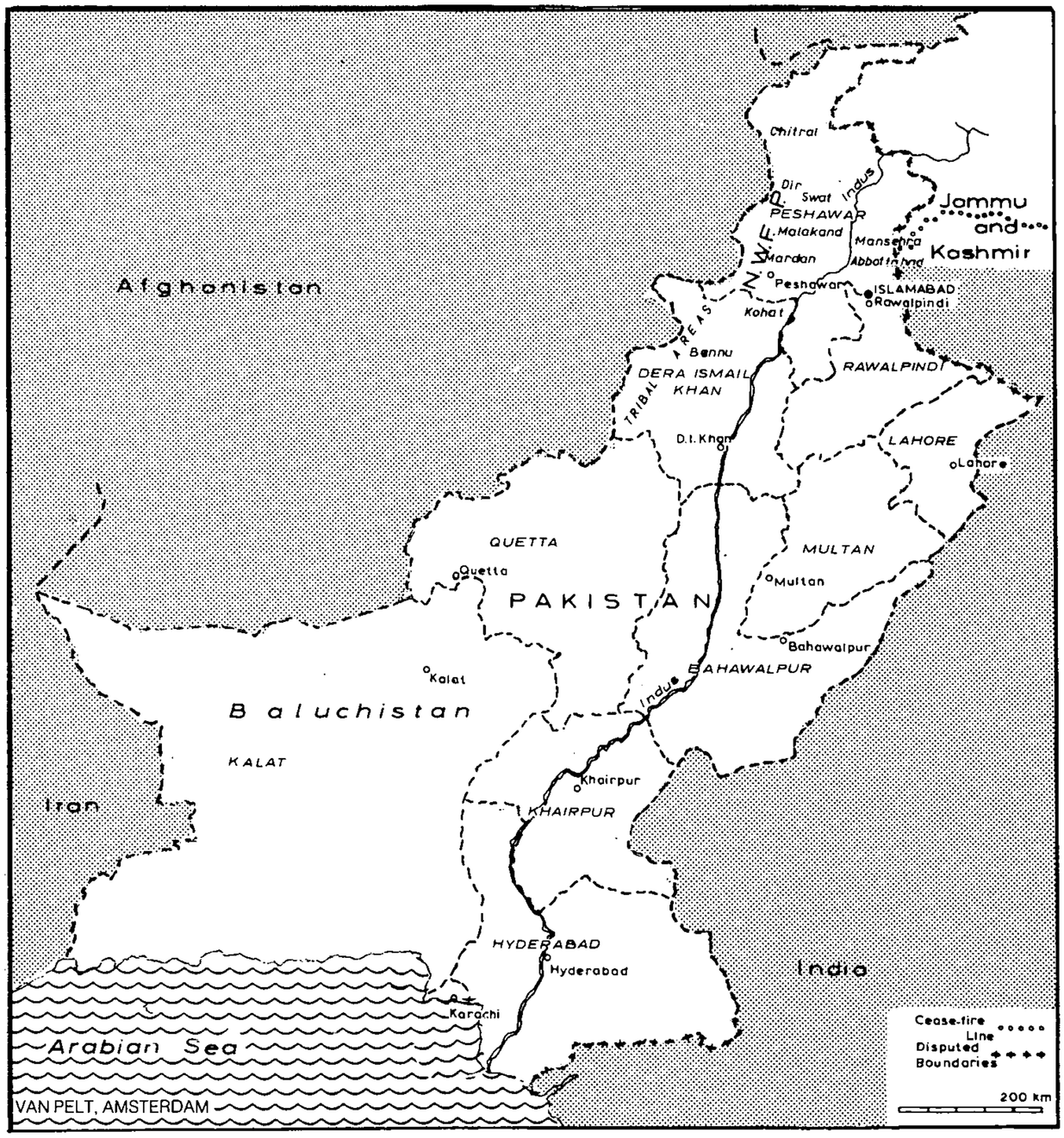


Tax incentive legislation is generally designed to promote certain socio-economic goals. These goals may include the development of manufacturing or industrial sectors in the economy, dispersal of the industries to less-developed (or pre-industrial) geographical areas or places (which are or may be the source of raw materials), developing import substitution and export oriented industries, attracting foreign capital and technology and, in the process, helping to create a socio-economic order which provides ample opportunities for employment, development of technical skills and adequate supply of goods and services for public consumption. The net result of the complementary fiscal measures (in the present context, income tax incentives) should be to encourage savings, stabilize the economy (and, of course, industrial growth), strengthen the balance of payment position, narrow down the gap in industrialization of various geographical regions of the country concerned, and utilize fully available technical skills and manpower. With these ends in view, appropriate tax incentive programs are envisaged and supplement the various non-fiscal and monetary measures intended for the same purpose.

The present study describes the role of fiscal incentives in the industrial development of Pakistan in the context of the overall economic strategy during the decade 1970-80. It identifies the economic priorities and the fiscal measures adopted during this period in historical sequence. In conclusion, an attempt has been made to evaluate the impact of income tax concessions in achieving the economic goals for which such measures were designed.

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B. History of tax incentives in Pakistan
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B. HISTORY OF TAX INCENTIVES IN PAKISTAN

The present study of the tax incentive legislation relates to the post-1970 period. It is, therefore, imperative to glance briefly through the economic scenario prevailing in 1970, the economic plan strategy announced through the Fourth-Five-Year Plan 1970/75[1] and the ensuing political and economic considerations requiring changes in the Plan Strategy accompanied by the changes in the fiscal policies. This will serve as a background to the legislative intentions behind the various tax measures adopted with a view to accelerating the pace of industrial (and, of course, the overall economic) development in Pakistan.

At the time of its independence in August 1947, Pakistan inherited an almost negligible industrial base, and also other infrastructural facilities were non-existent. In FY 1949/50, the industrial sector contributed 7.7% towards GDP of which 5.5% was accounted for by small-scale manufacturing. The value added in large-scale manufacturing increased to 8.8% in FY 1968/69, reflecting a growth rate of 14% over the two decades. During the 1950s, the aggregate growth rate recorded by large-scale manufacturing was as high as 16.3% and during the Second Five-Year Plan 1960/65, it was 13.0%.[2] Industry during this period passed from an initial concentration on cotton and jute textile to sugar, vegetable ghee and cement, and later on to more sophisticated chemical and engineering industries.[3] The considerable increase in industrial capacity was largely caused by the governmental effort in developing infrastructural facilities. A major stimulus was the creation of public corporations to play a pioneering role in establishing such industries, which the private sector was unable to undertake either because these industries were technologically complex or needed large investments. The Government further established specialised credit institutions and, to fill up the technological gap, set up engineering universities, colleges and industrial advisory institutes. These promotional activities were strengthened by providing fiscal concessions and a sizeable allocation of foreign exchange resources at subsidised prices to the industrial sector. As a result of the combined efforts of the public and private sectors, the manufacturing sector showed an impressive performance. Nevertheless, excessive protection and extra liberal concessions also led to the establishment of many inefficient industries and the neglect of productivity in general. While import substitution occurred regarding consumer goods, there was relatively little headway towards the production of capital goods. The net result was that whereas a great deal was accomplished in building an industrial sector from scratch, the more complex and challenging task of creating a balanced, efficient and modern industrial sector was not tackled satisfactorily.[4]

The Fourth Five-Year Plan 1970-75

With the prevailing economic scenario in mind, the Fourth Five-Year Plan 1970/75 stated that its policy was to provide for an adequate measure of flexibility in respect of unresolved issues. At the same time it would constitute a definitive and positive start in areas where no doubts existed about future trends and driving forces. The Plan suggested concrete proposals through which income inequalities could be reduced and equal opportunities assured for all people. It was also expected to serve as a vital instrument of accelerating development of less-developed areas.[5]

While referring to its strategy for private investment, the Fourth Plan stated that "Pakistan has a mixed economy with large part of the production activities in the private sector", and "it may appear surprising that the main emphasis in planning in Pakistan has been in the public sector". Nevertheless, "during the second Plan, the private sector strategy involved the setting up of an incentive mechanism sufficiently attractive to obtain a high investment response and evolution of an institutional framework for channelling real resources to the private sector to translate investment demand into physical investments. The absence of detailed and restrictive planning for the private sector combined with very powerful incentives and sizeable credit availability had the advantage of turning the private sector into a dynamic force. However, there was very little attention paid to the quality of investment, efficiency in the use of resources and consistency of private sector development with social goals."

During the Third Plan 1965-70, the conflict between the pursuit of social objectives and the maintenance of powerful incentives for private investment became obvious, and "many policy shifts were made". Therefore, for the Fourth Plan, it was considered "imperative to look deeper into the behaviour of the private sector and to start the process of integrating the private sector more adequately into overall national planning". Prior to the Fourth Plan, the strategy for the private sector "was based essentially on the premise that capital is shy and that enterprises need to be brought up with the help of special incentives in the form of subsidies, protection and tax concessions. Thus, a powerful and effective system of incentives was evolved over the years and, within the given framework, private enterprise was left free to exercise its option with a view to maximising its rate of return. The system produced results and has been responsible for a very high rate of industrialization." This strategy for the private sector resulted in a continuous rise in the cost of development. "Essentially the protection of infant industries, which are at times quite inefficient, implied that consumers have to pay high prices. The concessions to industry mean that others have to bear a large burden of taxation".[6]

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1. The Pakistan Government appointed a Planning Board in July 1953 to review the development that has taken place since independence and to prepare a national plan of development based on the fullest possible utilization of available resources. The First Five-Year Plan 1955-60 was published in May 1956 and it was subsequently revised in 1957 on the basis of public comments. Since the formulation of the First Plan, the Pakistan Government has formulated the Second (1960-65), Third (1965-70), Fourth (1970-75) and Fifth (1975-80) Plans. The Sixth Five-Year Plan is in the process of formulation.
2. *Pakistan – Basic Facts 1979-80,* Chapter 5, Paras. 1-2.
3. Ibid., Para. 5.
4. Fourth Five-Year Plan (1970-75), Chapter 1, Para. 14.
5. Fourth Five-Year Plan (1970-75), Introduction.
6. Fourth Five-Year Plan (1970-75), Chapter 6, Paras. 1-8.

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The Fourth Plan further stated that "the first element of new strategy is the recognition that over the years we have now developed an aggressive and dynamic private sector, quick to respond to profit incentives and capable of setting up and running large industrial business and service enterprises. Apart from the establishment and experience, there is a sizeable class of potential new entrants who are being attracted by the demonstrated success of the others. *The incentive mechanism is no more needed on a general basis, but more selectively for correcting regional imbalances and reducing the handicaps from which new entrants suffer.*" As to the old and more established industries they "have to acquire the level of efficiency where they would need a minimum of special incentives and protection."

Objectives: Increase of industrial production and closing the foreign exchange gap

As to the overall Fourth Plan Strategy on industrialisation, it had two inter-related objectives, viz., output of the industrial sector must grow at 10% per annum, and the foreign exchange gap should be kept within manageable limits, by maintaining the momentum of manufactured exports and replacing a larger proportion of imports, particularly of engineeering goods and imported raw material. The Fourth Plan envisaged a long-term view of export possibilities in the industrial sector and "shifting the structure of production towards other lines in which [we] possess, or may be reasonably expected to develop, a comparative advantage". The Fourth Plan indicated that for the purposes of industrialisation, criteria such as those relating to increased production for export and for import substitution, relatively higher value added, appropriate employment opportunities, encouragement of indigenous capital goods industry, etc. would be kept in view. Simultaneously, "reliance will continue to be placed on private investment for the bulk of industrial investment during the Fourth Plan in West Pakistan other than the less developed areas . . . . Public investment in manufacturing will be undertaken only in those cases where private investment is not forthcoming, where a joint venture cannot be organized or where considerations of national interest dictate public investment." As to the less-developed areas, "effective steps will be taken by way of fiscal and other measures to improve the investment climate . . . ".

The Fourth Plan Strategy, however, could not be implemented in the wake of the 1971 war with India and the shift in the overall socio-economic policies of the new government. A large portion of the industrial sector was taken over by the government and reserved for the public sector. The private sector was left with only a very small sector of capital intensive industries and as such the fiscal measures were oriented more towards developing public sector industries. In the process, generous tax exemptions and subsidies were granted to public sector industries, especially in the form of concessions to the foreign component of the capital outlays and the sophisticated technology needed for these projects.

Change in industrial development strategy

The poor performance of the manufacturing sector in the mid-1970s prompted the Government to initiate important changes in Pakistan's industrial development strategy in 1977/78. The new industrial development policy aimed at encouraging private sector participation while reducing the scope of the public industrial sector and improving the latter's operational and organizational efficiency. In 1977/78 agro-processing units were denationalized, and a re-demarcation policy was announced permitting private sector involvement in many fields previously reserved for the public sector. The measures taken in 1978/79 included the exemption from import duties for textile machinery required for balancing* , modernization, and replacement (BMR) and for the manufacture of garments and made-up textile goods; the introduction of export subsidies for cotton textile products ranging from 7.5% to 12.5%; and the abolition of excise duties on the manufacture of cotton yarn and fabrics. In addition, import procedures were streamlined for machinery valued up to 2.5 million Rs. In 1979/80 export rebates were extended to engineering goods, canvas footwear, and acetate yarn. In 1980/81 the authorities continued the policy of encouraging private sector investment by simplifying government investment approval procedures.

First, the ceiling below which private sector projects are exempt from approval procedures was doubled to 20 million Rs.

Second, machinery up to 10 million Rs. is now allowed to be imported under the Non-Repatriable Investment (NRI) Scheme or against cash licenses without government approval, provided that the projects do not fall within the "negative list" of industries which the Government does not want to encourage; previously the cutoff limit was 5 million Rs.

Third, establishment of new import-based industries (defined as those depending on imports for 50% or more of their input requirements) no longer needs the approval of the Economic Coordination Committee of the Cabinet, provided their annual import requirements are less than 5 million Rs; previously, all import based projects needed approval irrespective of their imported inputs.

Fourth, the role of the Central Investment Promotion and Coordination Committee, the agency which approves projects proposed by IPB, PICIC, and IDBP, was curtailed; only projects of 20 million Rs. or more

* *Editor's note:* The term "balancing" (of machinery) means installation of additional machines in an industrial unit for the purposes of achieving optimum efficiency of the various inter-related components of that unit. For instance, in the textile industry, if an industrial undertaking has both yarn-producing and weaving facilities, 25,000 spindles "balance" with 500 looms. Therefore, if such an undertaking does not have the spindles and looms in the appropriate proportion, either the spindles or the looms would be working below capacity resulting in less than optimum efficiency. Installation of additional looms or spindles, as the case may be, to bring about the right proportion between the two would mean "balancing" of the existing machinery. Similar standards can be found for the ideal capacity of machines involved in intermediate stages of production from raw material to the end product.

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sanctioned by IPB are now subject to review by the Committee, which has been reduced in size and renamed the Central Investment Promotion Council.[7]

On the income tax side, selective tax concessions for industrial undertakings established in less-developed geographical regions, viz., Baluchistan, N.W.F.P. (North-West Frontier Province), parts of the Punjab and Sind Province were granted during the fiscal year 1974/75. The process of granting income tax concessions to the manufacturing industry and export oriented trade accelerated during the subsequent years and tax incentives in the form of tax-holidays, investment credits, tax rebates, etc. were introduced to revitalize the process of industrialization in the country.

C. TYPES OF TAX INCENTIVES INTRODUCED IN PAKISTAN

Pakistan has adopted a variety of income tax incentives, which generally include:
(1) tax holidays, (2) tax rebates, (3) tax credits, (4) investment credits or rebates, (5) accelerated depreciations, (6) other investment-related tax incentives.

The types and extent of the tax incentives introduced since 1970 have varied depending upon overall economic priorities, as reflected in the Fourth and Fifth Five-Year Plans and the Finance Minister's budget speeches. The valid economic reasons, at times, gave way to the introduction of some ad hoc tax concessions, which, if looked at in the overall scheme of economic strategy, may not appear as a part of the overall package, and overlap some of the existing tax incentives. The net result, as we may see in the latter parts of this study, has been or still is the grant of too liberal concessions.

The position of various tax incentive programs during the period under study, i.e. July 1970 to June 1981, is as described below:[8]

1. Tax holidays

These include total or partial tax concessions to new industries set up in selected geographical regions, certain sectors of industries and to certain types of income.

a. Area-wise tax holidays

(i) The tax holidays scheme introduced in 1959 envisaged complete tax exemption for new industrial undertakings for a prescribed period of 4, 6 or 8 years depending upon the geographical location of such industries. It was further liberalized in 1966 by relaxing the condition for reinvestment of tax-exempt profits from 60% to 40%. The condition of reinvestment was altogether removed in 1968. In 1970, i.e. the end of the tax holiday period, it was decided to extend for an additional two years partial tax exemption to industries set up before 1 July 1970 is an industrial estate established by the Government or an authority thereof.[9] The tax holiday scheme was suspended by the 1971-72 assessment year, and it was decided that the tax realized for this year from companies eligible for the tax holiday would be allowed as a credit against the tax liability for the period following the expiry of the tax holiday. In 1972-73, the tax holiday scheme was abolished with retrospective effect from the assessment year 1971-72.[10]

(ii) The fiscal concessions in terms of a tax holiday on the basis of geographical location of new industries were not extended during the fiscal year 1974-75.

(iii) During the fiscal year 1975-76, a partial tax exemption was granted with respect to the income of companies registered under the Companies Act, 1913, earned between 1 July 1975 and 30 June 1981 from industrial undertakings commencing commercial production during this period to the extent of:
  (a) 10% of capital if the undertaking is located in Baluchistan, Tribal Areas, and Azad Kashmir.
  (b) 5% of capital if it is located in other areas (excluding the Talukas of Karachi and Hyderabad and Tehsils of Lyallpur and Lahore and such adjoining areas as may be notified by the Federal Government).[11]
  (Section 15B of the Repealed Income tax Act, 1922).

(iv) During the fiscal year 1976-77, the partial exemption granted under (iii) was restricted only to those industrial undertakings which are formed other than by splitting up or by reconstruction or by transfer to a new business of any plant or machinery used in a business being carried out in Pakistan prior to 1 July 1975.

(v) The existing relief provisions under which an investment deduction of 10% of capital was granted to industrial undertakings registered under the Companies Act, 1913 between 1 July 1975 and 30 June 1981 and commencing commercial production during the same period were, during the fiscal year 1978-79, turned into a full exemption for 5 years (from the month in which the industrial undertaking was set up or commenced industrial production, whichever is later) for undertakings established in Baluchistan, the Tribal Areas, the Northern Areas and Azad Kashmir. This exemption was further extended to similar industries established in the Districts of Mansehra, Kohistan, Northern Areas, and Tribal Areas

7. IMF Study on Economic Situation in Pakistan.
8. The summarised position of the various tax incentives as prevailing in Pakistan at present is given in Appendix I.
9. The Finance Minister in his Budget Speech for the year 1970-71 stated that the tax holiday played an important role in bringing about the rapid industrialization of the country. Due to the lack of infrastructure and other facilities, entrepreneurs found it difficult to start industries in the 6-year tax holiday zone and, of necessity, converged on the Government-established industrial starts located in the four-year tax holiday area, further extension of industries set up during Fourth Five-Year Plan period was of vital necessity.
10. The Finance Minister in his Budget Speech for 1972-73 stated that the "notorious" tax holiday scheme was being abolished as it did not achieve its purposes of industrial disposal but, instead, contributed to the concentration of economic power and wealth and encouraged the establishment of uneconomic units. The Government, instead, considered it a sufficient incentive to give full exemption from import duties in case of capital equipment to be installed in less-developed areas, and also to revive the Equity Participation Fund for giving support to private entrepreneurs who propose to set up industries in less developed areas.
11. The Finance Minister in his Budget Speech for the year 1975-76 stated that since 1969 there had been stagnation in private investment in large scale industries. Some improvement occurred in the recent past and the stock exchange showed some buoyancy. With a view to further strengthening this trend, new fiscal incentives (including the tax holiday) were being introduced. No adjoining areas were announced as referred to in the Fiscal measures.

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established during the period between 1 July 1979 and 30 June 1983.

(vi) During the fiscal year 1979-80, income of companies registered under the Companies Act, 1913 from an industrial undertaking established in under-developed areas, whose income is equal to 5% of paid-up capital and which were hitherto exempt from tax were made to qualify for such tax exemption on income equal to 10% of paid-up capital.

(vii) During the fiscal year 1978-79, an exemption was allowed with respect to the income of companies registered under the Companies Act, 1913 from an industrial undertaking set up between 1 April 1978 and 30 June 1983 for a period of 5 years beginning with the month in which the commercial production commences (whichever is later) if such an undertaking is set up in the Divisions of D.I. Khan Malakand in N.W.F.P. province.[12]

(viii) During the fiscal year 1978, a similar tax exemption was allowed with respect to the income of companies registered under the Companies Act, 1913 from an industrial undertaking set up between 1 March 1978 and 30 June 1983 in the province of Baluchistan.[13]

(ix) During the year 1980-81, income of companies registered under the Companies Act, 1913 from industrial undertakings set up in industrial estates in the whole of N.W.F.P., district of D.C. Khan, Mianwali and Tehsil Khushab in Punjab, and districts of Dadu (excluding Kotri), Jacobabad and Shikar-pur in Sind were exempted for a period of 5 years from the date of setting up of the undertaking or commencement of commercial production (whichever is later).[14]

b. Income-wise tax holidays

(1) *Dividends*

(i) During the fiscal year 1970-71, dividends paid out of capital gains on which tax had already been paid by the company or firm of which such person was a shareholder or a partner were exempted from income tax (S.14(4)) of the Repealed Income tax Act, 1922). This exemption was withdrawn during the year 1971-72 to the extent that the dividends paid out of the taxed capital gains were made liable to tax in a manner similar to dividends paid out of any other taxed income.[15]

(ii) During the fiscal year 1972-73, dividends received by a private company were made liable to taxation at normal rates. Intercorporate dividends in the hands of a public company continued to be taxed at the concessional rate of 15%.

(iii) During the fiscal year 1978-79, the existing preferential tax treatment accorded to dividends from NIT and ICP mutual funds was discontinued. From then onwards, dividends received from any company listed at stock exchange or from NIT or ICP mutual funds was exempted to the extent of 15,000 Rs. per annum.

(2) *Capital gains*

Capital gains from the disposal of movable assets (capital stocks of joint stock companies, etc.) have been exempt from income tax during the period beginning 1 July 1975 onwards. The exemption is available up to 30 June 1983. Capital losses during these years have been allowed to be carried forward for setting of against the future capital gains.[16]

c. Sector-wise tax holidays

(i) *Income from the manufacture of agricultural machinery:* Income derived from sales during the period 1 July 1968 – 30 June 1983 from the manufacture (not assembly of specified agriculture machinery and component parts thereof, provided the latter can be easily fitted into their places in these implements and cannot ordinarily be used for purposes other than agriculture, is totally exempt from levy of income tax.[17]

(ii) *Income from renting out of agricultural machinery, etc.:* Income derived from the business of renting out of machinery for agricultural operations, or providing pest control services to agriculturists, is exempt from income tax for a period of 2 years from the date such business is set up provided that the business has been or is set up during the period 1 July 1976 and 30 June 1983.[18]

(iii) *Income from storage and preservation of food grains, etc.:* Income derived from a business of providing services for the storage and preservation of food grains through scientific drying, fumigating and storing is exempt from income tax for a period of 5 years from the date of setting up of such business during the period 30 October 1969 – 30 June 1980.[19]

(iv) *Income from poultry farming, etc.:*

(a) Income derived during the period between 1 July 1971 and 30 June 1983 from poultry farming, fish catching and cattle or sheep breeding is exempt from income tax.[20]

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12. See SRO. 317(I)/78 dated 25 March 1978.
13. See SRO. 234(I)/78 dated 2 March 1978.
14. See Clause 82A of Second Schedule of the Income Tax Ordinance, 1979.
15. The Finance Minister in his Budget Speech for 1971 felt that there was no justification for giving preferential treatment to dividends out of taxed capital gains as compared with dividends from other types of taxed income. The measure was introduced as a step towards achieving neutrality in all types of income.
16. The tax concession was for the first time introduced in 1977 for a period of 2 years through an amendment in S.17(5) of the repealed Income Tax Act, 1922. It was further extended for a period of 2 years through the Finance Ordinance Acts of 1976, 1978 and 1980.
17. The tax exemption was for the first time allowed for a period of 5 years during FY 1968-69 through SRO 25(K)/68, dated 20 November 1968. The exemption period was subsequently extended through a series of amendments in this notification, viz., SRO.371(I)/71, dated 17 June 1972, SRO.960(I)/71, dated 28 June 1973, SRO.1535(I)/74, dated 19 December 1974, SRO.648(I)/76, dated 1 July 1976, and the Finance Ordinance, 1980. The tax exemption is now contained in Clause 98 of Part I of the Second Schedule to the Income Tax Ordinance, 1979.
18. The tax exemption was first introduced during FY 1976-77 through SRO.649(I)/76, dated 1 July 1976. The exemption period expiring on 30 June 1980 was subsequently extended to 30 June 1983 through the Finance Ordinance, 1980. The tax exemption is now contained in Clause 96 of Part I of the Second Schedule to the Income Tax Ordinance, 1979.
19. This tax exemption was first introduced through SRO.225(I)/69, dated 21 October 1969. The exemption, as expiring on 30 June 1975, was subsequently extended to 30 June 1980 through SRO.647(I)/76, dated 1 July 1976.
20. See SRO.142(I)/70, dated 1 July 1970. The exemption, expiring on 30 June 1976, was extended first through the Finance Ordinance, 1975 (by amending S.4(3)(xx) of the repealed Income Tax Act, 1922 and then through Finance Ordinance, 1980 by introducing Clauses 64-A and 64-B in Second Schedule of the Income Tax Ordinance, 1979. Presently, the provision appears at Clause 99 of Part I of the Second Schedule to the Income Tax Ordinance, 1979.

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(b) Income derived during the period between 1 July 1980 and 30 June 1983 from the business of poultry processing is exempt from income tax.[21]
(c) Income derived during the period between 1 July 1971 and 30 June 1983 from the business of dairy farming is exempt from income tax.[22]
(d) Income derived from an industrial undertaking manufacturing cattle or poultry feed as set up prior to 1 July 1971 for the period 1 July 1971 – 30 June 1975 was exempt from income tax.[23]
(e) Income derived during the period 30 June 1977 – 1 July 1982 from fish farming established after 1 July 1977 is exempt from income tax.[24]

(v) *Miscellaneous income:* Income of cooperative societies as derived from dealings with their members from the business of granting agricultural or rural credits; cottage industry; marketing of agricultural produce of their members; purchase of agricultural implements, seeds, livestock or other agricultural articles for supply to their members; ordinary processing of agricultural produce of their members to render the produce fit for marketing; letting of godowns or warehouses for storage, processing, etc. for their members is totally exempt from income tax.[25]

d. Exemption for the garment industry

During the year 1978-79, income of a company registered under the Companies Act, 1913 as derived from an industrial undertaking set up between 1 July 1978 and 30 June 1983, was exempt from tax for a period of 5 years beginning with the month in which the industrial undertaking is set up or commercial production is commenced (whichever is later) engaged in the manufacture of garments from cloth manufactured in Pakistan.[26]

e. Exemption for industries engaged in processing of dates, manufacture of chipboard or straw board or refining of edible oil

During the year 1978-79, income of a company registered under the Companies Act, 1913, from an industrial undertakings set up between 1 May 1978 and 30 June 1983, in the District of Sukkur in Sind Province and engaged in processing of dates, manufacture of chipboard or straw board or refining of edible oil, was exempted for a period of 5 years beginning with the month in which the undertaking was set up or it commenced commercial production (whichever is later).[27]

f. Exemption to mineral industries

During the year 1981-82 income of Pakistani companies engaged in the exploration and extraction of a selected number of minerals (other than petroleum) derived from industrial undertakings set up between 1 July 1981 and 30 June 1985 were exempt from income tax for a period of 5 years from the date of commercial production; and after expiry of the 5 years, tax on such income was levied at 50% of the normal rate for the next 5 years.[28]

2. Tax rebates[29]

Tax rebates allowed to the various industries during the period 1970 – 1981 include:

(i) Refundable surcharge (discontinued by virtue of the Finance Ordinance, 1970).
(ii) Tax at 10% on excess free reserves of companies (abolished by virtue of the Finance Ordinance, 1971).
(iii) Surcharge levied through the Finance Ordinance, 1970 (abolished from the assessment year 1972-73).
(iv) Flood relief surcharge on income tax (abolished by virtue of the Finance Ordinance, 1974).
(v) Super tax rebate at 5% was allowed to companies setting up industrial undertakings between 1 July 1975 and 30 June 1980 if their fixed assets did not cost more than 3 million Rs. (excluding cost of land) by virtue of the Finance Ordinance, 1975. During the year 1980-81, this concession was extended up to 30 June 1983. The relief was also extended in scope, viz., to companies owning assets of value of 5 million Rs. as against 3 million Rs. previously.
(vi) Export rebate at 25% of the tax attributable to income derived from approved items after 1 July 1975 allowed to manufacturers exporting such goods (Finance Ordinance, 1975). The tax rebate was increased from 25% to 50% in fiscal year 1976-1977. The scope of this concession was also extended to commercial exporters. During the fiscal year 1979-80, the tax rebate was further increased to 55%.
(vii) During the fiscal year 1977-78, the rate for inter-corporate dividends in case of private companies was reduced from 50% to 30%.
(viii) During the fiscal year 1980-81, the rebate on the surcharge on retained earnings was enhanced so that the rebate would bear the same ratio to the surcharge as the retained income bears to after-tax profits. The concession was restricted to those companies whose free reserves did not exceed 150% of the paid up capital.
(ix) Rebate of surcharge on companies was reduced from 10% to 5% during the fiscal year 1981-82. For the purpose of surcharge in case of financial institutions, the limit of reserves was raised to 300%.

3. Tax credits

The concept of tax credits was first introduced during 1974. The various measures adopted to date include:

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21. Exemption granted through the Finance Ordinance, 1980. See Clause 100 of Part I of the Second Schedule to the Income Tax Ordinance, 1979.
22. See footnote 9 above. It appears at Clause 101 of Part I of the Second Schedule to the Income Tax Ordinance, 1979.
23. See SRO.41(I)/70 dated 1 July 1970.
24. Tax exemption introduced through the Finance Ordinance 1977, by incorporating Clause (xxi).to S.4(3) of repealed Income Tax Act, 1922.
25. See Clause 103 of Part I of the Second Schedule to the Income Tax Ordinance, 1979.
26. See SRO 973(I)/78, dated 1 July 1978. The exemption now appears at Clause 125 of Part I of the Second Schedule to the Income Tax Ordinance, 1979.
27. See SRO 574(I)/78, dated 18 May 1978. The provision now appears at Clause 124 of Part I of the Second Schedule to the Income Tax Ordinance, 1979.
28. See Clause 123 of Part I and Clause 1 of Part II of the Second Schedule to the Income Tax Ordinance, 1979.
29. A number of new industries were set up during the years 1974-75 onwards. In order to maintain this trend and also to encourage private savings and investment, government took suitable measures to follow a relatively liberal scheme of reduction in taxes. In this context, see the Finance Minister's Budget Speech for the year 1974.

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(i) Finance Ordinance, 1974 provided tax credits to companies making an initial investment in shares of new industrial undertakings as approved by CBR at:
   (a) 30% of such investment if the industrial undertaking is set up in Baluchistan, Tribal Areas, Northern Areas and Azad Kashmir;
   (b) 15% of investment if it is set up elsewhere in Pakistan; except Talukas of Hyderabad, Karachi, Tehsil Lyallpur and Lahore and such adjoining areas of Tehsil Lahore as may be notified by the Federal Government (no such areas have actually been notified to date).[30]

(ii) During the fiscal year 1975-76, the above tax concession was also made admissible in respect of identifiable expansions carried out after 1 July 1975.

(iii) Pakistan companies investing any amount in the purchase of plant and machinery for installation between 1 July 1976 and 30 June 1983 in an industrial undertaking for the purposes of replacement, balancing or modernization of already installed plant and machinery are allowed a tax credit of 15% of the amount so invested. The unabsorbed tax credit can be carried forward for adjustment against the future tax liability.[31]

(iv) Pakistani companies making an initial investment in shares or debentures issued by the Equity Participation Fund established under the Equity Participation Fund Ordinance, 1970 as approved by CBR, were allowed a tax credit equal to 50% of the amount so invested. Provisions were also made to carry forward any unabsorbed tax credit (which is redeemable in the year in which such shares or debentures are sold, transferred or disposed of).[32]

(v) During the fiscal year 1980-81, a tax credit for investment in debentures or negotiable bonds issued by the Government or a government owned corporation (approved by CBR for this purpose) was allowed to the extent of 5% of the nominal value of such bond or debenture. The unabsorbed tax credit was allowed to be adjusted during the subsequent years.[33]

4. Investment credits

Under this method, a specified percentage of new investment is allowed as a reduction while computing taxable profits. The various measures taken during the period from 1970 onwards include:
Income of a Pakistani company derived from approved industrial undertakings set up in the territories of Pakistan (excluding Talukas of Karachi and Hyderabad and Tehsils of Faisalabad and Lahore and such adjoining areas of Lahore Tehsil as notified in this behalf by the Federal Government) not exceeding 10% of the capital employed is exempt from income tax, provided it has commenced its commercial production during the period from 1 July 1975 to 30 June 1983 and that it has not been formed by splitting up or reconstruction or reconstitution of an existing business or by transfer to a new business of any plant or machinery already used in an existing business. This concession applies in respect of assessment years ending on 30 June 1985.[34]

5. Accelerated depreciation

In addition to the normal depreciation allowance on plant and machinery installed by an industrial undertaking, certain special measures have been adopted during the period from 1970 onwards to depreciate the capital assets over a relatively short period of time. These measures were intended to ease the cash flow position of the companies engaged in industrial undertakings. These measures include:
(i) Initial depreciation allowance of 25% on plant and machinery installed between July 1976 and June 1983.[35]
(ii) Rate of initial depreciation in case of industrial undertakings commencing commercial production on or after 1 July 1981 admissible at 40% as against the earlier rate of 25%.
(iii) Depreciation allowance of 10% in respect of residential buildings for industrial labour. Initial depreciation allowance of 25% admissible on buildings constructed up to 30 June 1983 for industrial labour earning up to 1,000 Rs. per month.

6. Other investment related incentives

Apart from the specific income tax incentives discussed above, various other investment related incentive programs have also been introduced during the period from 1970-71 onwards. These include:
(i) The amount required to be distributed as dividends by tax holiday companies (under S. 15BB of the repealed Income Tax Act, 1922) was lowered from

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30. See Section 15FF of the repealed Income Tax Act, 1922 and Section 106 of Income Tax Ordinance, 1979.
The BMR concession was for the first time introduced through the Finance Ordinance, 1976 (by introducing S.15GG in the repealed Income Tax Act, 1922) at 10% of the amount invested in the purchase of plant and machinery and it was applicable up to 30 June 1979. The rate of tax credit was raised to 15% through the supplementary Finance Ordinance 1977, and the period of admissibility was extended to 30 June 1980 by virtue of the Finance Ordinance, 1978.
31. During FY 1978-79, the BMR concession was supplemented by exempting dividends paid by public companies incorporated between 1 July 1978 and 30 June 1982 and engaged in an industrial undertaking set up during this period for a period of 5 years from the year in which commercial production commenced (S.4(3)(xv)(4) of the repealed Income Tax Act, 1922).
32. See Section 105-A of the Income Tax Ordinance, 1979.
33. See Section 48 of the Income Tax Ordinance, 1979. The Finance Ordinance 1975 provided that this tax concession would be available for 5 years, i.e. 1 July 1975 to 30 June 1980 at the rate of 10% of capital, if the undertaking was set up in Baluchistan, Tribal Areas, Northern Areas and Azad Kashmir, and at 5% if it were located elsewhere (excluding Talukas of Karachi and Hyderabad and Tehsil Lyallpur and Lahore and adjoining areas of Tehsil Lahore as notified by the Federal Government through amendment in S.15B of the repealed Income Tax Act, 1922. The exemption was restricted to companies other than those formed by splitting up, reconstitution or reconstruction by virtue of the Finance Ordinance, 1976. The rate of the investment credit for areas other than Baluchistan, Tribal Areas, etc. was raised from 5% to 10% by virtue of the Finance Ordinance, 1979. The tax exemption which expired on 30 June 1981 was also extended to 30 June 1983 through the same Finance Ordinance.
34. This measure was adopted through the Finance Ordinance 1975 by amending Section 10(2) (V a) – Explanation 2.
35. In addition to the type of depreciation allowance described above, a special depreciation of 15% was also admissible to industries set up by 30 June 1980. The condition of two consecutive months use of plant and machinery for claiming depreciation has also been removed through the Finance Ordinance 1980.

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60% to 50% (and consequently the extent of reserves to be compulsorily retained raised from 40% to 50%) (during fiscal year 1970-71).

(ii) Tax on undistributed profits of companies was withdrawn (during fiscal year 1972-73).

(iii) To reduce the adverse effects of fluctuation in exchange rates, the Government allowed an adjustment in the rate of the written-down value of plant and machinery acquired through foreign loans with effect from 1975 (during the fiscal year 1978-79).

(iv) Listed holding companies were allowed to set off current losses of a wholly owned subsidiary company against current year's income for a period of 3 years with effect from assessment year 1981-82 provided that the holding company gives a scheme of revival of the sick mill* duly approved by a financial institution, namely, PICIC, IDBP, NDFC or Banker's Equity Ltd.[36]

(v) While computing taxable profits, Pakistani companies exporting carpets and engineering goods have been allowed a deduction of expenditure on account of publicity and free samples abroad at the rate of 3½ times of the actual expenditure by virtue of the Finance Ordinance, 1981.

(vi) In order to reduce the cost of technical expertise from abroad, as required for industrial projects, the income of expatriate technicians has historically been exempted from income tax for the initial period of 3 years, and exempt from payment of tax-on-tax during the subsequent 3 years if the employing enterprise pays the tax on behalf of such a person.

(vii) With a view to attracting foreign investment, a liberal tax exemption has been granted to approved foreign loans.

(viii) A tax holiday has been granted to industries set up in the Export Processing Zone to the extent that:

(a) income of the enterprise and of foreign employees is exempt from income tax for a period of 5 years, extendable by the Federal Government in the light of performance of the enterprise;

(b) a concessional rate of tax will be applicable at ¼ the prevalent tax rate for a period of 5 years after the expiry of the full tax holiday period;

(c) capital gains out of sale proceeds and shares of such enterprises are exempt from income tax.

In the light of the preceding paragraphs it can be safely stated that the government made a conscious attempt to provide liberal income tax incentives for accelerating the process of industrial development both in the already developed and "pre-industrial" regions of Pakistan. As to the adequacy or otherwise of these incentive programs, and their actual impact in accelerating the process of industrialization in the country, the following sections indicate actual performance.

D. Evaluation of the impact of income tax incentives on the pace of industrial development in Pakistan

The plan strategy for industrial development in Pakistan necessitated the introduction of various fiscal concessions. These were supplemented by non-fiscal and monetary measures such as providing infrastructural facilities, skilled manpower, advisory services, credit facilities, etc. The fiscal measures included exemptions (partial as well as total) from income tax, sales tax and customs duties. In the absence of economic data, it is not possible to identify the impact of individual measures through carrying out a regression analysis. As such, the following analysis regarding the impact of the income tax concessions with respect to the pace of industrial development during the decade of 1970-80 can merely serve as an indicator and any conclusions may be treated as the best approximation. This is especially true as factors like marketability or market share of industrial products, profit margins, etc. have not been accounted for.

Before actually embarking upon the evaluation of income tax concessions it seems appropriate to refer briefly to the customs duty concessions, as prevailing during the period under reference, due to the fact that they partially fit in the package of fiscal measures for developing the "pre-industrial" geographical regions of Pakistan. Further, considering the huge capital outlays for the industrial projects, partial or total exemption from customs duties on import of plant and machinery plays a vital role in making investment decisions. As to the customs duties, under-developed areas were extended total exemption on import of plant and machinery.[37] Relatively less developed areas were granted a 50% concession on duty on import of plant and machinery.[38] Similarly, plant and machinery for industrial units located in industrial estates in areas outside the geographical regions covered by the 50% concession attracted only a 10% rate of duty. Nevertheless, total exemption from customs duties was granted on import of plant and machinery for installation in the industrial estates in specified under-developed areas.[39] Selective concessions in duties were also granted on the basis of category of industry.[40]

It is, thus, obvious that whereas total exemption from customs duty is available on the import of plant and machinery for industrial establishment enjoying income tax concessions under Clauses 119, 120, 121 and 122 of Part I of the Second Schedule to the Income Tax Ordinance, 1979, the entire tax holiday area covered under Section 15B of the repealed Income Tax Act 1922[41] was

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* *Editors note:* sick industry.

36. See Section 34 A of the repealed Income Tax Act, 1922. This measure was adopted during FY 1980-81 so as to revive sick mills.

37. Total exemption from customs duty was granted through S.R.O.695(I)/77, dated 4 August 1977 as amended through S.R.O.22(I)/78, dated 1 January 1978 to the Province of Baluchistan, D.I. Khan & Malakand Division, Mansehra & Kohistan District, Tribal Areas, Northern Areas, and Azad Kashmir.

38. A concession to Government-financed industrial estates at Karachi and whole of Pakistan, excepting certain industrially developed districts, was granted through S.R.O.1481(I)/74 dated 4 December 1974.

39. The geographical regions attracting no duty include N.W.F.P. Districts D.G. Khan, Mianwali, and Tehsil of Khushab, Districts Shikarpur, Jacobabad and Dadu excluding Kotri.

40. This includes machinery for balancing, modernization and replacement of textile, tanning, cutlery, surgical goods, sports goods, leather garment and gloves, and garment manufacturing industries. Shoe manufacturing and hosiery industries, poultry and dairy farming and establishment of fertilizer units were later included in the list of such industries through S.R.O.829(I)/78 dated 20 June 1978, SRO.830(I)/78 dated 29 June 1978, and SRO.393(I)/74 dated 21 March 1978 respectively.

41. Section 15B of the repealed Income Tax Act, 1922 provided an investment credit to the new industrial undertaking.

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not extended the 50% concession in customs duties. Similarly, the concession in duty on import of plant and machinery for balancing, modernization and replacement (which enjoys a general income tax credit under Section 107 of the Income Tax Ordinance 1979) has been restricted only to a small group of industries. Further, the distinction in the rate of duty on plant and machinery imported under the "Repatriable and Non-repatriable Investment Scheme (NRI)" does not squarely fit in the overall package of income tax concessions granted to new industrial establishments. The sum total of the above discussion is that we can safely presume that due to the almost simultaneous existence of both income tax and customs duty concessions designed for dispersal of industries to the "pre-industrial" or less-developed geographical regions, the final conclusions reached through evaluating the role of the income tax incentives is not tangibly affected by not specifically taking into consideration the effect of customs duty concessions.

Against the above background, it is now easier to see through the overall industrial performance during the decade 1970-80 and spell out the effect of the income tax incentives on the pace of industrial development. The performance of the industrial sector in the Third Plan, though substantial, was not entirely up to expectations. The Plan has had a chequered career. It got off to a difficult start in FY 1965/66 and the pace of investment and production was again upset by the disturbances of FY 1968/69. The investments sanctioned for large, medium and small scale industries in the private sector between July 1965 and December 1969, both under CIIS and PLI amounted to 5,877 million Rs. (as against the Plan target of 9,287 million Rs.).

Phenomenal growth of public sector investment

Private sector industrial investments (in current prices) during FY 1969-70, 1970/71 and 1971/72, respectively, stand at 1,395.9 million Rs., 1,425.7 million Rs. and 1,235.4 million Rs. as against public sector investment of 179.2 million Rs., 69.2 million Rs. and 98.5 million Rs. during the same period. There was a fall in the private industrial investment during FY 1972/73 and 1973/74, i.e. 1,019 million Rs. and 1,022.8 million Rs. respectively. Subsequently, it reached 2,111 million Rs. during FY 1976/77 and 3,808 million Rs. in FY 1980/81. The growth in public sector investment during FY 1973/74 onwards was, however, phenomenal. It started from a very low level of 110.6 million Rs. during FY 1972/73 and touched 6,315.5 million Rs. during FY 1980/81. The average public sector investment during this period has varied between 10 and 60 times the investment during FY 1972-73.[42] Nevertheless, in spite of the entire emphasis on the public sector up to the year 1974/75, the growth in private sector investment has been on the increase (in current prices) which is to be attributed to the overall economic strategy including a package of fiscal incentives.

Impact of tax incentives on industrialization

While compiling the necessary statistical data to form the basis of evaluation, it has been observed that no consolidated data on a uniform pattern are available for the purposes of the present study.[43] Therefore, the consolidated data from the Annual Report of the State Bank of Pakistan and the Industrial Profile of the N.W.F.P., along with some other scattered information, form the basis of the present analysis. For the purposes of convenience, the N.W.F.P., which is relatively a less-developed geographical region, forms the focus of the present evaluation. Consequently, the analysis suffers from quite a few inadequacies and may be treated as the best approximation.

Appendix II shows the comprehensive picture of all Pakistan-based industrial investment, in both the private and public sectors. It appears that during the period FY 1972/73 to FY 1980/81, total industrial investment stands at 227,179 million Rs. out of which the share of private investment works out at 71,935 million Rs. The investment made in large scale and small scale manufacturing is reported at 18,678 million Rs. The N.W.F.P. attracted private investment to the tune of 1,267.33 million Rs. The all Pakistan investment pattern over FY 1972/73 – FY 1980/81 indicates a gradual increase in the private sector investment over the years. Nevertheless, during FY 1979/80 and 1980/81, there has been a greater buoyancy in favour of investment which respectively touched the figure of 2,995 million Rs. and 3,808 million Rs. The N.W.F.P. recorded the lowest investment of 1.194 million Rs. during the start of the period under reference, i.e. FY 1972/73 (Appendix III). It increased to 118.273 million Rs. during FY 1973-74. FY 1976-77 observed the record high investment of 402.086 million Rs. which again showed a decline during the subsequent period.[44] As to the number of industrial units established from 1972/73 onwards, the number gradually increased from 3 in FY 1972/73 to 28 in FY 1976/77 (the year indicating the highest investment). There is a gradual decline thence onward and only 18 industrial units were established during FY 1980/81.

As to public sector investment during the same period in N.W.F.P., it has been observed that out of the total public sector investment of 155,244 million Rs. N.W.F.P. got a share of 51,125 million Rs. for industries and mineral sectors. As to the total number of units, a total of 58 industrial units were established by various agencies including Sarhad Development Authority, Small Industries Development Board, and FATA Development Corporation during FY 1972/73 onwards. The total investment in these units stands at 855.552 million Rs. (in-

42. Source: Ministry of Finance and Economic Affairs.
43. The economic data on the industrial sector is reflected through the various Government publications which include Census of Manufacturing Industries (CMI), Economic Survey, Pakistan – Basic Facts, Pakistan Statistical yearbook, monthly publications of the Industries Developments, Annual Report of the State Bank of Pakistan, etc. The CMI is available only up to the period 1970-75. It is not possible to derive a uniform data pattern out of these publications on the required lines.
44. Industrial Profile of The N.W.F.P., Industries, Commerce, Labour, Mineral Development and Transport Development, p. 63.

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cluding 4.642 million Rs. spent in establishing 7 industrial estates during this period). The Federal Government (through various corporations) established 16 capital-intensive industrial units (cost of these projects is not available). The district-wise position of various projects established from FY 1972/73 to FY 1980/81 is reflected in the table below:

District	*Number of units established*	*Cost incurred Rs.*
Peshawar	12	339.118 million
Mardan	8	200.239 million
Kohat	5	4.782 million
D.I. Khan	6	32.930 million
Abbottabad	15	155.665 million
Mansehra	4	1.143 million
Bannu	4	16.444 million
Swat	7	45.010 million
Dir	1	0.146 million
Chitral	2	0.315 million

The employment generated by the 16 projects of Sarhad Development Authority and 9 FATA Development Corporation projects shows an average of 145.52 persons per project.[45]

The statistics indicate the total number of operating units in N.W.F.P. at 335 at the end of FY 1980/81. The majority of these units are located at Peshawar, Mardan, Swat and Abbottabad (i.e the already industrially developed districts). The districts of Kohat, Bannu, D.I. Khan, Malakand Agency and Mansehra respectively have 8, 8, 7, 7 and 6 units.[46]. The relatively detailed analysis indicates that as against a total number of 828 NOCs (No Objection Certificates) for establishing industrial units between FY 1970/71 and FY 1980/81, a total of 82 units were actually established. Whereas the number of units established from FY 1974/75 to FY 1978/79 stands at an average of 11 units, the highest number of units, i.e. 19, was established during FY 1979/80. Most of these units were established in the districts of Peshawar, Mardan, Hazara, and Swat, i.e. 38, 11, 11 and 15 respectively. The number of units established in the districts of Bannu, Kohat and D.I. Khan stands at 2, 8 and 3 respectively.[47]

As to the district-wise investment approved by the financial institution from FY 1969/70 to FY 1980/81, statistics indicate that out of the total approved investment of 801.3055 million Rs., the highest investment was observed during FY 1979/80, i.e. 132.0815 million Rs. for 24 cases. Except for FY 1970/71 which recorded the lowest investment approvals, i.e. 12.6 milion Rs. for 8 cases, the trend of investments approved showed a gradual increase from FY 1971/72 to FY 1975/76. There was a decline in the investments during FY 1976/77 after which a gradual increase was registered, reaching the highest during FY 1979/80. The investments approved during FY 1980/81 stand at 110.844 million Rs.[48]

Regarding the district-wise investment approvals during the same period, the Peshawar district received the highest amount of approved investment, i.e. 229.9285 Rs. The districts of Abbottabad and Mardan stand almost equal, i.e. 169.517 million Rs. and 165.884 million Rs. respectively, the districts of Kohat, Bannu, D.I. Khan and Mansehra received investment approvals varying from 40 million Rs. to 69 million Rs. The lowest investment was recorded in the Malakand Agency and Swat Division, i.e. at 26.00 and 25.195 million Rs. There was no investment at all in the districts of Kohistan, Dir and Chitral.

The analysis in regard to the private sector industrial units established in the Small Industrial Estates at Peshawar, D.I. Khan, Abbottabad, Swat, Mardan, Kohat and Bannu districts indicates that since the inspection of these industrial estates (mostly during early and mid-1970), the maximum number of plots was allotted at Peshawar, i.e. 1962. The next highest number of plots was allotted in the district of Mardan. The number of plots allotted in the industrial estates in D.I. Khan, Abbottabad, and Bannu district up to FY 1980/81 is relatively low, i.e. varying from 14 to 29. No plots were allotted in the Industrial Estates in Swat and Kohat district despite the availability of 131 plots in the latter district.[49]

The above analysis is summed up as follows:

(i) As against all Pakistan private investment of 18,678 million Rs. from FY 1972/73 to FY 1980/81, N.W.F.P.'s share is at 1267.33 million Rs. The N.W.F.P. public sector allocation for industries and mineral sector during the same period is reported at 5,1125 million Rs.

(ii) As against the total picture of 335 industrial units employing 49,452 persons as at the end of FY 1980/81, private sector industrial units starting operations between FYs 1970/71 and 1980/81 stands at 182 units (with a total capital investment of 1,691.611 million Rs. and employing 14,883 persons). During the same period 58 industrial units, with an investment of 855.22 million Rs. were established in the public sector. The position of loans approved in respect of the private sector from the FY 1969-70 to FY 1980-81 stands at 801.3055 million Rs. The district-wise position indicates that out of these units, the highest number of units was established in the Peshawar district, i.e. 82 units (with an investment of 504.299 million Rs.).The Mardan and Swat districts followed with 36 units (investment of 485.969 million Rs.) and 21 units investment of 62.126 million Rs. The Abbottabad district which attracted 16 industrial units from FY 1970/71 to FY 1980/81 had a total investment of 80.3347 million Rs.

(iii) Private industrial investment was lowest in FY 1972, i.e. 1.194 million Rs. as against the highest recorded investment at 402.086 million Rs. during FY 1976/77. There was a gradual decline in the subsequent years (except 1979/80 which showed an investment higher than the preceding as well as succeeding years).

(iv) The majority of the 335 industrial units operating at the end of FY 1980/81, were established at the Peshawar, Mardan, Swat and Abbottabad districts (i.e. 181, 46, 51 and 28 respectively).

The analysis indicates that despite very liberal tax incentives, the investment, both in terms of financial investment and number of units, converged on the already developed districts, i.e. Peshawar, Mardan, and Abbot-

45. Ibid., p. 65.
46. Ibid., p. 49.
47. Ibid., pp. 80-94, 64-65.
48. Ibid., p. 63.
49. Ibid., Table 11, p. 48.

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tabad. Nevertheless, the trend of industrial development in the other districts, i.e. Kohat, Bannu, D.I. Khan and Swat, indicates that investment started flowing to these areas only during the tax holiday period. The Kohat district recorded the lowest investment from FY 1973/74 to FY 1975/76, and FY 1980/81. No investment was made at all from FY 1976/77 to 1978/79 (which can probably be attributed to the relatively adverse political situation in the area). The investment in the Bannu district since FY 1971/72 has been more or less constant. The districts of Kohistan, Dir and Chitral (the areas with practically no infrastructural facilities) did not attract any investment at all.

Conclusions

The above analysis leads to the following conclusions:

(i) The overall level of industrial investment between FY 1970/71 and FY 1980/81 has been encouraging. However, the major investment appears to have been made in the public sector rather than the private sector.

(ii) Private sector investment was relatively lower between FY 1970/71 and FY 1974/75 (a period having few income tax concessions). It gradually started increasing with the introduction of income tax incentive programs during FY 1975/76, and during FY 1980/81 it touched a level four times higher than that during FY 1970/71. Thus, increased investment, apart from a variety of other factors such as economic stability, Government's changed emphasis on private investment, etc., can be attributed to tax concessions.

(iii) Whereas public sector investment has gone to all kinds of geographical regions, both pre-industrial and fully developed, private sector investment has been selective. It has essentially converged on these geographical areas with the necessary infrastructural facilities, market share, etc. Wherever such facilities were not available (which includes Dir, Chitral and Kohistan districts in the N.W.F.P.), either a too low investment or no investment at all was made. The pre-tax or post-tax profits (due to the availability or otherwise of the tax concessions) seem to have had no impact while making the investment decisions in the various geographical regions.

(iv) The overall Government policy regarding the role of private investment, the uncertainty in its economic policies and the political situation prevailing during a particular period of time governed the level of industrial investment. Thus, although tax incentive legislation was introduced from FY 1974/75 onwards, the level of investment remained almost constant from FY 1975/76 to FY 1978/79, essentially due to uncertain Government policies towards private investment. The moment that the credibility gap was to some extent bridged, there was a phenomenal increase in industrial investment from a figure of 2,293 million Rs. in FY 1978/79 to 2,995 million Rs. and 3,808 million Rs. in FY 1979/80 and FY 1980/81 respectively.

(v) Income tax incentive legislation played a vital role in inducing private sector investment in the areas where infrastructural facilities were in existence. This is indicated by the high level of investment in the districts of Peshawar, Mardan and Abbottabad in the N.W.F.P. between FY 1970/71 and FY 1980/81. The same is true in respect of the other tax holiday areas adjoining the developed regions of the other provinces.

(vi) As a result of the industrial investment motivated by the liberal tax concession, additional employment to the tune of 14,883 was created from FY 1970/71 to FY 1980/81 in the N.W.F.P. alone. The total number of industrial employment places stood at 49,452 at the end of FY 1980/81. The indicators show that whereas the capital intensive public sector projects generated relatively less job opportunities, private sector investment was essentially labour-oriented.

(vii) Regarding the improvement in industrial production, the overall country-wise manufacturing sector indices (Appendix IV) (in constant 1969/70 prices) stand at 104, 104, 101, 112, 115 and 127 respectively for FY 1974/75 through FY 1979/80.[50] The major portion of the value of production during FY 1975/76, i.e. approximately 47%, relates to textile and food manufacture. The trend continued during subsequent years. These industries, along with other manufacturing industries of the private sector, have been the major contributors to the overall value of production. The manufacturing sector indices indicate the level of increase in production over the period FY 1974/75 through FY 1979/80. The fiscal incentives had their role in increased production through encouraging new investment and balancing, modernization and replacement of existing industrial units.

(viii) The export oriented tax concessions can be referred to as having played an important role in the overall economic strategy for establishing industries aiming at the exports of manufactured products. The quantum of exports of manufactured goods increased from 1,998.4 millions Rs. in FY 1970/71 to 10,286.3 million Rs. in FY 1974/75, touching the figure of 21,393.9 million Rs. in FY 1980/81, showing an increase of 100% (in current prices) during the decade of 1970/71 – 1980/81. The ratio of exports of semi-manufactured and manufactured goods to exports of primary commodities during the period from 1975/76 to 1980/81 (the period of liberal tax concessions) has generally been around 3:2.[51] (Appendices V and VI).

(ix) As to the role of tax incentives in developing import substitution industries, nothing can be said with certainty, especially in view of the fact that importation of all kinds of goods including consumer goods, raw material for consumer goods, capital goods and raw material for capital goods has been constantly on the increase from FY 1975/76 through 1980/81. The quantum of imports (in current prices) increased from 20,672 million Rs. in FY 1975/76 to 49,809 million Rs. in FY 1980/81. The intervening period shows

50. Ministry of Finance & Economic Affairs.
51. Statistics Division, Ministry of Planning and Development.
52. Ibid.

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a gradual increase except FY 1979/80 which reflected a decline of 4,869 million Rs. as compared with the immediately preceding year. The ratio of imports of consumer goods to capital goods during the period under reference has generally been around 3:2.[52]

To sum up the discussion, the available information about the N.W.F.P. (without pro-rating it to the rest of the country) indicates a favourable impact of tax incentive legislation over the industrial investment, provided infrastructural facilities existed in the tax holiday area. The overall level of private investment in Pakistan in the manufacturing sector showed a favourable increase over the years 1970/71 – 1980/81. The extent to which it was influenced by the fiscal measures is a question of value judgement and cannot be stated with certainty. However, keeping in view the constant public demand for all kinds of tax concessions as a means of inducing investors, it can be safely stated that investment would not have been attracted to the given level without providing the necessary income tax concessions. The positive role of tax incentives is, thus, implicitly established.

APPENDIX I

Statement of industrial tax incentives

S.No.	*Type of tax concession*		*Brief description*	*Duration of tax concession*	*Expiring on*
1.	*2.*		*3.*	*4.*	*5.*
	Tax holidays				
1.	Area-wise tax holidays	(i)	Total tax exemption for industries set up in Baluchistan during the period from 1 July 1978 to 30 June 1983 (Clause 80 of Part I of the Second Schedule).	5 years	30.6.83
		(ii)	Total tax exemption for industries set up in D.I. Khan and Malakand division from 1 April 1978 to 30 June 1983 (Clause 81 of Part I of the Second Schedule).	5 years	30.6.83
		(iii)	Total tax exemption for industries set up in Tribal Areas, districts of Mansehra and Kohistan from 1 July 1979 to 30 June 1983 (Clause 82 of Part I of the Second Schedule).	5 years	30.6.83
		(iv)	Total tax exemption for industries set up in approved industries estates in N.W.F.P., D.G. Khan, Mianwali, Tehsil Khushab, Dadu (excluding Kotri), Jacobabad and Shikarpur (Clause 82A of Part 2 of the Second Schedule).	5 years from date of setting up	–
	Income-wise tax holidays	(i)	Total exemption of the dividends received from public companies from 1 July 1978 to 30 June 1982 (Clause 80 of Part I of the Second Schedule)	5 years	30.6.82
		(ii)	Dividends paid by a company wholly owned by a foreign Government (Clause 82 of Part I of the Second Schedule)		
		(iii)	Dividend income of an approved private company engaged in planning, promoting, developing, organizing and implementing schemes for establishing industrial, commercial mining, etc. (Clause 81 of Part I of the Second Schedule).	10 years	
		(iv)	Bonus shares issued by a company or body corporate between 1 September 1977 and 30 July 1982 (Clause 108 of Part I of the Second Schedule).	5 years	30.6.82
		(v)	Capital gains on disposal of shares of public companies, etc.		
	Sector-wise tax holidays	(i)	Total exemption of manufacture of agricultural implements to industries set up to 30 June 1983 (Clause 98 of Part I of the Second Schedule).		30.6.83
		(ii)	Total exemption of income from sale and renting of agricultural machinery or provision of pet control as set up from 1 July 1976 to 30 June 1983 (Clause 96 of Part I of the Second Schedule).	2 years	30.6.83
		(iii)	Income from poultry farming, fish catching, cattle sheep breeding tax exempt during the period up to 30 June 1983 (Clause 99 of Part I of the Second Schedule).	–	30.6.83
		(iv)	Income from poultry processing tax exempt between 1 July 1980 and 30 June 1983 (Clause 100 of Part I of the Second Schedule).	3 years	30.6.83
		(v)	Income from dairy farming up to 30 June 1983 (Clause 101 of Part I of the Second Schedule).		
		(vi)	Income of cooperatives (Clause 103 of Part I of the Second Schedule).	–	–
		(vii)	Income from garment industry exempt as set up during 1 July 1978 to 30 June 1983 (Clause 125 of Part I of the Second Schedule).	5 years	30.6.83
		(viii)	Income from date processing, manufacture of chipboard/ strawboard and refining of edible oil of industries set up from 1 May 1978 to 30 June 1983 in Sukkur district for 5 years (Clause 124 of Part I of the Second Schedule).	5 years	30.6.83

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S.No.	Type of tax concession		Brief description	Duration of tax concession	Expiring on
1.	2.		3.	4.	5.
		(ix)	Income of mineral industries exempt in respect of industries set up from 1 July 1981 to 30 June 1985 for 5 years) (Clause 123 of Part I of the Second Schedule).	5 years	30.6.83
2.	Tax rebates	(i)	5% rebate on super tax to industries set up between 1 July 1975 and 30 June 1983. (First Schedule of the Income Tax Ordinance 1979).	8 years	30.6.83
		(ii)	Tax rebate of 55% on export business (First Schedule to the Income Tax Ordinance 1979).	–	–
3.	Tax credit		BMR concession to industries during the period 1 July 1976 to 30 June 1983 (Section 107 of the Income Tax Ordinance, 1979)	9 years	30.6.83
4.	Investment credit		Concession to industries set up from 1 July 1975 to 30 June 1983. (Section 48 of the Income Tax Ordinance, 1979).	8 years	30.6.83

APPENDIX II

Investment (million Rupees)

S.No.	Year	Investment at current prices			Private investment by economic activity (at current prices)										
		Public sector	Private sector	Gross fixed investment (3) + (4)	Agriculture	Mining & quarrying	Manufacturing Total	Large scale	Small scale	Construction	Electricity & gas	Transport & communication	Banking, insurance & fin. insts.	Ownership of dwellings	Services
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
1.	1972-73	3,921	3,726	7,647	612	19	1,019	763	256	24	112	968	35	496	444
2.	1973-74	6,774	3,840	10,614	738	23	1,023	697	326	27	1	1,000	10	500	519
3.	1974-75	11,010	5,208	16,218	846	30	1,437	990	447	62	1	1,016	6	1,136	673
4.	1975-76	16,286	6,484	22,770	1,349	33	1,819	1,309	510	50	2	1,071	7	1,341	813
5.	1976-77	18,641	7,780	26,421	1,600	37	2,111	1,525	585	119	2	1,167	14	1,709	1,021
6.	1977-78	20,213	8,763	28,976	1,947	40	2,173	1,539	634	105	2	1,227	13	2,035	1,221
7.	1978-79R	21,871	9,556	31,427	2,064	44	2,293	1,569	724	118	2	1,384	17	2,273	1,359
8.	1979-80R	26,834	12,441	39,275	2,465	49	2,995	2,177	818	97	2	2,100	26	3,003	1,703
9.	1980-81R	29,694	14,135	43,829	2,757	53	3,808	2,832	976	123	5	1,712	12	3,777	1,887

Source: Annual Report 1980-81
Table II. 2, II. 3
State Bank of Pakistan

APPENDIX III

Statement of industrial investment in N.W.F.P. (private sector)

Units starting operation from 1970-71 tot 1980-81

Fiscal years	No. of units	Investment (in million Rs.)	Employment
1970-71	13	104.466	1,194
1971-72	10	319.839	1,599
1972-73	3	1.194	112
1973-74	12	118.273	1,642
1974-75	16	85.392	779
1975-76	19	16.565	708
1976-77	28	402.086	3,219
1977-78	26	178.820	1,670
1978-79	20	70.510	630
1979-80	17	252.950	1,815
1980-81	18	141.540	511
Total:	182	1,691.611	14,883

APPENDIX IV

Pakistan: Manufacturing sector indices, 1974/75 - 1980/81

(1972/73 = 100)

	1974/ 1975	1975/ 1976	1976/ 1977	1977/ 1978	1978/ 1979	1979/[1] 1980
Manufacturing output)in constant 1969/ 70 prices)	104	104	101	112	115	127
Manufacturing employment	115	118	122	126	129	133
Output per man (at constant 1969/70 prices)	91	88	83	89	89	94
Manufactured exports[2] (in current dollars)	103	122	129	161	221	235

Source: Ministry of Finance and Economic Affairs.

1. Provisional.
2. Includes exports of semimanufactures.

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APPENDIX V
Major exports

S.No.	Items	1970-71	1971-72	1972-73	1973-74	1974-75	1975-76	1976-77	1977-78	1978-79	1979-80 July-March	1980-81
1.	2	3	4	5	6	7	8	9	10	11	12	13
1.	Fish and fish preparations	61.3	111.1	233.7	276.0	156.5	278.8	381.3	341.4	461.9	530.5	530.9
2.	Rice	173.0	274.1	1136.1	2098.4	2303.7	2479.1	2477.9	2408.5	3380.0	4179.3	3846.1
3.	Hides and Skins	16.7	19.6	16.9	23.5	46.1	30.4	2.3	–	–	–	–
4.	Raw wool	20.9	24.6	82.8	64.1	20.3	66.2	76.2	72.8	100.2	94.6	30.2
5.	Raw cotton	270.0	954.8	1167.0	367.1	1543.9	980.5	292.1	1101.8	655.2	3321.0	4462.0
6	Cotton waste	14.8	27.4	31.4	35.0	18.6	10.4	23.7	16.1	14.6	18.6	13.0
7.	Leather	107.0	173.5	544.9	418.5	367.3	595.9	647.4	636.5	1247.0	1264.0	621.3
8.	Cotton yarn	344.2	592.3	1941.0	1810.6	851.4	1427.3	1171.7	1059.5	1956.1	2038.0	1465.1
9.	Cotton thread	12.8	13.4	33.3	52.5	57.4	39.5	43.4	70.7	57.7	70.1	67.0
10.	Cotton cloth	311.3	387.1	1247.1	1416.8	1312.5	1359.4	1603.3	1741.2	2135.2	2416.0	1711.1
11.	Petroleum and products	38.6	41.3	128.6	175.6	138.5	192.0	268.5	625.9	607.9	1764.2	1319.4
12.	Synthetic textiles	14.8	12.2	57.3	65.3	22.5	34.3	35.3	154.0	64.6	54.3	903.6
13.	Footwear	29.4	38.9	83.6	94.5	125.5	66.0	89.3	71.6	96.7	105.8	75.8
14.	Animal casings	8.3	9.5	21.2	29.1	21.2	35.1	33.0	26.4	31.1	41.1	42.3
15.	Cement and products	20.5	43.9	106.2	167.2	279.5	50.9	5.6	3.2	–	–	–
16.	Guar products	39.6	39.2	95.7	175.7	163.7	196.9	181.7	202.6	271.7	332.6	198.9
17.	Oil cakes	6.2	3.4	78.8	7.8	0.2	0.3	1.8	98.9	71.5	41.4	30.8
18.	Paints and varnishes	3.8	4.7	5.3	6.0	6.9	8.2	9.7	7.6	8.0	8.5	7.7
19.	Tobacco, raw and manufactured	14.4	25.3	49.0	107.2	132.6	160.2	163.8	126.1	100.8	80.6	41.7
20.	Readymade garments, hosiery	29.9	35.9	97.4	167.4	244.9	328.4	417.7	138.7	376.6	731.2	652.2
21.	Drugs and chemicals	11.9	10.9	37.0	102.8	116.3	133.3	134.3	146.3	131.0	122.2	102.9
22.	Surgical instruments	18.4	22.5	45.2	85.2	129.4	131.4	133.8	160.5	210.8	240.2	182.4
23.	Carpets and rugs	64.7	198.7	281.5	457.7	456.0	719.2	911.7	1170.8	1764.7	2198.4	1718.7
24.	Sport goods	32.7	50.7	136.0	188.0	204.5	189.2	199.1	194.9	212.1	244.6	216.9
25.	Others	338.2	346.4	894.2	1770.2	1566.9	1745.0	1988.9	2404.4	2969.6	3512.5	3255.9
	GRAND TOTAL	1998.4	3371.4	85551.2	10161.2	10286.3	11252.9	11293.9	12980.4	16925.0	23410.1	21395.9

Source: Pakistan Economic Survey 1980-81.

APPENDIX VI
Pakistan: Exports and imports by economic categories, 1975/76 - 1980/81[1]

	1975/76	1976/77	1977/78	1978/79	1979/1980	1979/80	1980/81
			I. Exports (in millions of U.S. dollars)				
Primary commodities	495.2	466.9	468.1	552.9	993.8	940.0	1,203.0
Semi-manufactured goods	208.8	190.7	193.1	352.4	355.5	328.5	305.7
Manufactured goods	432.6	483.2	650.0	804.3	1,015.4	901.8	1,162.3
Total	1,136.6	1,140.8	1,311.2	1,709.6	2,364.7	2,170.3	2,671.0
			(%)				
Primary commodities	43.6	40.9	35.7	32.3	42.0	43.3	45.0
Semi-manufactured goods	18.4	16.7	14.7	20.6	15.0	15.1	11.5
Manufactured goods	38.0	42.4	49.6	47.1	43.0	41.6	43.5
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0
			II. Imports[2] (in millions of U.S. dollars)				
Consumer goods	438.0	368.8	561.1	792.1	757.6	679.3	705.8
Raw materials for consumer goods	778.8	924.0	1,113.5	1,557.2	2,003.5	1,839.3	2,492.6
Raw material for capital goods	127.4	147.8	194.0	218.2	294.5	275.0	362.9
Capital goods	723.0	883.9	941.0	1,108.1	1,684.7	1,463.8	1,419.6
Total	2,067.2	2,324.5	2,809.6	3,675.6	4,740.3	4,253.4	4,980.9
			(%)				
Consumer goods	21.2	15.9	20.0	21.6	16.0	16.0	14.2
Raw materials for consumer goods	37.7	39.7	39.6	42.4	42.3	43.1	50.0
Raw materials for capital goods	6.1	6.4	6.9	5.9	6.2	6.5	7.3
Capital goods	35.0	38.0	33.5	30.1	35.5	34.4	28.5
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Statistics Division, Ministry of Planning and Development.

1. Customs data, which differ from balance of payments due to differences in timing, coverage, and valuation.
2. On a mixed c. and f. basis.

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PAKISTAN:

INCENTIVES FOR INVESTMENT IN INDUSTRIAL PROJECTS *

Incentives/concessions provided to the investors

A. Custom duty exemption:

(1) Complete exemption from custom duty if project is located in:
The Province of Baluchistan,
Territory of Azad Kashmir,
Northern Areas and Tribal Areas,
Dera Ismail Khan and Malakand Divisions, Mansehra and Kohistan Districts and approved Industrial Estates of N.W.F.P.,
Approved Industrial Estates in the Districts of Shikarpur, Jacobabad and Dadu excluding Kotri in the Province of Sind, and
Approved Industrial Estates in Districts of Dera Ghazi Khan and Mianwali and Tehsil Khushab in the Province of Punjab.

(2) Complete exemption from custom duty on such items of machinery as are not manufactured in the country for the industries relating to:
Fertilizer, readymade garments, poultry industry, and dairy industry.

(3) Complete exemption from custom duty on such items of imported machinery as are not manufactured in the country for balancing, modernisation and replacement in industries relating to:
Textile, tanning, cutlery, surgical goods, sports goods, and leather garments and gloves.

(4) 50% exemption in custom duty for specified under-developed areas as detailed below:

i) All Government financed industrial estates except those located at Karachi.
ii) The whole of Pakistan excluding the areas specified below:
   1) Tehsil of Rahimyar Khan
   2) Tehsil of Multan
   3) Tehsil of Faisalabad
   4) Tehsil of Shahdra
   5) Tehsil of Lahore
   6) Tehsil of Gujranwala
   7) Tehsil of Sialkot
   8) Tehsil of Rawalpindi
   9) Islamabad Capital Territory
   10) Karachi
   11) Taluka of Hyderabad
   12) Taluka of Kotri
   13) Taluka of Sukkur
   14) Such areas adjoining Karachi and Lahore as may be specifed by the Central Board of Revenue.

(5) Machinery and raw material for manufacture of goods meant primarily and exclusively for export can be imported free of custom duty under bonded ware-house scheme.

(6) Import of following machinery and raw material are allowed free of custom duty against a bank guarantee subject to the condition that goods are exported within six months:

(a) Material for processing, further manufacturing or repair.
(b) Material for embellishing or decorating goods produced in Pakistan for export.
(c) Packing material used or required to be used as external or internal covering of goods, or as holders on which goods are rolled, wound or attached provided that they do not change their original shape or form (packing material such as straw, paper, glass and like materials excluded).
(d) Machinery and equipment for repair.
(e) Professional equipment imported by visiting technicians, doctors, etc.
(f) Equipment and material imported by visiting television and broadcasting units, press photographers and film companies.
(g) Scientific and educational instruments, apparatus and appliances including simultaneous broadcasting equipment imported for scientific, educational or cultural seminars to be held in Pakistan.
(h) Goods imported by Government or semi-Government institutions for demonstration purposes in their display centres.
(i) Goods imported for display at international or single country exhibition for foreign Missions.
(j) Machinery imported by the representatives of foreign commercial firms for demonstration purposes.

B. Tax holiday:

Complete tax holiday is available as per details given below:
(i) Tax holiday for five years from the date of commencement of commercial production to industrial undertakings set up by the Companies between July, 1978 to June, 1983, in the Province of Baluchistan.
(ii) Tax holiday for five years from the date of commencement of commercial production to industrial undertakings set up by the Companies between April, 1978 to June 1983, in the Divisions of D.I. Khan and Malakand in the N.W.F.P.
(iii) Tax holiday for five years from the date of commencement of commercial production to industrial undertakings set up by the Companies between July, 1979 to June, 1983, in Azad Kashmir, Northern Areas, Tribal Areas and districts of Mansehra and Kohistan of N.W.F.P.
(iv) Tax holiday for five years from the date of commencement of commercial production to industries set up in the District of D.G. Khan in the Province of the Punjab and in the approved industrial Estates in the whole of N.W.F.P., District of Mianwali and Tehsil Khushab in the Province of Punjab, and Districts of Shikarpur, Jacobabad and Dadu in the Province of Sind.
(v) Tax holiday for five years from the date of commencement of commercial production to industrial undertakings set up by the Companies between May, 1978 to June, 1983, anywhere in Pakistan for the manufacturing of garments from cloth made in Pakistan.
(vi) Tax holiday for five years from the date of commencement of commercial production to industrial undertakings set up by a company between May, 1978 to June, 1983 in the district of Sukkur in the Sind Province and engaged in the processing of dates, manufacture of chipboard or refining of edible oils.
(vii) Income from poultry farming and dairy farming, fish catching and cattle and sheep breeding is exempt from income tax for the period July, 1975 to June, 1983. A similar exemption is available to fish farming for the period July, 1977 to June, 1982 where such business is established after 1.7.1977.
(viii) Income from poultry processing derived from 1st July, 1980 to 30th June, 1983 is exempt from income tax.
(ix) Income from manufactures of agricultural implements is exempt from income tax till 30th June, 1983.

C. Tax credit for modernization, balancing, replacement and extension of machinery to company in respect of existing units:

Tax credit equal to 15% of the cost of machinery installed for modernization, balancing, replacement, and extension of existing of existing industrial units, is allowed to a company where such machinery is installed between July, 1976 and June, 1983.

D. Income of industrial companies which is partially exempt:

Profits of industrial companies set up between 1975 and 1983 are exempt to the extent of 10% of the capital employed in the undertakings set up in the areas excluding Talukas of Karachi and Hyderabad, Tehsils of Faisalabad and Lahore for a minimum period of 5 years from the year of commoncement of commercial production.

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* Government of Pakistan, Finance Division (Investment & Capital Issues Wing).

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E. Tax credit for investment by companies in industrial undertakings:

Tax credit is admissible to a company in respect of the amount invested in the acquisition of share-capital of a company which set up an industrial undertaking to the extent indicated below:

(a) 30% of the amount invested if the industrial undertaking is located in Baluchistan, Tribal areas, Northern Areas or Azad kashmir.
(b) 15% of the amount invested where industrial undertaking is located at any other place, excluding the Talukas of Karachi and Hyderabad and Tehsils of Faisalabad and Lahore.

F. Setting off losses of wholly owned subsidiary companies:

Listed holding companies have been allowed to set off current losses of a wholly owned subsidiary company against current year's income. The concession is available for three assessment years, and is subject to the condition that the holding company gives a scheme of revival of the sick mill duly approved by a financial institution namely PICIC, IDBP, NDFC or Bankers Equity and submits a yeraly progress report to the said financial institution, showing that progress is in accordance with the scheme of rehabiliation.

G. Tax exemption on capital gains:

Capital gains including gains arising on sales of shares for the assessment year upto 30-6-1984 have been exempted.

H. Tax holiday for non-residents:

No tax is charged on income, profits or gains which accrue or arise outside Pakistan to a person:
(i) Who has not been resident in Pakistan in nine out of ten years preceding the income year; or if
(ii) He has not during the seven years preceding that year been in Pakistan for a period of for periods aggregating to, more than two years.

This tax exemption is however, not available in case such income gains and profits are derived from a business controlled in a profession or vocation set up in Pakistan or are brought into or received in Pakistan during the income year.

I. Tax rebate on repatriation of income from consultancy services rendered abroad:

Non company resident professionals earning income from consultancy services abroad shall on repatriation of such income be entitled to a rebate equal to 30% of the tax payable on such income.

J. Investment allowances to persons other than companies:

An allowance of 33⅓% of the total income subject to a maximum of Rs. 40,000/– is admissible to any person, except a company, in NIT Units, specified certificates and debentures, in the acquisition and debentures, in the acquisition of the share-capital of industrial companies other than purchase from a previuos owner.

K. Exemption of dividend from income tax:

Following income from dividends is exempt from tax:

(a) From the National Investment (UNIT) Trust or any mutual fund established by the Investment Corporation of Pakistan or from a company listed on stock exchange in Pakistan, other than that specified in sub-clauses (b) or (c):
(i) Where such dividend income does not exceed fifteen thousand rupees. (The whole of such income)
(ii) Where such dividend income exceeds fifteen thousand rupees. (Fifteen thousand rupees)
(b) dividends declared and paid by any public company registered at any time between the first day of July, 1977 and the thirtieth day of June, 1982 (both dates inclusive) under the Companies Act, 1913 (VII of 1913), and having its registered office in Pakistan, out of its profits for any income year ending in or before the thirtieth day of June, 1982. (The whole of such income)
(c) dividend income received from any public company registered under the Companies Act, 1913 (VII of 1913), at any time between the first day of July, 1978 and the thirtieth day of June, 1982 (hereinafter referred to as the said period), having its registered office in Pakistan and engaged in an industrial undertaking set up in Pakistan at any time within the aforesaid period out of the profits of the undertaking, for a period of five years beginning from the year in which commercial production is commenced. (The whole of such income)
(d) There is no deduction of 30% standard rate of Income tax on dividends paid to overseas Pakistanis Certificate holders of State Enterprises Mutual Fund of ICP. In other words the income to the certificate holders residing abroad is tax free.

L. Bonus shares:

Face value of any bonus shares or the amount of any bonus declared, issued or paid by a company to its shares holders is exempt in the hands of shareholders.

M. Exemption to foreign technicians:

Salary received by any person who is not a citizen of Pakistan is exempt for a period of three years from the date of his arrival in Pakistan for services rendered by him during such period as a technician under a contract of service approved by the Commissioner of Income Tax before the commencement of his service or within one year of such commencement.

N. Tax rebate on income from exports:

Rebate is allowed to all commercial and industrial exporters at the rate of 55% of the tax attributable to income from export of goods manufactured in Pakistan.

O. Tax relief to cooperative societies:

Cooperative Societies are allowed earned income relief, personal allowance and investment allowance as admissible to individuals.

P. Super tax rebate:

Super tax rebate of 5% is allowed to industrial undertakings set up between July, 1975 and June, 1983 provided the cost of fixed assets exclusive of cost of land does not exceed Rs. 5.0 million.

In the case of domestic Public Companies, rates of super tax have been reduced on intercorporate dividends from 15% to 10%. In respect of Private Limited Companies the rate of super tax on intercorporate dividends received by such Companies has been reduced to 30%.

A Pakistani construction company earning income from constuction contracts abroad, shall on repatriation of profits to Pakistan be entitled to a rebate equal to the amount of super tax payable on such income.

Q. Tax credit on investment by companies in shares and debentures:

Companies investing in shares or debentures of the Equity Participation Fund are allowed tax credit of 50% of the amount invested in such shares or debentures.

R. Interest on approved loans exemption from income tax:

Interest payable on loans made by approved foreign institutions or on approved loans taken by industrial undertakings in Pakistan for purchase of plant and machinery complete

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exemption from Pakistan tax if the country from which the loan has emanated grants exemption from its own tax to the income in question or agrees to give credit in the home assessment of lender for tax payable on his income in Pakistan but exempted by Government.

S. Sales tax exemption on machinery:

Machinery and components thereof for industrial use are exempt from payment of sales tax both at the import stage as well as when locally manufactured.

T. sales tax exemption on export of manufactured goods:

In order to promote the export of manufactured goods, a general exemption from sales tax is given to all goods exported from Pakistan. In addition, the raw material used in their manufacture is also exempted from sales tax.

U. Depreciation allowance:

Depreciation allowance is calculated on the cost of assets at the time of their acquisition in the first year and on the written down value in subsequent years.

An initial depreciation allowance at the rate of 30% is allowed on ships and at a rate of 25% on other plant and machinery installed between July, 1976 and June, 1983. Rate of depreciation allowance on residential buildings for industrial labour is 10%. Buildings constructed upto 30th June, 1983 for industrial labour drawing salary upto Rs. 1000 per month are allowed an initial depreciation at the rate of 25%.

In respect of assets most commonly in use of rates of normal depreciation allowance are as follows:

(1)	Building (not other-wise specified)	5%
(2)	Factory or workshop (excluding godowns, Offices and residential quarters)	10%
(3)	Furniture	10%
(4)/	Machinery and plant (not other-wise specified)	10%
(5)	Ships	
	(i) New	5%
	(ii) Second Hand	
	Age at the time of purchase:	
	(a) not more than ten years	10%
	(b) more than ten years	20%
(6)	Batteries, X-Rays and electro-therapeutic apparatus and accessories	20%
(7)	Machinery used in the production and exhibition of cinematograph films	20%
(8)	Motor-vehicles, all sorts	20%
(9)	Aircraft, aeroengines and aerial photographic apparatus	30%
(10)	Moulds used in the manufacture of Glass or concrete pipes	30%
(11)	Below ground installations in mineral oil concerns	100%

Extra depreciation allowance is also allowed for multiple shift working. In the case of machinery and plant, to which the general rate applies an extra depreciation allowance, equal to 50% of the allowance computed is allowed on account of double shift working and 100% of such allowance on account of triple shift working.

Limit for claiming depreciation allowance of original cost of motor vehicles has been increased from Rs. 75,000 to 100,000 for assessment year 1982-83.

V. Housing:

Tax relief has been provided to Pakistanis working abroad who maintain a house in Pakistan for their families. The mere maintenance of a house will no longer render a tax payer liable on foreign income. Further the condition regarding short visits to Pakistan has been relaxed and any tax payer, whose stay in Pakistan does not extend beyond 90 days, will not incur any extra tax liability.

W. Tariff protection:

Exemption from tax has been granted to new residential houses constructed between 1st July, 1981 and 30th June, 1983, and having annual rental value upto Rs. 18,000. For Islamabad, the exemption for new houses is Rs. 24,000/–.

X. Financing facilities:

(i) Lending rate for financing of fixed industrial investment has been reduced from 14% to 11%.
(ii) On rupee loans for purchase of locally fabricated machinery, IDBP charges incterest at the rate of 8½%. PICIC/NDFC also provide loan for purchase of locally fabricated machinery at concessionary rates.
(iii) Bakers Equity Limited have been established to make up rupee equity gap being faced by private investors.

Y. Tax concessions for the mineral industry:

(i) Depreciation is allowed @ 100% on below ground installations in mineral oil concerns.
(ii) Capital loss incurred upto the time of commercial production is treated as a revenue loss and allowed to be carried forward for a period of 10 years after the commercial production.
(iii) Depletion allowance is admissible @ 15% of the gross receipts in respect of exploration and production of petroleum and 15% of total income from extraction of other mineral deposits or 50% of the capital employed, whichever is the less.
(iv) Depreciation allowance @ 100% is allowed in respect of machinery and plant acquired for extracting mineral (other than petroleum) in the year in which they are used for the first time.
(v) Tax exemption upto 10% of the capital employed is available to an undertaking which is also engaged in the business of refining or concentrating in Pakistan the mineral deposits extracted by it in Pakistan. This concession is for mineral other than petroleum only.
(vi) Pakistani companies engaged in the exploration of selected minerals mentioned below have been given exemption for 5 years; and on the expiry of the 5 years, tax on such income shall be charged at 50% of the normal rate for next 5 years.

(i) Iron Ore; (ii) Byarite; (iii) Dolomite; (iv) Fireclay; (v) Lime Stone; (vi) Flourite; (vii) Bauxite; (viii) Phosphate; (ix) Chrome; (x) Soap stone and (xi) Copper.

Z. Export processing zone:

An export processing zone has been established at Karachi. Another one is contemplated near Lahore. These zones aim at enabling establishment of export-oriented industries. Exports from the Zones will be completely free from exchange control. Import of machinery, components, spare parts and raw matrerials for the industrial undertakings in the Zones and goods for re-export would be freely allowed and shall be exempt from all taxes and duties of both Federal and Provincial Governments including municipal taxes. The restrictions of Import Trade Control Act would not be applicable on imports into the Zones. Investors in the zones would be allowed following income tax relief:

(a) Income of the enterprise and of the foreign employees will be exempt from tax for five years which period is extendable by the Federal Government in the light of the performance of the enterprise.
(b) After the expiry of full tax-holiday period, a concessional rate of tax at ¼th of the prevalent tax rates shall be charged for next 5 years.
(c) Capital gains on sale of assets and shares will be exempt from tax.

Financial institutions

Providing credit and equity for industrial projects in Pakistan.

1. Investment Corporation of Pakistan, National Bank Building, I.I. Chundrigar Road, Karachi.
2. Industrial Development Bank of Pakistan, State Life Building, I.I. Chundrigar Road, Karachi.
3. Pakistan Industrial Credit & Investment Corporation, State Life Building, I.I. Chundrigar Road, Karachi.
4. National Investment Trust, National Bank Building, I.I. Chundrigar Road, Karachi.

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5. National Development Finance Corporation, NSC Building, Maulvi Tamizuddin Khan Road, Karachi.
6. Bankers Equity Limited, State Life Building, Dr. Zia-ud-Din Ahmad Road, Karachi.
7. Small Business Finance Corporation, National Bank Building, Civic Centre, Islamabad.
8. Equity Participation Fund, State Life Building, I.I. Chundrigar Road, Karachi.
9. Pak-Kuwait Investment Company Limited, Shaikh Sultan Trust Building, Beaumont Road, Karachi.
10. Pak-Libya Holding Company Limited, Shaikh Sultan Trust Building, Beaumont Road, Karachi.
11. Saudi-Pak Industrial, Agricultural Investment Company Ltd., P.O. Box No. 1594, Islamabad.

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INDIA:

IMPACT OF THE BUDGET*

No incentives to produce or save

By Kailash C. Khanna

In an address to the Income Tax Payers' Society in England, Sir Paul Chambers, who was responsible for an overhaul of the Indian income-tax law in 1939, once stated:

> It is easy to press for the separation of the taxation of individuals from the taxation of companies; once you have done that, the Chancellor, whatever his Party, will always be pressed to give more relief to individuals and classes of individuals because they are the people who vote and the taxation on industry will go up and up. And there again, politically companies are less articulate than individuals and classes of individuals. It is so easy to slip into doing the wrong thing.

The truth of this statement is amply borne out by India's corporate tax development. It was in 1959 that taxation of company profits was separated from taxation of shareholders. The rate of corporate tax was then fixed at 45%; it has since gone "up and up" and now stands at 55% for a widely held domestic company, exclusive of surcharge on tax (2.5%) and surtax (25% to 40%) on net profits in excess of 15% of capital and reserves. The aggregate tax burden can reach an unheard of maximum of 70%. The rates for closely held companies are still higher.

It was, therefore, expected that in his 1982-83 Budget proposals the Union Finance Minister, Mr. Pranab Mukherjee, would reduce company tax rates and modify the corporate tax structure. Belying these expectations, the Finance Bill does not suggest any noteworthy changes in the existing rates or basis of corporate taxation. Apparently, relying on scanty data and by citing stray cases of a few newly established or recently expanded companies which have derived full benefit of the initial tax reliefs and incentives, the Finance Minister's advisers came to the mistaken belief that corporate tax in India is not high. But it is fallacious to justify a high corporate tax rate on the grounds that numerous tax reliefs are available in the formative years. A company does not establish itself anew every now and then, nor does it acquire substantial new plant and machinery year after year. Consequently, the tax liability goes up when the initial allowances are exhausted or are nullified by disallowance of bona fide business expenditure. A low tax burden in the early years followed by confiscatory taxation in later years seems to justify the adage that tax incentives are short-term bribes for long-term handicaps. In any event, companies which have availed themselves of tax concessions are contributing to the development process and adding to the GNP. In fact, this is exactly what tax benefits are meant for and it should be a matter for gratification that the fiscal bait has worked.

A realistic basis for determining the average tax rate would be to ascertain the percentage of the tax levied on corporate profits during a financial year; this is likely to show a figure close to the standard rate. A study conducted by the Associated Chambers of Commerce & Industry of India showed that a 1% increase in corporate tax reduced resources of the company by 1.3%. Another study has shown that while corporate taxation has increased many times over the years, corporate savings have declined sharply. Apart from discouraging the generation of internal resources, high corporate taxation hampers corporate growth, distorts the debt-equity ratio, encourages corporate extravagance, erodes integrity and shifts the corporate tax burden, thereby mulcting the consumer and fanning the flames of inflation. It is, therefore, imperative to lower company tax rates, increase depreciation allowances, remove tax on all inter-corporate dividends and abolish surtax on company profits.

In the Finance Bill, the existing tax exemption limit of income from dividends, bank interest etc. is proposed to be raised from Rs. 3,000 to Rs. 4,000; that from Unit Trust from Rs. 2,000 to Rs. 3,000. Corresponding changes are proposed in the wealth tax law increasing the exemption limits to Rs. 165,000 and Rs. 35,000 respectively. It is proposed to increase the maximum amount of investment qualifying for the prescribed deduction relating to equity shares of an eligible issue of capital of new industrial companies or public housing finance companies from Rs. 10,000 to Rs. 20,000. The proposed changes are too trivial to have any effective impact on investment and savings.

The proposed tax relief to exporters, whose export turnover during the accounting year exceeds the export turnover of the immediately preceding year by more than 10% thereof is not available to all. The goods in relation to which the tax concession will be provided and the rate at which the relief will be calculated will be notified by the Central Government after taking into account the cost of manufacture of such goods, the prices of similar goods in the foreign market, the need to develop a foreign market for such goods, the need to earn foreign exchange, the destination of export and any other relevant factors. The maximum amount of deduction to which the taxpayer will be entitled will not exceed 10% of the amount of income tax otherwise payable by the taxpayer on the profits and gains from export of such goods. These limitations will detract considerably from the expected boost to exports. The tax benefit will be available for the 1983/84 assessment and 4 immediately succeeding assessment years.

With a view to encouraging contractors to undertake construction and engineering contracts outside India, it is proposed to provide that where an Indian company or a non-corporate taxpayer resident in India derives any profits and gains from the business of execution of a project under a contract entered into by him with the Government of a foreign State or any statutory or other public authority or agency in a foreign State or with a foreign enterprise, he will be entitled to a deduction, in the computation of his taxable income, of 25% of such profits

* This is a revised version of an article which appeared in *The Statesman* of 16 March 1982. The Editors of *The Statesman* kindly approved re-publication of Mr. Khanna's article.

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and gains, subject to certain conditions. This concession will also be available where the taxpayer undertakes the execution of any work in connection with any foreign project undertaken by any other person.

The benefit of this concession will be available in respect of projects for the construction of any building, road, dam, bridge or other structure outside India, the assembly or installation of any machinery or plant outside India, and the execution of such other work outside India of whatever nature as may be prescribed by the Central Board of Direct Taxes. The taxpayer will not be eligible for this concession unless the consideration for the execution of such project or work is payable in foreign currency and the following conditions are fulfilled:

(a) The taxpayer will have to maintain separate accounts in respect of the profits and gains derived from the business of the execution of the project or work forming part of the project.
(b) The taxpayer will be required to debit to the profit and loss account of the relevant accounting year and credit to a "Foreign Projects Reserve Account" a sum equal to 25% of the profits and gains from such project or work. The reserve must be utilised by the taxpayer during a period of 5 immediately succeeding assessment years for the purpose of his business and not for distribution by way of dividend or profits.
(c) The taxpayer will be required to remit into India in foreign exchange an amount equal to 25% of such profits and gains within a period of 6 months from the end of the relevant accounting year.

Where, however, the amount credited by the taxpayer to the Foreign Projects Reserve Account or the amount actually remitted into India by him or either of these amounts is less than 25% of such profits and gains, the deduction will be restricted to the amount so credited to the Foreign Reserve Amount, or the amount actually brought by him to India, whichever is less.

This is a useful suggestion and will be of value to specified overseas projects which make profits.

It is proposed to extend up to 31 March 1987 the grant of investment allowance now admissible at the higher rate of 35% to specified plant and machinery. Another suggestion seeks to exempt from tax intercorporate dividends in the case of 3 more industries, namely, synthetic rubber, chemicals and basic drugs.

In the field of personal taxation an increase in the standard deduction from 20% to 25% of salary, subject to a maximum of Rs. 5,000, is proposed; this will benefit salaried taxpayers only. Surely, salaried employees alone do not constitute the entire middle class; there is a very large number of self-employed small traders, retailers, artisans, builders, craftsmen and professionals who also form part of the same income group. Unlike salaried employees, the self-employed are not entitled to reimbursement of medical and leave travel expenses, gratuities and other like benefits. The apparent bias against the self-employed compels even the honest amongst them to seek redress in tax evasion and avoidance. Suitable amendments to remove these inequities are urgently called for in the interest of taxpayer morality.

A welcome feature of the Finance Bill is the promised modification of the provisions relating to the exemption from capital gains on transfer of house property. The condition of self-occupation of the property by the taxpayer will be deleted and the period for construction of a new property will be increased from 2 to 3 years. Likewise, capital gains arising from the transfer of certain long-term capital assets will be entitled to tax exemption provided the net consideration is utilised by the taxpayer for the purchase or construction of a house property within the specified period. But why restrict the utilisation to house property only? Mr. Pranab Mukherjee should go the whole hog and exempt all capital gains from tax if the net consideration is reinvested within the stipulated period in approved productive assets, movable or immovable. It is also proposed to relate the deduction in respect of long-term capital gains to the period for which the capital asset has been held; higher deduction being allowed if the capital asset is held for a longer period.

Under the existing provisions, an individual is said to be "resident" in India in any year, if:

(a) he is in India in that year for a period or periods amounting in all to 182 days or more; or
(b) he maintains or causes to be maintained for him a dwelling place in India for a period or periods amounting in all to 182 days or more in that year and has been in India for 30 days or more in that year; or
(c) having within the 4 years preceding that year been in India for a period or periods amounting in all to 365 days or more, is in India for a period or periods amounting in all to 60 days in that year.

In the case of an Indian citizen who is rendering service outside India, and who is on leave or vacation in India, the periods of 30 days and 60 days referred to in (b) and (c) are taken as 90 days.

With a view to avoiding hardship in the case of Indian citizens who are employed or engaged in other avocations outside India, the Finance Bill seeks to make the following modifications in the tests of "residence" in India:

(a) it is proposed to omit the provision relating to maintenance of a dwelling place coupled with stay in India of 30 days or more;
(b) in the case of Indian citizens who come on a visit to India, the period of "60 days or more" is proposed to be raised to "90 days or more";
(c) it is proposed to provide that where an individual who is a citizen of India leaves India in any year for purposes of employment outside India, he will not be treated as resident in India in that year unless he has been in India in that year for 182 days or more. The effect of this amendment will be that the "test" of residence in (c) above will stand modified to this extent.

With a view to encouraging the remittance of foreign exchange into the country by non-resident Indian citizens and foreign nationals of Indian origin, it is proposed to exempt from gift tax, gifts of foreign currency or other foreign exchange made by such persons to their relatives in India. For this purpose, "relative" in relation to an individual will mean the husband, wife, brother or sister or any lineal ascendant or descendant of that individual.

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Gifts made by such persons out of the moneys to their credit in a Non-resident (External) Account in India will also qualify for exemption.

But tinkering with the tax rate schedule applicable to individuals with incomes between Rs. 60,000 and Rs. 100,000 is contrary to Mr. Mukherjee's declared objective of maintaining the stability of law. The increased annual tax burden on individuals with incomes of Rs. 100,000 and above will be a maximum of Rs. 688 only; the gain to the Exchequer will be negligible but the psychological damage to the taxpayer will be tremendous. Individual initiative and enterprise will be stifled and the Government will loss its credibility. The rationale behind the proposed change is not at all clear suggesting little more than a political gimmick; this illogical proposal should be dropped.

The suggested increase in tax relief in regard to long-term savings such as life insurance premia and provident fund contributions is again marginal and not of much consequence; few taxpayers, if any, will be able to avail themselves of the proposed increase in the monetary ceiling of Rs. 40,000.

The Budget speech highlighted the buoyancy in revenue, decline in inflation and an alleged environment of strong agricultural and industrial growth in 1981-82. But Mr. Pranab Mukherjee did not rise to the occasion; on the contrary, he failed to provide adequate incentives for increasing production and savings. His direct tax proposals are too feeble and halting to assist in the achievement of the aims and objects outlined by him.

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UNITED STATES:

Competent Authority Consideration

Allocation of income or deductions*

SEC. 1. PURPOSE AND SCOPE

This revenue procedure explains the procedures to be used by the Internal Revenue Service and taxpayers in certain cases of double taxation that are governed by income tax treaties of the United States. The cases covered by this revenue procedure concern the allocation of income and deductions between a United States taxpayer and a related person (including a branch office) subject to the taxing jurisdiction of a country ("treaty country") that has entered into an income tax treaty with the United States. See Rev. Proc. 77-16, 1977-1 C.B. 573, for competent authority procedures used in resolving issues other than allocation of income and deductions, including the availability to United States taxpayers of credits against foreign tax, exemptions from foreign tax, reduced rates of foreign tax, and other benefits and safeguards. Rev. Proc. 70-18, 1970-2 C.B. 493, as amplified by Rev. Proc. 79-31, 1979-1 C.B. 599, is modified and superseded by this revenue procedure.

SEC. 2. BACKGROUND

01. Income tax treaties in force between the United States and other countries generally provide for the allocation of income and deductions among related persons whose dealings with each other are not the same as those that would be made between independent persons. These treaties recognize that taxation by a treaty country of a taxpayer with an affiliate or branch office that is subject to the taxing jurisdiction of the other treaty country may result in actual or economic double taxation. As a result, these treaties provide for consultation by the competent authorities of the United States and of treaty countries on the allocation of income and deductions between related persons. The provisions of this revenue procedure do not override the provisions of any income tax treaty entered into by the United States. Taxpayers should make themselves aware of the full content of the income tax treaty under which they are operating.

02. When the United States competent authority and a treaty country competent authority agree to discuss an allocation, whether made or proposed by the United States or by the treaty country, the United States competent authority will attempt to reach an agreement that is acceptable to the United States, to the treaty country, and to the related persons.

03. The Associate Commissioner (Operations) acts as the United States competent authority in administering the operating provisions of tax treaties and in interpreting or applying these treaties. In interpreting or applying tax treaties, the Associate Commissioner (Operations) acts only with the concurrence of the Associate Chief Counsel (Technical).

04. If the United States taxpayer fails to request competent authority consideration under this revenue procedure, the taxpayer may be denied a credit for foreign tax. See Rev. Rul. 76-508, 1976-2 C.B. 225, as amplified by Rev. Rul. 80-231, 1980-2 C.B. 219, and section 4.901-2(f)(5) of the Temporary Income Tax Regulations, T.D. 7739, 1981-1 C.B. 396.

05. The Associate Commissioner (Operations) may negotiate an agreement with the competent authority of a treaty country concerning the allocation of income or deductions between a United States taxpayer and a related person at the request of the United States taxpayer. The Associate Commissioner (Operations) also may initiate competent authority negotiations in any situation to protect United States economic interests. Such a situation may arise when a taxpayer fails to request competent authority consideration after agreeing to an allocation of income or deductions that creates either actual or economic double taxation.

06. The taxpayer should send written requests for competent authority consideration to the Associate Commissioner (Operations), Internal Revenue Service, P.O. Box 7799, Washington, D.C. 20044.

SEC. 3. GENERAL CONDITIONS UNDER WHICH THIS PROCEDURE APPLIES

01. The procedure prescribed in sections 3 through 9 of this revenue procedure apply when the United States or other treaty country allocates or proposes to allocate income or deductions and this allocation may result in actual or economic double taxation.

02. In seeking to arrive at an agreement with a treaty country, the United States competent authority will be guided by the standards of arm's length dealing (referred to in the regulations under section 482 of the Internal Revenue Code) and the equivalent standard of arrangements or conditions that would have been made between independent persons (referred to in a number of treaties). The United States competent authority also will take into account all of the facts and circumstances and the purpose of the treaty to avoid double taxation when negotiating agreements on the allocation of income and deductions.

03. It is the position of the United States competent authority not to re-open a case previously closed after examination to make an adjustment unfavorable to the taxpayer unless the exceptional circumstances described in Rev. Proc. 74-5, 1974-1 C.B. 416, are present. The United States competent authority may accept a taxpayer's request for competent authority consideration that will require the reopening of a case closed after examination.

04. If there is no income tax treaty between the United States and another country there is no authority for the Service to provide relief from United States tax due to double taxation arising under the tax laws of the other country and the United States. Therefore, in such a case the United States competent authority is unable to consider a taxpayer's request that involves a nontreaty country.

SEC. 4. PROCEDURES TO BE FOLLOWED IF TREATY COUNTRY PROPOSES ALLOCATION

01. If a treaty country allocates or proposes to allocate the income or deductions attributable to transactions involving a United States taxpayer, the United States taxpayer should request United States competent authority consideration.

02. The taxpayer must file a written request for competent authority consideration with the Associate Commissioner (Operations). Internal Revenue Service, P.O. Box 7799, Washington, DC 20044, as soon as practical after the treaty country's position on the adjustment has been sufficiently developed to permit consideration, whether or not the adjustment has been formally proposed. In any event, the request should be filed no later than 90 days after the treaty country's adjustments are formally communicated to the related person.

03. At the time of the request for competent authority consideration, the United States taxpayer must file an amended United States tax return (for exeample, a Form 1120X Amended U.S. Corporation Income Tax Return if a Form 1120 was originally filed), as provided by the regulations under section 6402, with the Internal Revenue Service Center where the original return for the same tax year was filed. On the amended United States tax return the taxpayer may claim a credit or refund of the taxes attributable to the proposed allocation and shall indicate that a competent authority request is being filed. A copy of the amended United States tax return shall be attached to the request for competent authority consideration.

* Rev. Proc. 82-29.

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04. The competent authority request must be signed by a person having authority to sign the United States taxpayer's federal income tax returns. The request must contain a statement that competent authority consideration is being requested and must include the following information:

(a) a reference to the specific income tax treaty provisions under which the request is made;
(b) the names, addresses, and taxpayer identification numbers of the United States taxpayer and all related persons involved in the proposed allocation and the tax years affected;
(c) the office where the United States taxpayer and the related person or persons filed federal income tax returns for the years in question;
(d) a statement whether the federal income tax returns of both the United States taxpayer and the related person or persons for the years in question were examined, or are in the process of being examined;
(e) a description of the control and business relationships between the United States taxpayer and the related person or persons;
(f) a statement of the status of the tax liability of the related person in the treaty country for the year or years of the proposed adjustment;
(g) actions requested of, proposed, or taken by the competent authority of the treaty country, a description of the pertinent transactions and the issues, and the amount of any correlative adjustment that would have to be made to the income or deductions of the United States taxpayer if the United States competent authority were to accept the position of the treaty country;
(h) copies of pertinent foreign income tax returns (with English translation), and a schedule (in United States dollars) showing the allocation proposed by the treaty country and computation of the resulting foreign tax;
(i) copies of pertinent correspondence from the treaty country, briefs, protests, and other relevant material (with English translation);
(j) copies of Foreign Tax Credit Computation (Forms 1118) that were filed with the tax return for each year under consideration;
(k) copies of powers of attorney on file with respect to the United States taxpayer; and
(l) on a separate document, a statement that the United States taxpayer consents to the disclosure to the competent authority of the treaty country (with the name of the country specifically stated) and the competent authority's staff of any or all of the items of information set forth or enclosed in the request for United States competent authority consideration. This statement must be dated and signed by a person having authority to sign the United States taxpayer's federal income tax return and is required to facilitate the administrative handling of the request by the United States competent authority for purposes of the recordkeeping requirements of section 6103(p) of the Code. Failure to provide such a statement will not prevent the United States competent authority from disclosing information under the terms of a tax treaty. See section 6103(k)(4).

05. If a treaty country is considering but has not yet proposed any adjustments to income or deductions arising out of transactions of or with a United States taxpayer, and the United States statutory period in which the United States taxpayer can file a claim for credit or refund of income taxes for the years involved is about to expire, the United States taxpayer should file a protective claim for credit or refund of these taxes on the appropriate amended United States tax return (including, to the extent available, the information required in a competent authority request under section 4.04 above). The amended United States tax returns must be filed with the Internal Revenue Service Center where the original tax return for the same tax year was filed. The taxpayer must send a copy of the amended United States tax return to the Associate Commissioner (Operations) (see section 2.06 above for address). Final disposition of the amended United States tax return will be deferred by the Service pending: (1) the perfection of the request for competent authority consideration under section 4.01 above and the disposition of the issues under consideration; or (2) the withdrawal of the claim for credit or refund by the taxpayer. Beginning 6 months after the amended United States tax return is filed and every 6 months thereafter, the taxpayer must state in writing (by a person authorized to sign its federal income tax returns) to the Associate Commissioner (Operations) that the treaty country is still considering an adjustment of the income or deductions. The statement must include any available information described in section 4.04 above not previously submitted and any necessary modifications or previously submitted information. The Associate Commissioner (Operations) may deny competent authority consideration if the United States taxpayer fails to file the supplemental statement within each 6 month period.

06. The amended United States tax return filed under this revenue procedure permits only the making of a credit or refund that is agreed to by the United States and the treaty country competent authorities or that is unilaterally allowed by the United States competent authority. This revenue procedure does not grant a United States taxpayer the right to invoke section 482 of the Code in its favor or compel the Service to allocate income or deductions or grant a tax credit or refund. If the United States taxpayer accepts the decision of the competent authority, the decision of the competent authority is not subject to judicial review.

SEC. 5. PROCEDURES TO BE FOLLOWED IF THE UNITED STATES PROPOSES ALLOCATION

01. If the Service allocates or proposes to allocate income or deductions attributable to transactions involving a United States taxpayer subject to the tax jurisdiction of a treaty country, the United States taxpayer should request United States competent authority consideration. (See Rev. Rul. 76-508, as amplified by Rev. Rul. 80-231. Also see section 6 of this revenue procedure for procedures to be followed by the related person if any.)

02. A written request for competent authority consideration should be submitted as soon as the amount of the adjustment is determined, communicated in writing to the taxpayer, and agreed to by the taxpayer subject to competent authority relief. Taxpayers who do not agree with the correctness of the adjustment are encouraged to pursue their right of administrative review befor the Appeals Division before requesting competent authority relief.

0.3 The taxpayer must file the written request for competent authority consideration with the Service office where the United States taxpayer's case is pending. A copy of the request must be filed with the Associate Commissioner (Operations), Internal Revenue Service, P.O. Box 7799, Washington, DC 20044. However, if the request for competent authority is not filed until after a suit contesting the tax liability of the taxpayer is pending in a court in the United States, the request should be filed with the Chief Counsel, Attention: Associate Chief Counsel (Litigation), Internal Revenue Service, Washington, DC 20044, and a copy filed with the Associate Commissioner (Operations).

04. The Internal Revenue Service office receiving the written request for competent authority consideration will promptly forward a copy of the request, pertinent files, and other appropriate information and documents to the Associate Commissioner (Operations).

05. If a request for competent authority consideration is filed, the Service will postpone further examination action on the issues accepted for competent authority consideration, except for cases pending in court and other cases in which action must be taken to avoid prejudicing the Government's interest. If there are other issues raised during the examination and the taxpayer is not in agreement with these issues, the district director will follow the usual procedures and issue the taxpayer a thirty-day letter. In preparing a protest of the unagreed issues, the taxpayer need not include any unagreed issue under consideration by the competent authority. Following the receipt of the taxpayer's protest, appeal procedures shall be initiated with respect to those issues not subject to competent authority consideration. If the competent authorities are unable to resolve the double taxation problem to the satisfaction of the United States taxpayer and the taxpayer wishes to then pursue other administrative or judicial avenues of appeal, the original protest will then be amended to include the issue unresolved by the competent authority.

06. The United States competent authority

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will not accept any taxpayer's request for consideration of a case that is pending in court without Chief Counsel's consent. If the case is pending in the United States Tax Court, the Chief Counsel may in appropriate cases request the court to delay trial pending competent authority action. If the case is pending in any other court, the Chief Counsel will consult with the Department of Justice about appropriate action. Final decision on delaying trial rests with the court. However, the filing of a competent authority request does not relieve the taxpayer from taking any action that may become necessary with respect to litigation. On completion of the competent authority consideration, the taxpayer must reinstate litigation if the taxpayer decides to continue litigation.

07. The competent authority request must be signed by a person having authority to sign the United States taxpayer's federal tax returns. The request must contain a statement that competent authority consideration is being requested and must include the following information:
(a) a reference to the specific income tax treaty provisions under which the request is made;
(b) the names, addresses, and taxpayer identification numbers of the United States taxpayer and all related taxpayers involved in the proposed allocation and the tax year affected;
(c) the district office which has made or is proposing to make the adjustment;
(d) a description of the control and business relationships between the United States taxpayer and the related person or persons;
(e) a statement of the status of the tax liability of the related person in the treaty country for the year or years of the proposed adjustment;
(f) actions requested of, proposed, or taken by the competent authority of the treaty country, a description of the pertinent transactions and the issues and the amount of any correlative adjustment that would have to be made to the related person's income or deductions if the treaty country competent authority were to accept the position of the United States;
(g) the adjustments should be stated in United States dollars and the appropriate foreign currency, identifying the conversion method used to reconcile the United States entity's books and records with the foreign entity's books and records;
(h) copies of pertinent foreign income tax returns, correspondence, briefs, protests, and other relevant material (with English translation);
(i) copies of Foreign Tax Credit Computation (Forms 1118) that were filed with the tax return for each year under consideration;
(j) copies of powers of attorney on file with respect to the United States taxpayer;
(k) copies of pertinent Forms 2952 (Information Return with Respect to Controlled Foreign Corporations), including copies of the financial statements and surplus analysis required to be filed with the return for each related entity and for each year under consideration; and
(l) on a separate document, a statement that the United States taxpayer consents to the disclosure to the competent authority of the treaty country (with the name of the country specifically stated) and the competent authority's staff of any or all of the items of information set forth or enclosed in the request for competent authority consideration. This statement must be dated and signed by a person having authority to sign the United States taxpayer's federal income tax returns and is required to facilitate the administrative handling of the request by the United States competent authority for purposes of the recordkeeping requirements of section 6103(p) of the Code. Faillure to provide such a statement will not prevent the United States competent authority from disclosing information under the terms of a tax treaty. See section 6103(k)(4).

SEC. 6. NOTIFICATION TO RELATED ENTITY

In any case covered by section 4 or 5 of this revenue procedure, the United States taxpayer should either itself take, or advise a related person to take, such timely protective action as may be necessary with foreign tax authorities. This includes the staying of the expiration of the foreign period of limitations on the making of a refund or other tax adjustment, complying with any applicable procedures of the treaty country for invoking competent authority consideration, and attempting to resist an adjustment or obtain an appropriate correlative adjustment.

SEC. 7. CASES RECEIVED FROM AND REFERRED TO, FOREIGN COMPETENT AUTHORITIES

01. The United States competent authority will not initiate action under this revenue procedure with respect to foreign corporations, partnerships, or other entities of a treaty country. Requests sent to the United States competent authority by these taxpayers will be referred to the competent authority of the treaty country.

02. When a treaty country competent authority refers a request for mutual agreement to the United States competent authority, the United States competent authority will contact the United States taxpayer and advise the taxpayer to comply with this revenue procedure in order to obtain consideration by the United States competent authority.

SEC. 8. REV. PROC. 65-17

Rev. Proc. 65-17, 1965-1 C.B. 833, and Amendment I of Rev. Proc. 65-17, 1966-2 C.B. 1211, as amplified by Rev. Proc. 65-31, 1965-2 C.B. 1024, provide that the United States taxpayer must file a request for the treatment provided by Rev. Proc. 65-17 in writing with the appropriate district director before closing action is taken on the section 482 issue that forecloses availability of Rev. Proc. 65-17. Therefore, if a United States taxpayer desires competent authority action and the benefits provided by Rev. Proc. 65-17, the taxpayer must file a request under Rev. Proc. 65-17 before entering into any closing agreement or before any other closing action (as defined in section 4.03 of Rev. Proc. 65-31) is taken on the section 482 issue.

Rev. Rul. 82-80, page 7, this [Internal Revenue] Bulletin, states that a United States subsidiary, whose taxable income has been increased for a tax year because of an allocation under section 482 of the Code, may receive payment from its foreign parent corporation from which, or to which, the allocation of income or deductions was made, in an amount not in excess of the taxable income increase without further federal income tax consequences. For procedures to be followed in applying this position and requirements that must be fulfilled to qualify for such treatment, see Rev. Proc. 65-17.

SEC. 9. ACTION BY COMPETENT AUTHORITY

01. The United States taxpayer will be notified if the facts provide a basis for competent authority assistance. The United States competent authority will not assist the taxpayer if:
(a) under the facts and circumstances the taxpayer is not entitled to such assistance (for example, actual or economic double taxation does not exist);
(b) the taxpayer indicates unwillingness to accept a competent authority agreement except under conditions that are clearly unreasonable or unfairly prejudicial to the interests of the United States;
(c) the taxpayer does not accept the concept that competent authority negotiations are a government to government activity that does not include the taxpayer's participation in the negotiation proceedings;
(d) the taxpayer does not furnish, upon request, sufficient information to determine whether the treaty applies to the taxpayer's facts and circumstances, or the taxpayer otherwise fails to act as required by this procedure;
(e) the request is from a taxpayer under the jurisdiction of another competent authority (see section 7.01 of this revenue procedure); or
(f) the taxpayer has demonstrated an unwillingness to execute a consent extending the period of limitations on assessment of tax for the tax year or years under consideration (see section 9.02 of this revenue procedure).

02. If the United States competent authority accepts a request for consideration, the United States taxpayer must supply any additional information needed to resolve the case

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and keep the United States competent authority informed about proceedings in the treaty country or any other pertinent developments. The taxpayer also may be requested to execute a consent extending the period of limitations on assessment of tax for the tax year or years concerned.

03. If the United States competent authority denies assistance, the United States taxpayer may ask the Commissioner of Internal Revenue to name a panel and have the panel review the denial of assistance. The panel will notify the taxpayer that the taxpayer may present oral arguments at a hearing, if so desired, in support of the taxpayer's request for competent authority assistance. The decision of the panel whether competent authority assistance should be provided is final and is not subject to judicial review. The United States competent authority will notify the taxpayer of the panel's decision. If the panel decides that the case is suitable for competent authority assistance, the United States competent authority will assist the taxpayer in accordance with this revenue procedure.

04. The United States competent authority will notify a taxpayer requesting assistance under this revenue procedure of any agreement or partial agreement that the United States and the treaty country competent authority reach with respect to the request. If such agreement or partial agreement is not acceptable to the taxpayer, the taxpayer may withdraw the request for competent authority consideration and may then pursue all rights to administrative and judicial review otherwise available under the laws of the treaty country and the United States.

05. When appropriate, in cases covered by sections 4 and 5 of this revenue procedure, the taxpayer will be requested to enter into a closing agreement reflecting the terms of the competent authority in accordance with sections 6.07 and 6.17 of Rev. Proc. 68-16, 1968-1 C.B. 770.

06. The United States competent authority will not grant unilateral relief to a United States taxpayer with respect to an adjustment to income, deductions, credits or other items solely because the period of limitations has expired in the foreign country and the competent authority of that country has declined to grant any relief from double taxation.

If the period provided by the foreign statute of limitations has expired, then the United States competent authority may take into account other relevant facts and may, as a matter of discretion, provide unilateral relief with respect to the adjustment to the extent necessary to avoid actual or economic double taxation of income. Relevant facts include the absence of actual or constructive notice of the proposed allocation so that the taxpayer could not avail itself of any remedies in the foreign jurisdiction; the absence of abusive tax arrangements in the structuring of the relevant international relationships and transactions; and the absence of recurring adjustments. In no event, however, will relief be granted where there is fraud or negligence with respect to the relevant international relationships and transactions.

Unilateral relief wil generally only be granted by the United States in the context of a tax treaty used by the other competent authority to grant unilateral relief to taxpayers of that country. If an income tax treaty is not in force with a particular foreign coutry, then the service wil not provide relief with respect to an adjustment because the period of limitations of that country has expired.

SEC. 10. REQUEST FOR RULINGS

01. Requests for advance rulings about the interpretation or application of a treaty on United States taxation, as distinguished from requests to the United States competent authority under this revenue procedure or Rev. Proc. 77-16, should be submitted to the Associate Chief Counsel (Technical) in accordance with Rev. Proc. 80-20, 1980-1 C.B. 633.

02. The Service does not issue advance rulings on the effect of the treaty on the tax laws of the treaty country for purposes of determining the tax of the treaty contry or the meaning of a treaty article for that purpose.

SEC. 11. EFFECTIVE DATE

This revenue procedure is effective 3 May 1982.

SEC. 12. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 70-18 and Rev. Proc. 79-31 are superseded.

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FOR FURTHER INFORMATION PLEASE WRITE TO:

Confédération Fiscale Européenne (C.F.E.): Secrétariat Général, Postfach 1340, Dechenstrasse 14, D-5300 Bonn 1 (Federal Republic of Germany).

International Fiscal Association (I.F.A.): General Secretariat, Woudenstein, Burgemeester Oudlaan 50, P.O. Box 1738, 3000 DR Rotterdam (the Netherlands).

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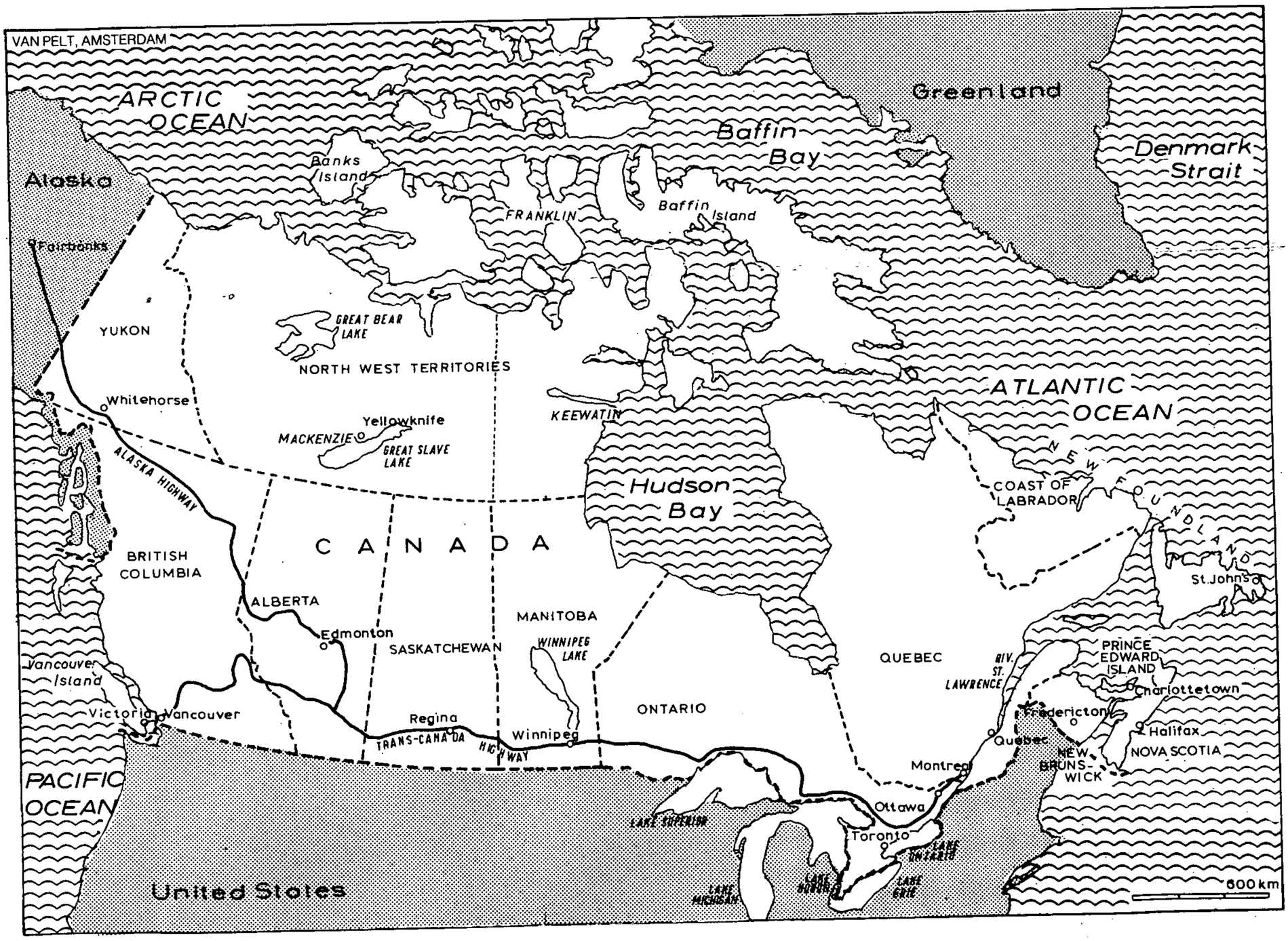
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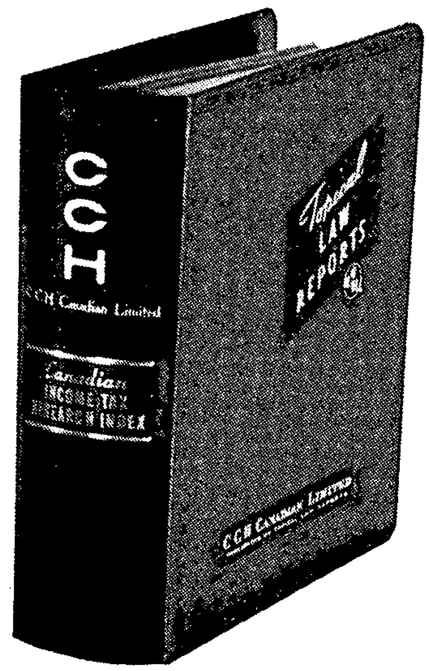
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Congrès Montréal 1982



MAX LAXAN
Président de l'IFA

Appelé à BERLIN, l'an dernier, à succéder à Alun DAVIES, je m'adresse pour la première fois aux lecteurs du Bulletin de Documentation Fiscale Internationale et, à travers cette livraison spéciale, que chaque congressiste trouvera dans sa serviette, à l'ensemble des adhérents de notre association. Je voudrais tout d'abord saluer K.V. ANTAL, qui vient de quitter, après quinze années de dévotion à ses fonctions, la présidence du Curatorium du Bureau International de Documentation Fiscale et adresser mes voeux les plus sincères à son successeur, le professeur A. NOOTEBOOM, qui a été choisi pour lui succéder et dont j'ai eu plaisir à prononcer la nomination. C'est aussi pour moi l'occasion de souligner la grande qualité de la documentation et des études que le Bureau met à la disposition des fiscalistes du monde entier, sous l'active direction de J. VAN HOORN et de son équipe, pour le plus grand renom de notre association.

Je dois maintenant, selon l'usage, présenter aux lecteurs du Bulletin le programme de notre trente-sixième Congrès.

En 1981, nous avons tenu notre réunion à l'avant-poste du monde occidental, dans une ville qui est le témoignage vivant de la division de notre planète. Cette année, nous portant à quelques milliers de kilomètres à l'Ouest, nous tiendrons congrès, à l'invitation du groupement canadien, dans une des villes les plus attachantes du continent américain, et dans un pays jeune qui a su concilier avec bonheur les deux cultures dont il est dépositaire. Après les déchirements de la vieille Europe, le creuset de civilisations du Nouveau Monde . . .

Les deux thèmes d'études qui nous sont proposés revêtent un grand intérêt et une réelle actualité dans la mesure où ils concernent les deux facteurs principaux du développement des échanges internationaux, à savoir la circulation des capitaux et celle des hommes. Sans doute, à travers l'un et l'autre sujets, ne s'agit-il que d'un cas particulier de mise en oeuvre de ces facteurs. Cependant l'internationalisation croissante du financement des entreprises comme le développement des technologies modernes donnent aux problèmes qui seront traités à MONTREAL une importance et un relief certains.

Le premier sujet, je le rappelle, concerne le régime fiscal des intérêts des prêts dans les relations transnationales. D'intéressantes contributions ont été apportées à l'examen de cette question à l'occasion de congrès précédents. Je citerai par example les études relatives à l'imposition des entreprises apparentées en 1971, à l'égalité de traitement entre investisseurs résidents et étrangers en 1978 ou encore, l'an dernier, aux mesures unilatérales tendant à éviter la double imposition. Mais il était assurément utile de procéder à un examen exhaustif du problème et il faut savoir gré au Prof. HÖHN d'avoir magistralement ordonné, avec beaucoup de clarté, dans son rapport général, les différentes questions se rapportant au sujet et d'en avoir effectué une brillante synthèse.

La principale difficulté provient de la circonstance que la plupart des pays entendent percevoir un impôt à la fois sur le montant des intérêts versés à des non-résidents et sur les intérêts reçus par leur propres résidents. On assiste, de ce fait, à l'application simultanée du principe de la source et du principe du domicile. Dans la plupart des cas, et notamment entre pays industrialisés, ce conflit se résoud dans le cadre de conventions internationales qui organisent en quelque sorte le partage de la matière imposable entre les deux administrations fiscales intéressées.

Ce partage s'effectue le plus souvent dans des conditions conformes aux recommandations des conventions modèles de l'O.C.D.E. et de l'O.N.U. Dans ce cadre cependant, l'impôt payé à la source – et qui frappe le revenu brut – ne peut pas toujours être imputé en totalité sur l'impôt dû dans le pays de résidence, qui s'applique à l'intérêt net: il subsiste alors une double imposition partielle. A l'inverse, c'est une exonération partielle qui peut intervenir lorsque l'imputation forfaitaire excède l'impôt reèllement payé à la source, dans le cadre de relations entre pays développés et pays en voie de développement.

A défaut de conventions internationales, de nombreuses dispositions unilatérales portent remède à la double imposition des revenus des capitaux prêtés. En bref, les dispositions prises au plan international ou au plan interne assurent aux dispositifs fiscaux qui enserrent les mouvements de capitaux une neutralité assez satisfaisante et ne constituent pas un obstacle au financement des investissements.

Les difficultés résiduelles concernent plutôt l'exigence, pour l'élimination de la double imposition, de la conformité aux taux du marché de l'intérêt servi au créancier, notamment entre sociétés apparentées: l'assimilation des intérêts réputés excessifs à des dividendes peut conduire à une surcharge fiscale, surtout lorsque les conséquences de cette qualification ne sont pas entièrement reconnues par l'administration fiscale du pays du domicile.

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Le second sujet soumis à nos réflexions concerne le régime fiscal applicable à la rémunération des services rendus par un non-résident dans le cadre d'une activité indépendante. Le dépouillement des vingt-quatre rapports nationaux et l'analyse très pertinente et très approfondie qu'a faite du sujet, sous ses différents aspects, le rapporteur général, M. Gérard COULOMBE, permettent de cerner très complètement les problèmes que peut rencontrer un prestataire de service exerçant ses activités dans un pays étranger. Il faut noter d'abord, dans les législations nationales, d'intéressantes convergences, spécialement en ce qui concerne les critères permettant de distinguer l'activité exercée à titre indépendant de celle exercée en qualité de salarié, même lorsque ces deux types d'activités sont développés de façon concomitante.

Par contre les conditions d'imposition des services rendus par un non-résident dans le cadre d'une activité indépendante varient considérablement d'un pays à l'autre. Aux deux extrêmes on relève la subordination de l'imposition à l'existence d'un établissement stable et, à l'inverse, l'extension de la taxation à tous les services rendus à un résident ou mis à sa charge. Mais on trouve, en fait, toutes les combinaisons possibles en fonction de l'endroit où le service est rendu, utilisé ou rémunéré. Les modalités d'imposition sont également très diverses, même si la pratique d'une retenue à la source est généralement observé.

L'application de la convention modèle de l'O.C.D.E., qui prévoit l'imposition au profit de l'Etat de la résidence des revenus de ce type, sauf si le contribuable dispose dans l'autre Etat de façon habituelle d'une base fixe, est d'une application de plus en plus générale, du moins entre pays industrialisés. De même, s'agissant d'artistes ou de sportifs, la conception plus extensive du droit d'imposer reconnue à l'Etat d'exercice de l'activité selon la même convention est largement suivie. De la sorte, le bon fonctionnement des conventions a réduit, de façon satisfaisante, le nombre des cas de double imposition. Il reste, comme le souligne le rapporteur dans ses propositions, qu'il serait souhaitable de parvenir à une harmonisation plus poussée des régimes d'imposition en vigueur dans les différents pays. D'autre part le caractère forfaitaire de certains prélèvements ne devrait pas excéder la capacité contributive réelle des prestataires de services.

La qualité des travaux présentés par les rapporteurs généraux, avec l'aide de leurs collègues nationaux, la rigueur de leurs analyses et le soin apporté à la formulation de leurs conclusions doivent permettre que s'instaure, à MONTREAL, sur les deux sujets retenus, un débat approfondi et enrichissant.

Pour compléter le programme, trois séminaires prendront place au Congrès de MONTREAL. Le premier développera les objectifs et les conséquences du système d'imputation et devrait donner lieu à des échanges de vues doctrinaux et pratiques des plus vifs. Le second mettra en lumière les aspects récents de l'évolution de la législation fiscale canadienne et sera l'occasion pour les participants de recueillir à la source une documentation du plus grand intérêt. Le dernier, enfin, traitera du projet de convention à intervenir entre le Canada et les



Etats-Unis: même s'il intéresse au premier chef les ressortissants des deux pays, il sera certainement suivi avec attention par un grand nombre de congressistes.

Il me reste à former des voeux chaleureux pour la pleine réussite, au plan scientifique comme au plan amical, du Congrès de MONTREAL.

The Congress of Montreal 1982

For the first time since I took over from Alun DAVIES in Berlin last year, I address the readers of the *Bulletin for international fiscal documentation*. Through this special issue, which everyone attending the congress will find in his congress kit, I also address all the members of our association.

First of all I would like to say farewell to Mr. K.V. ANTAL, who has just resigned as president of the Board of Trustees of the International Bureau of Fiscal Documentation after 15 years of dedicated work. I extend a hearty welcome to his successor, Professor A. NOOTEBOOM, who was chosen to succeed him and whose nomination I have ratified with pleasure. I also take this opportunity to emphasize the high quality of the documentation and studies that the Bureau, under the active guidance of Mr. J. VAN HOORN and his staff, offers tax experts all over the world, thus enhancing the fame of our association.

As usual, I will now present the programme of our 36th congress to the readers of the *Bulletin*.

In 1981 we held our meeting at one of the outposts of the western world, in a city which is the living witness of the division of our planet. This year we are holding our congress several thousand kilometers further west, at the invitation of the Canadian chapter, in one of the most attractive cities of the American continent and in a young country which has understood how to reconcile harmoniously the two cultures which it comprises. After the torn Old Europe, the cultural melting pot of the New World. . .

We are offered two subjects of great interest, which are especially topical as they concern two main factors in the development of international relations, namely the flow of capital and the movement of persons. In fact, both

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subjects show only a specific aspect of the operation of these factors. However, the increasing internationalization of enterprise financing as well as the development of modern technology invest the problems which will be dealt with in MONTREAL with an indisputable importance and significance.

The first subject concerns the tax regime of interest on transnational loans. At previous congresses interesting contributions have been made to the study of this matter. I would mention, for example, the studies on the taxation of related corporations in 1971, differences in fiscal treatment between local and foreign investors in 1978 and, last year, unilateral measures for the avoidance of double taxation. But it would certainly be useful to undertake an exhaustive study of the problem and we must be grateful to Prof. HÖHN for having arranged with great clarity the various questions on the subject in his general report and also for having brought about a brilliant synthesis.

The main problem arises from the fact that most countries want to receive taxes both on the amount of interest paid to non-residents and on the interest received by their own residents. Thus, the principles of source and domicile are simultaneously applied. In most cases, and especially between industrialized countries, this conflict is resolved through the conclusion of international conventions which provide for some kind of allocation of the income to be taxed between the two interested tax authorities.

This allocation is usually effected in conformity with the recommendations laid down in the model conventions of the OECD and the United Nations. However, notwithstanding the existence of tax conventions, tax withheld at source - which is imposed on the gross amount - cannot always be fully credited against the income tax which is due in the country of residence and which is levied on net interest: double taxation therefore remains to some extent. In contrast, where a fixed credit is granted which exceeds the tax actually withheld at source as is, for instance, often the case between developed and developing countries, there may be a partial exemption.

Where no international conventions exist, there are a great number of unilateral provisions which aim at remedying the double taxation of income from loan capital. In short, the measures which have been taken at international and national levels tend to ensure a satisfactory degree of neutrality and do not constitute an obstacle to the financing of investment.

Remaining problems concern, rather, the requirement that in order to obtain the elimination of double taxation, the rate of interest paid to the creditor must be in conformity with market conditions, especially in the case of parent companies: the labelling of interest deemed excessive as dividend may result in additional tax, in particular when such qualification is not fully accepted by the tax authorities in the country of residence.

The second subject which is submitted for our consideration concerns the tax regime applicable to the remuneration of services rendered by a non-resident carrying on independent activities. The General Reporter, Mr. Gérard Coulombe, has examined the twenty four national reports and his analysis, which is very relevant and very thorough, permits us to appreciate fully the problems which may beset a person supplying services and who performs his activities in a foreign country. It should in the first place be noted that there are interesting similarities in the national legislations, especially with respect to the criteria used to distinguish between independent and dependent personal activities, even where these two types of activity have developed concomitantly.

In contrast, the conditions under which services rendered by a non-resident in the framework of independent activities are taxed vary considerably from one country to another. There are two extreme positions: in some cases, the existence of a permanent establishment is a prerequisite for taxation whereas in other legislations tax is levied on all services which are supplied or charged to a resident person. However, one actually finds all kinds of possible combinations under which taxation may be based on the place where the service is rendered, utilized or remunerated. The manner in which taxation is effected also varies significantly, although in practice tax is generally withheld at source.

The application of the OECD Model Convention which prescribes that tax should be levied on this kind of income by the State where the recipient has his residence, except when the taxpayer habitually possesses a fixed base in the other State, is becoming more and more general, at least among industrialized countries. Also, with respect to artists and sportsmen, the more extensive concept to be found in the OECD Model Convention, under which the State where the activities are performed is permitted to impose tax, is now widely followed. Thus, a smooth functioning tax treaty network has satisfactorily reduced the number of cases of double taxation. As the General Reporter emphasizes in his suggestions, one problem remains which it is desirable to solve, i.e. a better harmonization of the tax regimes which are in force in the various countries. On the other hand, fixed withholdings should not exceed the capacity of persons supplying services to pay tax.

The quality of the studies presented by the General Reporters with the help of their national colleagues, the accuracy of their analyses and the careful formulation of their conclusions must result in a profound and rewarding discussion of the two selected subjects.

To round off the programme, three seminars will take place at the MONTREAL congress. The first will consider the aims and consequences of the imputation system and should provide an opportunity for a very lively exchange of theoretical and practical views. The second will shed light on the latest developments in Canadian fiscal legislation and will give participants the opportunity to obtain highly interesting first hand information. And last, the third seminar will deal with the new tax treaty which Canada and the United States are contemplating to conclude: even though it is of first and foremost interest to nationals of these two countries, this seminar will certainly be attended with interest by a large number of participants.

Let me finally express my warm wishes for a successful congress in Montreal, both on its scientific and social sides.

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INTRODUCTION

With the advent of the 1982 IFA Congress in Montreal, it was considered appropriate to have some articles in the *Bulletin* commenting on the Canadian fiscal scene for the benefit of non-Canadian participants. To this end 5 papers have been assembled, each written by a separate and qualified fiscal expert. Each article covers a facet on the subject in terms which it is hoped will give the non-Canadian reader a useful overview of a field in which he may have an interest and yet also be sufficiently detailed and technically accurate to provide him with points of departure should he wish to study any particular area in greater detail.

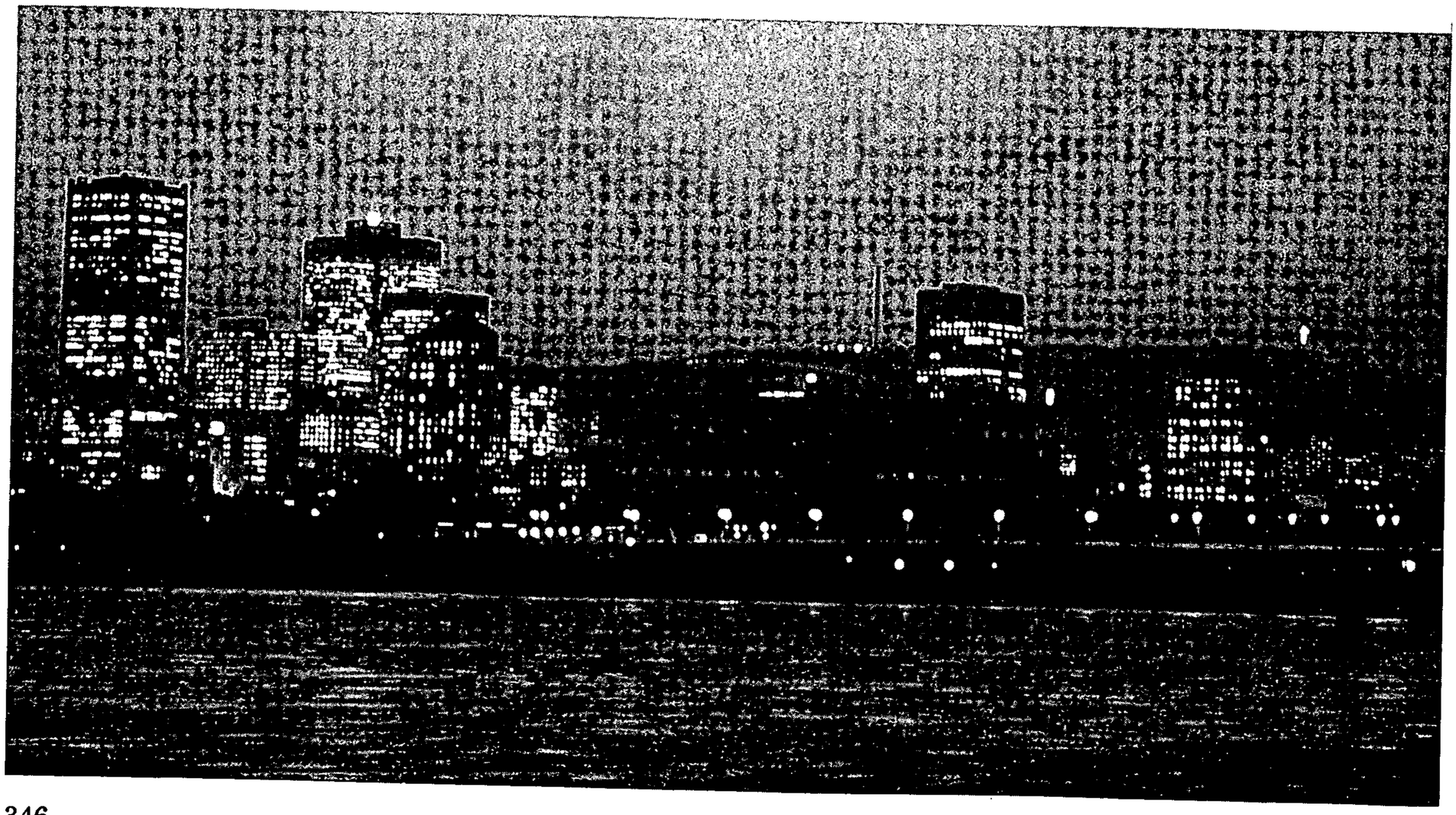
Two of the articles deal with doing business: one in Canada by non-residents ("Structuring Investments and Business Start-ups in Canada", by Nathan Boidman, a Montreal lawyer and international tax practitioner), the other doing business abroad by Canadians ("Taxation of Offshore Income and the Canadian Treaty Network", by H. Heward Stikeman, Q.C., also a lawyer practicing domestic and international tax law, based in Montreal and Toronto).

In addition to these rather specific articles, there are two more covering generalized fields: "The Influence and Impact of Canada's Tax Accounting Rules on Structuring Canadian Business Operations", by Edwin C. Harris, Q.C., a tax lawyer and lecturer in tax law at Halifax; and "Working with Canada's Statutory and Discretionary Industrial and Petroleum Assistance Program", by Peter McQuillan, C.A., a senior tax partner with Ernst & Whinney in Toronto. Mr. Harris's article deals with a subject that is important for any understanding of Canadian fiscal legislation: the growing divergence between the rules of tax accounting and the rules of public accounting. This divergence, which has been necessitated by the artificial structure of a so-called neutral tax system, often influences the choice of various courses of action in the commercial and financial world.

The article by Mr. McQuillan deals with the growing field of government grants and assistance programs which complement the fiscal system. These government programs either utilize the tax laws themselves or run parallel to them in such a fashion that any consideration of a problem based solely on the taxing statutes may be incomplete without a reference to and a knowledge of the various assistance programs that may affect it. Of particular importance, of course, is the recently introduced Canadian National Energy Program.

Finally we have been fortunate enough to obtain an article by the Federal Finance Minister, the Hon. Allan J. MacEachen, P.C. who describes how government fiscal needs and expenditure programs are developed. In particular he deals with the well known but recently introduced Envelope System of government budgeting and its impact upon tax expenditures and the rising of government revenue by fiscal measures.

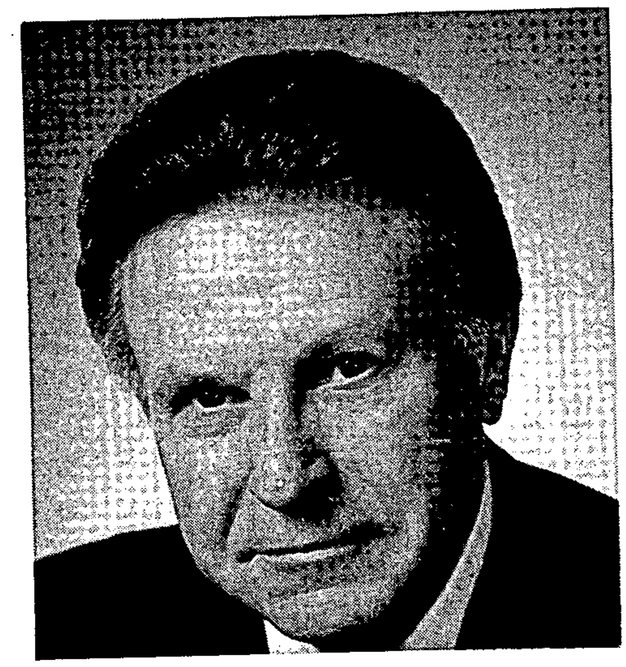
It is hoped that this collection of articles will, within the covers of one small volume, provide a comprehensive view of the Canadian fiscal scene.



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Integration of Tax Expenditures into the Government Fiscal Management System

by the Hon. Allan J. MacEachen
Deputy Prime Minister and Minister of Finance



Mr. MacEachen (61) received an M.A. from the University of Toronto.

He became professor of economics at St. Francis Xavier University at the age of 25.

Mr. MacEachen first entered federal politics in 1953.

In 1955, he attended the General Assembly of the U.N. as Parliamentary observer. He was alternate delegate in 1956 to the Economic and Social Council of the UN in Geneva.

In April 1963, he was appointed Minister of Labour. He, inter alia, piloted the Canada Labour Code through Parliament.

Mr. MacEachen was appointed Minister of National Health and Welfare in December 1965, and brought forward a series of major programs in the social security field.

Mr. MacEachen was Government House Leader in 1967-1968 and served as Chairman of the Committee on the Reform of Parliamentary Procedure.

In 1968 he was appointed Minister of Manpower and Immigration.

From 1970-74 he was President of the Privy Council and Leader of the Government in the House of Commons.

In August 1974, Mr. MacEachen became Secretary of State for External Affairs. He was responsible for the direction of Canada's effort at the Law of the Sea Conference. In June 1976, he announced the establishment of a 200-mile economic management zone for the continental shelf. Mr. MacEachen was also responsible for the Agreement on Commercial and Economic Cooperation between Canada and the European Economic Community. Between December 1975 and June 1977 he was co-chairman of the 27-nation Conference on International Economic Cooperation which was aimed at laying the basis for a more equitable world economic order. He also initiated Canada's successful bid for election to the Security Council of the United Nations.

In September 1976, Mr. MacEachen was appointed President of the Privy Council and Leader of the Government in the House of Commons. On September 16, 1977, Mr. MacEachen was appointed Deputy Prime Minister of Canada. He conducted the negotiations that led to the Northern Gas Pipeline Agreement with the United States in September, 1977 and subsequently piloted the Northern Pipeline Act through the House of Commons.

After the general election of February 18, 1980, he was appointed Deputy Prime Minister and Minister of Finance.

For the year 1980/81 Mr. MacEachen was appointed Chairman of the Group of Ten. In May 1981, Mr. MacEachen was elected, in Gabon, Chairman of the Interim Committee of the International Monetary Fund.

A proper fiscal management system is an important preoccupation of governments of most of the countries in the world. The principal objectives of a fiscal management system are to control the growth in public spending and to ensure an efficient allocation of public funds to various priority areas. It is also important that the system provide adequate opportunity for an ongoing review of the fiscal initiatives taken in the past, permit flexibility in shifting resources from one policy area to another in response to changing priorities, and provide for financial control.

To better achieve these objectives, Canada has recently adopted a new fiscal management system, under which the overall outlays of the federal government are divided into several broad policy areas or "envelopes". The spending decision within each envelope is then delegated to a committee of Ministers responsible for the policy areas within that envelope. While this system is similar in many respects to that found in some other countries, one unique feature of the system in Canada is the integration of tax expenditures or selective tax preferences within the system. This integration of tax expenditures into the system is in recognition of the fact that a variety of instruments may be used to achieve given policy goals. These instruments include grants, direct expenditures, loans and guarantees, and tax incentives. An appropriate fiscal management system should give a place to all of these alternatives so that the most appropriate mechanism is chosen. It should not bias the choice of instruments in a manner that is detrimental to the achievement of overall policy objectives.

THE ENVELOPE SYSTEM

The new fiscal management system, or the envelope system, as it is referred to, was adopted in response to a number of concerns that had developed over a period of years. The previous structure of federal government expenditure management presented certain difficulties which were articulated by successive Auditors General and by the government's Comptroller General. In November 1976 the government appointed the Royal Commission on Financial Management and Accountability, known as the *Lambert Commission*. The Commission's final report noted:

> Our review of the existing financial planning process revealed several fundamental weaknesses. None of the participants is held effectively accountable. Expenditures are proposed by departments in ignorance of projected revenues and without their being related to priorities. There is no public commitment to an expenditure plan and consequently no basis for effective parliamentary review. Finally, there is little public participation in expenditure planning.

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Another important consideration was the effort by the Canadian government, like the governments of many other Western countries, to restrain the growth of the public sector. Expenditures since 1975-76 have been kept to an average growth rate slightly below that of GNP. This is reflected in the decline in the ratio of "total outlays", which is the sum of budgetary expenditures and non-budgetary loans, investments and advances, from 22.9% GNP in 1975-76 to 20.2% in 1980-1981. Such a period of restraint creates special pressures on a fiscal management system and highlights the need for an effective allocation of resources in relation to priorities including an effective review of existing programs.

The 1970s also saw rapid changes in Canadian society and many new issues facing governments. New government departments and agencies evolved and existing departments found more than ever that their responsibilities were intertwined with other policy areas. Clearly, this situation requires a high degree of budgetary control and a system that is designed to highlight trade-offs between competing programs.

The envelope system is intended to deal with the problems identified by ensuring greater Ministerial control over both policies and expenditures. The envelope system does this by assisting Ministers in integrating policy making and fiscal and expenditure planning within the Cabinet Committee system.

The outline of the basic system is quite straightforward. Its basis is a medium-term fiscal plan encompassing revenues and expenditures over a 5-year period. Each year, the Cabinet reviews the overall level of expenditures on recommendations by the Minister of Finance and President of the Treasury Board. These overall expenditures are then divided into 9 allocations for broad policy areas, or 9 envelopes as they are called. Formally, an envelope is an authorized expenditure limit, expressed in current dollars for the fiscal year in question. The 9 envelopes are Economic Development, Energy, Social Affairs, Justice and Legal, Fiscal Transfers to Provinces, External Affairs, Defence, Parliament, and Services to Government. A separate account is maintained for the costs of public debt.

Overseeing the operation of each envelope is a policy Committee composed of Cabinet Ministers with responsibilities in the policy area of the envelope. These committees have the responsibility of allocating expenditures within the envelope to particular departments and programs.

Each Policy Committee is provided with a basic operational level of expenditures within its envelope. This provides for the forecast cost of existing programs and an operating reserve to meet cost overruns, although the Treasury Board works throughout the course of the year to identify program savings to avoid net overruns in expenditures where possible.

Policy Committees may also be provided with additional amounts for the financing of new or enriched programs or they may be required to reduce expenditures. Policy Committees control the allocation of funds for new or enriched programs and designate existing programs that can be reduced or eliminated within their policy area.

The Policy Committees thus have two sources of funds for new or expanded programs. These are additional amounts provided for an envelope in the annual review by Cabinet and reallocation of amounts from existing programs. The incentive to identify programs that can be reduced or eliminated, thereby freeing funds for uses that are currently more in line with government priorities, is crucial to the system and makes it an effective means of fiscal management.

The foregoing represents a brief summary of the system in terms of expenditures. As was indicated earlier, this fiscal management system does not differ in broad outline from that used in some other countries. However, a unique feature of the Canadian system is its treatment of tax expenditures.

TAX EXPENDITURES AND THE ENVELOPE SYSTEM

The inclusion of tax expenditures in the fiscal management system is a very important feature and one that is of particular relevance in regard to the responsibilities of the Minister of Finance. The integration of the tax and expenditure sides of the budget reflects several considerations and experience gained in the period of restraint since the mid-1970s.

The basic concept of a tax expenditure is a provision in the tax system which provides certain taxpayers with preferential treatment in comparison to a benchmark tax structure. The benchmark tax structure is one that provides no preferential treatment to taxpayers on the basis of demographic characteristics, sources, or uses of income, geographic location or any other special circumstances applicable only to a given taxpayer or particular group of taxpayers. The preferential treatment or deviation from the benchmark may be in the form of deductions from income, exemptions, tax deferrals, lower tax rates or credits.

Tax expenditures are, in many respects, a substitute for direct spending. They both implement government priorities. As well, they both lead to increases in the budget deficits or require program cutbacks or increases in the general tax revenues for their financing. A proliferation of tax incentives eventually means higher tax rates for all because of a reduced tax base, which, in turn, has potentially serious implications for incentives to work, save and invest. Tax expenditures, just as direct expenditures, represent a form of government intervention in the economy. This, in itself, suggests that decisions about tax expenditures should be integrated into the fiscal management system.

Another consideration is that the size of tax expenditures is substantial, in both the number of items and the aggregate value of revenues foregone. In several policy areas they rival the value of direct spending. Moreover, tax expenditures were growing rapidly. From 1976 to 1979, the rate of increase in the value of tax preferences was some 50% higher than the rate of increase in direct spending.

It was perhaps not surprising that a period of rapid growth in tax expenditures coincided with increasing efforts to restrain government spending. Under the previ-

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ous system additional funds directed to a policy area by tax expenditures did not affect the budget of the sponsoring department. With government expenditure restraint blocking all but the very highest priority new programs or expansion of existing programs from the mid-1970s, the introduction of new tax expenditures thus became one of the few avenues available for government program Ministers to pursue policy objectives that they quite legitimately identified in their areas of concern. It created strong incentives for each program Minister to seek new tax expenditures in his area of responsibility, usually with the support of the population groups or industrial sectors whose interests he or she was expected to represent. The Minister of Finance was placed in the lonely position of attempting to couple expenditure restraint with deficit reduction while maintaining the credibility of the tax system as a fair and effective means of raising government revenues.

The process of integration of tax expenditures into the fiscal management system comprises a number of elements. In the normal course of events, a program Minister would, initially, identify various alternative means of achieving a given policy objective and consider their relative advantages and disadvantages. These would then be reviewed by the relevant Policy Committee to determine if any policy action is warranted and if there are adequate funds set aside for it within the envelope. If it is the view of the Committee that the given policy objective is best achieved by a new tax expenditure item or extension of an existing one, the measure is then forwarded to the Minister of Finance who has the overall responsibility for the tax system. If the measure does not conflict with the basic objectives of the tax system or give rise to other structural or technical anomalies, then the Minister concurs with its adoption, and the cost of the measure is debited to the envelope for that policy area.

One crucial feature of this system is the concurrence of the Minister of Finance with the adoption of any tax measure. This is based on the need to maintain a tax system that operates in a fair and effective fashion. Unlike individual expenditure programs that can operate to a large extent almost independently of the other programs, the tax system is an integrated one. Changes in one part of the system may lead to repercussions elsewhere in the system. The Minister of Finance might not consider it desirable to proceed with a given tax change if, for example, it were to lead to significant difficulties in compliance and administration or give undue benefits to certain groups of taxpayers and thereby calling into question the fairness of the whole system. A tax incentive to one group or in respect of one activity might lead to pressures for similar incentives to other groups or in respect of other activities. It might sometimes be easier to resist such pressures when the incentive is provided through a direct expenditure program as opposed to the tax system.

Tax changes may also flow in the opposite direction, that is, the Minister of Finance may propose changes to a Policy Committee with the cost of the new tax expenditure to be charged to their envelope. Finally, the Minister of Finance may introduce changes on his own initiative for tax policy, fiscal policy, or administration grounds without giving rise to adjustments in envelopes.

In integrating tax expenditures into the financial management system, a key issue involves the treatment of existing tax expenditures. Should these existing tax preferences be assigned to envelopes and form a portion of the envelope entitlement? The decision taken was to exclude existing tax expenditures from the system.

While this may be considered a flaw in the implementation of the system, I believe it was a necessary and practical step that does not detract from the potential effectiveness of the system. First, the definition of a benchmark tax system against which to measure tax expenditures is far from a clear cut task. Commentators can differ sharply on such features as the appropriateness of using the individual or family as a unit of taxation, or assumptions about the integration of corporate and personal income taxes. When the tax expenditure accounts are for informational purposes, these questions of definition are not an obstacle to their presentation and use. They would, however, become of paramount importance if the full accounts were to be integrated into the fiscal management system. It was found that most of these issues arose in the context of existing tax provisions and that it was relatively easy to determine whether a new change was a tax expenditure or part of the benchmark structure.

The implication of this exclusion of existing tax expenditures is that their elimination or reduction does not provide additional amounts for an envelope, although the envelope could be credited by an appropriate amount where the Policy Committee recommends a cut-back in tax expenditures as part of a package to retarget fiscal incentives in a given policy area. In general, only tax incentives that have been provided for within the envelope system, i.e. new tax expenditures, will give rise to additional funds within when they are eliminated.

The integration of tax expenditures should have two direct influences on the frequency and the nature of tax proposals arising from program Ministers. First, program Ministers discuss the request for tax expenditures within their Parliamentary Committee as part of the actual budgetary process for their envelope, and thus should have vital interest in screening requests for tax expenditures coming out of the Committee. Second, since tax expenditures and direct expenditures both impact on the available amount of funds in an envelope, the decision to seek delivery through the tax system versus the expenditure system will be based on the relative merit of the two approaches.

The tax system may be a more advantageous way to carry out government policy for a number of reasons. First, the tax system is a self-assessment system and taxpayers themselves have the discretion to act on an incentive themselves. The degree of bureaucratic discretion and "red tape" is thus limited. Second, the tax system contains well-defined concepts and considerable information that, if used in delivering incentives, may simplify the process considerably. Finally, in the Canadian federal system, the tax system lends itself to joint federal and provincial action because income taxes are, in most cases, imposed on a common base.

However, there are also a number of negative consequences which may flow from the use of tax expenditures rather than direct expenditures. Tax incentives fre-

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quently have effects that run counter to maintaining the fairness of the tax system. For example, deductions from income are generally of more benefit to those with the higher marginal tax rates.

Tax expenditures, once put in place, have proved remarkably difficult to remove with their elimination always billed as a tax increase. Tax expenditures are thus likely to remain in place past the time when they are required. It is also difficult to determine the actual advantage of tax preferences to various groups in the economy as the number of such incentives multiply, because the incentives often interact with each other and may be offsetting.

Tax statutes need to be extremely precise because of the self-assessing nature of the Canadian tax system. With precision comes complexity and opportunities for tax planning activities which may reduce the amount of time and effort devoted to productive activity. The precision required also eliminates discretion, which in some cases may make a program much less flexible and responsive than is desirable. Finally, tax expenditures do not lend themselves to strict budgetary control. They must be available to all persons meeting the criteria established.

The new system adopted in Canada is designed to ensure that all these factors are given adequate consideration in the choice of instruments for achieving the given policy objective.

CONCLUSION

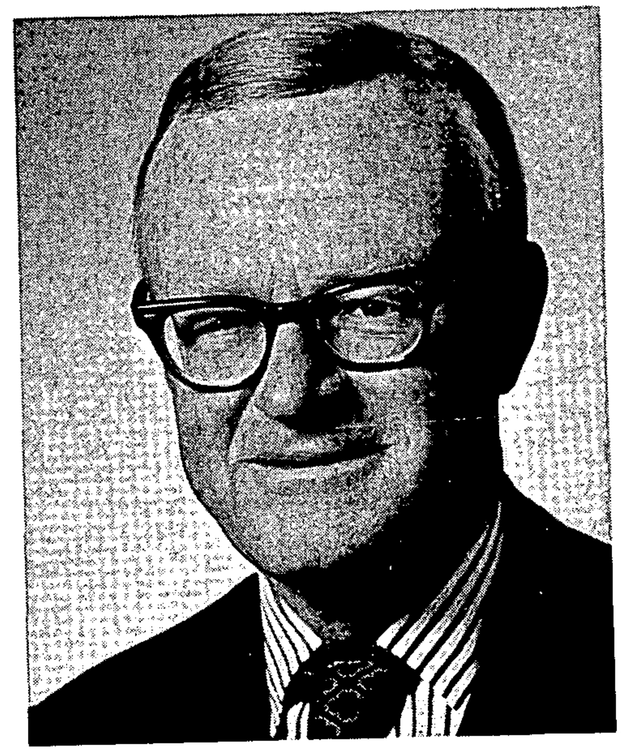
Canada has only recently adopted a system of fiscal management that incorporates tax expenditures. The system holds considerable promise in improving government decision-making, helping government in achieving fiscal restraint and ensuring that the most appropriate vehicle is used, whether that be the tax system, the expenditure system or loans and advances, when government intervention in the economy is desirable.

There are some very encouraging signs. Tax expenditures are taking their place in public and parliamentary debates. There is now generally more awareness of the limitations in the use of tax incentives for achieving policy objectives.

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Taxation of Offshore Income and the Canadian Treaty Network

by H. Heward Stikeman



H. Heward Stikeman, Q.C.
Senior Partner: Stikeman, Elliott, Tamaki, Mercier & Robb, Montreal, P.Q.
Senior Partner: Stikeman, Elliott, Robarts & Bowman, Toronto, Ont.

Educated at Trinity College School and McGill University where he received his B.A. and B.C.L. in 1938. Mr. Stikeman served as Assistant Deputy Minister (Legal) to the Income Tax Division of the Department of National Revenue in Ottawa during the second world war. After leaving the post in 1946, he was appointed Counsel to the Committee of the Senate formed to study and recommend a reformation of Canada's income tax laws. In this position he was responsible for the redrafting of much of the new Income Tax Act that emerged after the war. Concurrently with this task, he joined the form of Foster, Hannen, Watt, Stikeman and Elliot. In 1952, he formed his own law firm which has since become Stikeman, Elliot, Tamaki, Mercier & Robb where he is continuing his practice in taxation and administration law. In 1969, the firm opened a European office based in London, England. Since that time, the firm has opened offices in Hong Kong and Ottawa. In 1971, he and Mr. Elliot joined with the Honourable John P. Robarts, on his retirement from the premiership of Ontario, and with Mr. D.G.H. Bowman, formerly Director of Tax Litigation of the Department of Justice, to form a parallel law firm in Toronto under the name of Stikeman, Elliott, Robarts & Bowman.
He is an ex-governor of the Canadian Tax Foundation, Editor-in-Chief of the many tax publications of Richart de Boo Limited in Toronto, a director of a number of Canadian companies, and a member of the Bars of Quebec and Ontario.

In his accompanying article, Nathan Boidman has dealt with the appropriate structures by which non-residents may start up businesses in Canada. Ed Harris in turn has shown how the tug of war between income tax law and the principles of public accounting has helped shape Canadian income tax patterns.

The foregoing articles leave open for consideration some areas in which Canadian taxation affects Canadians, corporations and individuals investing or carrying on business outside of Canada. Any examination of this facet of Canadian income tax law must take account of the part which Canada's international treaty network plays in influencing overseas investment decisions by Canadians.

Throughout Canada's principal taxing statute, the Income Tax Act, R.S.C. 1952, c. 148, as amended by S.C. 1970-71-72, c. 63 (hereinafter ITA), are scattered isolated provisions with specific relevance to international taxation. In addition, there are certain areas of the Act which address themselves only to non-residents.[1] These last are dealt with in the paper by Nathan Boidman. Other provisions of the Act are only concerned with Canadians having interests abroad.[2] Finally, there are provisions which, though they do not distinguish between residents and non-residents, are of great importance when dealing with the subject of international taxation.[3]

The federal budget of 12 November 1981 contained a number of proposals for the amendment of the ITA which, if ever implemented, will radically alter many of its provisions. Reference should be made to the paragraphs of the Notice of Ways and Means Motion to amend the Income Tax Act that accompanied the Budget.[4]

Canada also has a network of tax treaty relationships with other countries which must always be considered as part of its fiscal law. However, before becoming part of the laws of Canada, a treaty must be enacted as a statute, instruments of ratification be exchanged, and only then will the treaty take effect in accordance with its terms. Lord Atkin in *Attorney General for Canada* v. *Attorney General for Ontario*[5] says:

> Within the British Empire there is a well established rule that the making of a treaty is an executive act, while the performance of its obligations, if they entail alteration of the existing domestic law, requires legislative action. Unlike some other countries, the stipulations of a treaty duly ratified do not within the Empire, by virtue of the treaty alone, have the force of law. If the national executive, the government of the day, decide to incur the obligations of a treaty which involve alteration of law they have to run the risk of obtaining the assent of Parliament to the necessary statute or statutes. To make themselves as secure as possible they will often in such cases before final ratification seek to obtain from Parliament an expression of approval. But it has never been suggested, and it is not the law, that such an expression of approval operates as law, or that in law it precludes the assenting Parliament, or any subsequent Parliament, from refusing to give its sanction to any legislative proposals that may subsequently be brought before it.

1. Sections 2(3), 18(4)-(8), 19, 19.1, 20(11) & (12), 48, 69(2), 69(3), 81(1)(c), 85.1(3), 87(8), 88(3), 88.1, 114, 115, 116, 126, 133, 134, 190, 250, 253, 255, 257 Income Tax Act (ITA) and Parts XIII and XIV thereof.
2. Sections 90-95 and 113 ITA and Part LIX of the I.T. Regulations.
3. Sections 15, (56)2, 84, 88(2) and 214 ITA.
4. Resolutions No. 12, 14, 35, 51(a), 63-69, 95, 112, 114, 119 and 120. 1980 Budget Notice of Ways and Means Motion.
5. [1937] A.C. 326 at p. 347.

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Canada's tax treaties
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1. Branch or subsidiary?

Generally speaking, the Canadian taxpayer dealing abroad will be faced with the same type of decision which confronts a non-resident coming into Canada. The Canadian taxpayer will consider a number of factors, many of which have also been reviewed by Nathan Boidman in his parallel article from the viewpoint of a non-resident dealing with Canada. Moreover, certain considerations must be weighed as regards transfers between parents and subsidiaries, and Canadian and foreign business operations. The use of a foreign branch is unusual, however, and generally confined to situations involving an unprofitable overseas operation. The profits earned by the foreign branch are deductible. This ability to deduct losses has prompted the use of foreign branches by Canadians in launching businesses abroad. Likewise, Canadian companies have established foreign branches during the start-up years in which losses could be anticipated so that these losses serve to offset other Canadian income. If it is expected that the losses will continue indefinitely or that the operations in the foreign jurisdiction will be run on a break-even basis, the branch is probably the best approach. If a Canadian subsidiary is used, losses in start-up years can only be applied against income earned by the subsidiary. On the other hand a profitable subsidiary will pay less tax if foreign tax rates are lower than those of Canada.

2. Differences in tax structures

As long as the Canadian taxpayer is not earning a profit on his foreign business operations, differences in tax structure between Canada and the foreign jurisdiction are of little interest. As soon as the branch begins to turn a profit, however, the Canadian taxpayer may decide to incorporate it. This decision may be prompted by a variety of tax considerations:

(i) the tax rates on business profits may be more attractive in the foreign jurisdiction than in Canada and neither the Canadian small business deduction nor the deduction of manufacturing and processing profits can be claimed in respect of foreign operations;[6]
(ii) tax incentives available in foreign jurisdictions may not be available in Canada; and
(iii) tax costs associated with remaining in Canada can be reduced or even eliminated.

3. Tax consequences of incorporating foreign branch operations

It is not possible for a Canadian taxpayer to utilize the rollover provisions of Section 85 ITA to transfer assets to a corporation which is not a Canadian corporation[7] except in the case of a transfer of shares in a foreign affiliate to a corporation which, immediately following the transfer, was also a foreign affiliate of the Canadian taxpayer. The Canadian taxpayer interested in doing business abroad must, therefore, decide at the very beginning of his foreign operations what form he wishes them to take. A transfer of property to a foreign subsidiary will subject the transferor to immediate Canadian tax on recaptured amounts of depreciation, capital gains and proceeds for goodwill. Where, however, such a transfer would result in a loss to the transferor, even though a rollover would be denied if a profit were involved,[8] the transferor's capital loss is deemed to be nil. An amount equal to the capital loss "disallowed" or "not recognized" is added to the adjusted cost base of the shares of the transferee corporation controlled by the transferor. In the case of a labour-intensive enterprise, the Canadian taxpayer could conceivably close his branch, and, using a subsidiary, start up his foreign operation a second time. Another alternative would be for the Canadian to transfer the assets to a Canadian subsidiary, leasing them to the foreign branch. See, however, the possible effect of Budget Resolutions Nos. 64 and 65.[9]

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6. Sections 125, 125.1 ITA.
7. Paragraphs 89(1)(c) and 85.1(3) ITA.
8. Subsection 85(4) ITA.
9. Budget Resolutions Nos. 64 and 65.

(64) That

(a) subsection 85.1(3) and paragraph 95(2)(c) of the Act be amended to apply to a disposition of shares of a foreign affiliate of a taxpayer after November 12, 1981 only where the disposition is to a foreign affiliate controlled by the taxpayer,

(b) effective after November 12, 1981, a definition "foreign merger" be added to the Act similar to the definition of amalgamation in subsection (87)1 of the Act read without reference to the exception for a merger by means of the acquisition of property,

(c) effective after November 12, 1981, subsection 87(8) and paragraph 95(2)(d) of the Act relating to mergers of foreign affiliates of a taxpayer be amended to apply only to foreign mergers and be extended to apply to foreign mergers of other non-resident corporations,

(d) changes similar to those proposed in this Motion to subsection 87(4) of the Act made applicable to foreign mergers after November 12, 1981,

(e) a rule be introduced to allow a tax-free transfer of any capital property on a foreign merger after November 12, 1981 of two or more foreign affiliates of a taxpayer in each of which the taxpayer's equity percentage was at least 90% to form a new foreign affiliate in which the taxpayer's equity percentage was at least 90% where such property was transferred

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4. Withholding tax

It should also be noted that Canadian withholding tax could be exacted from payments to non-residents made in the course of a branch business. This tax liability would be eliminated if the Canadian incorporated a foreign subsidiary.

5. Loan arrangements between Canadian parent and foreign subsidiary

When a corporation resident in Canada loans money to its non-resident subsidiary and the loan remains outstanding for a year or longer without interest at a reasonable rate having been included in computing the parent's income, interest at the rate of 16% per annum (as of 1 January 1982) on the outstanding balance will be imputed to the parent and taxed in its hands.[10] The lender can, however, escape imputation if it withholds tax on the amounts advanced.[11] When the loan is made to a subsidiary controlled corporation and the money is used in the subsidiary's business for the purpose of gaining or producing income, no interest is imputed to the parent.[12] If more than 50% of the voting shares of the subsidiary belong to the parent, the latter qualifies as a "subsidiary controlled corporation".[13] In a recent decision of the Tax Review Board, *Distillers Corporation - Seagrams Ltd.* v. *M.N.R.*,[14] it was held that the word "belong" in the definition of "subsidiary controlled corporation" must be interpreted as connotating "property" and consequently that the parent's control must be direct. See, however, the possible effect of Budget Resolution No. 14.[15]

In *Massey-Ferguson Ltd.* v. *M.N.R.*[16] the plaintiff loaned $1,000,000 to its wholly-owned Canadian subsidiary. The latter subsequently reloaned the money to its wholly-owned American subsidiary. The Federal Court, Trial Division held that the substance of the transaction was a loan from the plaintiff to a non-resident corporation. No legitimate business purpose explained the involvement of the plaintiff's subsidiary. Nor could the plaintiff claim the benefit of the exemption contained in Subsection 17(3) ITA: the borrower was not a controlled subsidiary corporation because the plaintiff's control was indirect. This decision was reversed by the Federal Court of Appeal: cf. *Massey-Ferguson Ltd.* v. *M.N.R.*[17] Despite the appellant's admission that the arrangement was set up to circumvent Subsection 18(1) ITA, the evidence disclosed that the parties intended to and did, in fact, create first a debtor-creditor relationship between the appellant and its subsidiary, and secondly, between the Canadian subsidiary and the latter's American subsidiary. There was no such relationship between the appellant and the non-resident. The Court concluded that the loaning of money to subsidiaries was a legitimate part of the Canadian subsidiary's business and neither its business nor its corporate existence was a sham.

It is Revenue Canada's position that when a Canadian corporation has loaned funds without interest to a wholly-owned subsidiary and the latter invests the fund in the capital of a subsidiary which it controls, interest will not normally be imputed to the Canadian corporation if the only undertaking of the wholly-owned subsidiary is financing its own subsidiaries by lending them money at interest, or subscribing for shares of their capital stock, on the condition that the funds are ultimately used by the borrower for the purpose of gaining or producing income from its business. The number of loans and the interest rate charged would generally be factors in deciding whether such activity was a business. If the wholly-owned subsidiary makes an interest-free loan to its subsidiary, interest will be imputed because these funds are not gaining or producing income.

If the Canadian parent borrows the money which it loans to its non-resident subsidiary, the interest payable is deductible under paragraph 20(1)(c) ITA. It must be em-

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free of foreign tax from the predecessor affiliates to the new affiliate,
(f) subsection 88(3) and paragraph 95(2)(e) of the Act relating to the liquidation of foreign affiliates of a taxpayer be amended to apply only to liquidations after November 12, 1981 of a foreign affiliate that was controlled by the taxpayer, and
(g) a rule be introduced to allow a tax-free transfer of any capital property on a liquidation after November 12, 1981 of a foreign affiliate of a taxpayer if the taxpayer's equity percentage in the foreign affiliate was at least 90% and the property was transferred free of foreign tax to another foreign affiliate of the taxpayer.

(65) That
(a) after November 12, 1981, the expression "excluded property" of a foreign affiliate be defined in the Act to mean property of an affiliate that is used in an active business of the affiliate, shares of the capital stock of another foreign affiliate all or substantially all of the property of which is excluded property and interests of the affiliate in partnerships, other than limited partnerships, in which the affiliate has at least a 10% interest where all or substantially all of the partnership property is used in an active business,
(b) any gain or loss of a foreign affiliate realized after November 12, 1981 with respect to indebtedness incurred for the purpose of acquiring excluded property be treated as a gain or loss from the disposition of excluded property,
(c) taxable capital gains and allowable capital losses of a foreign affiliate from the disposition after November 12, 1981 of excluded property (other than a disposition of shares to which paragraph 95(2)(c), (d) or (e) of the Act applies) be excluded from its foreign accrual property income,
(d) where at any time after November 12, 1981 a foreign affiliate disposes of shares of a second foreign affiliate that are excluded property (other than in a disposition to which paragraph 95(2)(c), (d) or (e) of the Act applies), an election under subsection 93(1) of the Act be deemed to be made in respect of such shares for a prescribed amount equal to the lesser of the proceeds of disposition and the amount that represents the portion of the net surplus of the second affiliate at that time that would be attributable to the shares sold if each foreign affiliate in which the second affiliate had an equity percentage had paid out its net surplus immediately before that time as a dividend, and
(e) a general anti-avoidance rule be introduced to deny the application of subsection 85.1(3) of the Act on a disposition after November 12, 1981 by a taxpayer of shares of a foreign affiliate, all or substantially all of the property of which is excluded property, to another foreign affiliate where the disposition is part of a transaction or series of transactions for the purpose of disposing of the shares to a person with whom the taxpayer deals at arm's length.

10. Subsection 17(1), ITA and Subsection 4300(5) of the I.T. Regulations.
11. Subsection 17(2) ITA.
12. Subsection 17(3) ITA.
13. Subsection 248(1) ITA.
14. [1980] C.T.C. 2737.
15. Budget Resolution No. 14:
(14) That for any period commencing after 1981, the provisions in section 17 of the Act be amended
(a) to extend the interest imputation requirement to any form of indebtedness regardless of its term,
(b) to remove the exception for loans to a subsidiary controlled corporation, and
(c) to require the imputation of interest at a prescribed rate on non-arm's length indebtedness.
16. [1974] C.T.C. 671.
17. [1977] C.T.C. 6.

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phasized, however, that interest will only be imputed if the amount outstanding is actually a loan. Consequently, if the amount is owed under a creditor-debtor relationship, e.g. the balance owing on a purchase price, interest would not be imputed. Moreover, deemed interest will only be included in the parent's income so long as the lender-borrower relationship subsists. See, however, the possible effect of Budget Resolutions Nos. 12 and 23.[18] In the case of *Banister* v. *M.N.R.*[19] it was held that interest could not be imputed to the lender because the debt was validly extinguished according to provincial law.

In the provinces of Quebec and Ontario interest imputed to a parent company must be included in income whether or not the parent has paid tax on the amount of the loan under Part XIII of the federal Act.[20]

6. Inter-company pricing

A parent corporation, like any other party in a non-arm's length relationship, is required both to give and to receive adequate consideration when dealing with a subsidiary. Subsection 69(2) ITA provides that where a parent has paid or agreed to pay a subsidiary an amount for certain types of consideration which is greater than the amount that would have been reasonable in the circumstances if the two parties had been dealing at arm's length, then the reasonable amount only is deemed to have been paid. It should be noted that the criterion is not fair market value, but rather what would have been reasonable in the circumstances. The provision assures that the parent may not unreasonably reduce its Canadian income by way of overly large payments to its subsidiaries. Broadly speaking, this subsection is concerned with the price, rental, royalty or other payment paid or payable for use or reproduction of any property; consequently, payments for use and the actual price of property are both caught. Also included is any amount paid as consideration for the carriage of goods or passengers or for other services.

Subsection 69(3) ITA is the converse of Subsection 69(2) ITA and deals with payments by a non-resident subsidiary to its parent company. The enumeration of the types of payments involved is identical to that found above. Under this provision, where the amount is less than the amount which would have been reasonable in the circumstances if the non-resident payer and the payee had been dealing at arm's length, the reasonable amount is deemed to have been the amount paid or payable. Consequently, the parent may be forced to increase its taxable Canadian income in those circumstances.

However, the recent decision in the Federal Court of Appeal in *Spur Oil Ltd.* v. *The Queen*[21] would appear to give some support to the argument that so long as pricing is at fair market value or less, an arrangement entered into by the parties and clearly adhered to, though motivated by tax reasons, would not be artificial. See also *Dominion Bridge Company Limited* v. *The Queen.*[22]

The inter-company pricing rules are not a factor in determining whether a Canadian taxpayer doing business abroad selects a branch operation or incorporates a subsidiary. Rather, they affect the computation of branch profits if a branch operation is undertaken, as well as the incomes of both parent and subsidiary, if a second company is used.

7. Foreign tax credit and deduction of foreign taxes paid

Canadian residents who earn income from sources outside Canada may deduct, either wholly or partially, taxes paid to foreign countries from which their income is derived.[23]

There are a number of special rules for the computation and application of the foreign tax credit provisions that space prevents considering in this article.

8. Canadian taxation of profits of foreign subsidiaries – "The foreign affiliate rules"

For taxation years following 1975, a Canadian resident taxpayer must pay tax on his proportionate share of "passive" income (e.g. dividends, interest, rents, royalties, non-active business income and certain capital gains) earned by non-resident corporations and trusts which are or are deemed to be controlled foreign affiliates. The first $5,000 of passive income is exempted from Canadian taxation.

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18. Budget Resolutions Nos. 12 and 23:
(12) That for the 1982 and subsequent taxation years, the provisions of subsection 15(2) of the Act apply not only to loans but also to other forms of indebtedness and, where an amount owing by a person who is connected to a shareholder is to be included in income by virtue of that subsection, the amount be included in the income of the shareholder.
(23) That for the 1982 and subsequent taxation years, the provisions of the Act relating to the deduction of interest be amended to provide that in computing the income of an individual or a partnership.
(a) any interest expense otherwise allowable as a deduction in computing the income of the individual or partnership from property for a year (referred to in this Motion as "restricted interest expense") be deductible only to the extent of the income from property for the year.
(b) the individual or partnership may elect to treat as a capital loss for the year any portion of the restricted interest expense for a year that is not deductible in the year, and
(c) the amount by which the restricted interest expense of the individual or partnership for a year exceeds the aggregate of the amount thereof that was deductible for the year and the amount thereof that was treated as a capital loss for the year may be carried forward and treated as interest expense incurred in the following taxation year,
and for this purpose
(d) any benefit required by virtue of section 80.4 of the Act to be included in computing the income of an individual for a year will be treated as interest expense incurred by him in the year,
(e) except where all or substantially all the property of a partnership is used in an active business or a non-qualifying business, any interest expense incurred by an individual or partnership in a year on loans made to invest in the partnership will be treated as an expense incurred to earn income from property, and
(f) the restricted interest expense of an individual or partnership will not include interest incurred on a loan (other than a non-arm's length loan) the proceeds of which were used to finance the acquisition by it on or before November 12, 1981 of a residential rental building in Canada or at any time to refinance such acquisition.
19. [1973] C.T.C. 2036.
20. Subsection 14(5) of the Ontario Corporations Tax Act. Sections 126 and 127 of The Quebec Taxation Act.
21. [1981] C.T.C. 336. Editors note: See Alun G. Davies: "A spur in the side of Revenue Canada?" in 35 Bulletin (1981) at 531.
22. [1975] C.T.C. 263, 1977 C.T.C. 554.
23. Section 126 ITA.

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The significance of foreign affiliates, other than "controlled foreign affiliates",[24] is limited to circumstances in which their shares are owned by Canadian resident corporations. Foreign passive income earned by non-controlled foreign affiliates is not taxable in Canada until distributed as dividends to Canadian resident corporate shareholders. Where dividends are paid out of the foreign affiliate's taxable surplus, the income is taxed in the hands of the resident Canadian corporation. Where, however, the dividends are paid out of either exempt surplus or preacquisition surplus, they are exempted from Canadian tax. Dividends received from non-resident corporations which are not foreign affiliates are taxed at full corporate rates. Dividends received from non-controlled foreign affiliates by individual shareholders resident in Canada are also fully taxable, with no deduction on account of foreign tax paid on the underlying earnings. Consequently, an individual with interests abroad can realize a tax saving by establishing a foreign affiliate and holding his shares in it through a Canadian corporation.

9. The rules of foreign accrual property income (FAPI)

The main thrust of the FAPI rules[25] is to deem a Canadian taxpayer, whether individual or corporate, who has a controlling interest in a corporation or trust outside Canada, i.e. a corporation or trust[26] which qualifies as a controlled foreign affiliate,[27] to have itself earned the foreign accrual property income, or FAPI, in excess of $5,000, of such controlled foreign affiliate.[28] As a result, Canadian taxation arises immediately, even if the income is not received by the Canadian taxpayer at that time. Related rules ensure that appropriate recognition is granted to other taxes already imposed on the income, and that the income is not taxed a second time if it is ever paid up to the Canadian taxpayer by way of dividend or otherwise. In addition, the rules elaborate a system for the taxation of dividends received from foreign affiliates which are not controlled foreign affiliates. See possible effect of Budget Resolution No. 66.[29]

A controlled foreign affiliate is defined[30] as a corporation which is not resident in Canada, and is controlled either directly or indirectly by the Canadian taxpayer, either alone or together with related parties, or with not more than 4 other persons resident in Canada, even if they be unrelated. A trust may also be a controlled foreign affiliate's FAPI, i.e. passive investment income, which exceeds $5,000 and which is included in the Canadian taxpayer's income for the taxation year in which the affiliate's taxation year has terminated.

FAPI is basically income for the year from property, or from a business other than an active business. Paragraph 95(1)(b) ITA contains detailed rules setting out certain specific types of income which are or which are not included in FAPI. The Act also contains rules respecting the computation of the foreign affiliate's income from an active business.

10. Inclusions and exclusions from FAPI

There is included in active business income, and hence excluded from FAPI,[31] any income from sources in a country other than Canada that might otherwise be income from property or a business other than an active business to the extent that it "pertains to or is incident to" an active business carried on by the affiliate. This "pertaining" rule presupposes that the affiliate is carrying on an active business in a country other than Canada. Interest earned by a construction company on securities put up to guarantee the performance of its contractual obligations is an illustration of the "pertaining" rule.[32] There is also excluded from FAPI any amount paid or payable to the affiliate by another foreign affiliate of the taxpayer to the extent that it is deductible from that other affiliate's earnings from an active business other than a business carried on in Canada.

If a controlled foreign affiliate earns income from services or an undertaking to provide services, that income is deemed to be FAPI if the relevant amount is deductible in computing the income from a business carried on in Canada by the Canadian taxpayer.[33] Services include the insurance of Canadian risks, but do not include the transportation of persons or goods or services performed in connection with the purchase or sale of goods. If a controlled foreign affiliate earns income from services or an undertaking to provide services, that income is deemed to be FAPI if the services are performed or are to be performed by an individual resident in Canada who controls the foreign affiliate. This provision is aimed largely at professional entertainers and athletes.

Foreign exchange gains realized by the foreign affiliate, by virtue of a fluctuation of the rate of exchange prevailing between the Canadian dollar and another currency, on the settlement of debts between the affiliate and another foreign affiliate of the Canadian taxpayer are excluded from FAPI.[34] Similarly, FAPI does not include any foreign exchange gain or loss arising on the redemption or non-arm's length disposition of the shares of a foreign affiliate of a Canadian taxpayer.[35]

FAPI does not include any of the following:
(a) interest received on certain debts created upon the sale or nationalization, prior to 18 June 1971, of Canadian-owned foreign public utilities;
(b) inter-affiliate dividends;
(c) taxable dividends deductible under Section 112 ITA; and
(d) taxable capital gains arising in respect of property used principally in gaining or producing income from an active business.

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24. Paragraph 95(1)(a) ITA.
25. Sections 90-95 ITA.
26. Subsection 94(1) ITA.
27. Paragraph 95(1)(a) ITA.
28. Subsection 91(1) ITA.
29. Budget Resolution No. 66:
That for the 1982 and subsequent taxation years, prescribed rules be provided to determine the foreign accrual tax in respect of an amount included in a taxpayer's income under subsection 91(1) of the Act where the foreign tax liability of two or more foreign affiliates of the taxpayer is determined on a consolidated basis or where in determining its foreign tax liability a foreign affiliate of the taxpayer deducts a loss of another foreign affiliate of the taxpayer.
30. Paragraph 95(1)(a) ITA.
31. Subparagraph 94(1)(b)(i) ITA.
32. Subparagraph 95(2)(a)(ii) ITA.
33. Subparagraph 95(2)(b)(i) ITA. Subsection 95(3) ITA.
34. Paragraph 95(2)(g) ITA.
35. Paragraph 95(2)(h) ITA.

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On the other hand, most taxable capital gains, to the extent that they have accrued since 1975, are automatically included in FAPI. See possible effect of Budget Resolution 68.[36]

Apart from these statutory exclusions from and inclusions in FAPI, there is a middle ground. Here, income may fall to be either excluded from or included in FAPI, depending on whether the facts are such that an active business is or is not being carried on.

11. Active business income

Income from an active business is not FAPI but income from property and a business other than an active business is FAPI. The definition of "active business",[37] which adopts the meaning given for the purposes of the small business deduction,[38] is specifically restricted to corporations resident in Canada, and, therefore, does not apply in computing FAPI. Of assistance in understanding these concepts are IT-73R3, which discusses the meaning of "income from an active business", and the case law interpreting "active financial and commercial business" in somewhat different contexts.

In IT-73R3[39] the Department takes the position that once income is established as being derived from a business source, any appreciable activity expended in the actual income generating process of that business, other than usual housekeeping functions such as banking and record keeping, characterizes that income as income from an active business. As previously noted, income of any nature that is ancillary to the activities involved in carrying on a business is income from that business, notwithstanding the fact that it could be described as income from property or another source.

The determination of what precisely is active business income is one of the most perplexing in Canadian tax law. In *MRT Investments Limited et al* v. *The Queen*[40] the plaintiff and two other companies made mortgage investments on a comparatively small scale. MRT had no employees of its own but there were several persons who worked on behalf of the company and other companies in the group and these persons carried out significant investigations of investment opportunities. The Court was influenced by the fact that the making of investments was the very purpose for which the company was incorporated and the company did pursue its mortgage investment opportunities. The fact that the company did not pay salaries to its own employees or rent office space or equipment did not necessarily indicate that the companies were not carrying on an active business. The Court held that two of the companies were carrying on an active business by themselves, but that the third company did not carry on active business since it turned over the management of its investment to others without supervision or any direction in connection with its day-to-day operations. The decision in respect of the two successful companies was upheld in the Federal Court of Appeal and the decision in respect of the third company was reversed to hold that its income also constituted income from carrying on active business: *cf. The Queen* v. *Rockmore Investments Ltd., The Queen* v. *MRT Investments Ltd.* and *ESG Holdings Ltd.* v. *The Queen.*[41]

In *D.S.B.K. Management Ltd.* v. *M.N.R.*[42] a corporation which provided management services to a firm of chartered accountants was held by the Tax Review Board not to be carrying on an active business. The company received all its fees for management services related to the one firm of accountants. The judgment stated that the financial statements indicated little economic activity. The use of labour and capital was relatively insignificant, as no charge appeared in the financial statements for salary or wages. The statement was made that Parliament never contemplated this sort of activity carried on by the appellant as qualifying under Section 125 ITA for the small business deduction. However, on appeal to the Federal Court, the Minister granted the taxpayer's appeal by consent to judgment.

In *Cadboro Bay Holdings Ltd.* v. *The Queen*[43] the Federal Court, Trial Division, held that rental income received from a small shopping centre with 7 tenants represented income from an active business. The comment was made that in the absence of any indication in the Income Tax Act as to quantum of activity necessary for characterization as income from an active business, any quantum of business activity that gives rise to income in a taxation year for a private corporation in Canada is sufficient to make mandatory the characterization of such income as income from an active business carried on in Canada.

In *King George Hotels Limited* v. *The Queen*[44] the appellant operated a hotel but also leased certain properties to tenants. It was contended that the net rentals were income from an inactive business. The appellant was managed by JP Management Services Ltd., a company owned and operated by the same parties as the appellant. The net income from the rentals constituted 10% of the total net income of the appellant. The work in connection with the leased premises involved the employees of the management company for about one hour per month. The trial judge attributed these activities to the appellant, and the rental income qualified as income from an active business. It remained income from an active business when remitted to a third company in the group, Cavalier Enterprises Ltd. *Cf. Cavalier Enterprises Limited* v. *The Queen.*[45]

12. Computation of FAPI

FAPI is computed in accordance with the Income Tax Act, and not under the tax laws of the jurisdiction of the

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36. Budget Resolution No. 68:
That effective after November 12, 1981, the capital gains and losses of a foreign affiliate of a taxpayer be calculated
(a) in Canadian currency in the case of property, other than excluded property, of a controlled foreign affiliate, and
(b) in the relevant foreign currency in all other cases,
and the provisions of paragraphs 95(2)(g) and (h) of the Act be applicable for all purposes of the Act.
37. Subsection 248(1) ITA.
38. Paragraph 125(6)(d) ITA.
39. IT-73R3 Information Bulletin issued by Revenue Canada.
40. [1975] C.T.C. 354.
41. [1976] C.T.C. 291, 294 and 295.
42. [1975] C.T.C. 2281.
43. [1977] C.T.C. 186.
44. [1981] C.T.C. 87.
45. [1981] C.T.C. 78.

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controlled foreign affiliate's residence.[46] The calculation of certain capital gains and losses is excluded from this rule. In a given year, the FAPI of a controlled foreign affiliate is the aggregate of all of its FAPI less its foreign accrual property losses and its allowable capital losses for the year.[47] The FAPI of a controlled foreign affiliate for a particular taxation year may be reduced by the affiliate's deductible loss for that year and the 5 immediately preceding taxation years. FAPI is never a negative number. If a Canadian taxpayer has a controlled foreign affiliate with foreign accrual property losses, these losses may not be used by it to offset its income from other sources; nor can the negative passive income of one controlled foreign affiliate be used to offset the FAPI of another. On the other hand, the FAPI imputed to a Canadian resident corporation may be offset by that corporation's non-capital losses, and the FAPI imputed to a Canadian resident individual may be offset by his non-capital losses, and even by his allowable capital losses up to $1,000 per year.

A Canadian resident corporation disposing of shares in a foreign affiliate may elect to treat the proceeds of disposition as a dividend rather than a capital gain. Section 94 ITA applies the FAPI rules to offshore trusts. Section 95 ITA, in addition to containing the definitions of "controlled foreign affiliate" and "foreign accrual property income" discussed above, also sets out a special set of FAPI anti-avoidance rules and rollover provisions concerning the transfer of shares in a foreign affiliate on a share for share exchange, merger or distribution. See possible effect of Budget Resolution No. 64.[48]

The FAPI earned by a controlled foreign affiliate is attributed to the Canadian taxpayer in that taxpayer's taxation year in which the affiliate's taxation year ends. If a controlled foreign affiliate earns FAPI, the cost base of the Canadian taxpayer's shares in the affiliate must be adjusted,[49] but the adjusted cost base to a Canadian taxpayer of a share owned by him in a controlled foreign affiliate will be increased by the amount of FAPI which the Canadian taxpayer has been required to include in computing income.[50] Consequently, if the Canadian taxpayer disposes of the shares of the affiliate before receiving a dividend out of its FAPI on which he has been previously taxed, he will incur no further tax as a result of having realized a capital gain which reflects the amount of undistributed FAPI.

As far as corporate Canadian taxpayers are concerned, FAPI is included in the affiliate's taxable surplus.[51] Any dividend subsequently paid out by the affiliate is included in the corporation's income.[52] The corporation is, however, permitted to deduct underlying foreign corporate income tax ("foreign business income tax credit") and foreign withholding tax ("foreign non-business income tax credit").[53] The corporation may lastly deduct the remaining amount of the dividend if it is paid out of taxable surplus.[54] In this way, FAPI can be repatriated tax free and double taxation avoided.

Dividends paid after 1975 to a Canadian corporation out of the after-1975 active business income of a foreign affiliate, whether controlled or not, which is resident or carrying on business in a non-treaty jurisdiction, i.e. out of taxable surplus, are subject to Canadian income tax to the extent necessary to ensure that such income has borne tax which at least equals the Canadian tax level.[55] These dividends are included in the Canadian corporation's income when received by it, and the taxpayer is permitted to deduct

(a) the lesser of the relevant tax factor, i.e. 1/46% or 2.17391[56] minus 1, or 1.17391, times the underlying foreign corporate tax, or foreign business income tax, and the dividend, and
(b) the lesser of the relevant tax factor times the applicable foreign withholding tax, or foreign non-business tax[57] and the dividend less (a).

The full amount of a dividend to the extent that it is prescribed to have been paid out of the exempt surplus of a foreign affiliate may be deducted in computing the recipient Canadian resident corporation's taxable income.[58] Exempt surplus includes such items as capital gains not included in FAPI, post-1975 active business income earned in a treaty country, and pre-1976 earnings of all sorts net of tax.[59] Therefore, dividends paid out of the post-1975 active business income of a foreign affiliate resident and carrying on business in a treaty country are not subject to any Canadian tax.

Because of what is in effect a total exemption of dividends paid out of exempt surplus, no recognition is granted to the underlying income or profits tax and no foreign tax credit or other recognition is granted to the applicable withholding tax. Nor is the adjusted cost base of the Canadian taxpayer's shares in the foreign affiliate affected.

To the extent that a corporation resident in Canada receives a dividend out of a foreign affiliate's pre-acquisition surplus, the full amount of the dividend is deductible in the computation of its taxable income. A dividend is deemed to have been paid out of a foreign affiliate's pre-acquisition surplus when it no longer had exempt or taxable surplus.[60] Pre-acquisition surplus includes the earnings of a corporation accumulated at a time prior to the taxation year in which it first became a foreign affiliate of the Canadian resident corporation. The purpose of the exemption from Canadian tax of dividends paid out of this surplus is to permit its distribution to the Canadian corporation as a form of repayment of capital. This fact explains why paragraph 92(1)(b) ITA requires that the adjusted cost base of shares in a foreign affiliate be reduced by any dividends paid out of the pre-acquisition surplus.[61] Because of the effective exemption of dividends paid out of pre-acquisition surplus, no recognition

46. Pararaph 95(2)(f) ITA.
47. Subparagraph 95(1)(b)(v).
48. Budget Resolution No. 64. See footnote 9.
49. Subsection 92(1) ITA.
50. Paragraph 53(1)(d) ITA.
51. Paragraphs 5907(1)(i) and (k) of I.T. Regulations.
52. Section 90 ITA.
53. Paragraph 113(1)(b) and (c) ITA.
54. Subsection 91(5).
55. Sections 90, 113 and 126 ITA.
56. Paragraph 95(1)(f) ITA.
57. Paragraph 126(7)(c) ITA.
58. Paragraph 113(1)(a) ITA.
59. Paragraphs 5907(b) and (d) I.T. Regulations.
60. Section 5901 I.T. Regulations.
61. Subsection 92(2) ITA.

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or foreign tax credit is granted in respect of the applicable foreign tax or withholding tax.[62] There is also a further reduction in the adjusted cost base of shares of a non-resident corporation.

Section 5901 of the Regulations determines the order in which dividends are considered to have been paid out of the various surpluses of a foreign affiliate:
- exempt surplus;
- taxable surplus; and
- pre-acquisition surplus.

A deduction is permitted in respect of a dividend received by a corporation resident in Canada from a foreign affiliate to the extent that the amount of the dividend has not been offset by the other deductions that are permitted.[63] This deduction is limited to the adjusted cost base of the share on which the dividend is paid as at the end of the 1975 taxation year of the Canadian resident corporation. This deduction is optional, and basically permits the pre-1976 investment of the Canadian resident corporation in its foreign affiliate to be recouped as a return of capital. As the deduction is claimed, the adjusted cost base of the shares concerned is reduced.[64]

CANADA'S TAX TREATIES

Notwithstanding the complicated and detailed provisions of Canada's domestic tax laws as described in the foregoing pages, any dealing with the subject of foreign investment by Canadians would be incomplete without some consideration of Canada's tax treaties with foreign jurisdictions.

In general, Canada's tax treaties attempt to relieve from double taxation income derived by residents of one country from sources within the other. Such relief may be provided by two methods: in the case of investment income by imposing a ceiling on the rate of withholding tax that the source country may impose and in the case of other income or capital gains by limiting the instances in which the source country can tax such gains. Accordingly, Canadians doing business or investing abroad must be concerned with the degree of treaty protection available to them.

During the negotiation of a treaty it is always assumed that the contracting parties are aware of the existing internal laws and that the treaty was negotiated in light of them. Accordingly, references to the internal laws of the signatory powers as subsequently amended are usually avoided since this might afford the opportunity to one of the parties to change the treaty unilaterally by amending its own internal law. Section 2 of the Protocol to the U.S.-Canada treaty foresees the possibility of change in internal law, and provides for a mechanism by which the provisions of the Treaty can be modified, if desired by the parties, in light of such changes. Section 2 of the Protocol to the Convention states:

> In the event of appreciable changes in the fiscal laws of either of the contracting States, the Governments of the two contracting States will consult together.

See also *Associates Corporation of North America* v. *Queen*.[65]

In Canada, therefore, treaty provisions override domestic law, past and future. In *Hunter Douglas* v. *The Queen*[66] the issue was whether the plaintiff should have withheld tax on dividends paid non-resident shareholders. Under the Income Tax Act, the plaintiff corporation was clearly resident in Canada and thus obliged to withhold tax on dividends paid to non-resident shareholders. Under Netherlands law, however, it was resident there. Due to a provision in the Canada-Netherlands tax treaty which deems a corporation to be solely resident in the country where its central management and control is located, if that country is either Canada or the Netherlands, the Federal Court found the plaintiff, on the facts, to be resident in the Netherlands. The Minister submitted that the plaintiff's Dutch residence should only be recognized in respect of its Dutch shareholders. The Federal Court, however, concluded that the treaty provisions overrode the definition of residence found in the Canada Act, regardless of the residence of the payees.

In Canada both the English and the French versions of a treaty are official.

Although the paramountcy of Canada's tax treaties is generally made explicit in Canada's enabling legislation, one should not assume, however, that such a result prevails generally. In the United States, for example, subsequent legislation can override existing treaties.

Canada's new treaty with the United States was initialled on 26 September 1980. It has not yet, however, been ratified by the American Senate, nor is the necessary enabling legislation before the Canadian Parliament. There are expectations that it will become law before the end of 1982. Canada's new treaty with West Germany, initialled on 17 July 1981, is not yet effective. Besides these treaties, Canada has more than 50 treaties or double tax agreements in force or under negotiation.

The renegotiation of the American treaty and the long years taken to reach agreement underline a problem that affects international businessmen everywhere: how to keep a treaty in step and current with domestic fiscal developments within the signatory countries. Business and investment cannot afford to wait out the potentially long delays between treaty amendments. Fortunately, however, tax treaties are anomalies in the fiscal system, and, unlike taxing statutes, they usually contain provisions known as "competent authority provisions" permitting the direct negotiation of administrative or interpretational problems between the government of Canada and the governments of other jurisdictions at non-political levels. Such provisions permit of a practical and non-technical approach to treaty problems without recourse to the courts. Largely as a result of the success of this approach over the years, under the U.S. treaty the concept of the "competent authority" approach has been elevated to an accepted general practice which has achieved a formalized structure and considerable efficiency.

In order to invoke the consultative or "competent authority provisions" such as that contained in Article XVI

62. Paragraph 53(2)(b) ITA.
63. Subsection 113(2) ITA.
64. Subsection 92(3) ITA.
65. [1980] C.T.C. 80.
66. [1979] C.T.C. 424.

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of the U.S.-Canada income tax convention, the taxpayer needs to "show proof" that he has suffered double taxation as a result of "the action of the Revenue authorities of the contracting States" and lodge a claim. If the claim "should be deemed worthy of consideration", the "competent authority" of one state may consult with the other. Unfortunately "double taxation" is itself a fuzzy idea. The administrative tendency has been to restrict the notion to the taxation of the same gain in the same hands by two jurisdictions. Taxing the same economic benefit in different hands is not usually considered double taxation. However, in the light of Canada's attempt to shape new treaties on the O.E.C.D. model wherever possible, the double taxation relief may be enlarged, and inroads on treaty protection by the administrators or legislators of the signatory countries may be contained.

PROVINCIAL TAXATION: QUEBEC

Quebec's Taxation Act,[67] which levies income tax on both individuals and corporations, follows the Income Tax Act in many ways, but for constitutional reasons does not impact on certain areas of international taxation. In particular, Quebec does not levy withholding tax on payments to non-residents. The Quebec Taxation Act has no equivalent to Parts XIII and XIV of the federal Act. It should be noted, however, that Quebec respects the treaty arrangements entered into between Canada and other jurisdictions and will not include in income, for Quebec tax purposes, amounts which are specifically exempted from federal income tax pursuant to a treaty provision.[68]

PROVINCIAL TAXATION: ONTARIO

Ontario levies a provincial income tax on corporations only under the Ontario Corporations Act.[69] Unlike Quebec, however, it does not uniformly respect treaty arrangements concluded between Canada and foreign jurisdictions. A Canadian corporation having a permanent establishment in Ontario is liable to tax.[70] In the case of corporations incorporated outside of Canada, liability to tax arises in any of the following circumstances:

(a) the existence in Ontario, whether in the year or any previous year, of a permanent establishment;
(b) the ownership, whether in the year or in any previous year, of real property, timber resource property or a timber limit in Ontario from which income is derived from the sale or rental thereof or from royalties; or
(c) the disposition in the year or any previous year of property situate in Ontario that was "taxable Canadian property" as defined.[71]

Comparable provisions are found in Ontario law.[72]

If, however, the corporations were incorporated in a jurisdiction with which Canada has entered into a tax treaty, it is not required to pay tax in respect of its rental and royalty income unless it has elected to pay tax under Part I ITA as a resident rather than under Part XIII.[73] Capital gains realized in connection with real property are also exempt from Ontario taxation.[74] Moreover, the Ontario Corporations Tax Act Regulations[75] provide that where no federal income tax is payable on a disposition of taxable Canadian property because of an exemption in the applicable treaty, property otherwise situate in Ontario is deemed not to be situate there for purposes of Ontario tax and thus not taxable by Ontario. Consequently, all capital gains realized by a non-resident corporation which are exempt from federal tax under a tax treaty are also exempt from Ontario tax, provided that the corporation does not otherwise have a permanent establishment in Ontario.

It should also be noted that the meaning given by Section 5 of the Ontario Act to the term "permanent establishment" is not precisely the same as that given the expression in Part IV of the federal ITA Regulations. Unless it maintains a permanent establishment elsewhere in Canada, a corporation is regarded as having a permanent establishment in Ontario if its head office or registered office is located there.[76]

PROVINCIAL TAXATION: ALBERTA

The Alberta Corporate Income Tax Act[77] became law on 22 May 1980 with effect after 31 December 1980. The tax levied under the Alberta statute is based on taxable income as determined under the federal Act, i.e. the taxable income declared in the corporation's federal return. Such taxable income is then adjusted to take into account existing and new tax incentives. The corporation must, however, file a separate Alberta tax return. While as yet uncertain, it is doubtful whether this new legislation will give rise to any problems.

PROVINCIAL TAXATION: OTHERS

The remaining provincial income taxes are levied as a percentage of the federal tax payable, and are collected by Revenue Canada. The possibility of conflicting federal and provincial provisions has accordingly been effectively eliminated.

SOME TREATY PROBLEMS

As a practical matter, there are really only a few areas that regularly cause trouble in the interpretation of treaties. For example, many treaties define "permanent establishment" and "industrial or commercial profits"

67. L.R. Quebec 1977 c. I-3.
68. Section 488R1, Quebec Taxation Act Regulations.
69. Revised Statutes of Ontario 1980 ch. 97.
70. Subsection 2(1), Ontario Corporations Tax Act.
71. Subsection 248(1) ITA.
72. Subsection 2(2) Ontario Corporations Tax Act.
73. Paragraph 2(3)(b) ITA.
74. Subsection 29(2) ITA.
75. Subsection 717(2), Ontario Corporations Tax Act Regulations.
76. Subsection 5(11) Ontario Business Corporations Act.
77. Statutes of Alberta, 1980 ch. 10.

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but the definitions are not always given the same effect. This is because both definitions can be somewhat artificial and may vary from treaty to treaty, sometimes deviating from the commercial meaning of the same words used in ordinary business parlance. It is important, therefore, in order to determine the taxability of industrial and commercial profits that may be attributed to a permanent establishment, for a businessman to examine carefully the terms of the particular treaty. He may find that the words "industrial and commercial profits" are not necessarily the same as income as defined in the local laws of the signatory countries. In the case of the Canada-U.S. treaty, for instance, certain items have been excluded which in ordinary business usage would be included in the meaning of industrial and commercial profits: e.g. royalties, interest, rents, dividends, management charges and capital gains.

REALLOCATION OF INCOME

In all of Canada's tax treaties with other countries, except that with Jamaica, special provisions exist relating to the allocation or reallocation of income between related corporations.

The key provision in Article IV of the Canada-U.S. tax convention[78] and similar ones in other treaties is that adjustment to profits may be made by disregarding conditions "made or imposed by the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises". There does not seem to be any real inconsistency between these provisions and those found in Subsections 69(2) and (3) of the Canadian Tax Act which purport to tax an amount that is "reasonable" in the circumstances if the non-resident person and the taxpayer had been dealing at arm's length. These provisions are most often involved in challenges by one of the contracting states against transfer prices charged by an entity of the other state. For example, in Article IX of the French treaty with Canada there is incorporated the associated enterprise rule contained in Article 8 of the Canada-U.K. tax agreement. Under this rule, commercial or financial relations between associated enterprises (as defined), different from those which would be made between independent enterprises, may be looked through by the national taxing jurisdictions.

The French treaty, however, adds a welcome relieving provision. Where the profits of an enterprise are altered by virtue of this rule with the effect that double taxation results, an automatic counterbalancing adjustment is provided in the other state. Furthermore, the initial adjustment made to the profits of one of the associated enterprises cannot be made "after the expiry of the time limits provided in the national laws" and in any case not after 5 years. This provision will prevent, for example, a readjustment by Canada of the profits of a Canadian establishment of a French enterprise beyond the 4-year reassessment limit under the Canadian Act. Following the wording[79] of the Canadian Income Tax Act this time bar does not apply in the case of fraud or wilful default. Generally this aspect of the French treaty seems workable and certainly superior to, for example, Article IV of the U.S. treaty under which adjustments to meet the initial reassessment require competent authority action, and without any protection against time-barred situations.

There may well be a problem as to the exact legal remedies available to the controlled Canadian resident corporation in the event of additional tax being levied by Canada by reallocating income to it on some basis not authorized by a tax treaty. A claim for relief under Article XVI of the Canada-U.S. convention, for example, with possible competent authority action, applies only with the government of the country in which the corporation is incorporated and then only if the taxpayer shows proof that it has suffered double taxation. In other treaties, such as that with the United Kingdom,[80] in order for a claim for relief to be lodged it need only be shown that the action of the taxation authorities of the contracting government has resulted, or will result, in taxation contrary to the provisions of the convention. Under these treaties, it is not necessary to show that the taxpayer, by itself, has suffered double taxation.

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78. Article IV, Convention between Canada and the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion in the case of Income Taxes, effective January 1, 1941:
1. (a) When a United States enterprise, by reason of its participation in the management or capital of a Canadian enterprise makes or imposes on the latter, in their commercial or financial relations, conditions different from those which would be made with an independent enterprise, any profits which should normally have appeared in the balance sheet of the Canadian enterprise but which have been, in this manner, diverted to the United States enterprise, may be incorporated in the taxable profits of the Canadian enterprise, subject to applicable measures of appeal.
(b) In order to effect the inclusion of such profits in the taxable profits of the Canadian enterprise, the competent authority of Canada may, when necessary, rectify the accounts of the Canadian enterprise, notably to correct errors and omissions and to re-establish the prices or remuneration entered in the books at values which would prevail between independent persons dealing at arm's length. To facilitate such rectification the competent authorities of the contracting States may consult together with a view to such determination of profits of the Canadian enterprise as may appear fair and reasonable.
2. The same principle applies, mutatis mutandis, in the event that profits are diverted from a United States enterprise to a Canadian enterprise.

79. Subsection 152(4) ITA.

80. Article 24, Convention between the Government of Canada and the Government of the United Kingdom of Great Britain and Northern Ireland for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital gains:
ARTICLE 24
Exchange of information
1. The competent authorities of the Contracting States shall exchange such information (being information which is at their disposal under their respective taxation laws in the normal course of administration) as is necessary for the carrying out of the provisions of this Convention or for the prevention of fraud or for the administration of statutory provisions against legal avoidance in relation to the taxes which are the subject of this Convention. Any information so exchanged shall be treated as secret and shall not be disclosed to persons other than persons (including a court or administrative tribunal) concerned with the assessment, collection or enforcement in respect of the taxes which are the subject of this Convention. No information as aforesaid shall be exchanged which would disclose any trade, business, industrial or professional secret or trade process.

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PRACTICAL QUESTIONS FOR THE BUSINESSMAN-INVESTOR

Basic questions that should be asked by Canadians contemplating foreign investment are the following:

1. If I do make profits abroad, can I bring them home?

2. Can I withdraw my capital from the foreign jurisdiction at will or are there exchange regulations or fiscal or security provisions that would make it more difficult than if I made the investment in Canada?

3. Will I suffer double taxation by investing abroad?

4. Will profits abroad be treated as capital or income gains and are the rules for the determination of capital gains vs. income the same as those at home or will I be whipsawed by different definitions on either side of the border?

5. Can I compute my income from the offshore source by the same accounting standards and with the benefit of the same reductions for cost and depreciation as would be applicable if the gain were to be made at home? If I cannot, will one jurisdiction accept the rules applied by the other in its assessment of my gains or income? On this point see the accompanying article by Edwin Harris.

6. Alternatively, is there a risk that income might be computed differently abroad so as to reduce the benefit of tax credits or other offsetting provisions at home?

7. Will I be treated any worse than a resident of the jurisdiction in which I propose to invest or do business because I am a foreigner or a non-resident or a Canadian?

8. What remedies do I have through the courts in Canada or by virtue of the competent authority provisions in the relevant tax treaty if I have trouble with the provisions of the treaty as it may apply to my venture?

U.S. TAX ON REAL PROPERTY GAINS BY FOREIGNERS

Of particular importance to Canadians investing in the U.S. is the recent legislation by the U.S. imposing a capital gains tax of 28% upon the disposition of real property or any interest therein, including shares in a company owning real property, where the property was disposed of by a non-resident of the U.S. At the moment, Article VIII of the present Canada-U.S. treaty protects gains realized in one jurisdiction by a resident of the other from capital gains tax imposed by the country in which the gain arose. While this protection will be removed under the new treaty, it will still give Canadian investors a step up on their cost for purposes of computing the U.S. capital gains tax. The cost base will be the value of the real property as of the effective date of the new treaty. There will be thus for Canadians two valuation days – 1 January 1972 for all capital property save U.S. real estate, and the date of coming into force of the new Canada-U.S. treaty for the latter.

On reviewing the complicated and sometimes confusing rules that govern Canadian taxpayers as set out in this short series of articles, the non-Canadian reader might be pardoned for wondering how the Canadian business and investment community manages to cope and survive. The answer is by dint of much effort and application of time and intelligence. Over the years, Canada's fiscal system, under the guise of a series of ongoing "tax reforms", has become more confining and introverted and places a heavier burden and more severe penalties on initiative and foreign capital formation. This in turn imparts upon Canada's competitive abilities in the international commercial and financial world. The only mitigating force is the treaty network with other countries, which is why I have given it some prominence in this article.

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Structuring Investments and Business Start-ups in Canada

by Nathan Boidman

I. INTRODUCTION

The advent of the 1982 I.F.A. Congress in Montreal is occasion to review the taxation parameters[1] of foreign investment in Canada, in general, and the impact thereon of recent developments,[2] in particular. The focus of this article will be the general tax considerations at the time of making the investment or acquiring or starting up a Canadian business, that is, "structuring" from the taxation standpoint.[3]

The initial structure normally establishes or fixes the manner in which Canadian tax will apply and, although re-structuring or reorganization at a later time may sometimes be feasible, it is usually possible and preferable to achieve the optimum structure from inception. For example:

- Whereas direct foreign ownership of Canadian real estate cannot be transferred subsequently to a corporation on a tax-free (rollover) basis, other types of directly held investments or business properties normally can be "rolled over" to a company formed under Canadian law.[4]
- An initial investment through a Canadian corporation[5] cannot be unwound on a tax-free basis in order to achieve direct foreign holding of the properties initially owned by the Canadian corporation.[6]



Mr. Boidman, Partner, Phillips and Vineberg, Advocats, Montreal. A chartered accountant with degrees in civil law and common law (McGill University) and called to the bar of Quebec in November 1981, Mr. Boidman practiced accounting from 1964 to 1973 following graduation from McGill University with a bachelor of commerce degree in 1962.

Since 1974, Mr. Boidman has restricted his practice to consulting in tax matters: he has authored numerous articles and papers on international tax and lectures frequently on the topic. Mr. Boidman, a member of the tax management advisory board on foreign income is contributing and consulting editor to several international tax journals and newsletters and is completing a book on treaty interpretation in Canada, and one on the impact of recent domestic tax law and treaty changes on structuring Canadian investment in U.S. real estate scheduled for publication in 1982, by CCH Canadian Limited; as well Mr. Boidman is co-authoring a book on taxation of foreign investment in Canada, to be published in 1983 by Kluwer.

1. The scope of this article is income taxation which is imposed by the Canadian Federal Government through the Income Tax Act, C.63 - 1970-71-72-73, as amended (herein the Act or I.T.A.) and by each of the 10 provinces through largely parallel legislation. The interplay of Federal and provincial law will be seen in various contexts below. Canada does not levy gift, estate, succession or inheritance taxes at either the Federal or provincial level except in the case of the Province of Québec; however, Canadian income taxes can arise at death in respect of unrealized appreciation of value of property. Retail sales taxes are levied at the provincial level while custom duties, excise and tax on manufactured goods are levied by the Federal Government, and in some areas by the provincial governments; these are beyond the scope of the article.

2. The impact of the Federal Government's 1980 National Energy Program on the oil and gas industry has been widely chronicled. In November 1981, the Federal Budget contained proposals for sweeping taxation changes, some of which will be seen in this article; however, at time of writing, detailed legislation in respect thereof had yet to be tabled in Parliament or published in draft form. Uncertainty brought about by unprecedented lobbying by various interested groups (business, etc.) and the broad imprecise language in which some of the proposals were couched (in the "Notice of Ways and Means Motions" which was tabled with the Budget) make it difficult to assess the full impact of the Budget on foreign investors.

3. The accompanying articles by Edwin Harris and Peter McQuillan address Canadian tax considerations of ongoing business operations, once structured and in place. Heward Stikeman's article on Canadian taxation of foreign investment by Canadians will be of interest to foreign investors considering Canada as a base for investment in third countries, such perhaps arising in respect of the redeployment of retained profits of foreign-owned Canadian subsidiaries.

4. Section 85 of the Act permits taxpayers to "roll over" most types of properties without recognizing appreciation in value, provided appropriate formalities (elections) and rules are complied with. However, foreign investors (that is, persons who are not resident in Canada) cannot transfer Canadian real estate under the protection of section 85.

5. "Canadian corporation", in this context, is one which is a resident in Canada. A company is resident in Canada if it has been formed under Canadian corporate law (Federal or that of a province) after 25 April 1965 or, where formed in another jurisdiction, has its "central mind and management" exercised in Canada - a case law doctrine which normally, but not always, refers to the seat of the board of directors; there are special rules of residency for companies formed in Canada before 26 April 1965.
However, the Income Tax Act uses the term "Canadian corporations" in a defined (and more narrow) manner: paragraph 89 (1) (a) of the Act reads as follows:

> 89 (1) (a). *"Canadian corporation"*. - "Canadian corporation" at any time means a corporation that was resident in Canada at that time and was
> (i) incorporated in Canada, or
> (ii) resident in Canada throughout the period commencing June 18, 1971 and ending at that time....

For most purposes of Canadian tax law, the distinction between a defined "Canadian corporation" and a foreign corporation which is resident in Canada under the common law rule is of no effect. However, there are important exceptions; most "rollover" and tax-free reorganization rules such as section 85 (see note 4) require a "Canadian corporation" and not one merely resident in Canada. To avoid confusion herein, where the tax rule under discussion turns on the question of corporate residence, reference will be to a "Canadian resident company" with the use of "Canadian corporation" being restricted to those circumstances requiring a company whose status is in accordance with paragraph 89(1)(a).

6. Where a Canadian resident company distributes property to its shareholders, whether in liquidation or otherwise, it is required to recognize a gain as if it had sold the property at fair market value (subsection 69(5)). The only exception to this rule is a liquidation of a Canadian corporation into a parent Canadian corporation (or one which owns at least 90% of its shares) (subsection 88(1) of the Act).

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SUMMARY COMMENT

The article will proceed by considering, in section II, underlying and basic factors, concepts and patterns of taxation relevant to and important in establishing the optimum structure for business start-ups and investments, generally, from the Canadian tax standpoint; section III will deal with some additional factors particular to passive foreign investment in Canada.

II. BASIC FACTORS AND PATTERNS OF CANADIAN TAXATION – INFLUENCE ON STRUCTURING STRATEGY

A. Tax on net income v. tax on gross income

1. Tax on net income – Part I of the Act

Although general rules abound, the Canadian tax system is sufficiently complex and its double tax agreement network sufficiently wide[7] to require close attention to the particular factors of each situation – type of investor, his country of residence and type of investment – and, usually, consideration to several alternative structures and forms of investment. However, the general scheme of the manner in which Canada taxes foreign investment results in one of two taxation patterns, regardless of the particular facts or structure selected:

- normal corporate or progressive individual tax rates[8] applied to net income or profit;[9] or
- flat (25%) withholding tax applied to gross revenue or gross receipts.

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7. Canada has 61 double tax agreements (tax treaties) in force or in some phase of negotiation or implementation, at the time of writing. Treaties have been signed and are in force with 32 countries, await ratification with 3 countries, have been initialled but not yet signed or published or are in negotiation with 26 other countries. In addition, 7 treaties in force at present are under renegotiation, to bring them in line with the 1977 OECD Model Convention, which serves as the basis for Canada's modern treaties. With certain exceptions, such modern treaties conform closely with the principles set out in the OECD Model. Two of the important pre-OECD Model treaties now in force are with the Netherlands and the United States, both offering tax planning opportunities, particularly in the area of real estate investment, not found in the modern or new generation treaties. The U.S.-Canada treaty has been renegotiated, and a new treaty was signed in 1980 and at time of writing awaits ratification. Renegotiation with the Netherlands is under way.

8. In this pattern, a foreign investor will be subject to the same type of tax rates applicable to a Canadian resident individual or corporation although modifications may arise where applicable to non-residents. For example, the normal aggregate Federal and provincial corporate tax rate is in the area of 50% but private Canadian corporations which are not controlled by non-residents ("Canadian-controlled private corporations", per paragraph 125(6)(a) of the Act, including situations where non-residents own up to but not more than 50% of the shares) may be entitled to a rate reduction of 21 percentage points in respect of Canadian business profits under section 125 of the Act (see also note 52). For individuals subject to a progressive rate scale, taking into account proposals of the 12 November 1981 Budget, maximum aggregate Federal and Provincial personal tax rates range from a low of roughly 47% in the Province of Alberta to roughly 61% in the Province of Québec. Foreign individuals subject to this first pattern of taxation may sometimes be liable only for Federal income taxes, in which case the aggregate rates (including a surtax in view of the absence of provincial taxation) would give rise to maximum rates of roughly 50%.
Unlike certain countries such as the United States, the Federal and provincial tax regimes are parallel and complementary in the sense that the Federal taxes are not deductible in computing the taxable income base for provincial purposes or vice versa, but rather the rates at the Federal and provincial levels are established in a fashion which take cognizance of the other. It can be noted that, at the time of writing (February 1982), the Federal and provincial authorities are experiencing difficulty in working out revenue sharing programs and it is not unlikely that provincial tax rates will increase, thereby increasing the aggregate Federal and provincial rates noted earlier. Prior to the 12 November 1981 Budget, aggregate personal tax rates ranged from roughly 59% in the Province of Alberta to nearly 70% in such provinces as Québec, and the present uncertainty from the Federal-provincial revenue sharing debate is whether the provincial governments will be forced to emasculate all or part of the cuts in personal tax proposed in the Federal Budget.

9. Net income or profit ("income" within the terminology of the Income Tax Act) means income determined in accordance with general accepted accounting principles unless modified by specific statutory or case law to the contrary. A more important aspect of such modification is the substitution of the Canadian "capital cost allowance" system for book depreciation. For a detailed review of these concepts, reference should be made to the papers by Harris and/or McQuillan.

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(a) *Basic rule: Mainstream tax*

The first pattern of taxing regime arising under Part I of the Income Tax Act[10] applies to:

- business operations in Canada owned and carried on directly by investors, that is, not through a Canadian subsidiary;[11]
- certain gains realized directly by foreign investors in respect of certain types of Canadian property and which are not otherwise included in business profits;[12]
- investment income or business profit regardless of source or type earned through a Canadian resident (subsidiary) company;[13]
- rents derived from real estate the operation of which is not considered to comprise a business but in respect of which certain "net income" elections have been made.[14]

(b) *For corporations: Secondary taxes (branch v. subsidiary corporation)*

Where a company is involved, there may be a secondary tax.

(i) *Branch tax – Part XIV of the Act*

Under Part XIV of the Act, a non-resident company is subject to a "branch tax" on business income earned in Canada, whether or not involving a fixed place of business or permanent establishment within the treaty concept thereof. The rate of this tax is 25% and it applies to the excess of the income base determined for purposes of the mainstream corporate tax payable under Part I of the Act as described earlier, over the amount of such mainstream corporate taxes (including those levied by the provinces).

Generally, the rate of such tax is reduced by treaty, and the reduction normally is to the rate which would apply to dividends were the business carried out through a Canadian subsidiary. As in the case of mainstream corporate tax, where a treaty is involved, there is normally an exemption from the branch tax if the business profit earned in Canada is not effectively connected to a permanent establishment in Canada.

(ii) *Subsidiary: Dividend withholding tax – Part XIII of the Act*

Under Part XIII of the Act, where the foreign investor utilizes a Canadian resident company as a subsidiary to make the investment or carry on the business, profits realized by the subsidiary are subject to withholding tax when repatriated by way of dividend payments; the rate of withholding tax is 25%.[15] As a general rule, Canada's treaties do not reduce the withholding tax below 15%.[16]

The 12 November 1981 Budget proposes an important change to the dividend withholding tax rules. Under present law,[17] the rate of withholding tax otherwise exigible (whether or not the rate is subject to treaty reduction) is reduced by 5 percentage points where there is Canadian ownership of 25% or more of the Canadian resident company; accordingly, in a typical treaty situation where the withholding tax rate is normally 15%, there would be a one-third reduction to a net withholding rate of 10%. The Budget proposes to eliminate the 5 percentage point reduction.[18]

(iii) *Branch–subsidiary comparison*

Nominally, the branch tax is payable in the year profit is earned, with the result that the use of a subsidiary can appear to be more advantageous as the secondary tax (on dividends) due in respect thereof can be deferred for as long as profits are maintained in Canada; however, comparable timing results as between a branch tax or a tax on dividends paid by a subsidiary often arise where regard is had to the deferral available in respect of the branch tax where profits are reinvested in the business carried on in Canada.[19] Also, under certain of Canada's treaties, branch tax may be subject to broader restriction or exemption in favour of the foreign investor than dividends paid by a subsidiary.[20]

2. Tax on gross income – Part XIII of the Act

The second pattern of regime, comprising a flat withholding tax of 25% on gross revenue or receipts derived from Canada, arising under Part XIII of the Act applies to:

- passive income such as interest, dividends, royalties or rents realized directly by a foreign investor and not effectively connected[21] to a business carried on in Canada;
- certain "deemed" income amounts arising out of transactions between foreign shareholders and Canadian resident companies; for example, certain loans by such companies to such shareholders.[22]

10. The Income Tax Act consists of 258 sections divided into 16 parts, the most important of which is Part I comprising sections 1 through to 180, although for foreign investors Parts XIII and XIV (see below) are also of substantial application and import. Part XIII comprises sections 212 to 218 while Part XIV comprises section 219.
11. See, inter alia, paragraph 2(3)(b) and subparagraph 115(1)(a)(ii) of the Act.
12. See, inter alia, paragraph 2(3)(c) and subparagraph 115(1)(a)(iii) of the Act.
13. See, inter alia, paragraph 2(1) and (2) and Part I of the Act generally.
14. See, inter alia, section 216 of the Act, Section III below.
15. Subsection 212(2) of the Act.
16. Under Article X(2)(a) of the renegotiated but as yet unratified treaty between the United States and Canada, the withholding rate will be reduced to 10% in the case of corporate participations of 10% or more. Under Article VII of the Netherlands-Canada treaty, dividends paid by a Canadian resident company to a shareholder resident in the Netherlands stemming from non-Canadian source interest or dividend income, and where certain other requirements are met, are exempt from Canadian withholding tax. See also Article VII of the Canada-Ireland treaty.
17. Sections 212(3) and 257.
18. It is probable that the proposed rate reduction under the U.S. Treaty (see note 16) occasioned this proposal (see Resolution 154 of the Notice of Ways and Means Motion).
19. See section 219 of the Act.
20. Under Article X(6) of the Canada-Switzerland Treaty, there is a complete exemption from branch tax on business profits earned through a permanent establishment where the Swiss company's principal business is not carried out in Canada.
21. The term "effectively connected" is not used in the Act, rather the simple concept of income "from" a business or property.
22. Under subsection 15(2) of the Income Tax Act, certain loans made to shareholders are treated as income when not repaid by the end of the taxation year of the lending corporation following the year in which the loan is made. (It should be noted that the exemption where such loans are repaid does not apply if the loans are part of a series of loans or repayments. This rule also applies in the case of loans made to non-resident shareholders and the loan is treated as a dividend for purposes of the withholding rules noted earlier, pursuant to sections 212 and 214.

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The tax is applied to gross revenue and, without benefit of deduction for expenses incurred by the foreign investor and in the case of rental income, may require that the gross revenue to which the tax applies be "grossed up" for payments required to be made by the tenant under the lease which normally constitute "owner" expenses.[23]

3. Structuring to achieve advantageous regime

(a) *Basic considerations*

There can be substantial differences in the net tax depending which of the two regimes applies; some situations are susceptible to "structuring" to achieve the optimum arrangements. The conceptual basis to "structure" or effectively select, as between the two regimes, is the underlying notion of whether or not the investment gives rise to a carrying on of business: if it amounts to a business, the Part I net income regime applies; if not, the Part XIII gross income regime applies.[24]

This dichotomy is similar to that of other tax systems such as that arising under the Internal Revenue Code of the United States.[25] Because there are no statutory rules for distinguishing between activities which amount to a carrying on of business and those which do not, the characterization is governed by somewhat flexible case-made law. This can give rise to uncertainties in marginal situations. Case law has generally involved issues respecting revenue-producing real estate in the context of domestic taxpayers where a similar distinction has been required for other purposes of the Canadian Income Tax Act.[26]

In principle, the distinction will turn on the degree of continuous entrepreneurial or managerial activity required to be exercised in earning the income from the investment. For example, in the case of the rental of property, particularly where the owner-lessor is not required to provide substantial services, it may be difficult to achieve taxation under the Part I net income regime, and a foreign lessor may well pay a greater tax under the Part XIII regime. However, in the case of rental real estate, foreign investors, otherwise subject to the Part XIII regime are entitled to elect to be taxed on a net income basis.[27] It will be noted below, under the section dealing with the role of a trust, that foreign investors can sometimes achieve net income taxation on purely passive payments by structuring a trust resident in Canada to make the investment.[28]

The general principle governing the distinction may well be subservient to a second principle, evolved in case law, that a corporation is presumed to be formed for the purpose of carrying on business with the result that what may give rise to passive income (from "property") in the hands of an individual may be considered to be derived from the carrying on of business in the hands of a corporation, particularly where it has no other activities.[29]

(b) *Withholding tax issues*

Finally, it should be noted that in unclear situations, the direct foreign investor may be subject to withholding tax at source, refundable to the extent that it subsequently can be successfully asserted that the income upon which withholding was levied was effectively connected to a Canadian business (and thus to be taxed in accordance with the Part I net income regime). The payor of an amount contemplated by Part XIII, such as dividends, interests, rents, royalties, to a non-resident is required to withhold the statutory Part XIII 25% tax regardless of whether the amount is earned by the resident in the course of carrying on business in Canada, unless the non-resident has obtained a certificate from the Minister of National Revenue evidencing that the payment is exempt from withholding tax on the basis of being connected to a Canadian business. The Minister is only required to issue this certificate where he is of the opinion that the payment is indeed related to carrying on a business.[30] Refusal of the certificate does not, in and of itself, establish the basis upon which the income is to be taxed, merely that the payor is required to withhold Part XIII tax and leaving it open to the non-resident investor to make a claim for refund of the tax under Part XIII[31] and file returns of income on the net basis under Part I of the Income Tax Act.

B. Joint investments: Partnership v. co-ownership

1. Basic considerations

Foreign investors also face choices with respect to appropriate structure for joint investments:

- whether to proceed in unincorporated form and to be taxed as a partnership or as a mere co-owner;[32]
- whether to incorporate, with the "joint" element being reflected simply by shareholdings.[33]

Although a partnership is not a separate person[34] for Canadian tax purposes (but, rather, usually serves as simply a tax accounting center with each partner thereof accounting for his share of partnership activities, profits, etc. as though a sole proprietor in respect thereof[35]), there can be important differences between the applicable rules so as to warrant an assessment of the feasibility of selecting or structuring for one mode rather than the other.

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23. *Burland* v. *M.N.R.* 68 D.T.C. 5220.
24. Of course, as already noted net income taxation can always be achieved by utilizing a Canadian resident company to make the investment regardless of whether its activities amount to a carrying on of business. Also see section III. B. below dealing with the use of a Canadian resident trust.
25. Sections 861, 864, 871, 881 and 882 of the Internal Revenue Code, 1954 as amended.
26. See *Wertman* v. *M.N.R.* 62 D.T.C. 1020; *Walsh and Micay* v. *M.N.R.* 64 D.T.C. 2032.
27. Section 216 of the Act.
28. See note 24.
29. See, for example, *Birmount Holdings* v. *The Queen* 77 D.T.C. 5031, but also see the (contrary) views of Revenue Canada: paragraph 10 of Interpretation Bulletin IT-420R2.
30. Subsection 214(13) of the Act and section 805 of the Income Tax Regulations, which were amended in 1981 to include certain payments in respect of resource property.
31. Subsection 227(6) of the Act.
32. The Canadian tax system does not distinguish between a co-owner or joint venture or member of a syndicate, all such direct undivided interests (which are not considered to comprise a partnership) being treated as though the investor were a sole owner or proprietor in respect of his undivided interest in the property and related revenues, costs and expenses.
33. The possibilities of a third format – trust – are dealt with below.
34. Taxpayers under Canadian tax law are "persons" which include individuals, corporations or estates or trusts, but not partnerships.
35. Subsection 96(1) of the Act.

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Generally, investors prefer to be treated as mere co-owners in order to have optimum flexibility in determining write-offs and deductions. These and other differences between partnerships and co-ownerships are reviewed in the third section below.

2. Structuring for the desired mode

In theory, it is always possible for joint investors to arrange either partnership or mere co-ownership, although in practice it is not feasible for certain types of joint investments to avoid characterization as a partnership. This is because (and unlike the United States, for example) the taxation law does not contain special or additional rules for characterizing a joint investment, leaving the determination to be made under the relevant property or contract law applicable.[36]

Joint investors can generally "structure" mere co-ownership by incorporating the following features in their arrangement:

- avoid formal declaration of partnership;
- avoid joint and several liability – both as between them and in their relationship with third parties;
- maintain investor interests in revenues, costs and expenditures in proportion to the interest in the underlying property;
- maintain the right to a direct interest in the gross proceeds or receipts;
- avoid having one co-owner act as general agent or mandatory, with a general power to contract, on behalf of the other co-owners.

Because the determination is left to commercial law, this means, in Canada, reference is made to provincial law of property or contract dealing with partnerships. The views of the Department of National Revenue, reflective of these principles, are set forth in Interpretation Bulletin No. IT-90 which outlines the issue succinctly as follows:[37]

1. The Income Tax Act does not define a "partnership", but outlines the tax consequences if one exists. Section 102 defines what is meant by a "Canadian partnership", but presupposes that there is a partnership. A partnership is not a person, nor is it deemed to be within the meaning of the Act, notwithstanding that section 96 provides that the income of a member of a partnership is computed as if the partnership were a separate person resident in Canada.

2. Generally speaking, a partnership is the relation that subsists between persons carrying on business in common with a view to profit. However, co-ownership of one or more properties not associated with a business (which under Common Law might be a joint tenancy or a tenancy in common) does not of itself create a partnership, and this is so regardless of an arrangement to share profits and losses. For guidance on whether a particular arrangement at a particular time constitutes a partnership, reference should be made to the relevant provincial law on the subject and such law will be viewed as persuasive by the Department of National Revenue.

3. A characteristic of a partnership is a sharing of profits of a business as opposed to a sharing of gross returns. Where the share of profits represents the payment of an obligation as opposed to a partnership right to so share, any presumption of partnership relating to the share of profits is rebutted.

4. A joint venture agreement, whereby two or more persons agree that each provides his own property to perform a specific task and receives a specific division of profits from such a task, may be considered a partnership as regards such profits; but as long as the property is not held under joint tenancy or tenancy in common, it is not considered to be partnership property. Thus the capital cost allowance provision relating to partnership property does not apply.

5. Where several persons form an association for the purpose of carrying out particular business transactions in which they are mutually interested, the association has the characteristic of partnership. However, such persons may associate without each accepting total liability for the association's debts. In these circumstances, contracts may indicate that the associated persons will be liable only for their respective agreed portions of the debts. The existence of such an arrangement is viewed as an indication that a partnership does not exist. One of the original examples of this type of association which does not constitute a partnership is a syndicate of insurance underwriters. Associations or syndicates in connection with natural resource industries often are in the same category.

6. Since a partnership is a relationship between persons carrying on business for profit, the type and extent of a person's involvement in the business is relevant in determining whether he is in reality a partner . . .

3. Differences in taxation of partnership and co-ownership

It was noted earlier that partners account personally for their shares of partnership activities, profits and losses, etc. and to that extent partnership income is taxed in Canada on a basis comparable to that earned by a mere co-owner. However, important differences between the two types of arrangement can arise and are as follows.

(a) *Timing of income*

A co-owner has more flexibility than a partner in determining the timing of claiming deductions in computing net income for Part I purposes where there is a discretionary element thereof. This is because in the case of partnership, it (the partnership) is required to compute income, and make appropriate deductions, with a partner accounting for his share thereof. Therefore each partner is subject to the will of the majority of the

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36. In contrast, see sections 761 and 7701 of the Internal Revenue Code. It should be noted that also unlike the United States, in Canada an association of investors is never treated as a corporation unless actually carried out through a company formally incorporated under applicable company law: cf. section 7701, Internal Revenue Code.

37. See also: "The Business of Defining a Partnership under the Income Tax Act", Howard Kellough, *Canadian Tax Journal*, XXII (2), March-April 1974, p. 190.

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partners as to the manner in which such elections are made.[38]

For example, the system for deduction of depreciation, in the form of a capital cost allowance, on capital assets provides taxpayers with a great deal of flexibility in timing deductions inasmuch as the amount of such claim in a particular year is at the discretion of the taxpayer, subject to the maximum limits thereof.[39]

This can be of particular importance in the case of a foreign investor for the reason that if there is a net loss from the partnership business, the benefits thereof can only be carried forward and enjoyed during the subsequent 5 taxation years.[40]

To the extent that losses arise as the result of the manner in which timing options and elections have been exercised, the foreign investor, as partner, faces the possibility of losing the benefit thereof if the losses cannot be used in the 5-year carry forward period; in contrast, a co-owner would have been entitled to select a tax-accounting rule, in the initial year, that would have avoided the creation of losses which subsequently become stale-dated. The problem can be particularly acute where the foreign investor is in a joint investment with a Canadian person who may often be in the position to immediately enjoy the benefits of losses from the partnership, as an offset against other sources of income subject to Canadian tax,[41] whereas the foreign investor without other Canadian business activities would not enjoy such an advantage.

Conversely, if all of the joint investors are foreign persons, it is likely that their interest will be common and the agreed timing of recognizing income through partnership elections and options will not prejudice any particular partner.[42]

(b) *Partnership interests – Co-ownership interests*

Although a partnership is not a separate person for Canadian tax purposes, an interest in the partnership is recognized as a separate property and transactions in or in respect of such interests can give rise to Canadian tax effects – whereas a mere co-owner simply has a direct "undivided" interest in each property (comprised of the co-ownership) for Canadian tax purposes. Normally, a partnership interest is treated as a capital property with the result that a disposition thereof normally gives rise to capital gain taxation, whereas disposition of an interest in a co-ownership requires identification of the nature of each property disposed of and may give rise either to capital gain or ordinary income, the latter, for example, in respect of the disposition of inventories of the co-ownership or recapture of capital cost allowance previously claimed; the notions of capital gains and recapture of capital cost allowance merit further consideration.

(i) *Capital gains*

First, under Canadian tax law, the general rule is that where a property used to produce or gain income is disposed of, a capital gain arises, measured as the excess of the proceeds over the "adjusted cost base"; one-half of such "capital gain" is a "taxable capital gain" required to be included in income to be taxed at ordinary rates.[43] Where a foreign investor is involved, such taxation will arise (see above respecting the first pattern of taxation) if the property is considered to be a "taxable Canadian property".[44] Such property includes, inter alia, Canadian real estate, shares of private Canadian corporations,[45] movable or personal capital property used by a foreign investor in carrying on business in Canada or interests in partnerships 50% or more of the property of which comprises the type of property just noted.

The implications thereof are twofold. On the one hand, it is possible that a foreign investor's interest in a Canadian business partnership will not be subject to Canadian tax upon a disposition where, for example, the majority of assets of the partnership does not comprise taxable Canadian property. On the other hand, if the latter is not the case and the partnership interest is a "taxable Canadian property", the disposition thereof will generally give rise to capital gains, not ordinary income, notwithstanding that a sale of the underlying property would give rise to ordinary income. It should be noted, however, that the purchaser of the partnership interest does not achieve a step-up in cost base in respect of his interest in the underlying properties of the partnership for purposes of future computation of profit or loss from the operations of the partnership.[46]

The terms of a Canadian treaty can give rise to additional differences between the tax arising on the disposition of an interest by foreign investor as partner rather than as co-owner. Most new generation, OECD model-based treaties would allow Canada to tax a foreign investor disposing of a direct interest in properties owned in co-ownership and used in carrying on business in Canada.[47] However, these treaties normally provide exemption from Canadian taxation in respect of gains realized in

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38. The only exception to this rule is in respect of certain exploration and development of costs in respect of resource ventures (subsection 96(1) of the Act).
39. See Part XI of the Income Tax Regulations: cf. the rule in the United States where minimum depreciation is deemed to be claimed.
40. Section 111 of the Act.
41. As a general rule, a Canadian resident taxpayer may offset losses from one source of business or investment against income from other sources, whether earned directly or through a partnership (paragraph 3(d) and section 96 of the Act).
42. Timing options can arise with respect to both the recognition of gross revenue or claiming deductions or expenses. Subject to important modifications proposed in the 12 November 1981 budget (see also the 18 December modifications thereof), taxpayers can normally, for example, claim reserves in respect of instalment sales. Timing options, arise, inter alia, in respect of the immediate deductibility of interest expense (under paragraph 20(1)(c)) or the capitalization thereof (under section 21), depreciation on tangible capital expenditures and on some forms of limited life intangibles (under section 20(1)(a) and Part XI of the Income Tax Regulations) and the deductibility of certain intangibles such as goodwill (collectively: "eligible capital expenditures") (under paragraph 20(1)(b) and related provisions of section 14 of the Act).
43. Sections 3 and 38-55, I.T.A.
44. Taxable Canadian property is defined in paragraph 115(1)(b), I.T.A.
45. Paragraph 89(1)(f) of the Act: that is, a corporation the shares of which are not treated on a stock exchange in Canada nor controlled by such a company.
46. Again, this is in contrast to the U.S. system (see section 754 of the Internal Revenue Code).
47. See, typically, Article 13(2) of Canada's newer treaties and the same article in the 1977 OECD Model Convention.

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disposing of an interest in a partnership unless the principal property thereof comprises immovables.[48]

(ii) *Recapture of capital cost allowance*

Any recovery (recapture) of capital cost allowance previously claimed upon the disposition of the subject depreciable property is required to be included in ordinary income and only proceeds realized in excess of original cost are subject to capital gains treatment.[49]

However, where an interest in such property is disposed of through the sale of a partnership interest, the general rule holds and the recapture realized in the form of a gain on the disposition of the interest is accounted for as capital gain; however, as already noted, the purchaser of such an interest would not enjoy a step-up in cost base in the underlying property.

(c) *Transactions between partner and partnership*

Another important difference between partnerships and co-ownerships to be noted and considered in structuring the joint investment is the general rule that transactions between a partner and a partnership are considered to take place at fair market value and that, for example, where a partnership property is transferred to a partner, a taxable gain may arise. The exceptions to the rule, providing for "rollovers", are restricted to transactions involving "Canadian partnerships" requiring that all partners be residents of Canada.[50] In contrast, there is no recognition of any transaction between an investor and the co-ownership, unless it entails a disposition of property by one co-owner to another. However, an important exception to the general rule is that the cash withdrawals by a partner, if and when in excess of his adjusted cost base, are tax-deferred.

4. Joint ventures through a "Canadian-controlled private corporation"

It was noted earlier[51] that private Canadian corporations may be entitled to a corporate tax rate reduction of 21 percentage points[52] where not more than 50% of their shares are owned by non-residents. This reduction, applicable to the first $200,000 of net income in a year, and subject to an overall limit of $1,000,000 (under the 1981 Budget proposals), can make it advantageous to carry out joint investments with Canadian partners through a single corporation, rather than by way of co-ownership or direct partnership.

C. Financing and licensing factors

1. General considerations

The combined effect of Part XIII taxes (25% flat withholding on gross payments) on dividends, interest, royalties and rents paid to foreign investors and deductibility of certain of such payments under Part I of the Income Tax Act can provide several options in structuring Canadian investment and business undertakings. Subject to the thin capitalization rules (below), equity provided in the form of debt can produce interest charges deductible against high taxed income, substituting therefor lower Part XIII withholding taxes. In contrast, equity provided either directly by the investor or by share investment in the company utilized to make the investment or undertake the business produces non-deductible dividend payments. Similarly, the licensing of technology rather than outright transfer or direct use thereof can produce different tax results. The range of the possible results, assuming one of Canada's newer treaties in respect to a business venture, may be seen in the following comparisons:

	Financing		*Technology*	
	Debt	*Equity*	*Licensing royalty*	*No royalty*
Profit	$100	$100	$100	$100
Interest or royalty charge	(100)	–	(100)	–
Taxable profit	–	100	–	(100)
Corporate profit tax (Part I) @ 50% (a)	–	$ 50	–	$ 50
Secondary – branch (Part XIV) or dividend (Part XIII) tax and Article X(2) @ 15% (b)	–	$ 7.50	–	$ 7.50
Part XIII and AXI (3) @ 15% (c)	$ 15	–	–	–
Part XIII and AXII (4) @ 10% (d)	–	–	$ 10	–
Net return	$ 85	$ 42.50	$ 90	$ 42.50

(a) Actual combined federal and provincial taxes may range from 25.5% to 51% depending upon applicability of a 6 percentage point reduction for manufacturing and processing operations or (section 125.1 I.T.A.) and the particular province involved (where tax rates may range from a low of 5.5% in the Province of Québec (in 1983 and subsequent years) to a high of 16% in British Columbia, and leaving aside a temporary 5% federal surtax (section 124.2 I.T.A.) which is to be extended through 1983 under the 12 November 1981 Budget. See notes 8 and 52 and related texts.

(b) See, for example, treaties with Switzerland, U.K., France, Germany (as yet unratified), Belgium and Italy.

(c) See treaties referred to in (b).

(d) See treaties referred to in (b).

2. Debt v. equity: Thin capitalization and withholding taxes

The general rule providing deductibility, under Part I, for financing charges is subject to thin capitalization restrictions where paid by a Canadian resident company to certain foreign shareholders or persons affiliated with them. In order for full interest charges to be deductible, the ratio between loans provided by such foreign shareholders owning 25% or more of the shares of the Canadian resident operating company and the balance sheet equity thereof must not exceed 3:1. Persons not dealing

48. See, for example, Article XIII(4) of the Canada-Switzerland income tax treaty.

49. Section 13, I.T.A.: this may be contrasted to the rule in the U.S. in respect of certain straight-line methods of depreciation of real property where recaptured depreciation is treated as a capital gain (see the Economic Recovery Tax Act).

50. See sections 97, 98 and 102 of the Act.

51. See note 8.

52. Where regard is had to the 6 percentage point reduction in corporate tax rates (5% where the 21% reduction applies) in respect of manufacturing profits under section 125.1 of the Act and recent corporate rate reductions in the province of Québec, overall corporate rates may be as low as 13%.

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at arm's length[53] with shareholders are taken into account for this computation as well as back-to-back loans made through foreign banks or other financial intermediaries.

Interest paid or incurred in respect of debt in excess of the 3:1 ratio is not deductible in computing taxable income under Part I of the Act. This means that in establishing a Canadian subsidiary with, for example, a $1,000,000 investment at least $250,000 must be invested by way of share capital in order that interest charges on the balance be deductible.[54] However, these rules do not apply to operations carried on in Canada through a branch of a non-resident Canadian company.[55]

Canadian withholding taxes under Part XIII in respect of such financing charges are exigible at the rate of 25% unless reduced by treaty which, as noted above, normally provides for reduction to 15%. There is also provision under the domestic law for exemptions from withholding tax on interest paid to arm's length persons on loans made before 1983 where no more than 25% of the principal amount of the loan is required to be repaid, in the absence of default, during the first 5 years of the loan.[56]

It is not known at the time of writing whether this exemption, introduced in 1976, will be extended, as it had been from the initial expiry date of 1979. Considering that arm's length relationship arises where the share ownership is restricted to 50% or less or that back-to-back loan arrangements are not specifically ruled out (as in the case of the thin capitalization rules), there is some degree of flexibility in some circumstances to take advantage of this exemption in financing business start-ups in Canada – although concerns respecting agency or sham and the imminent expiry of the exemption reduce substantially the potential interest therein.[57]

3. Transfer of technology

The basic question may arise as to whether to license or assign (outright) industrial technology (patents and other proprietary rights or non-exclusive or non-proprietary technology, such as know-how). The parameters are as follows.

From the standpoint of deductibility to the operating entity (say Canadian subsidiary), royalties or similar payments are normally deductible in the year in respect of which the payment arises while the cost of an outright acquisition is either deductible over the life of the technology in the case of limited life rights or at the rate of 10% but only on one-half of the cost of unlimited life rights, unless the benefits obtained are of current or short-lived duration in which case the entire cost may be deductible in the year in which acquired.[58]

From the standpoint of taxation to the foreign transferor or licensor, Canadian tax could arise under either Part I of the Act or Part XIII, as more fully discussed in the next paragraphs.

Normally, the transferor will not be subject to tax under Part I, on the net income basis, in respect of either a single transaction of transfer of his technology or licensing thereof to a Canadian business enterprise, whether in the form of outright transfer or technology license. This is because either the transaction does not amount to carrying on of business in Canada,[59] or, even if it does, exemption, in the case of outright transfers, should arise under the normal business profits rule of a Canadian treaty.[60]

Uncertainty can arise in respect to the outright assignment of some but not all of a transferor's proprietary interests in his technology, such as in the case of the provision of know-how. The issue will be whether or not a mere "use" is being provided; but, notwithstanding some uncertainty in the jurisprudence, it would seem that in the absence of any restriction on the use to which the technology may be put, withholding taxes under Part XIII should not arise.[61]

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53. Non-arm's length relationships exist where there are certain defined relationships between persons such as a common parent or where a person controls a corporation or persons are affiliated by blood or marriage relationships (paragraph 251(1)(a) and subsection 251(2) of the Act or, in the absence of such relationships as a matter of fact, entailing the question of separate economic interests or a common directing mind whithin rules made under case law and pursuant to paragraph 251(1)(b)).

54. The 1981 Budget would exclude third-party shares, if any, from "equity".

55. Canada's treaties do not restrict the applicability of Canada's thin capitalization rules and, for example, the renegotiated treaty between the U.S. and Canada specifically precludes a claim under a non-discrimination clause (Article XXV(8)):

> 8. The provisions of paragraph 7 shall not affect the operation of any provision of the taxation laws of a Contracting State:
>
> (a) Relating to the deductibility of interest and which is in force on the date of signature of this Convention (including any subsequent modification of such provisions that do not change the general nature thereof)....

56. Subparagraph 212(1)(b)(vii) of the Act.

57. With respect to the concerns respecting sham or agency it should be noted, however, that for purposes of both the section 212(1)(b)(vii) exemption and the section 18(4) thin capitalization rules, a bona fide third-party loan simply collaterized or secured or guaranteed by a foreign shareholder would be perfectly acceptable. With respect to the concern respecting sham or agency in respect to back-to-back loan arrangements designed to circumvent the arm's length requirements of section 212(1)(b)(vii), see the decision of the Supreme Court in *Swiss Bank Corp.* v. *Her Majesty the Queen* 72 D.T.C. 6470.

58. As a general rule, case law distinguishes between a current expenditure for purposes of gaining or producing income, pursuant to paragraph 18(1)(a) of the Act, and a capital expenditure entailing one which provides an enduring benefit to the acquirer or increases or augments the income earning process pursuant to paragraph 18(1)(b); in the latter case, specific provision for deductibility must be found within the rules of the Act or the Regulations. Where an intangible capital expenditure with a limited life is involved, Part XI and Schedules 2 and 4 of the Income Tax Regulations (made pursuant to and for the purposes of paragraph 20(1)(a) of the Act) provide for straight line write-off over the useful life of the right acquired while section 14 of the Act provides for a 50% deductibility, at the rate of 10% per annum on a declining balance basis, in respect of intangible capital expenditures without a limited life, within the "eligible capital property" rule referred to above (note 42).

59. Section 253 of the Income Tax Act extends the meaning of carrying on business in Canada to include a mere offering for sale of anything in Canada. On the other hand, a single isolated transaction ("adventure in the nature of trade") has been held not to amount to the carrying on of business (*Tara Exploration Ltd.* v. *Her Majesty the Queen* 72 D.T.C. 6288).

60. The exemption would normally arise under Article VII of the OECD based treaties unless the payments in respect of the outright transfer are contingent in nature and thus perhaps are contemplated by the royalty provisions normally found in Article XII of such treaties.

61. Paragraph 212(1)(d) of the Income Tax Act provides for 25% withholding tax on rents, royalties and similar payments including, inter alia, any type of payment for the right to use in Canada know-how or other non-proprietary technology. In *St. John Shipbuilding Dry Dock Ltd.* v. *Her Majesty the Queen* 80 D.T.C. 6272, the Federal Court of Appeal suggested that lump sum payment for sale of a computer program to build ships would have been subject to withholding tax under the rent or royalty rule had it not been for exemption arising under provisions under the current treaty between the U.S. and Canada. However, it seems that restrictions placed on the right of the Canadian acquirer to alienate and the requirement to maintain confidentiality brought the

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Where the technology transfer arrangement involves the payment of either a conventional royalty or licensing fee or a lump sum price, the payment of which is contingent upon the use (sales, profits, etc.) of the transferee or licensee, the Part XIII, 25% withholding tax will apply.[62] Canada's newer treaties do not eliminate the liability but restrict the rate to 10%.[63]

4. Intercompany pricing considerations

As a general rule, intercompany pricing arrangements, including those respecting the provision of financing and technology, must conform to a fair pricing or reasonable price standard, in the absence of which deductibility for Part I purposes may be denied to the payor and Part XIII 25% withholding tax (to the extent not otherwise applicable) on disguised or deemed corporate distributions may arise for the payee in respect of an excess price. It is to be noted that the Canadian rules in this area are comprised largely of broadly stated principles[64] without elaborate statutory language or a substantial body of case law.

D. Anticipating the ultimate disposition

Structuring the investment or business start-up from the standpoint of minimizing Canadian taxes on an ultimate disposition turns on three basic factors:

- under the Income Tax Act, as already noted, gains realized on the sale of "taxable Canadian property" comprising, inter alia, shares of private Canadian resident companies, Canadian real estate, resource properties or capital properties used in carrying on a directly-held business[65] or other property thereof[66] are subject to tax;
- Canada's new generation treaties would generally exempt the sale of shares of private Canadian companies whose principal property does not comprise real estate;[67] and
- the sale of shares of a foreign company (a non-Canadian resident company) is not subject to tax under the Income Tax Act; but, on the other hand, a purchaser of the shares thereof cannot achieve a step-up in cost base for Canadian tax purposes in respect of the property owned by such corporation without undertaking a liquidation which would give rise to immediate taxation, in respect of the type of Canadian properties noted above.[68]

It was just noted that the purchaser of shares of a foreign company used to carry on a Canadian business does not achieve a step-up in cost base in the underlying properties on a tax-free basis, thus decreasing the potential benefits of a sale of the shares of such a company without liability to Canadian tax. However, the results are not much different in respect of a sale of the shares of a private Canadian company which, absent a treaty exemption, would be subject to Canadian tax. In particular, and unlike the rules, for example, in the United States,[69] a purchaser of the shares of a Canadian corporation may only achieve a step-up in cost base in respect of non-depreciable capital property (thereby excluding inventories and depreciable properties, such as plant and equipment or intangible assets such as goodwill, etc.) by acquiring the shares through a Canadian holding company and proceeding with the liquidation of the acquired company into such holding company.[70]

Accordingly, where the choice is between a Canadian resident company and one which is not resident, from the standpoint of ultimate disposition, the use of a foreign corporation will be preferable in the sense that reliance upon treaty exemption is not required. Finally, in this context Canada's treaties do not generally exempt a foreign direct investor from the sale of business properties or assets comprising a permanent establishment.

Individual foreign investors would also benefit from the insulation from Canadian tax, afforded by the holding of the shares of a non-resident company, arising under Canada's deemed disposition rules at death.[71]

III. ADDITIONAL FACTORS PARTICULAR TO PASSIVE INVESTORS

A. The role of the non-resident-owned investment corporation

Foreign investors in Canadian portfolio securities generally are exempt from Canadian tax in respect of dispositions thereof[72] and are subject to 25% withholding tax on

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payment within the concept of a mere use (as opposed to an acquisition of outright ownership) within the meaning of subparagraph 212(1)(d)(i), thus leaving it open to structure arrangements not comtemplated by that provision. It is also to be noted that subparagraph 212(1)(d)(i) refers to a use in Canada and not, in concept, a lump sum payment for a right of use which is not restricted to Canada.

62. Section 212(1)(d) of the Act.
63. See, for example, Article XII of the treaties with Switzerland, France, the U.K., Italy, Belgium and Germany.
64. Subsection 69(1) requires a fair market value price with respect to the sale of goods between related or non-arm's length parties; however, subsections 69(2) and (3) deal specifically with international non-arm's length transactions and refer to "reasonable price in the circumstances" and there is no jurisprudence to date on whether there is a difference between the two concepts. For detailed discussions of the various factors noted in this section, see "Intercompany Pricing: In Search of Guidelines", by George Tamaki and Richard Pound, *Canadian Tax Journal,* XXII (5), September-October 1974, p. 460; "Working with Canada's Technology Transfer Rules", by Nathan Boidman, *Tax Planning International Journal,* August 1981, p. 3; "Intercompany Charges for Services and Use of Property – Canadian Income Tax Considerations", a paper presented to the Canadian Tax Foundation Annual Conference in Toronto in 1974, by André Gauthier and written by Gauthier and Nathan Boidman and appearing in the 1974 Conference Report at page 145.
65. Subparagraph 115(1)(a)(iii) and paragraph 115(1)(b) of the Act, note 43 above and related text.
66. Subparagraphs 115(1)(a)(ii).
67. E.g. Article XIII(4), Switzerland-Canada Treaty.
68. Subsection 69(5) of the Act.
69. Sections 332, 334(b) and 336 of the Internal Revenue Code.
70. See subsection 88(1) I.T.A.
71. See note 1: capital gains exemptions provided in Canada's newer treaties in respect of shares of private Canadian companies (not principally involved in real estate activities) apply to deemed dispositions at death. The contrary was suggested by the Federal Court, Trial Division in the case of *Davis* v. *The Queen* 76 D.T.C. 6109, in an obiter dictum respecting the exemptive provisions of Article VIII of the current U.S.-Canada Treaty in respect of a "sale or exchange" but the wider ambit inherent in the new generation treaty concept of "alienation" should make those comments of the Court, if correct, inapplicable.
72. A less than 25% holding in the shares of a public corporation that is, one whose shares are listed on a stock exchange in Canada (paragraph 89(1)(g) of the Act) and debt instruments of Canadian companies are excluded from the "taxable Canadian property" category and, in the absence of systematic and continuous trading activities in such securities in Canada, gains in respect thereof are not subject to Canadian tax.

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interest or dividend payments, subject to treaty protection.[73]

However, gains and income in respect of such portfolio investments may be subject to full Canadian corporate taxation if held through a foreign corporation portfolio which is managed on a discretionary basis by a Canadian broker or other advisory personnel.[74]

To guard against this type of concern, a non-resident can structure Canadian portfolio investments, or other types of passive activities, through a company formed in Canada and qualified for purposes of the Income Tax Act as a "non-resident-owned investment corporation" which is taxed on a "flow-through" type basis. The chief characteristics of such a corporation are:

- all shares are owned by non-residents of Canada;
- investment and other undertakings are primarily of the passive variety, in compliance with specific statutory rules and, for example, no more than 10% of the income of the corporation can be derived from rents or royalties;
- the corporation has made an election to be taxed as a "non-resident-owned investment" corporation within 90 days after its formation or start of business.[75]

The scheme of the rules governing an NRO is to provide a foreign investor with the same overall Canadian taxes on distributed income and profits of the corporation as though the underlying investments had been held directly. The principal rules and the procedures to achieve this result are:

- dividends, interest and other incomes are subject to an initial 25% tax in the hands of the corporation, which is totally refundable upon payment of dividends to shareholders;
- gains realized in respect of portfolio investments which if realized directly by the foreign investor (that is, shares of public corporations[76] and other non-"taxable Canadian property") are not subject to taxes at the level of the corporation.
- on payment of dividends, the NRO receives a refund of the initial 25% tax and Canadian withholding taxes on such dividend do not apply to the portion thereof stemming from capital gains which would be tax-free if realized directly.

There are, however, certain anomalies and difficulties in respect of:

- foreign investments by the NRO, and ideally the NRO is not used for non-Canadian investment purposes;
- investments in Canadian securities which if received directly would benefit from a reduction in or exemption from the standard 25%, Part XIII tax, such as corporate debt or bonds qualifying for the "5-year" exemption referred to earlier.[77]

An important manifestation of the last problem noted has been the loss of the 5 percentage point reduction in the rate of withholding tax on dividends paid by Canadian companies in which there is a 25% or greater Canadian ownership.[78] However, as noted earlier, the 12 November 1981 budget proposal to abolish this reduction will eliminate this particular adversity of utilizing an NRO to hold Canadian portfolio equities.

B. Role of Canadian resident trusts

A Canadian resident trust can serve to reduce taxation on Canadian source rents derived from personal or moveable property or royalty-type payments when such income is derived from investment activities which are not considered to amount to carrying on of business.[79] The trust provides a basis to achieve taxation under Part I[80] rather than under Part XIII,[81] and where tax under the former regime is less than that which would arise under the latter this approach is advantageous.

As already noted, a foreign investment which does not amount to the carrying on of business can be rendered subject to net income taxation by the use of a Canadian resident corporation. However, this entails not only the cost and complexities of a corporation but aggregate Canadian taxes (where regard is had to both the primary (mainstream) corporate taxes and the secondary distribution withholding taxes) of rates ranging up to 60% and greater.[82] A corporate structure may also prevent the investor from realizing optimum tax results in his country of residence; for example, it may preclude a flow-through of tax write-offs. It was noted in the preceding section that an NRO cannot be used to earn rents and royalties.

A trust can optimize results in both Canada and the State of residence by not only effecting net income taxation in Canada but, as well, a reduction of the overall Canadian taxes to a maximum of 25% of net income while possibly providing flow-through characteristics in the country of residence.[83]

The requirements of, and general considerations related to, effective trust arrangement in respect of passive rentals and royalties may be summarized in respect of a hypothetical situation where a helicopter having a cost of $100,000, financed at 20% per annum, is leased to a Canadian user at an annual rent of $30,000:

- if the helicopter is leased directly by the foreign investor(s) to the Canadian user, annual Canadian in-

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73. Part XIII of the Act.
74. As noted (note 5 above), a foreign company can be considered resident in Canada on the basis of central mind and management which, although generally is a reference to the seat of the Board of Directors, could also be determinated on the basis of day-to-day operational management; see the decision in *Crossley Carpet* v. *M.N.R.* 69 D.T.C. 5015.
75. Sections 133 and 134 of the Income Tax Act.
76. See note 72.
77. See note 56 and related text.
78. See note 17 and related text.
79. See note 24 and related text.
80. See section II(A)(1) above.
81. See section II(a)(2) above.
82. See note 80. It should also be noted that the 1981 Budget increases taxes on investment income earned through a Canadian resident corporation by eliminating the applicability of the refundable tax provisions of section 129 to foreign controlled corporations.
83. For example, typical commercial trusts may often be ignored for U.S. tax purposes allowing the U.S. inventor, as beneficiary or unit holder, to direct write-offs of the costs and expenditures of the trust. This may either arise under the grantor trust rules or as a matter of the trust being characterized as a partnership.

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come taxes would arise at 25%, producing taxes of $7,500;[84]

- if a proper trust is constituted[85] and the trustee is a resident of Canada, the trust can acquire and lease the helicopter and be governed by the net income regime of Part I;[86]
- the trust could, for example, in its first year have no taxable income, the gross lease payments of $30,000 being offset by interest financing costs of $20,000 and depreciation claims of $10,000;[87]
- in a subsequent year when the gross lease payments exceed the aggregate financing and depreciation charges, the net income would either be taxed in the hands of the trust at the rate of roughly 50%[88] or in the hands of its beneficiaries at a maximum rate of 25%. Taxation in the hands of the trust would arise if the trust arrangements do not require that annual income be distributed to beneficiaries and in fact there are no such distributions in the year earned. Where such distribution is required and/or is made no tax arises under Part I in the hands of the trust, but rather a 25% withholding tax on the beneficiary under Part XIII.[89] If it is assumed that in the subsequent year in question aggregate financing and depreciation charges amount to $20,000, net income for Part I would amount to $10,000 and, in cases where the income is accumulating, Canadian taxes of $5,000, computed at the rate of roughly 50%, would be incurred, which may be contrasted to the gross withholding taxes of $7,500 which would arise where the helicopter is leased directly by the foreign investor; and where the income is payable to the beneficiaries, Canadian taxes would amount to $2,500 comprising the 25% withholding tax on the net income distributed to the beneficiary, comparing rather favourably with the gross taxes in the case of the direct holding;
- it is important to note that if the trust is not resident in Canada (that is where the trustee is a non-resident) the taxpayer would simply be a direct foreign investor, bringing into effect the flat withholding tax of 25% on gross lease payments under Part XIII of the Income Tax Act.

C. Revenue-producing real estate

1. Overview

In general terms, a direct foreign investor in Canadian revenue-producing real estate may elect to be taxed on either a net basis at regular rates of tax or pay a flat 25% withholding tax on gross rents; this is considered below in section 3. Full implications of Canadian tax results including issues of corporate taxes on capital are beyond the scope of this paper.[90]

The precise circumstances of the investment may affect to a considerable extent the overall results. The variables include the status of the investor (that is, individual versus corporation and in the latter case whether the Canadian rental property investment is a principal or ancillary activity), the size and nature of the property, the manner in which it is leased (gross lease versus net lease, single tenant or multi-tenants), and the manner in which it is managed (which may range from little if any under net leases, to independent property managers or the maintenance of a full time staff). Some of the variables and some of the effects arising thereunder are briefly reviewed herein.

Assessment of all factors determines whether the investment should be made directly by the foreign investor, through a Canadian resident company or perhaps through a Canadian resident trust: the factors include effects under Canada's domestic law and the extent to which a treaty may alter the results. Recent treaties largely permit Canada to fully apply its domestic law in respect of foreign investment in Canadian real estate held directly or through Canadian corporations.[91]

2. Financing considerations

The financing objectives are normally twofold: maximize the deductibility of interest expense in computing Canadian taxes on rental income and minimize Canadian withholding taxes on interest paid to non-resident lenders in order to minimize the cost of borrowing. The basic considerations and factors underlying these objectives have been considered in Part I, and in relation to investment in Canadian real estate may be summarized as follows (regard also being had to certain additional factors particular to real estate investment):

- Interest expense will generally be deductible where

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84. It is assumed that the helicopter is leased on a net basis (the lessee assuming full responsibility for its maintenance and operation) comprising circumstances where the rental income should generally not be considered to be derived from carrying on of business in which case Part XIII of the Income Tax Act – Section 212(1)(d) and not Part I of the Income Tax Act will apply, resulting in a flat 25% withholding tax on the gross lease payment, subject to reduction under applicable treaty, if any.

85. Constitution of the trust would be governed by English common law principles in all provinces other than the province of Québec, in which it may be difficult to utilize the provisions of the Civil Code to constitute a commercial trust: see the Supreme Court of Canada in *Crown Trust* v. *Higher* (1977) I S.C.R. 418.

86. The trust will be considered resident in Canada: *Thibodeau* v. *The Queen* 78 D.T.C. 6376 and subject to Part I tax as an "individual" (section 104 of the Act).

87. Normally, a helicopter could be depreciated at rates of 25% per annum on a declining balance basis under the Income Tax Regulations and pursuant to paragraph 20(1)(a) of the Income Tax Act with the trust being entitled to such part of the maximum claim as is required to eliminate taxable income.

88. See Resolutions 95 and 101 of Notice of Ways and Means Motion, 1981 Budget.

89. In the latter circumstances noted, the trust income is considered as "payable" under subsection 104(24) and may thus be deducted in computing the trust's own income for purposes of Part I under section 104(6), thus giving rise to Part XIII withholding tax in respect of taxes payable by the beneficiary under Sections 212(1)(c), and (11) and 214(3)(f). (It is important to note that a trust is not entitled to reduce its income for purposes of Part I of the Income Tax Act in respect of income "payable" if the income is derived from Canadian real estate rentals, resource activities, businesses carried on in Canada or the disposition of "taxable Canadian property". None of these restrictions however could apply in the hypothetical case under consideration.) Care would be required in drafting the income interests to ensure that the amount "payable" is net of depreciation.

90. For a detailed study of this topic see "Investment in Canadian Real Estate by Non-Residents", a paper written by André Gauthier and Nathan Boidman, delivered to the Corporate Management Tax Conference of the Canadian Tax Foundation in June 1977 by André Gauthier and appearing in the Conference Report at page 195; a number of changes since the date of writing have not substantially altered the rules and results analyzed therein.

91. Present treaties with the U.S., Netherlands, Sweden and Finland can provide some interesting planning possibilities with respect to disposition gains, but as noted (note 7) these treaties are now being renegotiated.

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the investment is acquired by a Canadian resident corporation or trust or, in a case of direct foreign investment, the revenue property is considered to comprise a business in Canada, or in the absence thereof a net income election is made.[92] The constraints are the thin capitalization rules where a Canadian resident corporation is involved.[93] It can also be noted that interest incurred during a period of construction can be capitalized at the option of the investor.[94]

– With respect to Canadian withholding taxes, interest paid to a non-resident lender may be subject to Canadian tax in both the direct and indirect investment structure. Where the investment is direct, and interest is paid by the foreign investors to a foreign lender, Canadian withholding tax is applied to the extent that the interest is deductible and the loan is secured by the real estate[95] or the investment amounts to the carrying on of business and comprises the principal business activity of the foreign investor.[96] Where the investment is made through a Canadian corporation or trust, withholding taxes will generally apply.[97] In both the direct and indirect context if a corporate investor is involved exemption may arise under the 5-year rule.[98]

Participating or bonus financing arrangements, whereby a lender receives an interest in rents or eventual disposition proceeds, are being used more frequently and may arise in the context either of the financing available to the investor or may comprise the manner in which the investor makes his investment. When viewed from the former standpoint, the issues include the deductibility of contingent amounts paid under the arrangement by the investor and the extent to which a withholding tax obligation may arise. Where the context is the use of such arrangements by the investor as the means of participating in Canadian real estate, structuring issues are, in effect, the mirror image of the second consideration just noted, that is, the manner in which Canadian tax may arise on payments made to the investor under the participation arrangement or perhaps in respect of a sale of the instrument. As a general matter there is, at this time, a lack of precise law on this point, either under the Income Tax Act or in the cases, and it will be necessary to rely on the principles already discussed. The main issues will involve the questions of whether the participation should be treated under rules relating to loans, the payment of principal and interest, rules relating to joint ventures or partnerships, or some combination of the two. The particular features of the participating arrangement will have to be carefully examined in order to assess the most appropriate characterizations for and consequences under Canadian tax law.[99]

3. Selecting the regime of taxation

Normally, it would be desirable to be taxed in Canada on a net income basis. As already noted such treatment may be achieved regardless of the investment structure. It applies automatically where a Canadian resident corporation or trust is involved, and, in the case of direct investment, the foreign investor may opt for net income taxation by making an election under section 216 of the Income Tax Act if the activity is not considered to be the carrying on of business.[100] This may be contrasted to the difficulties foreign investors may have in regard to rents derived from moveable or personal property and the alternate strategies required and the specific need of utilizing the Canadian resident trust.[101]

Where the investment is direct, regardless of whether it amounts to the carrying on of business or net income elections are made under section 216 of the Act, withholding tax obligations may arise in the hands of the payor (lessee) of the rent (or Canadian agent of the lessor); these rules must be coordinated with the substantive tax regime selected. For example, in the case of direct investment amounting to the carrying on of business in Canada, a certificate would have to be obtained by a lessee under section 805 of the Income Tax Act Regulations made pursuant to subsection 214(13) of the Income Tax Act in order that there not be withholding taxes (which the investor would then have to claim as a refund upon filing an income tax return for the taxation year). Or where the section 216 election is involved, a lessee would have an obligation to withhold the 25% of gross rents, again causing the investor to suffer a reduction of cash flow and claim a refund on a tax return for the year; however, an intermediate regime of withholding, applicable to net cash flow available from the gross rents, may be opted for under subsection 216(4) of the Act by the filing of appropriate undertakings and forms by a Canadian agent with and on behalf of the foreign investor.

4. Cash flow

Canadian tax on cash flow, whether or not represented by taxable income, does not arise in the case of direct investment; for example, there are never Canadian withholding taxes on dividends or distributions made by a non-resident corporation to a non-resident shareholder. However, where the investment is made through a Canadian resident corporation, any distribution, whether or not represented by underlying net rental income, would

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92. With respect to carrying on of business, see note 24 above and related text; with respect to net income election, see section 21t of the Act and next section.
93. Subsection 18(4) and following of the Act. See section II above.
94. Section 21 of the Act.
95. Paragraphs 212(1)(b) and 212(13)(f) of the Act.
96. Paragraphs 212(1)(b) and 212(13.2) of the Act.
97. Paragraph 212(1)(b) of the Act.
98. Subparagraph 212(1)(b)(vii), see note 56 and related text, bearing in mind that the exemption is scheduled to expire at the end of 1982 with the result that interest on loans entered into after 1982 will no longer be exempt.
99. Regard should be had to Resolution 151(b) of the 12 November Notice of Ways and Means Motion which excludes contingent interest payments from the 5-year exemptive provisions of subparagraph 212(1)(b)(vii). Thought should be given to the interrelationship between this new rule, the case-made rule that participation payments may not, in the first instance, have the character of interest and, therefore, whether the new Budget rule will have application. In this context, regard may also be had to paragraph 212(1)(d) dealing with rent or royalty payments and whether it can have applicability to participating payments under the bonus debt arrangement.
100. As discussed earlier, net income taxation, under Part I of the Act, applies, without need of an election if the rental property amounts to a business, under characterization criteria evolved in the case law.
101. See section III B respecting the use of a Canadian resident trust.

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be subject to dividend withholding taxes under Part XIII of the Income Tax Act.[102]

5. Dispositions generally

Any disposition of an interest in Canadian real estate will be subject to Canadian tax except in the case of the sale of shares of a non-resident Canadian corporation owning Canadian real estate or a beneficial interest in a trust not resident in Canada. All corporate liquidation procedures give rise to tax in the hands of the distributing or liquidating corporation, instalment sale reserves do not apply to non-residents who do not or cease to carry on business in Canada and tax-free exchanges of real estate are not permitted. Both direct and indirect dispositions are normally subject to the taxable disposition rules detailed to some extent in the first part of this paper. Aside from exemptions under a few of Canada's treaties,[103] the use of straight debt financing as a means of sheltering income including gains and the uncertain possibilities with respect to participating debt arrangements, strategies in structuring investments from the disposition standpoint will normally relate to differentiating aggregate Canadian tax burdens which may arise under different structures selected and normally within a relatively limited range of possible results, the average Canadian tax burden on gains realized from disposition of revenue property ranging from 25% to 35%.[104]

SUMMARY COMMENT

It is apparent that effective structuring of foreign investment and business operations in Canada requires identification and adroit use of a host of rules and factors, arising under both domestic law(s) and treaty(s). In most situations careful planning should improve the results which would otherwise be realized.

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102. It is important to note for those who also invest in U.S. real estate that the distribution rules in Canada are quite different. Under U.S. law a distribution by a U.S. corporation may be taxed either as a dividend to the extent of underlying earnings and profits, per sections 301 and 316 of the Internal Revenue Code, or a capital gain to the extent in excess of earnings and profits and cost base in the shares of the payer corporation, pursuant to sections 301(c)(3) and 897; in Canada, in contrast, there is, as already noted in the text, no reference made to underlying earnings and profits in respect of corporate distributions with all such distributions being taxed as dividend, under subsection 212(2) of the Act.

103. See note 91.

104. Factors, discussed earlier, which can differentiate the overall results include dividend distribution rules, branch tax (Part XIV of the Act) considerations and taxes of the different provinces.

CANADA: Summary of Modifications in Draft Legislation (Finance Department Release of 28 June 1982)

The Honourable Allan J. MacEachen, Deputy Prime Minister and Minister of Finance, today tabled in the House of Commons comprehensive Notices of Ways and Means Motions relating to the budget of 12 November 1981. The motions set out the draft income tax legislation to implement proposals of that budget.

The draft legislation reflects the modifications to the budget measures announced by Mr. MacEachen on 18 December 1981. It also contains further alterations reflecting many of the constructive suggestions received over the past several months.

The legislation is being issued in draft form to afford those taxpayers whose interests are affected and their professional advisers an opportunity to review the proposed amendments and suggest modifications to ensure that the changes do not have unintended or inappropriate effects. Mr. MacEachen said that in order to provide ample time for review he would not be proceeding with final legislation in Parliament until after the summer recess.

The practice of tabling draft legislation in the form of comprehensive Notices of Ways and Means Motions was proposed in the document entitled "The Budget Process: A Paper on Budget Secrecy and Proposals for Broader Consultation" issued in April. In that document the Minister said this procedure, which has been followed in recent years, provides an opportunity for significant input by the public and the legal and accounting professions in the development of tax legislation.

Interest expense

The Minister said that a committee of tax professionals has been appointed to review proposals in Resolutions 23 and 24 of the November budget involving the deduction of interest expense. Their effective date is being postponed pending the review and would not in any event apply before 1983.

Standby charge and corporate distributions tax

More significant modifications to earlier proposals include a reduction of the automobile standby charge from 2½% per month to 2% and a postponement of the 12½% corporate distributions tax to 1 January 1983. The automobile standby charge is used in calculating the benefit to an employee from the personal use of a company car. The corporate distributions tax is intended to adjust for the difference between the rate of tax paid by certain small business corporations and the amount of the dividend tax credit to which shareholders are entitled when earnings are distributed.

Charities and insurance measures delayed

Draft legislation relating to charities and to the tax treatment of life insurance policies is delayed as a result of the extensive discussions that have taken place with representatives of both interests. Details of changes relating to life insurance taxation are outlined in a separate press release. The Minister said proposed amendments in these areas would be made public as soon as they are available.

Forward averaging

There are modifications in the draft legislation to the proposals relating to forward averaging which will improve its effectiveness. Forward averaging is a method of averaging tax rates so that someone with an unusually high, non-recurring income is not taxed at an excessive rate. The changes in this area will extend the application of forward averaging to all income earned by artists and athletes from their activities as such.

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Working with Canada's Statutory and Discretionary Industrial and Petroleum Assistance Programs

by Peter McQuillan



Canada, like many industrialized nations of the world, makes available a vast array of assistance programs for both industrial enterprises and for petroleum development. At last count there were in excess of 300 federal and provincial government assistance programs for industrial development alone. The nature or type of assistance available ranges from non-repayable grants to ongoing subsidies, from incentive loan terms to income tax concessions. Proggrams may be characterized as either "incentive" in nature (i.e. reduced interest rate loans, outright grants, accelerated write-offs, etc.), or "last resort" in nature (i.e. government loan guarantees where debt security is insufficient for private sector lenders).

I. INDUSTRIAL ASSISTANCE

It is important to gain an understanding of several parameters within which Canadian government assistance programs operate. Of utmost importance to the non-Canadian reader is the fact that Canada has, over at least the last decade, evidenced a high degree of nationalistic and even protectionist economic policy. Foremost amongst such policies is Canada's Foreign Investment Review Act (FIRA). By rendering reviewable all new business start-ups and most acquisitions of control of a Canadian business, the Agency has significant power to influence the degree of competition in Canada. Within the context of government assistance programs this nationalistic flavour is apparent in one key way: the number of programs available to a foreign-controlled business, as opposed to the number available to a Canadian-controlled business, is dramatically reduced. Just as important, however, is the fact that the amount of funding available to foreign-controlled businesses as a percentage of total funding is not reduced so dramatically. In fact a Canadian subsidiary of a foreign company may be restricted in approximate terms to, say, 15% or less of the available programs in terms of number of programs, but will still qualify for well over 50% of government funding in terms of gross monetary incentives available in any one year.

A second key characteristic of Canadian government programs is the distinction between "statutory" programs and "discretionary" programs. The former type of incentive refers to those found in the various taxing statutes of Canada (primarily the Income Tax Act of Canada). These incentives differ from the second category in that they are part of the laws of Canada, and thus a taxpayer (whether Canadian or foreign-controlled) has a legal right to them provided the rules and regulations governing their administration are complied with. One major example of an incentive of this type is the federal investment tax credit program. New manufacturing and processing equipment, current and capital expenditures for research and development, and certain railway, air, water and long-haul land transportation equipment qualify for credits against income taxes otherwise payable in ranges of 5 to 50% of the eligible expenditures. The exact credit varies according to either the nature of the expenditures, the size of the taxpayer, or the geographic location of the taxpayer in Canada.

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General investment considerations

Discretionary incentives are significantly different in that there is no legal right to assistance which may be available. A prospective recipient of this type of assistance must enter into an application process administered by any one of a number of government agencies or departments. Thus the success in obtaining assistance of this nature, and even the precise magnitude of the eventual assistance, is left to the discretion of program officials who act according to their perception of the specific circumstances surrounding that application.

By and large, discretionary programs are more difficult for foreign companies to qualify. Generally speaking, the economic benefit provided by a project proposed by a foreign-controlled entity must be significant enough to more than compensate for the potential negative (nationalistic) reaction often associated with granting assistance to a non-Canadian company.

Some final general characteristics worthy of note are:
(a) Canadian government incentives are usually geared to stimulate change in the enterprise, as opposed to maintaining the status quo;
(b) last resort assistance is available to prevent companies from becoming insolvent;
(c) true "incentive" assistance is available only in circumstances in which new initiatives are being proposed or in which corporate growth is sought.

Theoretically, the incentive becomes the inducement to act in a way which brings positive economic benefit to Canada. By the same token, every effort is made to ensure that incentive assistance is not given to situations in which a company would have gone ahead with a project irrespective of the availability of incentive assistance. Program officials administering discretionary incentive programs, however, are very careful to avoid granting assistance in situations where no inducement is felt to be necessary. Failure to demonstrate a need for an inducement is often the cause of otherwise eligible projects not receiving incentive assistance.

The number of programs and their various underlying objectives, administration and sensitivities are ever-changing. Thus it is difficult, and sometimes misleading, to attempt too specific an analysis of this topic at any one point in time.[1] Rather, the foreign business person interested in this aspect of Canada's business climate is better served by an overview of the key general characteristics of the major government programs.

Perhaps the best means to effect this type of overview is by examining an actual case example of a multinational corporation operating in Canada. The case discussed below involves a fairly common corporate situation for a multinational manufacturing company. Please note that while this narrative represents an actual situation, certain facts have been omitted or altered so as to preserve client confidentiality.

MAC Consolidated Inc. is a major, diversified, Canadian public corporation, which is controlled by a large foreign multinational. MAC's proposed project encompassed a $10 million modernization of one of its significant manufacturing divisions. This division employed in excess of 300 people and was located in a relatively small community in a region of Canada designated under the Regional Development Incentives Act (RDIA). This latter designation qualified the region as being one characterized by generally high unemployment and slow economic growth. Approximately 75% of Canada is similarly designated (i.e. all of the Maritime Provinces; Saskatchewan; Manitoba; most of Quebec; and the northern segments of Ontario, Alberta and British Columbia). Companies either presently located in RDIA regions or contemplating locating in them are eligible for incentive assistance in the form of outright grants for expansions, start-ups or modernizations. A modernization is intended to increase the productive abilities and efficiencies of a company as well as to strengthen medium to long term viability.

MAC proceeded to seek parent company approval for modernization of the subject division in order to ensure the commercial and competitive viability of the operation for at least another 10 years. The alternative to modernization was a gradual phase-out of the division over a 3 to 5 year period as profitability and cash flow diminished. Most of the modernization expenditures were to be capital in nature, such as the acquisition of new, more technically advanced production equipment. As a result, the company automatically qualified for a number of statutory incentives. These included a 10% investment tax credit based on total capital costs; a 2-year write-off (for tax depreciation purposes) of all manufac-

1. For specific details on every program please refer to the current edition of "Industrial Assistance Programs in Canada, 1981-1982", by Ernst & Whinney; CCH Canadian Limited.

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turing equipment purchased and duty remission on a significant portion of the equipment which had to be imported from the U.S. because comparable equipment was not available in Canada. Despite the benefits of the above incentives, as incorporated in the capital expenditure proposal and pay-back calculation, the parent company was reluctant to approve the project because the projected return on investment from the modernized facility was not as attractive as several other investment opportunities competing for parent company approval.

Although the Canadian company was aware of the discretionary RDIA program no application for assistance had been contemplated mainly because MAC had had no previous experience in dealing with the government department that administered the program (the Department of Regional Economic Expansion - DREE). Professional advice was sought and received concerning eligibility for assistance from DREE. Facing the impending turndown from the parent company, MAC initiated application procedures with DREE.

Given the magnitude of the number of jobs at stake, and the demonstrated reluctance of the parent company to approve the modernization, the DREE officials moved very quickly to review and approve a maximum non-repayable modernization grant of 20% of approved capital costs, or $1.9 million. Although a DREE grant is taxable in the sense that it reduces the overall capital costs available for future tax depreciation; it nonetheless improved the project's return on investment to a point where it made sense from an internal corporate point of view. The parent company subsequently approved the Canadian company's capital expenditure proposal and the modernization was completed.

The above case illustrates a number of useful points in addition to those covered in general terms earlier. The geographic location of a proposed project is extremely important because of the wide range of economic conditions in Canada. Regional development is a high profile concern of both the federal government (DREE is a federal department) and every provincial government. Further, when regional development is being enhanced, foreign ownership of the applicant company is usually of only minor concern. Likewise, applications to FIRA proposing a location in one of these areas are usually much more acceptable than those proposing locations in areas such as industrialized Southern Ontario (including Toronto). The size of a proposed project, and thus the economic impact, is also of critical importance for obvious reasons. Had only 50 or less jobs been at risk instead of over 300, it is unlikely that the project would have received the immediate attention that it did. At a minimum, the company probably would not have received a maximum modernization grant. Again, size can go a long way in tempering concern over foreign ownership.

Prior approval is necessary in virtually all incentive application situations. Had the above project proceeded in any tangible form prior to receiving official DREE approval, the application for assistance would have been automatically rejected in full. The incentive applied for must always be viewed by government as the inducement for the company to act.

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In addition to regional development and job creation/protection, governments in Canada have other high profile concerns as evidenced by the nature of other specific incentive programs. Foremost among the other areas of concern are enhancement of Canada's technological capabilities. There are significant statutory and discretionary incentives in place to encourage research and development. Foreign controlled companies can qualify for such assistance provided that the technology to be developed is commercially exploited from Canada (i.e. world product mandates for Canadian subsidiaries of foreign companies).

Another large area of concern which is common to any industrialized country is our Balance of Payments position. The creation of exports or the replacement of imports is always an important ingredient in qualifying for government assistance. The magnitude of a project's proposed impact on the Balance of Payments is again a key concern for foreign companies contemplating efforts in this regard.

Notwithstanding many of the comments made in this paper with respect to a foreign company's opportunity for government assistance, a significant project which addresses one or more of Canada's inherent economic concerns is always worth discussing in at least conceptual terms. Flexibility and a willingness to modify the rules of program administration will usually be exhibited when the benefits to Canada are correspondingly large.

II. PETROLEUM DEVELOPMENT ASSISTANCE UNDER CANADA'S NEW NATIONAL ENERGY PROGRAM

Canada's new and highly controversial and still evolving National Energy Program (NEP) is designed to meet three goals:

(1) the security of supply and ultimate independence from the world oil market;

(2) the opportunity for Canadians to participate in energy industries, especially oil and gas;

(3) fairness in pricing and sharing of revenues among governments and industry.

Petroleum Incentive Payments (PIP)

From the viewpoint of incentives for petroleum development, the NEP has had its most positive component with the introduction of cash grants for certain qualifying taxpayers. These new grants are called Petroleum Incentive Payments (PIP).

Petroleum Incentive Payments (PIP) were introduced under the NEP to replace earned depletion which is being phased out. They will increase as the corporate entitlement to earned depletion base additions decreases. The amount of PIP which will be received by an investor will be determined by a number of factors. These factors will be the degree of Canadian ownership – called Canadian Ownership Rate (COR, see following) – of the investor, the location of the expenditure and the date on which the expenditure was incurred. The availability of

PIPs is perceived by the Federal Government as a means of encouraging direct Canadian investment in the industry by increasing investor cash flow on a current basis.

The old system of earned depletion for oil and gas ventures favoured the more established companies that were already receiving resource income, because the earned depletion base accumulated was only deductible against resource profits. New companies having no resource profits could not immediately make use of the earned depletion base. In order to make smaller (and presumably Canadian) companies better able to compete with large, established foreign companies, the Government is phasing out the oil and gas earned depletion deduction and substituting direct grants called PIP payments. The amount of the PIP payments will be determined on the basis of COR, type and location of expenditures and the year in which the expenditure is incurred.

PIP summary

Qualified persons who incur eligible expenses on oil and gas exploration and development in Canada or who incur eligible costs in the purchase of certain assets can obtain PIP payments.

The amount of the PIP incentives will depend upon the:

(a) COR of the applicant;
(b) Canadian control status of the applicant;
(c) location of the expenditures;
(d) type of expenditures;
(e) year in which the expenditures are incurred.

Individuals, corporations, partnerships and trustees are qualified persons eligible to apply for the PIP incentives. Persons who are income tax exempt at the time the eligible expenses are incurred are not eligible for PIP incentives in respect of such expenses, other than the 25% Crown Share Incentive for exploration expenses on Canada Lands. Pension trusts, pension corporations and certain deferred income plans such as employees' profit sharing plans, supplementary unemployment benefit plans, registered retirement savings plans, deferred profit sharing plans, registered edutation savings plans and registered retirement income funds, to the extent they are permitted to participate directly or indirectly in the oil and gas business, are eligible for PIP incentives.

The COR of qualified persons is reduced for PIP purposes by the number of percentage points of the applicant that are attributable to ineligible persons.

There are 4 steps in determining the amount of the PIP incentive:

(1) calculate the amount of eligible costs or expenses;
(2) adjust the eligible costs or expenses by the appropriate adjustment factors; these adjustment factors are designed to prevent the transfer of the PIP benefits to non-Canadians;
(3) determine the appropriate PIP rate;
(4) multiply the adjusted eligible costs or expenses by the appropriate PIP rate.

After 1980, individuals will no longer earn depletion in respect of oil and gas resource expenditures. An earned depletion base will still be accumulated by individuals and corporations with respect to exploration expense in connection with mining properties. In addition, corporations will continue to earn depletion on exploration and development expenses and tangible costs in respect of prescribed enhanced oil recovery projects, oil sands and Saskatchewan upgrading plants.

Canadian ownership rate (COR)

On 22 June 1981 a discussion draft of the Energy Security Act, 1981 was tabled in Parliament by the Minister for Energy, Mines and Resources. This Act contains amendments to a number of existing Acts as well as introducing several new Acts. One of the new Acts is titled the "Determination of Canadian Ownership and Control Act" which sets out the legislation governing the determination of a person's COR and Canadian control status.

The COR is a central piece of the government's NEP and will be required to determine the applicant's PIPs, a person's ability to obtain a production permit on Canada Lands, the ability to obtain export permits for oil and natural gas, and to receive benefits conferred by means of the creation of the natural gas bank. For these purposes individuals and business enterprises will require a certificate which sets out both their COR and Canadian control status. COR means the degree of beneficial Canadian ownership of an entity as determined under the Act and the related regulations.

The COR of a particular entity will be one of the most important criteria in determining the level of PIP available to an investor. Individuals who are investors will not be directly involved in the determination process, other than that they will be required to complete information relevant to their Canadian status. In the case of corporate investors, they will be required, in most instances, to compute the COR of the corporation and forward the information to the manager of the investment. The Department of Energy, Mines and Resources has not yet made its final determination of the rules and the procedures which will be necessary, but, suffice it to say, they will be complex.

The main points of the Act and Regulations are:

1. It is a self-assessing system. The applicants determine their COR and apply for the COR certificate. The certificate will generally have a 1-year term.
2. Deemed CORs are provided in certain circumstances.
3. Non-public enterprises must make inquiry from all investors.
4. Public enterprises use an approximate COR based on the COR of a sample of the outstanding equity.
5. The required accuracy of measurement by an investor depends on the proximity to the applicant and the existence of special relationships.
6. Formal classes of shares must be combined where appropriate. Uncombined classes are measured separately and the results are averaged to obtain the COR.
7. The COR of optionees and owners of convertible securities will in certain circumstances be considered in the COR measurement of the applicant as well as "informal equity" such as overrides and management fees.

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Basic scheme for COR determination

An applicant for a COR certificate is required to calculate its COR by applying the COR of each of its investors to the portion of the equity of the applicant owned by each investor. It is up to the applicant to make inquiries from investors as to the investors' COR. An investor that has been requested to supply its COR to an applicant is, in turn, required to calculate its COR either by applying one of the permitted deeming provisions or by applying the COR of each of its investors to the corresponding proportional ownership of equity.

This process of successive inquiries is pursued until a deeming provision is found to apply or an individual investor is identified. Generally, the inquiry will be cut off at the second level of investors. Inquiries are made to owners of shares as at one specific date. The application must be submitted within 120 days of the specific date chosen. Changes in share ownership will generally be ignored unless the result is a decrease in the COR of more than 1%. The COR certificate, when issued, will otherwise have a 1-year term. If an applicant's COR increases substantially, it may apply for a new certificate.

Qualified applicants

The following are qualified to apply for a certificate:

(a) an individual other than a non-eligible person;
(b) a corporation incorporated in Canada;
(c) a partnership constituted under the laws of a province;
(d) a trustee with respect to a trust, if the trustee and beneficiaries are, with respect to their status as such, governed by the laws of Canada or a province;
(e) an insurance company incorporated in Canada in respect of its segregated fund within the meaning of the regulations;
(f) any person prescribed as being qualified to apply for a certificate or who falls into a class of persons prescribed as being qualified to apply for a certificate.

Non-eligible person

For the purpose of this Act the expression "non-eligible person" has the same meaning as it has under Section 3 of the Foreign-Investment Review Act and the regulations made pursuant to that Act, with one exception.

A non-eligible person for the purposes of COR means:

(a) an individual who is neither a Canadian citizen nor a permanent resident within the meaning of the Immigration Act, 1976 and includes a Canadian citizen who is not ordinarily resident in Canada who has applied for citizenship of a country other than Canada;
(b) the government or agency of a government of a country or a political subdivision of a country other than Canada; or
(c) a corporation incorporated in Canada or elsewhere that is controlled in any manner, directly or indirectly, by a person or group of persons described in paragraphs (a) and (b) above.

The exception is that for the first 5 years after this Act comes into force, a permanent resident who has been ordinarily resident in Canada for more than 1 year after the time at which he first became eligible to apply for Canadian citizenship will be considered not to be a non-eligible person for the purposes of the COR determination.

Looking at the definition from the positive rather than the negative viewpoint, one could say that a Canadian citizen ordinarily resident in Canada or a landed immigrant is a qualified applicant.

Canadian control status

The question of Canadian control status, although related to the COR, is determined independently of the COR rules.

Presumption

In determining the control status of a partnership or trust, the partnership or trust will be deemed to be a corporation incorporated in Canada or elsewhere, the interests in its capital or income will be deemed to be shares of a corporation and the beneficial owners of those interests will be deemed to be shareholders of the corporation. The trustees of a trust will be deemed to be members of the board of directors of the corporation.

Control status

Pursuant to the regulations, an individual, a corporation, or a partnership or a trust, either of which is deemed to be a corporation, is Canadian controlled if he or it is not a non-eligible person.

Control of a corporation is often defined by reference to the ownership of the number of shares which represent a majority of the voting rights in a corporation. For instance, the Canada Business Corporations Act (CBCA) provides that a corporation incorporated under the Act is controlled by a person who beneficially owns more than 50% of the shares to which are attached the votes that may be cast to elect directors and who is in the position to elect a majority of the directors of the corporation. The various provincial statutes have similar provisions relating to control. Control defined in this manner by the CBCA and by the provincial statutes is generally referred to as "legal control" (de jure).

The Foreign Investment Review Act provides that a corporation is a non-eligible person if it is controlled in any manner that results in "control in fact" (de facto) by an individual or government that is a non-eligible person, or by a group of persons, any member of which is a non-eligible individual or government, whether directly through the ownership of shares or indirectly through a trust, a contract, the ownership of shares of any other corporation or otherwise. In many cases, de jure and de facto control, in fact, may be synonomous. In other cases, the identity of the person or persons who control the corporation will depend upon a factual determination of who effectively controls the corporation.

Location of expenditure and types of expenditures – Eligible costs and expenses

Eligible expenditures incurred on or after 1 January 1981 fall into three categories:

(1) eligible exploration expenses;
(2) eligible development expenses;
(3) eligible asset costs.

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In general, expenses are eligible exploration expenses and eligible development expenses if they fall within the definitions of Canadian exploration expense or Canadian development expense in the Income Tax Act. However, expenses in respect of a mineral resource (including oil sands), as defined in the Income Tax Act, do not qualify as eligible exploration or development expenses.

Eligible asset costs include capital costs incurred in the construction or improvement of a heavy oil upgrader or a tertiary oil recovery project located in Canada.

Generally, Canada Lands will include all northern and offshore areas. One of the reasons for the distinction in the rates of PIPs is the fact that the federal government collects no royalties from provincial lands.

Year in which expenditure is incurred

The amount of any PIP attaching to an expenditure must be accrued in the year the expense is incurred so as to reduce the balance of CEE and CDE available, whether or not the payment has been applied for or received. The PIP follows the relevant expenditure and, accordingly, will be available to an investor regardless of the nature of his investment.

The following chart illustrates the entitlement of PIPs for the various possible combinations of the factors.

Transition period for phasing in incentive payments

Year starting 1 January	*Level 1*	*Level 2*	*Level 3*	*Level 4*
1981	50%	50%+	60%+	65%+
1982	50%	50%+	61%+	67%+
1983	50%	50%+	62%+	69%+
1984	50%	50%+	63%+	71%+
1985	50%	50%+	64%+	73%+
1986	50%	50%+	65%+	75%+

Levels of incentive payments for oil and gas exploration and development

	Provincial lands				*Canada lands*			
	Level				*Level*			
Exploration	*1*	*2*	*3**	*4*	*1*	*2*	*3**	*4*
1981	nil	nil	25	35	25	35	65	80
1982	nil	10	25	35	25	45	65	80
1983	nil	10	25	35	25	45	65	80
1984	nil	15	25	35	25	50	65	80
1985	nil	15	25	35	25	50	65	80
1986	nil	15	25	35	25	50	65	80
Development								
1981	nil	nil	15	20	nil	nil	15	20
1982	nil	nil	15	20	nil	10	15	20
1983	nil	10	15	20	nil	10	15	20
1984	nil	10	15	20	nil	10	15	20
1985	nil	10	15	20	nil	10	15	20
1986	nil	10	15	20	nil	10	15	20
Non-conventional, etc.								
1981	nil	nil	15	20				
1982	nil	10	15	20				
1983	nil	10	15	20				
1984	nil	10	15	20				
1985	nil	10	15	20				
1986	nil	10	15	20				

* Level 3 is an addition to the PIP system. Levels 1, 2 and 4 were announced in the NEP.

PIP — The role of the province of Alberta

The PIP was initially conceived and was to be administered wholly by the federal government. The September 1981 Memorandum of Agreement between the Government of Canada and the Government of Alberta relating to energy pricing and taxation indicated that the Government of Alberta would administer and pay the incentives under the program for activities within Alberta. The Government of Alberta will have the authority to make its own rules with respect to the administration aspects of the Alberta portion of the PIP.

Any change in PIP incentives rates as specified in the NEP for activities on provincial lands will require agreement between the Government of Alberta and the Government of Canada.

Similar agreements have been entered into by the federal government and other provinces; however, Alberta is the only province administering and paying the PIP incentives itself.

Canadian exploration expense (CEE)

Canadian exploration expenses (CEE) which are eligible for a discretionary 100% write-off in the year incurred include:

(1) the costs of geophysical, geological and geochemical expenses incurred in order to determine the existence, location, extent or quality of a petroleum or natural gas accumulation in Canada;
(2) expenses incurred prior to 1982 in drilling or completing or preparing a site for an oil or gas well in Canada, if the expense was incurred in the year or in a prior year and, within 6 months of the completion of the drilling, the well is:
   (a) determined to be the first well capable of production from a previously unknown accumulation; or
   (b) it is reasonable to expect that commercial production will not commence within 12 months of completion (primarily in the case of gas or frontier properties where production permits are unavailable or production is not feasible, commonly referred to as "shut in");
(3) expenses incurred after 1981 in drilling or completing a well as in (2) if drilling is completed within 6 months of the year end and the well is abandoned within 6 months of the year end and 12 months of its completion;
(4) expenses incurred after 1981 in drilling or completing an oil or gas well in frontier areas, unless the well was drilled to obtain commercial production from a known accumulation or for the purpose of delineating a field or determining the extent or quality of the accumulation and the drilling was commenced after commercial production commenced.

The amount of an investor's CEE available for deduction is reduced by the value of any assistance or benefits received in the form of government grants, subsidies, benefits, etc., received after 25 May 1976 (see below, discussion of PIP and small explorer's credit). CEEs will be available to an investor who invests directly in a joint

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venture, limited partnership units, flow-through shares or shares of a joint exploration corporation.

Canadian development expense (CDE)

Canadian development expenses (CDE) which are eligible for a discretionary deduction at, effectively, a 30% rate on the declining balance basis include:

(1) expenses incurred to drill or complete a well to the extent the expenses are not CEE;
(2) expenses to drill or convert a well to assist in production from an oil or gas well (this includes a wide variety of wells drilled or converted for stimulation of production);
(3) expenses for drilling or recompleting a well after the commencement of production;
(4) payments made to acquire Canadian resource properties prior to 11 December 1979.

CDEs will be available to an investor regardless of the form of his investment. Any government assistance received after 25 May 1976 will reduce the investor's CDE balance in the same fashion as described for CEEs above.

Canadian oil and gas property expense (COGPE)

Canadian oil and gas property expenses (COGPE), which are eligible for a discretionary deduction on the basis of a 10% declining balance, are the costs of acquisition of a Canadian resource property (see below) or a right to or interest in such a property. While the initial cost of acquiring a resource property is COGPE, any costs incurred in preserving the right are not COGPE, but rather are lease rentals and as such are not eligible for any deduction by virtue of paragraph 18(1)(m) of the Income Tax Act.

The balance of COGPE will be reduced in the same fashion as CEE and CDE with respect to the value of any grants or assistance received. Similarly, COGPE will be available to any investor regardless of the form of his investment.

Canadian resource property

A Canadian resource property includes any property, acquired after 1971, which is a right, licence or privilege to explore for, drill or take petroleum, natural gas or related hydrocarbons in Canada. In addition, a Canadian resource property includes a right, licence or privilege to store petroleum, gas or related hydrocarbons underground as well as any oil or gas well in Canada. Finally, the definition includes any rental or royalty which is computed by reference to the amount or value of production from an oil or gas well in Canada and any right or interest in any such property including the right to receive proceeds of disposition of any property described above.

Foreign exploration and development expense

Foreign exploration and development expense is subject to reasonably complex rules with respect to the amount of any claim by an investor. Foreign exploration and development expenses include expenses incurred for geological or geophysical exploration or drilling in respect of petroleum or natural gas outside Canada as well as any annual payments made to preserve a foreign resource property (the definition of foreign resource property is the same as the definition of Canadian resource property, except that it is outside Canada) and payments to acquire a foreign resource property. There is no provision to reduce the balance of foreign exploration and development expense for the value of any government assistance received. Foreign exploration and development expenses can only be incurred by a taxpayer through a direct investment, a joint venture or a partnership.

The deduction for foreign exploration and development expense is limited to the lesser of the taxpayer's foreign exploration and development expense account balance and the greater of:

(a) 10% of his foreign exploration and development pool; and
(b) the sum of his foreign petroleum and gas production, plus his foreign oil and gas royalty revenue, plus his proceeds from dispositions of foreign resource properties included in income for the year.

Resource allowance

The resource allowance was introduced to the Income Tax Act as a consequence of the historical disagreements between the federal and provincial governments. It is designed to partially offset the disallowance for federal tax purposes of provincial crown royalties. The pegging of the allowance at 25% is premised on the assumption that a 25% net royalty to the provincial crown would result in a reasonable "take" to the provinces.

Historically, prior to the federal-provincial pricing agreements signed in the Fall of 1981, the resource allowance available to a taxpayer with Canadian production income, including royalties, was 25%. Resource profits for this purpose have been: income from production and royalty income (net of losses from these sources) net of direct costs of production (referred to as "lifting costs"), the capital cost allowance referrable to the revenue and a reasonable allocation of general and administrative expenses.

No deduction is required in calculating resource profits with respect to interest expense, CEE, CDE, COGPE or earned depletion. It should be noted, as well, that for the purposes of this calculation, disallowed crown royalties and certain income deemed by the Income Tax Act to arise with respect to transactions with the Crown are included in income.

Profits derived from the processing and transportation of petroleum and natural gas are specifically excluded from the profits eligible for the resource allowance. The former, in the case of corporate taxpayers, are eligible for the federal deduction from corporate tax for manufacturing and processing profits.

Certain amendments are to be made to the resource allowance provisions. Commencing 1 January 1982, the resource allowance will apply to a taxpayer's total production profits prior to the deduction of royalties payable to other participants in the well and a royalty owner will no longer receive the resource allowance on his royalties.

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Further, draft regulations available indicate that a new category of expenses, "Canadian exploration and development overhead expenses" (i.e. administration costs relating to CDE and CEE), will not be deductible in the computation of resource profits.

Those taxpayers who have production interests whose tax liability is unaffected by non-deductible crown royalties (i.e. those individuals paying freehold royalties only) will not receive the benefit of the resource allowance after 31 December 1981. It is unclear whether those producers paying nominal crown royalties are to be affected by this change or not.

The resource allowance is available to investors in joint ventures and partnerships but not to the investor in flow-through shares or shares in a joint exploration corporation, as these investors do not have production revenues. In the case of a partnership investment, the resource allowance is claimed at the partnership and not the partner level. The deduction is a permissive one, but if it is not taken in the year in which the resource profits are earned, there is no way to carry it forward.

Earned depletion

Earned depletion is another discretionary deduction based on resource profits. Earned depletion is restricted to the lesser of 25% of resource profits, but not the same resource profits calculation as for the resource allowance, and the earned depletion base. Resource profits for this purpose include the same revenues as for the resource allowance calculation plus the proceeds of disposition of resource properties and reserves on sales of resource properties brought into income in the year.

In arriving at the eligible resource profits, it is necessary to deduct direct costs, relevant general and administration costs, applicable capital cost allowance, the interest expense applicable to the earning of the production revenue, CEE, CDE, COGPE and the resource allowance. Profits or losses from processing, transportation and transmission of oil or gas are excluded for these purposes.

The earned depletion base of a taxpayer, prior to 31 December 1980, consisted of ⅓ of all expenditures for exploration and development, regardless of where the expenditures were incurred, and 50% of all expenditures made with respect to synthetic oil and prescribed enhanced recovery projects.

Subsequent to 1980, only corporations will be able to earn further earned depletion base, although those individuals who have not fully utilized their previously accumulated earned depletion base will be able to continue to do so. The rate at which the earned depletion base will be accumulated is illustrated by the following chart.

The foregoing changes with respect to the accumulation of the earned depletion base relate to oil and gas expenditures only and not to mining operations.

In general, then, an investor which is a corporation will accumulate an earned depletion base for CEEs and CDEs incurred and expenses which have been renounced to it. There has always been a requirement to exclude capitalized interest, expenses renounced by the

	Conventional areas	
	Exploration	*Development*
After 1980 (corporations only)		
1981	33⅓	Nil
1982	20	Nil
1983	10	Nil
1984	Nil	Nil
1985	Nil	Nil

	New synthetic oil and prescribed enhanced oil recovery projects	Canada Lands
		Exploration
After 1980 (corporations only)		
1981	33⅓	33⅓
1982	33⅓	33⅓
1983	33⅓	20
1984	33⅓	10
1985	33⅓	Nil

* After 1980, eligible expenditures will be net of any relevant incentive payments

taxpayer and expenses recovered after 28 April 1979 and, as a consequence of NEP-related proposed amendments, it will be necessary to exclude capitalized general and administration expenses relating to exploration and development. Qualifying expenditures have never included the costs of acquiring a Canadian resource property.

Investment tax credits

Many of the tangible properties acquired through an oil and gas investment will be eligible for investment tax credits, with the rate of the credit determined by the location where the equipment is put into service. The assets which will qualify are new assets which are machinery or equipment acquired after 23 June 1975 to be used in the operation of an oil or gas well, the processing of heavy crude oil to the stage of crude oil or its equivalent and exploration and drilling for petroleum or natural gas. Assets which do not qualify are those which are eligible for classification as CEE or CDE, such as well casing. The amount of investment tax credit claimed will reduce the undepreciated capital cost of the equipment in the year in which it is claimed.

Investment tax credits will be available only to investors who invest by way of partnerships, joint ventures or direct investment, as the capital cost of equipment cannot be renounced by a joint exploration corporation and is not eligible for the flow-through under the flow-through shares rules.

Capital cost allowance (CCA)

Capital cost allowance (CCA) is the tax equivalent of accounting depreciation. Most assets acquired by oil and gas ventures will fall into Class 10 for CCA purposes, eligible for a write-off on a 30% declining balance basis by virtue of being:

(1) either oil and gas well equipment; or

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(2) property (provided it was acquired after 22 May 1979) designed principally for the purpose of determining the existence, location, extent or quality of accumulations of petroleum or natural gas, or drilling oil or gas wells.

Any storage tanks for oil acquired will be eligible for Class 29 treatment.

In the case of a partnership investment, the CCA will be claimed at the partnership and not the partner level. In the case of a direct or joint venture investment, the claim will be at the discretion of the investor; for those who invest in flow-through shares or shares in a joint exploration corporation, no CCA claim will be available to the investor.

The Budget Papers, tabled on 12 November 1981, contained proposals to restrict CCA in the year in which an asset is acquired to 50% of the amount otherwise available. Under the rules previously in existence, such CCA was prorated in the year of formation of a business venture to the proportion of the year the venture was in existence. It is unclear whether the proposal will create a compounded restriction or not. On 18 December 1981, the Honourable Allan MacEachen tabled a number of revisions to his previous Budget, some of which related to CCA. The available information is too imprecise at this time to allow for specific comment.

Interest expense

Prior to the Budget tabled on 12 November 1981, all interest expense with respect to oil and gas investments was generally treated as deductible in the year it was incurred. Resolutions 23 and 24 of the Budget contain provisions which would greatly curtail the deductions available with respect to the interest expense on certain types of investments. Because oil and gas operations are specifically included in the definition of active business income, interest expense relating to an investment in an oil and gas venture directly, through a joint venture or through a limited partnership, did not appear to be affected by the Budget. However, as the only income which an investor in a joint exploration corporation or flow-through shares could earn was dividend income, which is income from property, interest expense incurred with respect to such investments would be restricted to the dividend income earned from the shares which, in most cases, would be nil for a number of years. It appears that the Budget resolutions will now be amended in the following manner:

(1) for 1982, interest expense will be restricted only to the extent that it exceeds ⅔ of a taxpayer's total income prior to the interest expense claim;
(2) for 1983, the ⅔ will be ⅓; and
(3) there will be an additional $10,000 of interest expense which will be unrestricted for investments in taxable Canadian corporations.

All of the foregoing changes to the interest deductibility will tend to neutralize one of the biases against investment by way of flow-through shares or shares in a joint exploration corporation.

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Small explorers' credit

The Province of Alberta provides certain incentives to industry participants, one of which has come to be known as the "Small Explorers' Credit". The credit is available as an offset to Alberta royalties and freehold mineral taxes. Prior to 1 September 1981, the total available for any well was $1,000,000 and from that date it will be $2,000,000. However, similar limitations apply on a per taxpayer basis. It is not necessary to have tax payable in Alberta in order to benefit from this credit and it is refundable, in cash, upon the filing of the requisite forms with a taxpayer's income tax return. Generally, the credit will be available only to direct, joint venture or partnership investors.

Forms of investment

Traditionally, the most common forms of investment offered to the public (whether through private placement or prospectus) have been limited partnership units and joint venture interests. Less common have been flow-through shares and shares in joint exploration corporations. These investment structures are discussed in the remainder of this paper.

(1) Joint exploration corporation

A joint exploration corporation is a principal business corporation which has not, since its incorporation, had more than 10 shareholders. A principal business corporation includes a corporation whose principal business is exploring or drilling for petroleum or natural gas, or the production, refining or marketing of petroleum, petroleum products or natural gas.

The method whereby an investor obtains tax benefits from his investment is through the mechanism of the joint exploration corporation renouncing its expenses to its shareholders. Expenses can only be renounced to corporate shareholders and are renounced in agreed proportions. Expenses which may be renounced are those for which payment was made by the shareholder to the joint exploration corporation in respect of CEE, CDE or COGPE.

(2) Flow-through shares

Flow-through shares are generally shares of a corporation, of a new class, issued under an agreement between the shareholder and the corporation whereby the shareholder contributes funds to the corporation to be used by the corporation to incur CEE, CDE or COGPE. The agreement specifies that the expenses are being incurred by the corporation on behalf of the investor and the expense incurred is the sole consideration for the issue of the share.

Prior to 13 November 1981, any shares issued under such an arrangement were treated for income tax purposes as inventory and not capital property, with a nil cost base. This treatment was not an unreasonable one as the expenditures in respect of which the shares may be issued are not capital property. The Budget, tabled 12 November 1981, contains a resolu-

tion which would make flow-through shares, issued after 12 November 1981, eligible for treatment as capital property (however, the shares will still be subject to the ordinary tests of income vs. capital). It is thought that this proposed amendment was to compensate for some of the proposed amendments to the reorganization provisions outlined below.

When CEE and CDE are incurred by investors in flow-through shares, the investors are entitled to the PIP incentives. The corporation will act for the investor in filing the application and receiving the incentives. The relevant COR is that of the corporation issuing the shares. A joint exploration corporation is a qualified person and entitled to incentives in its own right.

(3) Limited partnership

The limited partnership has become a popular vehicle for tax shelter investment because it allows for a full flow-through of tax deductions, while limiting the liability of the investor to the amount of his capital subscription. Because of this limitation of liability, it is Revenue Canada's position that an investor may not claim further deductions for income tax purposes when his adjusted cost base in the limited partnership is nil or negative. A limited partnership will be governed by the relevant law in the province of its formation.

Converting the investment to liquid form

Prior to the Budget tabled 12 November 1981, it did not matter much what form the initial investment in the venture took. Generally, the investor expected, at some point, to obtain shares in the operator/promoter, which would be readily saleable. This subsequent conversion of the investment interests relied upon the tax-free reorganization provisions contained in the Income Tax Act. The Budget, tabled on 12 November 1981, would have eliminated, in most cases, the opportunity to effect these transactions on a tax-deferred basis. One of the possible rationales for these proposed changes is that, as a consequence of these transactions, it was possible to convert income gains on a disposition of the direct investments to capital gains on a future disposition of the shares received on the reorganization. With the proposed abolition of the reorganizaton provisions in these circumstances, investors, to the extent they had insufficient balances in their CEE, CDE and COGPE pools, generally from other investments in the industry, would have suffered a recapture of previous deductions.

It appears, as a consequence of the Speech referred to earlier, that the reorganization provisions will not be amended prior to 1983 and that future amendments may differ radically from those tabled on 12 November 1981.

Alberta announces new incentives in April 1982

Leading a drive to improve the industry's cash flow position is the Alberta Government's package of financial incentives, a series of royalty cuts and special grants.

The Alberta package includes a $250 million grant to offset the costs of servicing existing wells in 1982. The grant can be taxed by Ottawa as income at a rate of 36%, reducing the benefit by $90 million.

Most of the benefits from the Alberta package are earned through reductions in provincial royalty rates. Because royalties are deductible before the Incremental Oil Revenue Tax (IORT) is calculated, royalty reductions increase the amount of the tax.

The IORT is calculated on incremental revenue, the difference between the actual price paid for oil and the price established by the NEP. The average price for 1982 is $24.63 a barrel, compared with $20.25 a barrel under the NEP, so incremental revenue is $4.38 a barrel.

Because of Alberta's changes, the new royalty on incremental revenue is $1.63 a barrel and incremental income subject to IORT is $2.75 a barrel (incremental revenue less royalty). Under the old rules, incremental income is $2.43 a barrel.

The new IORT, 50% of incremental income, is $1.37 a barrel compared with $1.22 a barrel under the old rules, an increase of 15 cents a barrel.

Alberta's royalty changes give companies a benefit of $1.80 a barrel, based on average rates, so the 15% IORT portion represents 8.3% of the benefit.

Alberta Premier Peter Lougheed said any attempt by Ottawa to increase its take would be considered a breach of the energy agreement and could lead to a new confrontation between the province and the federal Government.

Because the federal portion is small, however, Alberta's opposition is considered to be more of a question of principle than a financial issue that affects the industry, in the near term at least.

The federal Government says changes to the Alberta royalty structure were noted as a possibility during the negotiations that established the energy agreement in 1981 and the province realized that IORT would increase if royalties were cut.

All federal energy taxes are under review because of falling world oil prices but no changes are expected for several months.

Other taxes – Some of the disincentives

The NEP and the federal-provincial pricing agreements have spawned a new set of taxes.

(1) Petroleum and gas revenue tax (PGRT)

The petroleum and gas revenue tax (PGRT) was introduced effective 1 January 1981. It was prior to 1982, an 8% tax on production revenue. Production revenue is computed as revenue from production (including crown royalties, but net of freehold royalties paid) net of lifting costs, without any allowances for interest, CCA or rental payments in respect of tangible property. It is necessary to file separate returns for this tax on the due date of the investor's income tax return and also, in some circumstances, to make instalments with respect to this tax.

Commencing 1 January 1982, the rate of PGRT was increased to 16%, but a resource allowance equal to

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25% of production revenue is available to those taxpayers whose tax is affected by the payment of non-deductible crown royalties.

(2) Incremental oil revenue tax (IORT)

Generally, investors in new oil and gas ventures will be unaffected by the incremental oil revenue tax (IORT). The IORT is a 50% tax on the difference between the prices which would have been obtained under the NEP price schedule and the prices under the new pricing agreements. The tax is applicable only to oil production from accumulations known, prior to 1981, to exist in commercial quantities. The IORT is effective 1 January 1982 and any income subject to the IORT is exempt from income tax.

The profits for IORT purposes are reduced for related crown royalties which are calculated on a well-by-well basis, based on the average royalty rate for the well applied to the incremental revenue.

General investment considerations

Having examined various tax and incentive considerations associated with an investment in an oil and gas venture, it becomes necessary to examine the investment criteria to which a potential investor should have regard.

With the abolition of super-depletion, any investor in an oil and gas tax shelter will have a net cash investment in the project after his benefit from tax deductions.

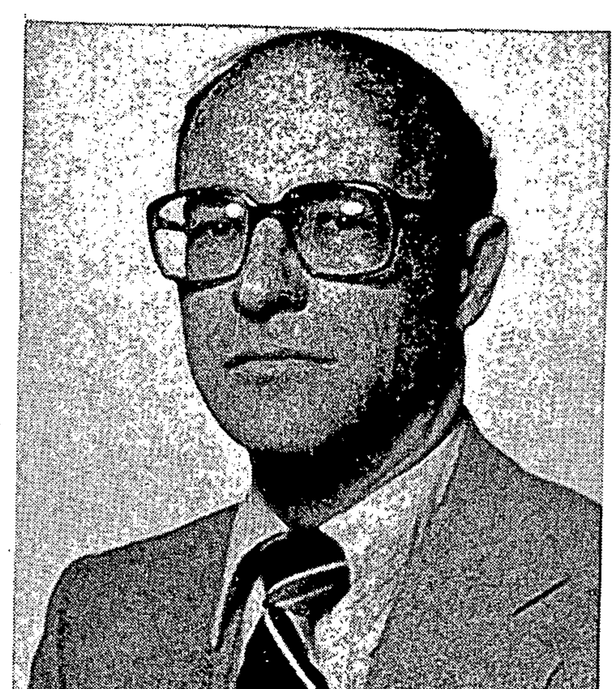
There are a number of common-sense questions which an investor should ask. A brief checklist of some issues to be considered by a potential investor is provided:

1. A determination should be made of the amount of the promoter's "carried interest" in the project. A promoter's carried interest will be the percentage of the future profits which he earns from the investment property without incurring a proportionate amount of the costs.
2. The rate of provincial royalties which future production from the fund will suffer should be determined.
3. A determination should be made of the allocation of the various provincial drilling incentives between the promoter and the investors. If the investor is to share in the drilling incentives, he should ensure that he will be able to utilize them before they expire. If the promoter is to be the beneficiary of the incentives, the investor should ensure that he is receiving some compensation for the value of the incentives earned with his money but assigned to the promoter.
4. An investor should ensure there is a market for and a means of getting to market the production found by his investment. Many investors have invested in funds where there is no technology or availability of transportation to take the product discovered to market. The investigation should also encompass current and prospective government regulations relating to pricing, royalties, allowable production, import and export of the product and environmental protection regulations.
5. A determination should be made of the profitability, particularly in the case of gas discovered in Alberta, of the production being shut in.
6. Because of the fact that oil and gas reservoirs often extend over a number of leases, an investor should ensure that neighbouring lessors will not be able to draw upon the oil and gas on the investor's lease. This insurance generally takes the form of the driller entering into contracts with neighbouring lessors to prevent such "sucking out" of the investor's petroleum and natural gas reserves. Commonly, protection against this eventuality is accomplished by means of a "step-out" agreement, allowing the fund to drill development wells on its neighbours' properties and taking any oil or gas so found in return for a royalty, or a unitization agreement whereunder the fund obtains a share of all the oil and gas in the neighbourhood and the neighbours must reimburse the fund for its drilling expenses. These are only two of the methods of obtaining this type of protection. An investor should ensure that some form of protection has been obtained for his investment.
7. A potential investor should ensure that the geological information on which he is basing his potential investment has been provided by an independent geologist. Further, he should investigate the promoter's track record, his previous funds and their performance.
8. Some oil and gas ventures require that after a successful exploration effort, the investor will be required to provide additional funds for the development and commencement of production. An investor should evaluate his willingness and ability to contribute additional funds to the venture and the penalty for a failure to do so.

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The Influence and Impact of Canada's Tax Accounting Rules on Structuring Canadian Business Operations

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1. INCOME TAXATION AND TAX ACCOUNTING IN CANADA

(a) Evolution of income tax law

Federal income iax began in Canada in 1917 with the enactment of the Income War Tax Act. This legislation, as amended from time to time, remained in force until the first major effort at tax reform, represented by the 1949 Income Tax Act. In turn, this Act, as much amended, was substantially "reformed" after the appearance of the report of the Royal Commission on Taxation (the "Carter Report") in 1967. The new legislation, still known as the Income Tax Act, came into force in 1972 and is still the applicable law, though the volume of annual amendments has been substantial.

While it was always recognized that the determination of income for purposes of income taxation would involve questions of accounting, most questions of tax accounting were left to commercial practice, and relatively few such questions were directly addressed in the earlier versions of the statute. Even today, many issues of timing and other questions of accounting practice are not directly provided for in the Act.

(b) The accounting profession and income taxation

The development of income taxation and its growing importance in the Canadian economy have been accompanied by a remarkable growth in the accounting profession. Most of the personnel who administer the law for Revenue Canada, Taxation (popularly called the "Department"), as well as most persons in the private sector who advise on tax matters, are professionally qualified accountants or have had accounting training. Consequently it is not surprising that accounting principles and practices would be generally followed in measuring income for purposes of income taxation wherever there was no specific direction in the Act.

(c) Legislating generally accepted accounting principles

In the course of the discussions leading to each of the two major "reforms" of Canadian income tax law, the question was raised whether the Act should contain a provision to the effect that, absent any specific provision in the Act to the contrary, income for purposes of the Act shall be determined in accordance with generally accepted accounting principles (GAAP). Some commentators felt that both the statute and the case law required departures from GAAP that were not necessary to protect the national revenue, that often had inequitable consequences, and that needlessly complicated taxpayers' record keeping; in their view, the proposed statutory provision would permit income measurement for tax purposes to evolve in a manner parallel to the evolution of financial accounting principles.

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On each of these two occasions, however, after consultation with the accounting profession, the government decided not to add the proposed provision to the Act. On the first occasion, the profession did not appear to have sufficient confidence that GAAP could be clearly identified in a particular case, and it was feared that such a statutory provision might lead to more, rather than less, uncertainty. On the second occasion, the accumulation of formal pronouncements by the profession on accounting principles made the earlier objection much less valid; nevertheless many accountants felt that the proposed statutory provision would have a restricting effect on the application and development of accounting principles. While the Carter Report recommended that many of the rigid timing rules in the Act be removed, so that more reliance could be placed on accounting principles in determining matters of timing,[1] even this limited recommendation was not implemented.

(d) Generally accepted accounting principles and case law

Even so, much of the pre-1950 case law supported the application of accounting practice in the measurement of income for tax purposes in cases where the Act was silent. Partly because of changes in wording implemented by the 1949 Act, which specifically recognized accrual accounting, subsequent case law came increasingly to refer to accounting principles and practices to fill gaps in the Act. With occasional exceptions, this trend has continued to the present time and has taken Canadian tax law almost to the position where it would have been if the twice-rejected statutory reference to GAAP had been enacted. In some areas, however, the case law has recognized that a taxpayer may make a choice between following GAAP and following a less sophisticated approach to timing – as was the case for prepaid expenses before recent relevant amendments to the Act.

(e) Consolidated tax returns

While the idea of permitting a group of resident corporations under common control to file consolidated tax returns has been proposed from time to time, it has always been rejected by the government because of the complexity that it is thought to entail. No simple alternative procedure is available for shifting losses between affiliated corporations, though 1977 amendments to the Act permit accumulated losses to flow through an amalgamation of corporations and the winding up of a substantially owned subsidiary into its parent corporation, subject to certain restrictions. Consequently, when losses are anticipated, such as on the commencement of a new business, there is a tendency to have the business activity in question carried on by a profitable corporation rather than by a new corporation that will have no current profits against which to offset the early losses.

(f) The "matching" principle

The accountant's principle of matching revenues and related expenses in the same accounting period has received increasing, but not total, recognition for tax purposes in both the case law and recent amendments to the Act. In several cases, on the other hand, departures from the "matching" principles that appear to be permitted may give taxpayers a choice to accelerate the recognition of expenses.[2] Perhaps largely for this reason, the Department has abandoned its earlier hostility to the use of accounting principles for deciding timing questions and is trying to insist on more general application of the "matching" principle.[3] In some areas where the Department has attained, or anticipated that it would attain, little success, such as with respect to the deferral of deduction of prepaid expenses, it has recently obtained amendments to the Act to enforce the application of the "matching" principle.

Some years ago the case law decided that the "matching" principle could not be followed in measuring annual income for tax purposes from construction contracts. The case law required that billings on such contracts less holdbacks be included in the contractor's income and that all expenses be deducted as incurred, regardless of whether they related to amounts that had been billed. For administrative purposes, however, the Department has allowed the use of the "completed contract" method where the duration of the contract is not expected to exceed two years, providing that the taxpayer consistently follows this practice for all such contracts; subsequent additions to the job that may postpone completion are regarded as separate contracts.[4] Consequently, until Departmental practice changes, a series of shorter-term contracts may be preferable, for the contractor's tax position, to a single longer-term contract.

The Act has permitted individuals to account for interest revenue on either a cash or a "receivable" basis, depending on the accounting method that they regularly follow.[5] By administrative practice, the Department also permits the accrual method of accounting for interest revenue by individuals, though it has attempted to restrict the individual's right to change from one method to another.[6] Previously these options were available to most other taxpayers, but, by recent amendment, corporations, partnerships, and certain trusts are now required to account for interest revenue by the accrual method.[7] Thus individuals, but not corporations or partnerships, could defer recognizing interest revenue by investing in deferred annuities, coupon bonds, or bank deposit certificates on which interest payments are deferred. The amendments proposed in the budget of 12 November 1981, however, will require individuals to recognize accrued interest revenue at least every third year.

The case law allowed a taxpayer that has to treat foreign

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1. 4 *Report of the Royal Commission on Taxation* 218-20 (1967). See also 1 ibid. 113.
2. See, e.g., *The Queen* v. *Oxford Shopping Centres Ltd.*, [1981] C.T.C. 128, 81 DTC 5065 (Federal Court of Appeal).
3. See, e.g., Mitchell, "Current Assessing Trends", 21 *Can. Tax J.* 256, 261 (1979); Reed, The Dilemma of Conformity: Tax and Financial Reporting – A Perspective from Revenue Canada, in *Corporate Management Tax Conf.* (Can. Tax Foundation 1981).
4. Interpretation Bulletin IT-92R, para. 12 (3 March 1975).
5. Income Tax Act, paragraph 12(1)(c). On the timing of interest expense, see paragraph 20(1)(c).
6. Interpretation Bulletin IT-396 (17 Oct. 1977).
7. Act, subsections 12(3)-(6).

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exchange gains or losses on revenue account to recognize any such gains on outstanding indebtedness as of the end of each year, even though the debt might not be settled for some years.[8] While accepting this result, the Department is also prepared to accept any method of determining foreign exchange gains or losses on revenue account that is in accord with GAAP, if the same method is followed in the taxpayer's financial statements and is used consistently; in certain cases, however, the Department will accept a change to what it regards as a more appropriate accounting method for foreign exchange. A taxpayer is also permitted by the Department to choose not to recognize any foreign exchange gain or loss until the account is settled.[9]

2. Legislating conformity of tax accounting with business records

(a) An early attempt

When the present system of tax depreciation (known as "capital cost allowance") was instituted with the 1949 Act, the Regulations under that Act purported to limit the capital cost allowance that could be claimed on depreciable assets in any year to the amount of depreciation shown for the year in the taxpayer's financial statements.[10] Because diminishing balance rates of capital cost allowance were prescribed for tax purposes, allowing quite generous deductions in the early years that an asset was held, many taxpayers faced the dilemma of either recording excessive depreciation in their financial statements or postponing some of the capital cost allowance that would otherwise be available to them. Public corporations that were under pressure to avoid qualifications in their auditors' reports were at a disadvantage in this respect in comparison with closely held corporations. A growing level of protest against this rule led to its removal from the Regulations effective in 1954.

(b) Deferred taxes

A consequence of the freeing of capital cost allowance claimed for tax purposes from the amount of depreciation shown in the taxpayer's financial statements was the recognition, in the financial statements of many businesses, of growing amounts of deferred taxes in subsequent years. This recognition was required by the pronouncements of the Canadian Institute of Chartered Accountants in order to achieve a proper allocation of income tax expense to the appropriate accounting periods.[11] In the case of many corporations the deferred taxes have grown continuously and have reached very substantial levels, and all indications are that this growth will continue indefinitely. Many accountants are concerned about this result and would like to see existing accounting rules relating to tax allocation re-examined.[12] Some may argue, however, that any excess of existing deferred taxes over what might be regarded as more reasonable levels may be justified as an offset to the effect of failing to make provision in financial statements to correct the overstatement of accounting profit that results from inflation.[13]

It seems clear that the general system of capital cost allowance is widely accepted by both the Department and taxpayers, because of its simplicity of application and its relatively generous rates. Consequently it is unlikely that the tax depreciation rules will be changed to conform with depreciation for purposes of financial accounting. The solution to the problem raised by growing deferred taxes, therefore, will need to be developed by the accounting profession and is not likely to come from changes in tax law.

(c) Capital cost allowance as an incentive

The problems raised by divergent deductions for depreciation for purposes of income taxation and financial accounting can be aggravated where generous rates of capital cost allowance are granted as an incentive for taxpayers to invest in certain kinds of assets or industries. The fact that deferred taxes must be provided for in the financial statements of a taxpayer who seeks to take advantage of such an incentive may reduce the attractiveness to him of doing so.

3. "RESERVES"

The government's traditional concern about the possible use of conservative accounting principles to postpone the recognition of income is reflected in the long-standing prohibition in the Act against the deduction of "an amount transferred or credited to a reserve, contingent account or sinking fund" except where such a deduction is specifically permitted in the Act.[14] The specific provisions that allow deductions that are described in the Act as "reserves" indicate that the term "reserve" is being used in a broader and less precise way than under prevailing accounting practice in Canada.[15] According to the Department, this term when used in the Act "means more generally an amount set aside that can be relied upon for future use".[16] It might be more accurate to say that "reserve" in the Act means an expense the amount of which is only estimated or contingent as of the end of the year in question.

The restriction against deducting "reserves" has the effect of encouraging businesses to avoid contingencies applicable to the expenses that they claim or to take steps to bring themselves within the specific wording of a provision of the Act that expressly permits the deduction of a "reserve". Thus, careful documentation of executive bonus schemes appears to be necessary to ensure the current deductibility of bonuses payable.[17] A publisher or

8. *Canadian General Electric Co. Ltd.* v. *M.N.R.*, [1961] C.T.C. 512, 61 DTC 1300 (Supreme Court of Canada).
9. Interpretation Bulletin IT-95R (16 Dec. 1980).
10. Former Regs., subsection 1100(4).
11. CICA Handbook, s. 3470.
12. See, e.g. Drummond & Wigle, "Let's Stop Taking Comprehensive Tax Allocation for Granted, *CA Magazine,* Oct. 1981, p. 56.
13. See, e.g., Report of the Ontario Committee on Inflation Accounting 68 (Ont. Government Bookstore 1977); *The Budget in More Detail* 42 (Department of Finance, 12 Nov. 1981).
14. Act, paragraph 18(1)(e).
15. See CICA Handbook, s. 3260.
16. Interpretation Bulletin IT-215R, para. 12 (12 Jan. 1981).
17. Id., para. 10; Interpretation Bulletin IT-109R, subpara. 12(e); Act, section 78.

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wholesaler of publications who delivers the publications to a retailer who has a right to return items that are not sold is better advised to retain title to the publications until they are sold by the retailer than to transfer title to the retailer on delivery and later take back title to the items returned: in the former case no revenue need be recognized until items are sold by the retailer, whereas, in the latter case, sale revenue must be recognized at the time of delivery to the retailer, and no deduction can be taken for estimated returns, since such a deduction would represent a "reserve" that is not specifically provided for in the Act.[18] A transaction the only purpose of which was to enable a taxpayer to qualify to deduct a "reserve" and thereby to postpone the recognition of income has been held to be effective.[19]

The budget of 12 November 1981 proposes to eliminate the "reserves" that permit the recognition of gross profit on dispositions of trading property or capital property to be spread over the period during which the proceeds are to be collected. For dispositions after the budget date, the entire taxable gain must be recognized in the year of disposition, regardless of when the proceeds fall due. This can be expected to discourage sales on terms that provide for a substantial portion of the price to be paid over a period of time.

4. INVENTORY VALUATION

The earliest attempts by Canadian taxpayers to protect themselves against the distortion of taxable income caused by continuing inflation concentrated on the valuation of their inventory. An attempt to use he last-in-first-out (LIFO) method for determining inventory cost for tax purposes was judicially rejected some years ago;[20] and periodic suggestions since then that the law be amended to permit the use of LIFO have not borne fruit.[21]

Taxpayers have been permitted, by the Act and the Regulations, to value their inventory for tax purposes entirely at cost, entirely at market, or at the lower of cost and market. The method of valuation used for a taxpayer's closing inventory in any taxation year must also be used for his opening inventory in the next year.[22] It had been generally thought that a taxpayer remained free to change to another permitted method in valuing his closing inventory in any year, but the Department has recently taken the position that any such change is only permissible when it can be justified by reference to GAAP.[23] This Departmental position will probably be challenged in the courts.[24]

In 1977 the government responded to requests for relief from the effects of inflation by permitting an arbitrary 3% deduction applied to the tax value of a taxpayer's opening inventory of goods that are held for sale or to be incorporated into goods to be sold or to package these goods.[25] While this relief was welcome to taxpayers who could qualify for the deduction, it was not a meaningful solution to the inflation problem.[26] This rule undoubtedly is influencing some new businesses to choose their year end at a time when inventories are high, even though this may be undesirable from a business point of view.[27]

The Department will permit the cost of inventories of work in progress and finished goods to be determined by "direct costing" (excluding fixed overhead) or by "absorption costing" (including fixed overhead); "prime costing" (excluding all overhead) will not be accepted. The Department will accept a determination of the fair market value of inventory based on either replacement cost or net realizable value, if the method is followed consistently. It says that the method used to determine both cost and market for tax purposes must correspond to the method used in the taxpayer's financial statements; here, as elsewhere on timing questions, no statutory or case authority is cited to support the Department's position.[28]

For some years it had been accepted that, to reconcile accounting income with tax income, accounting depreciation would need to be added to accounting income, because the depreciation was not deductible for tax purposes.[29] Then the appropriate amount of capital cost allowance would be deducted, and, of course, any other applicable adjustments would be made. Eventually some taxpayers realized that the Act did not require them to add back to their accounting income for a year any portion of the accounting depreciation expense for that year that was included in the cost of closing inventory, since it would not be deducted in computing the taxpayer's income for tax purposes if it was left in closing inventory. The Department became alarmed by the amount of potential tax reduction that would occur if many taxpayers switched from adding back all depreciation to adding back only the part not included in closing inventory. Consequently, by recent amendment, any such amount in closing inventory must now be added back to income for tax purposes, and the same amount is deducted in computing tax income for the following year, when it would relate to opening inventory.[30]

5. ACCOUNTING FOR INFLATION

Monetary inflation has been a problem for Canadian accountants for many years and has accelerated in recent years. During 1981 prices will have increased in Canada at an annual rate of over 12%. Not surprisingly, the in-

18. *Sinnott News Co. Ltd.* v. *M.N.R.*, [1956] C.T.C. 81, 56 DTC 1047 (Supreme Court of Canada); *Harlequin Enterprises Ltd.* v. *The Queen*, [1977] C.T.C. 208, 77 DTC 5164 (Federal Court of Appeal).
19. *The Queen* v. *Esskay Farms Ltd.*, [1976] C.T.C. 24, 76 DTC 6010 (Federal Court, Trial Division).
20. *M.N.R.* v. *Anaconda American Brass Ltd.*, [1955] C.T.C. 311, 55 DTC 1220 (Judicial Committee of the Privy Council).
21. See Broadhurst, "Financing and Tax Incentives", in *Corporate Management Tax Conf.* 300, 301-10 (Can. Tax Foundation 1980).
22. Act, subsections 10(1), (2); Regs., section 1801.
23. Interpretation Bulletin IT-473, para. 4 (17 March 1981).
24. Consistency of accounting treatment was required in *The Queen* v. *Wilchar Construction Ltd.*, [1979] C.T.C. 117, 79 DTC 5086 (Federal Court, Trial Division), where a change of method would permit some income to escape tax. See also Act, subsections 10(3)-(5).
25. Act, paragraph 20(1)(gg).
26. See Report of the Ontario Committee on Inflation Accounting 64-67, note 13.
27. Some loopholes in the original rules were blocked by the addition to the Act of subsections 20(17), (18).
28. See Interpretation Bulletin IT-473, paras. 8, 12, 16 (17 March 1981).
29. Act, paragraph 18(1)(b).
30. Act, paragraphs 12(1)(r), 20(1)(ii).

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come tax system, which uses only historical costs to measure expenses, has been criticized for imposing taxes on inflated profits. The existing indexing of "personal exemptions" and rate brackets for individuals does not remedy the overstatement of business income or capital gains for tax purposes. As mentioned earlier, generous rates of capital cost allowance and the 3% inventory allowance may offer some relief; but any such relief is arbitrary, is discriminatory among different classes of taxpayers, and in the great majority of cases is patently inadequate.

Understandably, the government regards requests for relief from the effects of inflation on the measurement of business income as involving threats to its revenues. Consequently it has not resisted the temptation of sheltering behind the accounting profession's failure to agree on a method of resolving the inflation problem for accounting purposes. In effect the government has said that once an appropriate method of accounting for inflation has become generally accepted, the possible adoption of that method for tax accounting can be seriously considered.

The Canadian Institute of Chartered Accountants has given careful consideration to the implications of adopting either price indexing or current cost accounting to resolve the problem of inflation accounting.[31] It now appears to be ready to recommend current cost accounting – initially as a supplement to financial statements prepared in accordance with traditional historical cost accounting. Obviously any such hesitant development offers little hope for a speedy resolution of the problem of tax accounting for inflation.

One thoughtful commentator has questioned the appropriateness of the government's "wait and see" position on addressing the inflation problem for tax purposes. According to G.E. Cronkwright,[32] a prominent Canadian tax accountant, current cost accounting would never be suitable to be used to measure income for tax purposes: the calculations and assumptions involved, in his view, are too subjective. Attempts should therefore proceed to resolve the inflation problem for tax purposes without waiting for a resolution of the problem for accounting purposes, since the solutions are likely to be different. This conclusion seems valid; but any resolution of the tax problem, unless it is to be totally arbitrary, still involves what is essentially an accounting question, which will need to be answered by skilled accountants.[33]

What seems to be required, therefore, is prompt action by the federal government to appoint a committee consisting of prominent accountants from the private sector and tax policy personnel from the Department of Finance, with a mandate to recommend a practical and equitable method of eliminating inflationary profits from the computation of taxable income. If and when such a system is implemented, a small standing committee representing both the government and the private sector should be charged with monitoring its effectiveness and with recommending any changes that appear to be required having regard, among other things, to any relevant developments in financial accounting.

In the absence of corrective provisions in the Act, Canadian businesses appear to have no direct way of insulating themselves specifically from the tax penalty that is imposed on inflationary profits. Obviously they will try to structure their operations as to minimize adverse effects from inflation – as by maximizing debt financing – and to take whatever steps are open to them to minimize or defer their income taxes. Largely because of the rate of inflation, however, debt financing has become very expensive.

The conclusion reached in 1977 by the Report of the Ontario Committee on Inflation Accounting still seems valid:

> It is clear that the impact of inflation on the taxation of business income creates major cash flow and liquidity problems. In addition, inflation also results in an unintended and automatic shift of wealth from business capital to government. To date, tax relief for the effects of inflation has been limited and largely fortuitous being based on the effect of allowances permitted for other reasons.[34]

6. REQUIRED CONFORMITY WITH FINANCIAL STATEMENTS

As indicated earlier, the Department in recent years has taken the position that, except where the Income Tax Act requires the adoption of a specific accounting method for tax purposes, a taxpayer's choice among alternative methods must conform with the choice made in his financial statements. Presumably the Department's concern is that taxpayers will choose for tax purposes, among acceptable alternatives, the method that will give them maximum tax advantage even though, by choosing another method for their financial statements, they indicate that the method adopted for tax purposes is not the most appropriate way of measuring their income.

There is no support in the Act for the Department's position, and some leading judicial decisions seem to have rejected it.[35] If that position did reflect the present state of the law, it would be open to the same objections as was the former rule, mentioned earlier, requiring the amount of capital cost allowance to be limited to the amount shown as accounting depreciation: it would force some taxpayers to pay more tax than they would otherwise have to pay, because they are unwilling or unable to report to shareholders and creditors in their financial statements in a way that minimizes their accounting income;[36] and taxpayers not so constrained would be induced to distort their financial statements in order to achieve a maximum tax advantage. As well, if the Department's

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31. See Guideline on *Accounting for the Effects of Changes in the Purchasing Power of Money* (Can. Institute of Chartered Accountants 1974); Discussion Paper on *Current Value Accounting* (Can. Institute of Chartered Accountants 1976).
32. Cronkwright, "The Dilemma of Conformity: Tax and Financial Reporting – A Perspective from the Private Sector, in *Corporate Management Tax Conf.* Can. Tax Foundation 1981).
33. See also Arnold & Bonham, "The Measurement of Income: Selected Problems, in *Canadian Taxation* 543, 563-71 (B.G. Hansen, V. Krishna, & J.A. Rendall eds., De Boo 1981).
34. Loc. cit. note 13, at p. 75.
35. See, e.g., *The Queen* v. *Oxford Shopping Centres Ltd.*, note 2.
36. See Arnold, "Conformity between Financial Statements and Tax Accounting, 29 *Can. Tax J.* 476 (1981).

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position is to become law, many of the same considerations that arose when it was proposed to legislate the application of GAAP for tax purposes may need to be debated again.

7. CONCLUSION

It is fortunate that, on the whole, tax accounting rules in Canada are not so artificial as to require, or make advisable, unusual or complex corporate structures. Inevitably these rules will influence business decisions, and there have been several recent statutory, judicial, and administrative developments relating to tax accounting that may affect business planning. Much of the current confusion and uncertainty can be traced to the failure of the government to invite discussion and seek a consensus on the appropriate relation between tax accounting and financial accounting. Such a dialogue might prove highly productive at this time.

CANADA:
Summary of Modifications in Draft Legislation

continued from page 374

Reserves

There are also modifications to proposals relating to the deduction of certain reserves on instalment sales of property where the proceeds are not received until a future year. The business reserves proposed for sales of real estate will be extended to sales of all inventory and the computation of the reserve will be based on the portion of the total proceeds that remain unpaid over a three-year period.

Foreign subsidiary loans and corporate reorganisation measures delayed

With respect to the changes proposed in Budget Resolution 14 relating to low-interest or interest-free loans by Canadian corporations to their foreign subsidiaries, and amendments affecting corporation reorganizations, Mr. MacEachen intends to further consider these particular changes. The treatment of loans to non-resident corporations is part of a broader study of the taxation of foreign source income that is currently under way. In the area of corporate reorganizations, the Minister intends to refer the amendments in this very complex area of the law to a group of outside consultants for review. Changes in these areas will not be proceeded with before the studies have been concluded and a discussion document has been made public.

Employees share purchase loans

The Minister said that the proposed restriction on deductibility of interest expense would not apply to interest under commitments prior to 12 November 1981 relating to employee share purchase loans. The decision to "grandfather" such loans recognizes that in many circumstances employees are locked into relatively long-term arrangements and are unable to reorganize their affairs. The application of the interest restriction to corporations under Budget Resolution 24 was intended as an anti-avoidance measure and the Minister confirmed that, as such, it would apply only to those private corporations that carry on either a personal service or a professional business.

RRSP loans

The draft legislation does, however, contain the proposals in Budget Resolution 20 relating to the non-deductibility of interest on loans to finance contributions to registered retirement savings plans (RRSPs) and certain other plans.

Non-resident withholding tax exemptions

The Minister also announced a three-year extension of the non-resident withholding tax exemption for interest paid on government and long-term corporate borrowings. The existing exemption is scheduled to terminate for bonds and other debt issued after 1982. The Minister indicated that the amendments necessary to provide for the extension of the exemption for interest on debt obligations issued before 1986, while not included in the draft legislation would be reflected in the implementing legislation to be introduced in the fall.

Draft regulations defining terms

In addition, Mr. MacEachen released the text of draft regulations (attached) that describe what is to be included in the expression "prescribed share" for the purpose of paragraph 112(2.3)(g) and paragraph (f) of the definition "term preferred share" in the draft legislation. The draft regulations are essential for an understanding of these two provisions.

Communication with Department of Finance

Mr. MacEachen said that taxpayers with particular technical concerns arising out of the draft legislation should write to the Tax Policy and Legislation Branch, Department of Finance, Ottawa, K1A 0G5.

DRAFT INCOME TAX REGULATION

SCHEDULE

1. Section 6201 of the *Income Tax Regulations* is revoked and the following substituted therefor:

"6201(1) Subject to subsection (2), for the purposes of paragraph 112(2.3)(g) of the Act and paragraph (f) of the definition "term preferred share" in subsection 248(1) of the Act, a share is a prescribed share with respect to a corporation (in this subsection referred to as the "recipient") that receives a dividend at any time in respect of the share if it was acquired after 28 June 1982 and is of a class or of a series of a class of the capital stock of a corporation that is listed on a stock exchange referred to in section 3200 unless in the aggregate dividends are received at that time from the corporation in respect of more than 10% of its issued and outstanding shares of that class or of that series, as the case may be, by

(a) the recipient, or
(b) the recipient and persons with whom the recipient does not deal at arm's length.

(2) For the purposes of paragraph 112(2.3)(g) of the Act and paragraph (f) of the definition "term preferred share" in subsection 248(1) of the Act, a share is hereby prescribed that is a share last acquired before 29 June 1982 and is of a class or of a series of a class of the capital stock of a corporation that is listed on a stock exchange referred to in section 3200 unless in the aggregate more than 10% of the issued and outstanding shares of that series or of that class, as the case may be, are owned by

(a) the owner thereof, or
(b) the owner and persons related to him."

2. Section 1 is effective on and after 13 November 1981.

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INCOME TAXATION IN CANADA

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The Long Reach of the United States in Tax Matters

by Piroska E. Soos*

In *United States v. Quigg,*[1] the United States District Court for the District of Vermont ordered a Canadian bank to produce certain records which were located at the bank's branch in the Bahamas and which related to accounts held by a U.S. citizen who was being criminally prosecuted on charges of federal income tax evasion. The District Court's decision was recently affirmed by the U.S. Court of Appeals for the Second Circuit.[2]

The case involved a U.S. taxpayer (hereinafter "T") as well as the Canadian Imperial Bank of Commerce (hereinafter "Bank"), a large bank based in Toronto with approximately 1,700 branches and agencies throughout the world, including the U.S. and the Bahama's. On 21 November 1980, in response to an application by the U.S. Government (hereinafter "Government"), the District Court (hereinafter "Court") issued a trial subpoena ordering the Bank to produce records of any account maintained by T at the Bank since 1972. The subpoena was addressed to "any authorized officer" at the Bank's agency in New York City and was served on an assistant accountant at the New York agency. Although the subpoena sought the production of records at any of the Bank's branches or agencies, the Government indicated that the subpoena was limited to a search of the records at the Nassau branch in the Bahamas.

The Bank objected to the subpoena on two grounds: (i) pursuant to cases decided by the U.S. Court of Appeals for the Second Circuit,[3] the Bank could not be compelled to produce bank records if production would subject it to criminal liability under the banking laws of the Bahamas, and (ii) service of the subpoena on the New York agency did not give the Court jurisdiction over the Bank's headquarters and branches located outside the U.S., and the New York agency could not produce the records because they were beyond its control. For the reasons stated below, the Court rejected both objections.

CRIMINAL VIOLATION OF BAHAMIAN LAW

In considering the Bank's first objection, the Court noted that, under Bahamian law, it was a crime for any officer or employee of a bank or trust company to disclose "information relating to the identity, assets, liabilities, transactions, (and) accounts of a customer" without the customer's consent, except under certain circumstances not relevant in this case.[4] Relying on principles of comity and international law, the Court refused to compel the Bank to disclose anything that would subject it or its employees to criminal liability. Enforcement of the subpoena, therefore, depended on T's consent to the disclosures.

T stated that he would not voluntarily consent to the release of the Bank's records and, thereupon, the Government requested the Court to order T to execute a consent form permitting the Bank to release the records. The Court granted the Government's request and, in so doing, rejected T's arguments that requiring T to consent would violate his rights under the due process and self-incrimination clauses of the Fifth Amendment to the U.S. Constitution.

The relevant part of the Fifth Amendment provides that

> . . . nor shall any person be subject for the same offense to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property without due process of law; nor shall private property be taken for public use without just compensation.

The Court generally agreed with T that the due process clause means that a criminal defendant is not obliged to cooperate with the Government in his own prosecution. However, the Court pointed out that T had not considered some important exceptions to the general rule. For example, a criminal defendant may be required to submit to a blood test, to participate in an identification lineup, to produce a handwriting sample, or to produce papers in his possession which may be damaging at trial but which fall outside the protection of the Fifth Amendment.

The Court relied on *Fisher v. U.S.*[5] in which the U.S. Supreme Court said that an individual under investigation for tax violations could not refuse to produce papers in his possession which were prepared by an accountant and thus beyond the scope of the Fifth Amendment. The Court concluded that, unless the privilege against self-incrimination or another constitutional right applies, a criminal defendant may be ordered to produce evidence in his possession or to cooperate in other ways.

The privilege against self-incrimination did not apply in this case since the records involved were not the kind (private or testimonial) protected by the Fifth Amendment. The Court cited two U.S. Supreme Court cases[6]

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1. — F. Supp. — (D. Vt., 5 January 1981); 48 AFTR 2d 81-5953.
2. Affirmed by an unpublished order dated 30 November 1981.
3. *Ings. v. Ferguson,* 282 F.2d 149 (2d Cir. 1960); *Application of Chase Manhattan Bank,* 297 F.2d 611 (2d Cir. 1962); *Trade Development Bank v. Continental Insurance Co.,* 469 F.2d 35 (2d Cir. 1972).
4. The Court cited the Bahamian Banks and Trust Companies Regulations (Amendment) Act, 1980. Section 101(1)(iii) of that Act states that one of the exceptions to the secrecy requirement concerns disclosures of records required by any court of competent jurisdiction within the Bahamas. The Court noted that, although the records sought by the Government could probably be obtained by requesting the courts of the Bahamas for an order authorizing release of the records, this procedure was not realistically available in this case since it was a time-consuming procedure and T's trial was scheduled to start in one week.
5. 425 U.S. 391 (1976); 37 AFTR 2d 76-1244.
6. *California Bankers Asso. v. Shultz,* 416 U.S. 21 (1974); 33 AFTR 2d 74-1041, and *U.S. v. Miller,* 425 U.S. 435 (1976); 37 AFTR 2d 76-1261.

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for the proposition that, for purposes of the Constitution, bank records are records maintained by a third party (the bank) and are neither private nor testimonial. The banking laws of the Bahamas did not alter this rule. In *U.S. v. Payner,*[7] the U.S. Supreme Court considered the bank secrecy laws of the Bahamas and concluded that the laws create no special expectation of privacy which is not present under American banking laws. Thus, the Fifth Amendment did not bar production of the records. The Court noted that, under the rule in *Fisher v. U.S.*, the records could be subpoenaed directly from T if they were in his possession. Ordering T to remove an obstacle created by Bahamian law was in effect no different from subpoenaing the records from T.

Finally the Court rejected T's argument that the act of executing the consent form was a testimonial act which is protected by the privilege against self-incrimination. In the Court's view, the consent merely permitted the Bank to release any records it might find, and the consent did not mean that T admitted ownership of an account in the Bahamas or vouched for the accuracy of the records.

JURISDICTION OF U.S. COURTS OVER RECORDS LOCATED ABROAD

The jurisdictional question related to the Court's subpoena power over the Bank's branches outside the U.S. The Government's position was that service of the subpoena on the Bank's New York agency subjects the Bank's headquarters and all the branches to the subpoena power of the Court.

The Court stated that the subpoena power of the Court in criminal matters is not explicitly conferred by statute but derives from the U.S. law which grants jurisdiction over offenses against the U.S. to the federal courts. The grant of subject matter jurisdiction (i.e. over the offense) necessarily carries with it an implied grant of the subpoena power subject, however, to certain restrictions not applicable here.

The geographic reach of power may be inferred from the Federal Rules of Criminal Procedure. Rule 17(e)(2) relates to service on a witness in a foreign country who is a national or resident of the U.S. This provision did not apply to the Bank since it was not a U.S. resident. Rule 17(e)(1), however, provides for service of a subpoena on anyone *found in* the U.S., and for this purpose, a foreign corporation may be found in the U.S. even though its headquarters and place of incorporation are in a foreign country.

The Court said that the Bank would be considered to be "in" the U.S. if it were "doing business" there. The Court examined the affidavits of the Bank's representatives and concluded that the Bank, through its New York agency, carried on activities in the U.S. on a scale sufficient to constitute "doing business".[8] Since the subpoena power over a foreign corporation doing business in the U.S. extends beyond the corporation's operations in the U.S., the Bank's records in the Bahamas could be reached by the Court.

The Court was not willing to go so far as to say that a foreign corporation might be obliged to open all its files to American courts and prosecutors merely because it opens an office in the U.S., but the Court did not say where it would draw the line. The Court noted, however, that, in this case, the subpoena was directed only at the bank records concerning a U.S. citizen who was under indictment for violations of U.S. tax laws. The subpoena, therefore, represented no great intrusion into the purely foreign affairs and operations of the Bank and its customers. In addition, the Bank should not be surprised that the Government is interested in the foreign bank accounts of its citizens. The Bank chose to enter the U.S. to conduct business and, by that act it became obliged to respond to reasonable requests for information concerning its transactions with Americans both in the U.S. and abroad.

COMMENTS

In *Quigg,* the Court stated unequivocally that it was unwilling to compel any disclosures that would subject the Bank or its employees to criminal liability in the Bahamas. This statement may be compared to an opinion rendered by the U.S. Court of Appeals for the Ninth Circuit in which the Ninth Circuit was less sympathetic to the taxpayer's plight that compliance with a summons would violate Swiss law.[9] In that case, the U.S. Internal Revenue Service sought production of certain records of a U.S. corporation and its foreign subsidiaries. Some of the records were in Switzerland, and one of the grounds on which the taxpayer objected was that production of the Swiss records would violate Swiss law that makes it a crime to disclose business secrets. The Ninth Circuit rejected the objection because the taxpayer had not shown a substantial likelihood of a successful prosecution in Switzerland. The Ninth Circuit also noted that the taxpayer would not be in this predicament had it complied with U.S. law which requires it to keep certain records pertaining to its foreign subsidiaries.

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7. 48 *United States Law Week* 4829 (23 June 1980); 46 AFTR 2d 80-5174.
8. The Court noted that the Bank's objection was analogous to the affirmative defense of lack of personal jurisdiction which a defendant must raise and prove. The Bank had failed to meet its burden of proof as there was nothing before the Court which indicated that the Bank was not doing business in the U.S.
9. *United States v. Vetco, Inc. et al.*, 81-1 U.S.T.C. Para. 9428 (9th Cir. 1981); *certiorari denied* by the U.S. Supreme Court on 24 August 1981. For a discussion of this case, see 21 *European Taxation* 12 (1981) at 402.

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BRAZIL:

The Supplementary Income Tax on the Remittance of Dividends Abroad — Legal Nature and Computation

by Ives Gandra da Silva Martins*

I. BRIEF INTRODUCTION TO THE BRAZILIAN TAX SYSTEM

The Brazilian taxation system, dealt with in the Federal Constitution under that heading, encompasses 5 different categories of taxation, namely, "taxes", "duties", "contributions", "special contributions", and "compulsory taxes".

Of course, the most significant of these are the taxes. The Federal Constitution sets forth the competence for the introduction of taxes in the following manner: 9 different taxes may be imposed by the Federal Union (Art. 21), 2 by State Governments (Art. 23), and 2 by municipalities (Art. 24). There is a narrow definition of each tax, and new taxes may be introduced exclusively through the residual competence of the Union (Art. 18 §5), provided that their computation basis and generating facts are different from those of existing taxes.

The imposition of the tax on income and gains of any nature is exclusively the prerogative of the Federal Union (Art. 21, item IV of the Federal Constitution). Art. 43 of the National Taxation Code delimits the scope of this tax. It reads as follows:

> The tax on income and gains of any nature is under the competence of the Union, and its generating facts are the acquisition of economic or juridical availability:
> I – of income, such as the proceeds of capital, of work, or of a combination of both;
> II– of gains of any nature, such as property increases not included in previous items.

The tax on income and gains of any nature is governed by Federal legislation of a varied nature, under which 3 different tax regimes exist, i.e. for individuals, for legal entities, and taxation by withholding.

A fourth regime can be mentioned, resulting from the 13 double tax treaties whereby Brazil, adjusting its tax system to the systems of other countries, has many times adjusted its internal system to adapt itself to systems of other countries under which the place where the service was rendered is considered as the generating fact of taxation and not the place of the source of payment. Such treaties have been concluded with: Austria, Belgium, Denmark, Finland, France, Germany, Italy, Japan, Luxembourg, Norway, Portugal, Spain and Sweden.

On the other hand, Brazil adopts generally a progressive rate system for the income of individuals, and a fixed rate for most legal entities. The rates of individual income tax range from 3 to 55%, and corporate income tax has a fixed rate of 35%, except for the few cases in which an additional 5% on taxable profits in excess of Cr $ 86,000,000 is levied (base year 1981, fiscal year 1982).

In addition to income tax on the profits of legal entities, there is an income tax on the distribution of dividends, ranging from 15 to 25%, in the form of a withholding tax for both individuals and legal entities.

When dividends are remitted abroad the rate of the withholding tax is 25% (except for reduced rates in double taxation treaties), provided that they do not exceed the limit of 12% per year (computed over a 3-year period), in which case the tax is considerably increased by the supplementary income tax ranging between 40 and 60%. Arts. 544 and 555 of item I of the Income Tax Regulation read as follows:

> Art. 544
> Dividends, cash bonuses, profits, and other interest, except for those referred to in items I, III, and IV of Art. 37 and those referred to in the introduction to Art. 547, are subject to withholding tax at the rate of:
> I –15% when distributed to individuals residing or domiciled in the country by open capital corporations and by service companies relative to the exercise of a duly regulated profession;
> II –25% when distributed to individuals residing or domiciled in the country by the remaining types of legal entities;
> III–15% when distributed by legal entities to other legal entities with head office in the country.
>
> Art. 555
> The following are subject to withholding tax:
> I –at a 25% rate, income received by individuals or legal entities referred to in the previous article, gains derived from short term operations included, as well as capital gains relative to investments in foreign currency, except for those referred to in items II and III (Law 3470/58, Art. 77, Decree-Law 1401/75, Art. 4); . . .

Our intention is to analyze the philosophy behind the supplementary income tax in view of the wide discrepancies of interpretation in Brazilian taxation circles. In order to provide the reader of the *Bulletin* with a clear view of such discrepancies, we first present our position and then Federal Revenue Ruling No. 77/78, which briefly presents the interpretation of the Federal Treasury.

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II. INTRODUCTION TO THE STUDY

Tax law is based on principles, norms, and institutions similar to those of other legal disciplines, but it is an autonomous part of Brazilian legislation. However, it has an important impact on other branches of knowledge such as economics, public finance, politics, sociology, and even ethics.[1]

There may perhaps be no other branch of law with such varied connections, which is reflected by its capacity of touching the very essence of the science it influences.

Poor formulation of taxation policy and subsequent application of inadequate laws has been a major factor altering history, examples being offered by the out-break of the American Revolution or by the Brazilian "Inconfidência Mineira".[2] Likewise, it is common knowledge that taxes are used to treat severe economic illnesses, namely, inflation, recession and underdevelopment. In addition, the socialist societies have their foremost trend indicator in the formulation of the taxation policy, and, in some countries, taxes are sometimes used to re-orient mores and preserve moral values.

Formally, a country's budget is, in practice, prepared on the basis of the forecast of tax revenues, the tax being the most relevant among the 5 classic public revenues.[3]

Taxation, therefore, is an essential and unique feature of Budget Law, far more so than its principles which, although pertaining to this area of law, are similar to principles of other areas of the law, for instance, *the principle of strict legality, the principle of characterization and the principle of the provision in law,* the latter also being peculiar to criminal law.

Taxes have such an important function, in any of their categories,[4] that they are always created by the legislator for a special purpose so that the essence of their creation rests on their teleological aspect. Taxes may have a wide range of objectives which determine the essence of their legal nature.

Among the most important intentions of the legislature are those which result in a tax being both a penalty and a guideline for economic policy, as may be seen in the case of the urban property tax: the City of São Paulo increased this tax to 200% on illegal buildings. In such a case, the penalty is incorporated into the very structure of the tax, serving as a strong disincentive to concealed operation and as a factor re-orienting municipal policy, and aiming at harmonious and planned urban development.[5]

It is in such light that one should carry out a preliminary study for purposes of discussing the supplementary income tax, i.e. taking into account this important aspect of the Brazilian legislation, which accepts that taxation is used to reach certain goals.[6]

Article 3 of the National Taxation Code defines the concept of tax:

> A tax is any mandatory money payment, in currency, or whose value may be expressed in currency, which is not punishment of an illegal act, provided by law and collected by administrative authorities vested with their lawful power.

This definition is accepted by the vast majority of Brazilian legal commentators[7] as having general validity.

This concept is supplemented by Article 113, which provides:

> Tax liability is either primary or accessory.
> § 1– Primary liability is brought about by the occurrence of the generating factor, its object is represented by the payment of the tax or fine, and is terminated together with the claim it entails.
> § 2– Accessory liability is a result of taxation legislation and its object is represented by positive or negative measures provided therein in the interest of tax collection or auditing.
> § 3– When not observed, the accessory liability becomes primary liability as regards the fine.

Two conclusions may be immediately arrived at: the Code explicitly defines the concept of tax and implicitly defines the concept of penalty, as the latter, although a punishment for an illegal act, has the same nature as a tax; and, secondly, that the above article places tax and penalty in the same category.

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1. In the Second Latin American Regional Symposium of Taxation Law, Edvaldo Brito stressed such interaction in his paper "Social and Economic Contributions: Legal Nature and Prescription" *(Resenha Tributária,* 1976).
2. In our lecture opening the First Brazilian Congress on Revenue-Taxpayer, organized by the Federal Revenue, entitled "Taxes: Social Justice and Development" *(Revista Projeção,* pp. 68-71, December 1979), we said: "When we were invited to open the academic session of the Interamerican Association of Taxation dedicated to Interamerican Taxation Coding, in Rosário, Argentina, in 1976, we were surprised at the excellent studies prepared by the then dean of Rosário University, Prof. Manuel de Juano, current chairman of the Fiscal Commission of the Interamerican Bar Association. Prof. de Juano, when he organized the first Taxation Law Museum of the world, showed that there has never been a revolution or insurrection in the history of mankind that did not have an incorrect application of taxation policy at its roots. Such incorrect application generated tensions which directly led to the non-acceptance of the directions desired and led to upheavals, such as the "derrama" in the Brazilian episode of the "Inconfidência Mineira", or in the Townshend Law, imposing import duties on glass, lead, paper, paints and tea, by the time America was fighting for independence, starting in 1767."
3. Aliomar Baleeiro stresses this aspect in his well-known *Introduction to Financial Science* (*Forense* - several issues).
4. Authors do not agree as to the number of categories of tax. Geraldo Ataliba only distinguishes between taxes levied for a specific purpose and general taxes ("Em prol da contribuição de melhoria", *Resenha Tributária,* 1976); Paulo de Barros Carvalho discusses two categories: taxes and duties ("Comentários ao Código Tributário Nacional - Artigo 16º", *Revista dos Tribunais,* c/ Geraldo Ataliba and Rubens Gomes de Sousa); most authors tend to distinguish between 3 categories: taxes, duties, and special contributions – Ruy Barbosa Nogueira ("Curso de Direito Tributário", Saraiva), Fábio Leopoldo de Oliveira ("Curso Expositivo de Direito Tributário", *Resenha Tributária)* among others; Aires Fernandino and Manuel de Juano list 4 categories divided into 2 sectors: first, "improvement contributions" and "special contributions", excluding, however, the compulsory loan *(Caderno de Pesquisas Tributárias* 2), and, second, distinguishing the "improvement contribution" from the "special ones" *(Manual de Finanzas e Derecho Tributário,* Molachino); Ives Gandra da Silva Martins ("As Contribuições Especiais numa Divisão Quinquipartida dos Tributos", *Resenha Tributária),* Fábio Nusdeo *(Comentário ao CTN,* vol. 3, José Bushatsky) and Bernardo Ribeiro de Moraes *(Caderno de Pesquisas Tributárias* 2, *Resenha Tributária)* defend the existence of 5 categories (taxes, duties, special contributions, improvement contributions, and compulsory loans).
5. The Second Interamerican Congress of Taxation Law was specially dedicated to the theme "Determination of guidelines for a taxation policy for urban development" (papers published by *Resenha Tributária,* 1975).
6. See H.L.A. Hart: *The Concept of Law* (Clarendon Law series).
7. Geraldo Ataliba and Souto Maior Borges, in "Sistema Constitucional Tributário", in "1º Ciclo de Conferência sobre Temas Tributários" and "Lei Complementar" *(Resenha Tributária* and *Revista dos Tribunais,* respectively), do not totally accept it, and represent isolated positions which conflict with those of Gilberto de Ulhao Canto, Rubens Gomes de Sousa, Aliomar Baleeiro and Carlos de Rocha Guimarães, the drafters of the Brazilian tax system.

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On the other hand, such a legal frame leads to the existence of 2 special forms of tax assessment in the Brazilian legislation: "punitive taxation" and "discouraging taxation", with closely related areas of application, the former encompassing all characteristics of the latter, but the latter not always encompassing those of the former.[8] The taxes levied on disguised profit distributions (individual and corporate taxes are solely borne by individual taxpayers) or for the property tax mentioned above, with the objective of penalizing and discouraging, are considered "punitive taxation". An example from French legislation of simple "discouraging taxation" is the tax on real estate concentration, the aim of which is to reduce urban verticalization, although some commentators say that discouraging is a means of penalizing those activities which are supposedly legal, but in essence illegal.[9]

It is a fact that punitive or discouraging taxation, within the scope of defined objectives, occurs more in view of its extra-fiscal function than for its function of generating funds for public services.[10]

From the above concept one understands that the Brazilian legislature wished to liken their legal natures even when it stressed their differing elements (whether or not they should be considered a punishment), treating them as species belonging to the broader category of taxes in general. Tax liability is considered to become effective upon the occurrence of a generating fact, and it is transformed into a taxation claim upon the assessment. With respect to discouraging and punitive taxes, as well as taxation punishments, legal interpretation may not admit any principles other than those of strict legality, characterization, and of the provision in law as the only manner to avoid arbitrariness of interpretation.[11]

Such principles are applied to the entire tax system, for they are inherent to a system under which the taxpayer has only the law as his guarantee. As he cannot take part in the formulation of law, which is always imposed on him under the legal power of authorized Revenue agents, the only guarantee that nothing will be required from him in addition to what the law provides lies solely in the 3 mentioned principles.[12]

That is why legal theory and the courts do not grant any room to the administration to issue regulations with respect to the norm provided in the law, because the power of regulating is often confused with the power of demanding, and such integration in the person of the Revenue agent may lead to an interpretation to the benefit of the Revenue and thus always unfavorable to the weakest party, i.e. the taxpayer or the assignee.[13]

Thus, when the Constitution states that only the law creates tax liabilities, and the National Taxation Code provides that only the law may introduce an increase in taxes, the principles to safeguard the rights of the taxpayer or the assignee were obviously included in the legislation. Thus the drafters of the Constitution and the supplementary legislation adopted the 3 principles mentioned above, which prevent the analogical interpretation as to tax laws or the use of a "benigna amplianda" (extensive) interpretation and, in cases of doubt, the law must be interpreted in favor of the taxpayer.[14]

As this is the essence of the Brazilian tax system, under the principle of strict legality, only what is provided in the law may be demanded. As a result, taxation law encompasses the principle of provision in the law, meaning that under no circumstances is the legislative competence delegated to the Revenue agent nor permission given to use such extensive interpretation by such agent. This principle is absolute and not merely formal.

As a last corollary, the type of the tax is "closed", i.e. may not be extended, and must be fully described in the law due to 4 additional sub-principles: (i) the principle of exclusiveness, stating that such tax is exclusive and may not be mistaken for other types of tax; (ii) the principle of selection, according to which the law indicates the tax; (iii) the principle of determination, which after the selection of the tax delimits its scope in an accurate and objective manner; and (iv) the "numerus clausus" principle, which limits the number of taxes and prevents any addition not provided for in the law to this type of tax.[15]

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8. *Caderno de Pesquisas Tributárias* 4, dedicated to the theme "Taxation Penalties" *(Resenha Tributária,* 1979) containing studies by 13 well known Brazilian and Argentine authors, in addition to the drafter of the ruling, studies several aspects of these two types of fiscal assessment.

9. In France, the higher taxes on luxury hotels and X-rated films (even when they are considered art films) intend to reach those grey areas, where the illegal dwells in a certain atmosphere of legality.

10. See Fábio Fanucchi, "A Tributação Penal", *Revista de Direito Público* 25, pp. 105-119.

11. Aires Fernandino Barreto prefers to call the first of them the "principle of absolute provision in formal law" ("Princípio de Legalidade e Mapas de Valores", in *Caderno de Pesquisas Tributárias* 6 of the Centro de Estudos de Extensão Universitária and *Resenha Tributária* - 1981, dedicated to the theme "Principle of Legality").

12. Yonne Dolácio de Oliveira, in her book *A Tipicidade no Direito Tributário Brasileiro* (Saraiva, 1980), states: "As the legal relation between the Revenue service and the taxpayer is established by law, creating a legal obligation for the legal subjects, the normative structural characterization limits the will of the parties, of the legislature and of the enforcer. This causes a great tension originating in the two values, "sureness" and "safety", calling for a closed type of law. These two values are different but imply each other: *sureness provides for a situation in which the scope of the law will not be extended; safety guarantees that only that which is the object of a legal definition shall be required"* (p. 180; our emphasis).

13. Gerd. W. Rothmann reaches the same conclusions in his study "O Princípio de Legalidade Tributária" in *Direito Tributário* - 5º Coletânea (Bushatsky, 1973), p. 154.

14. Art. 153 § 2 of the Federal Constitution, Art. 97 items I and II, Art. 108 § 1 and Art. 112 of the National Taxation Code read as follows:

"Art. 153 – The Constitution assures all Brazilians and foreigners residing in the country the inviolability of the rights related to life, freedom, safety, and property, on the following terms: . . .

§ 2. No person shall be obliged to do or not to do anything if not under the law."

"Art. 97 – Solely the law may determine:

I. the institution of taxes, or their termination;

II. the increase of taxes, their reduction, provisions of Arts. 21, 26, 39, 57 and 65 being observed . . ."

"Art. 108 – In the absence of express provision, competent authority, when enforcing taxation legislation, shall successively resort to, in the order indicated:

I– analogy;

II– general principles of taxation law;

III– general principles of public law;

IV– equitableness.

§ 1. The use of analogy may not result in the demand of a tax not provided for in the law".

"Art. 112 – Taxation law defining infringements, or attributing penalties to such infringements, shall be interpreted in a favorable manner to the defendant whenever there is doubt as to:

I– the legal classification of the fact;

II– the nature or material circumstances of the fact, or the nature or extension of their effects;

III– the nature of the applicable penalty or its grading."

15. P. 337 of *Caderno de Pesquisas Tributárias* 6 *(Resenha Tributária e Centro de Estudos de Extensão Universitária)* reads as follows: "It so happens that in the area of taxation law, the principle of legality, through the definitive pro-

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In sum there are the guidelines orienting the national taxation law, particularly in the areas of taxation punishments, punitive taxation, and discouraging taxation.[16]

III. SUPPLEMENTARY INCOME TAX – LEGAL NATURE

We will now try to see where the supplementary income tax fits in view of its legal nature.

Two questions immediately arise. The first one is to know whether or not such tax would fit in the category of discouraging taxation. The second is whether it would have the same legal nature as the regular withholding tax.

As to the first question, the answer seems simple.

When the law regulating the legal nature of foreign investments in Brazil (Law 4,131/62) was created, Art. 44 introduced the concept of the supplementary income tax, thus increasing the regular tax by an additional 20% for those foreign corporations of little national interest. The objective was to ensure the right of remittance of dividends, but, simultaneously, to show that their presence in Brazil was considered of little significance to that country, since they could be taken over by national capital. The 2 objectives laid down in Art. 44 in 1962 were: (1) the policy of discouraging the presence of foreign capital in Brazil and the remittance of profits, and, (2) encouraging the re-investment of profits within the country.[17]

In 1964, the legislation with respect to supplementary income tax was amended and the introduction of its current form made the governmental intention more clear. The present policy is to attract foreign capital, to stimulate its permanence and to reinvest the results in Brazil, and to discourage excessive remittances through the adoption of considerably higher and progressive tax rates.

Brazil is a country clearly lacking capital for development, and in need of both such capital and more developed technology from industrialized countries. Therefore, in 1964, the government tried to apply a formula with sufficient flexibility to attract capital from industrialized countries, allowing its repatriation and, at the same time, clearly discouraging the non-reinvestment of results in excess of certain limits, reflecting the average profitability figures of national companies.[18]

Therefore, the aim of the supplementary income tax was to discourage the taxpayer to remit too much profit abroad and to keep part of his profits in the country.[19]

Therefore, this is a type of tax which, even more than other taxes, is subject to interpretation under the foregoing principles, because the taxpayer who legally exercises his right to remit dividends abroad in excess of the limits set by the law will be subject to a higher tax.

There is no doubt that this concept fits within the category of discouraging tax mentioned above, so that the pertinent law may only be interpreted within strict limits, and the Revenue agent is not permitted to create, innovate, amend, change, or include any fact or norm which is not expressly foreseen by the law.

The second aspect concerns its legal nature. Does the supplementary income tax have the same legal nature as the withholding tax or does it have a different nature?

Although *Alberto Xavier* tends to find a different nature in this tax, and presents it in his brilliant and talented way, we do not agree with him.[20]

The famous author concludes that the characteristics of collection of the regular tax are different from those of the supplementary tax, first of all in view of the 3-year computation period, then in view of the factor reducing the percentage from one 3-year period to the next, related to those years in which remittance was above 12%, and, finally, in view of the factors related to the manner of computation.

We do not believe that this conclusion can be accepted, as all of the different characteristics refer to the mere collection technique and not to the structure and essence of the tax.[21]

The withholding tax assessed on remittances of up to 12% of capital or in excess of this amount has the same

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vision in law, allows for the necessary characterization, which determines the tax obligation as well as its factors, namely: the exact quantification of the rate, of the computation basis, or of the penalty. To conclude, it becomes evident that the logical consequence of the application of the principle of selection, the taxation norm determines the type of tax or penalty; according to the "numerus clausus" principle, it voids the use of analogy; according to the principle of exclusiveness, it renders the factual situation different from any other, although the situations may resemble each other very closely; and, finally, according to the principle of determination, it states the event to be taxed in a clear and objective fashion, whereby the use of elastic norms is absolutely forbidden."

16. Alberto Xavier, in his small but brilliant book *Os Princípios da Legalidade e da Tipicidade da Tributação* (Revista dos Tribunais, 1978), states: "And it follows that the norms which institute must necessarily be material decision norms (Sachentscheidungsnormen), according to the work of Werner Flume, because, contrary to what happens to action norms (Handlungsnormen), *these are not limited to authorizing the enforcement agency to exercise power in a relatively free manner, they rather impose a concrete decision criterion, thus predetermining its behavior"* (emphasis added).

17. Art. 44 reads as follows:
"Said tax shall be collected with an added 20% in the case of companies engaged in economic activities of lesser interest to the national economy, considering its localization, as defined in a decree of the Executive Power and in view of a hearing of the National Economy Council and the Council for the Superintendence of Currency and Credit."

18. It is interesting to recall that a stricter formula was adopted under the revolutionary regime, whose politics were aimed at maintaining a market economy. See Roberto de Oliveira Campos and Mário Henrique Simonsen, *A Nova Economia do Brasil* (Livraria José Olympio Editora, 1974).

19. Law 4,390 dated 29 August, 1964.

20. In his "Direito Tributário Internacional do Brasil", p. 204, he says: "With the purpose of determining their legal nature, we tried to understand the basic characteristics of this tax distinguishing 4 different traits: (i) it is a withholding tax; (ii) it is a special tax; (iii) it has the nature of a surtax; (iv) it has an extra-fiscal nature, the center of gravity of our viewpoint lying in the extra-fiscal aspect of the tax (which, for scientific coherence, we would rather call a "discouraging tax", because this extra-fiscal nature is a fiscal nature for it takes a fiscal character and has a specific final purpose as any other tax). This, however, is not part of its legal nature, it is merely explanatory and marginal to its essence.".

21. On the occasion of the Third National Symposium of Taxation Law at the Centro de Estudos de Extensão Universitária, about the collection technique, the Plenary concluded that:
"No, the added value is not an element of the theory underlying the imposition of the ICM tax. The constitutional principle of non-cumulation consists solely of deducting the amounts payable in previous operations from the tax payable, not considering the existence of an added value" *(Caderno de Pesquisas Tributárias* 4, *Resenha Tributária,* p. 642), for one cannot equate a mere collection technique with the essence of the theory for the imposition of any tax.

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legal nature, only the rates differ. However, the taxes are assessed as a *withholding tax and on remitted values*. That is to say that both taxes have the same purpose aiming at imposing tax on profit remittances; only a higher rate is applied in the case of the supplementary tax. In the same token, there is a higher tax on the disguised distribution of profits, but this does not alter the legal nature of the income tax on distributed profits.

The difference lies in the field of collection, just like the collection technique in the cases of deferred ICM tax in relation to assessment immediately following the generating fact with no resulting change of the legal nature.[22]

Thus, although we usually take positions quite similar to those of Alberto Xavier expressed in his brilliant comments, we firmly believe that he confuses the external aspects of a tax with its essence. We cannot accept that a special tax may be considered to have characteristics different from those of the regular tax just because it employs different collection techniques.

The supplementary income tax (which is withheld) and the regular income tax are identical, differing solely in their external aspects, i.e. with respect to their collection methods mentioned in the law.[23]

IV. THE BASIS FOR THE CALCULATION OF THE SUPPLEMENTARY INCOME TAX

After these introductory remarks we will examine the problem which is discussed by tax experts and which has been the subject of litigation, i.e. whether the supplementary income tax assessed on excess remittances in the previous 3-year period may be the basis for computation of the tax payable in the following 3-year period.

Article 43 of Law 4,131/62, as modified by Law 4,390/64, provides:

> The amount of net profits and dividends effectively remitted to individuals and legal entities residing or with head offices abroad is subject to a supplementary income tax whenever the average of remittances in a 3-year period, starting in 1963, exceeds 12% of registered capital and reinvestments under Arts. 3 and 4 thereof.
>
> § 1– The supplementary income tax provided for in this article shall be levied in accordance with the following table:
>
> - between 12% and 15% of profits on the capital and reinvestments – 40%;
> - between 15% and 25% of profits – 50%;
> - above 25% of profits – 60%.
>
> § 2– Such supplementary income tax shall be withheld on the occasion of every remittance exceeding the 3-year average referred to in this article.

On the other hand, item 10 of Federal Revenue Ruling 77/78 sets forth that:

> Secondly, remittances shall be considered in their net amount, that is, the tax assessed under Art. 344 of RIR/75 being deducted. The basis for calculation, however, shall not exclude the amount of the supplementary income tax relative to the previous 3-year period, which, to facilitate collection, is deducted from the remittance itself.

A mere comparison of both texts shows that the inclusion of the supplementary income tax assessed in view of the excess remittance of the previous 3-year period in the basis for computation of the following 3-year period is set forth in a ruling and not in the law.

This interpretation of a legal provision by a ruling which expressly states that the supplementary income tax must be included in the taxable base makes one wonder whether such inclusion is implicitly prescribed by the law. Thus the question remains whether the ruling would, within the 3 principles mentioned above, merely be stating the meaning of the legislature, or whether it would introduce an additional obligation.[24]

This is exactly what we are going to discuss in this paper.

The legal text, first of all, does not contain *even a suggestion* that

> one shall not exclude the amount of the supplementary income tax relative to the previous 3-year period from the basis of computation.

What the text does contain is a different statement that the tax shall be deducted and withheld on the occasion of every remittance exceeding the 3-year average referred to in the article.

The FR Ruling and the law deal with 2 completely different matters: the ruling adds an amount corresponding to the tax deducted to the taxable basis which is represented by the remittances; and the law considers the withholding tax merely as a collection technique.

The theory expounded by the FR Ruling increasing the taxable base is nowhere to be found.

On the contrary, the law clearly provides that "the amount of profits and dividends effectively remitted" should be considered, which means the sums which have not *efficiently* been remitted, i.e. the sums which not *effectively* left the country and which have not *effectively* been received by the recipient, may not be used as basis of computation for the supplementary income tax.

In interpreting the law, words may not be carelessly used and thus misused. Every word has its own meaning and its sole and unique value, allowing for an exclusive interpretation.[25]

When the legislature states that only *effective* remittances are subject to the supplementary tax, it does not

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22. As to this matter, we have already expressed our opinion in a report published by the *Revista Legislação e Jurisprudência Fiscal (Estudos LJF* 6, June 1980) under the title "Natureza Jurídica do ICM".

23. Dejalma de Campos clearly states the need for the law to hold the complete set of requirements: "This principle has a double concept: it obliges the legislature to formulate taxation-legislative commands with a rigorous absolute provision; it obliges the enforcer of law to exclude subjectivism in the enforcement of the law, the legal or administrative creation of taxation law, and the prohibition of analogy and discretion" *(Caderno de Pesquisas Tributárias* 6, *Resenha Tributária,* p. 218-219.

24. Commenting on Arts. 108 and 111 of the National Taxation Code, A.J. Franco thinks it is possible to render explicit a presumably implicit norm whenever the result represents a tax increase *(Comentários ao Código Tributário Nacional,* vol. I, José Bushatsky, edited by Hamilton Dias de Souza, Henry Tilbery and Ives Gandra da Silva Martins, 1974, pp. 147-237).

25. Francisco Ferrara *(Interpretação e Aplicação das Leis,* 2nd edition, Coimbra, 1963, p. 129) states that worse than a literal interpretation of the literal legal text is a forced interpretation, adding to the legal text what one would like to have included, or eliminating what is not in accordance with one's own preferences.

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mean "*effective* remittances and those which are neither *effective* nor *remittances*". The placement of adjectives by the legislature can, if teleologically interpreted, very clearly only be understood to mean that the tax should be assessed solely on what *actually* leaves country.

This is so because the introduction of the supplementary income tax is aimed at preventing foreign currency to flow away which would result in the removal of resources which the country needs so much, and which, although legitimately acquired, are thus encouraged to remain in Brazil and discouraged to leave the country.

In such light, only the sums leaving the country are subject to the supplementary income tax, for the legislature has only focussed on this situation. And, to avoid any doubts, it added the adjective *effective* to the noun *remittance,* or, more precisely, it used an adverb in the drafting of the legal text, the expression "effectively remitted".

To accept the introduction of a provision not written in the law would mean considering the Federal Constitution, the National Taxation Code, all principles of taxation law and the ordinary law unneccessary, and to grant to the Revenue the right to introduce and increase taxes not based on any legal provision.

The principles analyzed aboved are quite clear on this matter. To accept the FR Ruling means that the supplementary income tax will be increased, which is a blatant breach of Art. 97, item II of the National Taxation Code, which states:

> Only the law may determine:
>
> . . .
>
> II. The increase in taxes or a reduction thereon, provisions of Arts. 21, 26, 39, 57, and 65 being observed;

Here, once more, the legislature resorted to the strength of an adverb to exclude delegation of legislative competence, as it states that *only* the law (which means that *solely* the law, *exclusively* the law, *nothing but* the law) may increase taxes.[26]

When Alberto Xavier defended a treatment for the supplementary income tax different from that of the regular tax, excluding the latter and including the former in the basis for computation, he did so because he differentiated between the legal nature of the taxes and equated the different collection techniques with the structure of the taxes, which, as we have demonstrated, are similar.

As they have the same legal nature, the supplementary income tax, like the regular income tax, cannot serve as a basis for computation, otherwise the legislature would expressly state so, which, as has sufficiently been demonstrated, it did not.

Recently, the famous professor, chairing a round table at the *Office of Legal Studies* on international investment together with the author of this paper and who at that event acted as the representative of the *Instituto dos Advogados de São Paulo,* examined the legal nature of the supplementary income tax and admitted the possibility of revising his previous position, as the vast majority of the participants was favorable to the position expressed by the author.

Widely covered by the press, the round table was held on 15 July 1981 at the head office of the *Instituto dos Advogados de São Paulo.* A summary of the debates was published by the newspaper *O Estado de São Paulo,* and a more detailed report by the newspaper "*Diário de Comércio e Indústria*".[27]

Not only a number of participants in the round table, but also many commentators reacted unfavorably to the interpretation of Professor Alberto Xavier.[28]

It is noteworthy that the FR Ruling itself, when it gives examples of the manner of calculation, has not considered the interpretation given by its item 10 and has

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26. In "O Princípio da Legalidade no Direito Tributário Brasileiro" *(Caderno de Pesquisas Tributárias* 6), we have written that: "In fact, in taxation law, it is only possible to study the principle of legality through an understanding that the formal provision in law is not sufficient for its characterization. The principle of the formal provision in law would allow for a certain discretionary power, which cannot be admitted either in criminal law or in taxation law."
As Sainz de Bujanda says in *Hacienda y Derecho* (Madrid, 1963, Vol. 3, p. 166): "the provisions in tax law may not be only formal, they must also be absolute. The law must contain not only the fundaments, the basis for the behavior of the enforcer, but also, and mainly, the very criterion for decisions in the concrete case. This requirement of a "lex scripta" peculiar to the formal provision in law, is added to that of "lex stricta", peculiar to the absolute provision" (pp. 336-337).

27. *O Estado de São Paulo,* p. 26, 25 July 1981.

28. Nilton Latorraca in *Legislação Tributária* (Atlas), p. 212: "Finally, there is another statement in FR Ruling CST 77/78 which goes against the legal norm. We refer to item 10, where it is said that the basis of computation shall not exclude the amount of the supplementary income tax relative to the previous 3-year period, which is deducted from the remittance. It so happens that the tax is not deducted from the remittance, but "debited to the account of the beneficiary abroad, to be deducted on occasion of subsequent remittances" (RIR, Art. 559 § 1). "Deducting on occasion of the remittances" means failing to remit. And as the supplementary tax is only assessed over amounts effectively remitted abroad (RIR, Art. 559), we do not see a way to calculate the tax over the same tax debited to the account of the beneficiary of the profit or dividend."
Hiromi Higuchi in *Imposto de Renda das Pessoas Jurídicas* (1981), p. 309: "FRR 77/78 item 10 states that remittances are considered at their net value, that is, the withholding tax is deducted under Art. 555 of RIR/80. The basis of computation, however, shall not exclude the amount of supplementary tax relative to the previous 3-year period which, for a mere simplification of collection procedures, is deducted from the remittance itself. We do not see the reason for which the supplementary tax is considered a profit or a dividend effectively remitted if, in fact, the amount of the tax is deducted from the profit or dividend to be remitted in the following 3-year period. The very legal provision leaves no doubts as it provides that the amount of net profits and dividends effectively remitted to individuals and legal entities residing or with head office abroad is subject to a supplementary income tax whenever the average remittances in a 3-year period exceed 12% of capital and reinvestments registered with the Central Bank of Brazil. The supplementary income tax has the purpose of controlling the outflow of foreign currency, that is why the law considers only those net profits and dividends effectively remitted."
Carlos Alberto Baroni, in "O Parecer Normativo 77/78 e o Imposto Suplementar de Renda. O que são Remessas líquidas?" *(Boletim de Estudos Jurídicos do Investimento Internacional* 2, p. 26, *Informações Objetivas – IOB e Gabinete de Estudos Jurídicos do Investimento Internacional:* "As to this aspect, however, we disagree with the interpretation given by the FRR, because it does not seem lawful to us to include the tax paid in the previous 3-year period in the basis of computation. Analyzing the above-mentioned Art. 43 of Law 4,311, we understand that the only possible interpretation is that the supplementary income tax relative to the previous period must be excluded from the basis of computation. Our opinion is based on the fact that the article says, "profits and dividends effectively remitted", and the supplementary income tax is not a remitted amount.
Our opinion is reinforced by items 35 and 41 of Regulatory Instruction SRF of 9/12/69.
"Item 35: Net profits or dividends *effectively remitted to individuals and legal entities residing or domiciled abroad . . .*"
As we can see, the two texts above expressly refer to "net profits or dividends effectively remitted". Thus it does not seem to us that the intention of the law was to include in this net amount the gross amount of the supplementary income tax".

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made its computation based on *remittances effected* and not with these remittances plus the supplementary income tax of the previous year, which clearly demonstrates the addition of item 10 represents a misinterpretation corrected in the example.

The adverb *effectively* eliminated any possibilities of creating *legal fictions,* which certainly cannot be accepted as an act of the very authority interested in the collection of the tax. Legal fictions can be created *solely by law.*[29]

As demonstrated above, it is our opinion that the supplementary income tax collected in the previous 3-year period may not be used to compute the taxable base for the supplementary income tax assessed in the following 3-year period, because this would represent a "bis in idem" (double taxation). Its manner of computation should follow the same system used for the regular income tax, for neither Law 4,131/62 nor Law 4,390/64 indicates otherwise.

V. MANNER OF COMPUTATION

The seond aspect under discussion relates to the computation of the 3-year period as, also in this matter, the Revenue has adopted a position disadvantageous to the taxpayer.

Although the legislature provided that remittances exceeding 12% per year of the average capital cause the supplementary income to become due, it is evident that, due to the fact that the computation is made over a 3-year period, the rate will necessarily be multiplied by 3, as the total assessed refers to 3 years.

It is interesting to note that this multiplication is acknowledged by the administrative authority itself in the "a contrario sensu" interpretation of the subtraction factors of those fiscal years in which remittance percentages were beyond the 12% mark, when it states, according to item 41 of Regulatory Instruction 2/69, that:

> Remittances of the 2 last years of the 3-year period shall be considered in the 2 first years of the following 3-year period pursuant to effectively remitted amounts, except when they have already been part of a 3-year period in which there was excessive remittance, and the respective tax has been paid, in which case they will be computed only on the value corresponding to 12% of the average capital of each of these years.

It is the Revenue which states that the subtraction shall be done

> in accordance with the value corresponding to 12% of the average capital of *each of these years* (our emphasis).

If one admits that each year must be considered separately and that the 3-year period must be split up in 3 separate years, the logical consequence of what is stated in the Regulatory Instruction is that one admits that 12% corresponds to one year, 24% to two, and 36% to three.

Therefore, when Art. 43 mentions 12% per year, it undoubtedly means each year of the 3-year period, that is, for the calculation of the 3-year period one could only mean the multiplication of the percentages by 3, under the risk of reducing the range applied to each rate of the tax.

If we take the example of FR Ruling 77/78 (see Appendix), we will see that the correct computation would be:

	Capital	*Ranges*	*Excess value in the range*	*Rate*	*Tax*
FRR computation:	1000	12 to 15%	30	40%	12
		15 to 25%	100	50%	50
		above 25%	230	60%	138
		TOTAL	360		200
Correct computation:	1000	36 to 45%	90	40%	36
	1000	45 to 75%	270	50%	135
	1000	–	–	–	–
		TOTAL	360		171

As one can observe, the tax assessed would be only 171 and not 200. And if one applied the formula to determine over what percentage the tax would have started in each year, one would see that:

$$171 \times 12\% = 200 \times X \text{ (or } X = 10.26\%)$$

which means that the tax would become due on remittances in excess of 10.26% of the capital per year, and not 12% per year or 36% per 3 years, as provided for in Art. 43.

Commentators unanimously agree that the 3-year computation cannot be done on a per year basis.[30]

29. On this issue, see Ruy Barbosa Nogueira's "Da interpretação e da aplição das leis tributárias" *(Revista dos Tribunais,* 1965), in which he always eliminates the intended flexibility of the regulation of the norm and lets the right of the weakest party prevail in the taxation relationship.

30. Hiromi Higuchi (note 28): "FRR 77/78, item 24, has in our opinion given an example of the computation of the supplementary tax with a wrong result. If the average capital were 1,000 and the excessive remittance 360, the supplementary income tax would be 171, 90 being computed at the 60% rate. The computation was incorrect because he did not consider the 3-year period. The 40% rate is assessed on the excess over 3% per year, therefore, in a 3-year period, such rate is computed over the amount exceeding 9% of the average capital."

Nilton Latorraca (note 28): "there is a basic mistake in this computation: it compares excess remittances of 3 years to ranges determined for annual remittances. However, as acknowledged in item 6 of the FRR, the assessment of the excess remittance is done on a yearly basis. Thus, the excess of 360 considered for the 2nd 3-year period was calculated in view of a 120 annual limit, computed on a capital of 1,000. Therefore, as is provided by the law, profits between 12% and 15% over capital and reinvestment are subject to the 40% rate, and so forth.

According to the legal system, we would then have an annual excess of 120, subject to a tax of 57:

Capital	*Ranges*	*Excess in the range*	*Rate*	*Tax*
1,000	12% to 15%	30	40%	12
	15% to 25%	90	50%	45
		120		57

Should the 120 excess correspond to the annual average, the tax would have been 57 throughout the 3 years, thus amounting to 171 (57 × 3), as computed in the FRR CST 77/78."

Alberto Xavier (note 16): "Second principle of full offsetting: Considering the 3-year character of the basis for computation, a logical corollary results in the *principle of offsetting* within the 3-year period, computation of the limits year after year not being necessary. But, on the other hand, from the unity of that basis, it follows that the principle can only be operated *within each period,* offsetting beyond the limits of the 3-year period not being possible. As the legislature assumed the 3-year period as a time measurement, it did not take into consideration the manner in which the corporate taxpayer organizes its distribution schedule within the period. It is sufficient within this 3-year period that remittances not exceed 36% of registered capital and re-investments".

Henry Tilbery, in "Aspectos Polêmicos de Imposto Suplementar de Renda"

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To adopt a different, odd, and incoherent criterion, trying to base the tax payable in a 3-year period on an annual computation is to thwart the logical application of the tax law. The interpretation adopted is not logical, it is not provided for in the law and it is more burdensome to the taxpayer and thus violates the principles of strict legality, of characterization, and of the provision in law. In addition, it violates another provision of a superior law, i.e. Art. 112 of the National Taxation Code:

> Taxation law defining offenses, or attributing penalties to offenses, shall be interpreted in a manner which is favorable to the defendant whenever there is a doubt as to:
> I–the legal classification of the fact;
> II–the nature or material circumstances of the fact, or the nature or extension of its effects;
> III–the authorship, imputability or punishability;
> IV–the nature of the applicable penalty or its grading.

The official interpretation seems to lead to the result that, whenever doubt arises, the interpretation adopted should penalize the taxpayer, which is absurd and cannot be admitted even for the sake of argument in view of the clear legislative intention.[31]

We feel that the fiscal authorities are incorrectly interpreting the law and that the 3-year computation should have the corresponding ranges, as indicated in the legal text, multiplied by 3, since the law requires such multiplication when it refers to the annual basis.

The official interpretation therefore, is illegal, because it considered a minimum percentage range inferior to 12% as taxable base. FR Ruling 77/78, in the example, started the supplementary assessment starting with remittances of 10.26% per year.

If the computation of a tax would result in a tax increase lacking any legal base, such computation is illegal, because any increase of taxes is the sole competence of the law.[32]

These are the most relevant legal aspects of the issue and those which we deem of interest to the readers of the *Bulletin,* which can be summarized as follows:

(a) inclusion of the supplementary income tax levied on the previous 3-year period as the basis for computation of this tax of the following 3-year period is incorrect;
(b) the percentage defining the range of assessment of this tax, in Art. 43, shall be multiplied by 3 because the computation of the tax payable encompasses a 3-year period, and one cannot consider the adopting of an annual criterion for the computation of the excess during a 3-year period.

(Resenha Tributária, secção 1.3, ano XII, p. 71): "Moreover, the full *offsetting possibility* between "excesses" and "remainders", *within the 3-year period,* is the key to the system, a principle which is uncontestedly and universally accepted, even though different opinions do exist as to other aspects of the issue. A "ratio legis", obviously, is to give a greater flexibility to the company, for instance allowing it not to remit dividends in 2 consecutive years in order to preserve the working capital, and effecting a bigger remittance only in the third year, of up to 36%."

Dalton Maranhão, in "O sistema de cálculo do Imposto Suplementar de Renda e o PN 77/78" *(Boletim dos Estudos Jurídicos do Investimento Internacional* 2, p. 33): "In addition, such system seems to lead to distorted values when it takes the excess (159,000) above the 36% of the average capital and reinvestments in order to submit it to taxes which start above excesses of 12%."

31. As we said in the beginning, "discouraging taxation" has some characteristics in common with "punitive taxation", so that Art. 112 must always be interpreted to the benefit of the taxpayer, as Aliomar Baleeiro wrote: "Using different words, as regards the penalties, the National Taxation Code said that the restrictive character of the Criminal Code is to be observed, resorting to analogy – except for isolated opinions. Here, too, the saying "in dubio pro reo" holds true. "Benigna amplianda", although it does not acknowledge an equation of fiscal laws to the "lege odiocese" as they were called by old authors" *(Taxation Law).*

32. Art. 97, item II of the National Taxation Code.

APPENDIX

FEDERAL REVENUE RULING CST NO. 77, 4 SEPTEMBER 1978

3.10.00.00 – Income of those residing or domiciled abroad
3.10.40.00 – Supplementary income tax

Supplementary Income Tax (Art. 43 of Law 4,131, of 3 September 1962):

Assessment. Make-up of the 3-year periods. Calculation of the excess remittances. Computation of the tax.
We are here examining issues relative to the supplementary income tax, involving a great part of its system. We shall analyze the different aspects separately for a better understanding of the problem.

Specific legislation

2. The supplementary income tax was introduced in its present form in Art. 1 of Law 4,390 of 29 August 1964, which modified Art. 43 of Law 4,131, of 3 September 1962, which is the basic legislation concerning capital invested in the country. (Law 4,131/62 was regulated by Decree 55,762, of 17 February 1965.)

3. According to Art. 43, which is the legal matrix of Art. 348 of the Income Tax Regulation approved by Decree 76,186, of 2 September 1975, net profits or dividends effectively remitted to individuals or legal entities residing or domiciled abroad are subject to a supplementary income tax when the average remittances in a 3-year period exceed twelve percent (12%) of the capital and reinvestments registered at the Central Bank of Brazil.

4. The Fiscal Administration has issued supplementary norms to Art. 43 of Law 4,131/62 through Regulatory Instruction SRF 2, of 12 September 1969, with the modifications introduced by Regulatory Instruction SRF 17, of 30 April 1971.

Time aspect

5. In the case of the supplementary income tax, the tax liability is a function of two independent variables (profits and dividend remittances, and capital and reinvestments) along a period of time: 3 years.

6. Although remittances made in a period of 3 years are taken as the basis of computation, the tax is assessed whenever the twelve percent (12%) limit is exceeded at the end of the 3-year period. Therefore, starting in the second 3-year period, calculation of the excess is made on a yearly basis, hence allowing for annual tax

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liabilities, not triennial, always based on the amount of remittances in the 3-year period.

7. Item 40 of Instruction no. 2/69 made it clear that, in accordance with the provisions of Art. 43 of Law 4,131/62, the 3-year period is made up of calendar years.

8. It is now worth clarifying the initial term to determine the 3-year period.

For investments prior to 1963, 1963 is the first year of the period. Later investments shall consider as the first year the year in which the application for registration of the initial investment was submitted.

Amounts computed for remittances

9. Supplementary income tax is assessed over excess remittances, therefore only those amounts effectively remitted abroad are computed, even if they correspond to proceeds earned in previous years.

10. Secondly, remittances are accounted for in their net amount, that is, the tax levied under Art. 344 of RIR/75 being deducted. However, the basis for calculation shall not exclude the amount of supplementary tax relative to the previous 3-year period, which, to facilitate collection, is deducted from the remittance itself.

11. Finally, in accordance with provisions contained in item 36 of Regulatory Instruction SRF 2/69, for the purpose of assessment of the supplementary income tax, expenses which are not deductible in the calculation of real profit of a legal entity with head office in the country are considered profits.

Amounts attributed to capital

12. In accordance with the provisions of Art. 43 of Law no. 4,131/62, amounts transferred for capital and reinvestment are those registered at the Central Bank of Brazil.

However, computation of pending amounts "ex vi" item 39 of Regulatory Instruction SRF no. 2/69 are admitted.

13. In the calculation of the average capital, capital and capitalized profits shall be computed proportionately to the time in which they remained in the company during the 3-year period (item 38 of R.I. 2/69).

14. Thus, invested amounts shall be weighed as a function of the time they were present in the company, in conformity with the following formula:

$$\text{average } K = \frac{K_0 \times t_0 + K_1 \times t_1 + K_2 \times t_2 \ldots K_n \times t_n}{T}$$

Where: K = capital (investments and reinvestments)
t = number of days the capital was present
T = number of days in the 3-year period

Verification of the occurrence of excess

15. As we have seen above, the excess subject to taxation is calculated on a yearly basis after completion of the first 3-year period, which means that the 2 last years of a period will be the 2 first years of the succeeding period.

16. We shall now examine the point on which doubts existed, that is, which amounts are to be considered as remittances in the transfer from one 3-year period to the following. The specific question concerns the possibility of offsetting remainders observed in a 3-year period (the amount under 12%) with excess remittances in the following period.

17. In accordance with item 41 of Regulatory Instruction SRF 2/69, as modified by Regulatory Instruction 17/71, remittances of the 2 last years of a 3-year period are considered in the 2 first years of the following 3-year period:
(a) for the amounts effectively remitted, and
(b) for amounts corresponding to twelve percent (12%) of the average capital of each of such years whenever they are part of a 3-year period in which there was an excess.

18. The supplementary norm did not move away from the provisions of Law 4,131/62 when it set forth the criterion for the make-up of the 3-year period, because the latter, in Art. 43, determines that the computation of any excess be made with respect to the 3-year period, therefore the amount remitted in each year is not important, the excess of a year being offsettable against the remainder of any other year of the same period.

19. But, if offsetting is allowed among the years of a given period, the same reasoning does not apply to the transfer to the following period, since the law itself established that the calculation on the excess is limited to the excess occurred within each 3-year period. Thus, as a rule, amounts transferred are those effectively transferred.

20. Except for those situations in which there was an excess in the preceding period, amounts transferred shall be those corresponding to twelve percent (12%) of the average capital of each of the last 2 years of the period and one should not compute excess remittances already subjective to tax. In this manner, one avoids assessing the supplementary tax with respect to the same fact more than once.

21. For a better understanding we give an example in which capital is considered as not having changed, in the amount of 1,000 units, for the period 1970 to 1974:

Three-year period	Years	Capital (investments and reinvestments)	Effective remittances	Permitted remittances	Excess	Remainder	Supplementary tax
	1970	1,000	0				
1.	1971	1,000	120	120	–	120	
	1972	1,000	240	120	–	–	
			360	120	120	–	
	1971	1,000	120	360	120	120	none
2.	1972	1,000	240	120	–	–	
	1973	1,000	360	120	120	–	
			720	120	240	–	there is
	1972	1,000	120	360	360		s/360
3.	1973	1,000	120	120	–	–	
	1974	1,000	100	120	–	–	
			340	120	–	20	
				360		20	none

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Computation of the tax

22. The supplementary income tax is a progressive tax. The excess remittances in a 3-year period are divided into parts to which the rates are attributed.

23. Total tax payable is a result of the aggregation of the amounts obtained through the application of the rates to each of the parts, according to the table below:

Rates	Excess remittances
40%	between 12 and 15%
50%	between 15 and 25%
60%	above 25%

24. Hence, in the example above, an excess of 360 (2nd 3-year period), which is therefore in excess of 25% of the average capital (1000), the supplementary tax shall not be that resulting from the mere application of the 60% rate on such amount, which would result in a tax of 216, but 200:

Capital	Ranges	Amount of excess in the range	Rate	Tax
1000	12 to 15%	30	40%	12
	15 to 25%	100	50%	50
	above 25%	230	60%	138
	TOTAL	360		200

25. Finally, in accordance with provisions of item 42 of Regulatory Instruction SRF 2/69, as modified by Regulatory Instruction SRF 17/71, the tax shall be assessed within 30 days of the end of the 3-year period to which it corresponds in order to be deducted in later remittances.

Conference Diary

OCTOBER 1982

Management Centre Europe: International Tax Management (including: Inter-company pricing of goods; inter-company licensing; service fees; inter-company loans; handling of disputes between tax administrations) (Seminar). Nice (France), October 11-12 (English).

Steuer-Telex-Seminar: Hidden profit distribution in practice. Munich (German Federal Republic), October 30 (German).

NOVEMBER 1982

Management Centre Europe: 11th International Finance Conference: Changes in international finance and their implications for business (including: Financial and tax incentives aimed at attracting investments). Geneva (Switzerland), November 3-5 (English).

Management Centre Europe: Leasing; techniques and analyses (including: Tax aspects of leasing). Brussels (Belgium), November 17-19 (English).

DECEMBER 1982

Management Centre Europe: Taxation of International Group Companies and Branches (including: Taxation of branches and subsidiaries; taxation of shareholders; domestic and tax treaty "anti-avoidance" measures) (Seminar). Brussels (Belgium), December 2-3 (English).

Management Centre Europe: International cash management (including: International tax aspects in cash management). London (United Kingdom), December 6-8 (English).

Management Centre Europe: Stanley B. Lubman on China (including: The joint venture income tax law; the tax on individual income; the tax on foreign enterprises; recent regulations and interpretations by central and local tax authorities). Brussels (Belgium), December 9-10 (English).

OCTOBER 1983

37th Annual Congress of I.F.A.: I. Tax avoidance/tax evasion. II. International problems in the field of turnover taxation. Venice (Italy), October 10-15 (English, French, German, Spanish).

FOR FURTHER INFORMATION PLEASE WRITE TO:

Confédération Fiscale Européenne (C.F.E.): Secrétariat Général, Postfach 1340, Dechenstrasse 14, D-5300 Bonn 1 (Federal Republic of Germany).

International Fiscal Association (I.F.A.): General Secretariat, Woudenstein, Burgemeester Oudlaan 50, P.O. Box 1738, 3000 DR Rotterdam (the Netherlands).

Management Centre Europe: Avenue des Arts 4, B-1040 Brussels, Belgium.

Steuer-Telex-Seminar: Dr. Peter Deubner Verlag GmbH, Abteilung Seminare. Postfach 410268. 5000 Köln 41, Federal Republic of Germany.

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BERMUDA:

Fiscal Structure of a Low Tax Country

by H.W.T. Pepper

An island of 21.5 square miles, 600 miles from the nearest land, Bermuda, with a population of about 54,000, has limited natural resources, but does a rather splendid job of maintaining itself without calling for aid from industrial countries. Bermuda has fine harbours and some useful types of limestone or coralline bed-rock which can be used for building and roofing material. The islands have a pleasant climate, full employment, and excellent personal relations within a mixed population of about 60% black and 40% white residents.

Tourism is the main industry, but Bermuda also functions as a highly respectable financial centre, specialising in international insurance and in financial trusts. Apart from ship and boat repairing there is a perfume factory and medical services are provided for sick persons on passing vessels who can be brought in by helicopter. There is a U.S. air and naval base and the personnel help to maintain the airport.

The Bermudan dollar is maintained on a par with the U.S. dollar - both currencies circulate freely within the country.

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Budget

The country's Budget has been kept in surplus for each of the past 5 years, no mean feat when world tourism has been hit by fast rising fuel costs and air fares over the past few years. Bermuda has, in fact, no doubt because of the excellence of the service provided, managed to maintain healthy levels of tourist visits.

Fiscal "shape"

It used to be conventional wisdom that a country's fiscal structure should be roughly equally divided between direct and indirect taxation. Direct taxes would not normally burden the low income groups who would usually be within the exemption limits. Indirect taxes were practical because they were easier to collect, if levied at import or factory-gate level, and automatically covered a wider tax base while the regressive effects could be mitigated by not taxing food and by applying the higher rates of tax to luxuries.

Bermuda, as a country with no taxes on corporate or personal income and none on capital gains, nevertheless does manage to come near the old guidelines, by drawing a relatively high proportion of revenue from direct taxation, including some fairly moderate levies which fall on the tourist rather than on local wage-earners.

About 45% of revenue comes from customs duties, and wharfage charges at seaports and airport could be classified along with those duties. The remainder comes from a series of levies, including payroll taxes and stamp duties and from profits made from public services such as postal and transport services, so that the fiscal structure may be reasonably regarded as well-balanced.

The fact that the Budget has been in surplus for the last 5 years and that there is no national debt is also a tribute to the island's fiscal policies which, besides being well-balanced , display a measure of ingenuity and are efficiently administered.

Exemption guarantee: income taxes

In a low tax country, newcomers may fear that at some future date income taxes may be introduced. An exempted company may, however, apply to the relevant Government ministry, for an undertaking that in the (unlikely) event that corporation tax, dividend tax etc. might at some future date be imposed, the company will remain specifically exempted therefrom up to the year 2006.

Exchange control

Virtually all exempted companies are designated by the Bermuda Foreign Exchange Control Authority as "non-resident" for exchange control purposes.

Banks and insurance companies are exempt from Exchange Control which, however, applies to residents of Bermuda who pay a 10% levy for their foreign investments.

The levy also applies to interest on overseas loans taken out to finance foreign investment, and, of course, to the repayment of those loans.

Interest rates

Maintenance of exchange control makes it possible for interest rates to be kept low. The maximum bank lending rate is 7% although up to 2% may be added as a service

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charge. The maximum interest rate allowed to depositors is also 7%.

Customs duties

Although producing 45% of revenue, customs duties are not unduly heavy. Duties are levied not on c.i.f. but on an f.o.b. basis. This has a healthy effect on keeping prices of imports competitive because the weight of duty would be the same on goods originating from halfway around the world in Hongkong, South Korea, Japan, etc., and those coming from the eastern seabord of the U.S.A. The standard rate of customs duty is 22% but some luxuries, e.g. boats, television sets, motor cars, bear duty at 33% ad valorem. Food is imported duty free and there are no internal commodity or sales taxes. See also "Budget changes" below.

Wharfage fees

There are, however, minor taxes on commodities in the form of wharfage fees charged at 1% ad valorem on goods imported by sea. The revenue yield goes to the Hamilton Corporation (Local Authority). A similar 1% charge is levied upon goods imported by air, the yield from which is shared by the Corporation of St. George, and the Central Government. Under the Agreement regarding the American naval and helicopter base, the cost of maintaining the airport and runways is undertaken by the Americans.

Charges on services

There are taxes on services referred to in the notes on Hotel Occupancy Tax and the Tax on Condominiums and Time-Shared Properties. Other charges are referred to under Social Security. The fact that the Post Office and Government transport services (buses and ferries) make moderate profits amounts to a form of levy on the users which comes in on the revenue side of the Budget. Of course, it is essential that the services should show a surplus so that adequate provision may be made for replacement of equipment to maintain the services efficiently.

Hotel occupancy tax

A tax of 5% on room charges is levied and there is a parallel charge in the case of certain types of letting of apartments. (See Condominiums, Time Sharing.) The tax is not levied on the precise charge for the room occupied but on a standard value known as a "rack rate".

Condominiums and time-sharing tax – services tax

There is a 10% tax, payable to the Ministry of Home Affairs on the cost of buying a condominium. The 10% rate also applies to the cost of buying a "Time-Sharing" interest in a property.

Where the owners of a condominium or of a Time-Share of a property pay fees for maintenance and other services, or "club dues" as they are sometimes called, a 5% tax applies, similar in a way to the Hotel Occupancy Tax.

Time-Sharing schemes do offer scope for possible sharp practice by the sponsors, but in Bermuda all money collected must go into escrow and a Trust Fund must be set up to protect the interests of the investors.

Transportation taxes

Vehicle licenses are payable annually and charged within the following ranges.

Motor cars

The fee varies from $80 to $240 according to the length of the vehicle.

Commercial vehicles

The fees vary from $160 to $1200

Motor cycles and motorised bicycles

The fees vary from $8 to $40. The maximum engine capacity permitted is 100 c.c.

Other charges related to transportation are referred to under Passenger Terminal fees.

Passenger terminals

A departure tax of $5 is charged on outgoing air passengers to cover administrative expenses at the airport. There is no charge on incoming or transit passengers, nor on children under 2 years old. A fee of $10[1] is charged on outgoing passengers at maritime passenger terminals.

Employment tax

Employment tax, basically a 5% payroll tax, has a similar tax base to Hospital Levy (see below), except that fringe benefits are included. The tax also applies to the self-employed on the same basis as for the Hospital Levy.

Exemptions and abatements

Small businesses, i.e. where payroll is less than $36,000 per annum, are exempt from the tax. Where payroll does not exceed $100,000 per annum, an abatement in the form of a deduction of $1,000 per month is made.

Complete exemption is accorded to international companies, registered charities, and public bodies, as well as to certain individual entrepreneurs, e.g. farmers, taxi-drivers, and commercial fishermen.

Abated tax rate

The 5% rate is abated to 2% for hotels and restaurants and for hotels the rate is reduced to zero for the low season of tourism, viz. the 3 months of December, January, and February.

Social security

Hospital Insurance is compulsory and is administered by the Hospital Insurance Commission. The full cost of hospital treatment for children up to 16 years of age, and 80% of the cost to persons over 65 years of age is paid by the Government which imposes a Hospital Levy (see below) to produce the required funds.

Social Security can be a troublesome, open-ended commitment which can create havoc with Budgets. It has done so, for example, in Britain, Holland and the U.S.A. so that using commercial financial institutions to

1. To be increased to 20% from 1 April 1983.

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provide the bulk of medical services through contributions by the beneficiaries makes excellent fiscal sense. The system also creates a stronger feeling of self-reliance among the public. Once taxpayers are led to expect all things to be provided by Governments, the appetite for aid quickly grows, Budget imbalance increases and public morale falls, processes which the Thatcher and Reagan Governments in Britain and the U.S.A. are presently trying to reverse.

Hospital Levy

This is a levy at 3% on all employers' payrolls.

The employers may collect 1½% from their employees. Gratuities, an important source of income for hotel employees, do not enter in the calculation. Taxable fringe benefits do not include payments by the employer for employees' health insurance, pensions and life assurance.

The tax is payable also by international companies, but on a notional basis, i.e. the pay of their employees in Bermuda is estimated at $21,000 per annum for tax purposes. The employer has the right to collect 1½% of the tax from the employee but only up to the limit of his actual pay should this fall short of the notional $21,000.

Self-employed

The self-employed are also taxable, on a figure equivalent to their own earned income from their business or profession. The gross income from a business or profession will normally include substantial elements relevant to the provision of premises, equipment, etc., whereas the hospital levy is intended to relate only to what the self-employed might receive for his services if all else were provided by others.

Abated rate

(a) Government, parishes, churches and charities are liable only at the rate of 1½% of payroll. Again the tax may be deducted from the employees' pay.
(b) For other employers where the payroll is less than $36,0000 the tax rate is reduced from 3% to 2%.

Payment

Tax is payable quarterly, within 15 days of the end of March, June, September, and December. If an employer did not deduct the tax when paying his employees' remuneration he must still pay the tax in full but has no legal right to make retrospective deductions from the employees.

The tax is collected jointly with Employment Tax (see above) and both levies are entered on a single form.

Land tax

Land tax is charged on improved values of land which is developed for houses, apartments, commercial or industrial businesses or used for quarries or as storage areas. Agricultural land is exempted. The yield is intended to help pay for services relating to health, education, police and for fire and ambulance services.

Revaluations are made quinquennially and tax is charged as a percentage of annual rental value (ARV).

Exemptions

(a) Properties owned by the Crown, local government, charities, schools, and by foreign governments, e.g. Embassies, are not taxed.
(b) Persons aged 65 or more who own and occupy property with an ARV of $6,300 or less are exempted from land tax.
(c) In cases of financial hardship, abatement or exemption may be granted by the Accountant General.
(d) Property incapable of occupation, e.g. premises severely damaged, which require renovation or substantial repair may qualify for relief from tax for the period when occupation is not possible.

Basis of valuation

The ARV is based on the fair rental per annum which a reasonable owner might expect from a reasonable tenant from the property in an unfurnished condition. No form of abatement is allowed for property which is in a bad state of repair – on the other hand no extra tax is charged on property which is exceptionally well maintained.

Rent control applies to residential units with an ARV of $7,500 or less and this is taken account of for land tax purposes.

In practice property tax assessable values are about 2/3 of the gross current rentals charged.

Dates of payment

The tax is payable half yearly but if property is mortgaged to a financial institution tax is usually collected by the institution on a monthly basis along with the mortgage repayment and interest.

As a device to assist with land tax collection, a person who wishes to register a motor car must, when applying, quote the street name and house number or valuation number of his residence.

Rates of tax

Properties with ARV's from $240 to $2,220 pay tax at 3% and the rates graduate to a maximum of 20%. These graduated rates apply to residential property and *a rebate of 5%* is deducted from the gross tax computed at those rates, where payment is made promptly.

Commercial and Industrial properties are taxed at a flat rate of 6.25% of the ARV.

Transfer taxes

Transfer taxes in the form of stamp duties are payable on
(a) the sale or transfer of real estate at ½% on the first $50,000 and 1% on the excess;
(b) transfers at death are taxed by a stamp duty on the total value of the estate at a rate of 3% on the first $100,000 and 5% on the remainder; and
(c) transfers inter vivos are taxable at ¼%.

2. There is a 10% levy on the Transfer of ownership of real estate by non-Bermudians.
3. Investments overseas by Bermuda residents are taxed under Exchange Control provisions at 10%. The same levy is charged on repayments of foreign currency loans and on investments in foreign currency.

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Stamp duties

Apart from the stamp duties referred to under Transfer Taxes, there are also minor duties on certain financial transactions and most legal documents.

0.2% stamp duty is charged on the nominal value of any mortgage, bond, or debenture issued by a company, and 0.25% is charged on the authorized capital (and additions thereto) of Exempted Companies (see Company Registration Fees, below).

Company registration fees

Companies in Bermuda are divided into 3 categories –

(a) *Exempted companies* are those incorporated in Bermuda, but exempted from the requirement to register the nationalities of their shareholders, and which operate *outside* Bermuda from a principal place of business *in* Bermuda.

The minimum capital for an exempted company is $12,000. In the case of an insurance company the minimum is $120,000 fully-paid-up.

An exempted company cannot acquire a mortgage on land in Bermuda nor any bonds or debentures secured on Bermuda lands. Such a company cannot carry on trade or business in Bermuda either directly or by acquiring an interest in any other concern trading in Bermuda. There are, however, no restrictions on its trading outside the country.

(b) *Local companies* are those which may trade or do business *in* Bermuda. Such companies must have at least 60% of their shares and voting rights in the hands of Bermudians.

(c) *Non-resident companies* are those incorporated outside Bermuda and which operate *outside* Bermuda from a principal place of business *in* Bermuda.

Initial registration fees

Local companies, and *exempted* companies are registered in Bermuda and are subject to initial registration fees (in the form of stamp duties) of 0.25% on authorised capital.

For *non-resident companies* the initial fees are $2,250 for –

(i) Insurance (excluding management and brokerage);
(ii) Mutual funds;
(iii) Finance business; and
(iv) Management of Unit Trust Scheme (the fee is payable for each separate scheme).

The same fee is charged as an *annual* charge (see also below), sometimes referred to as "franchise fees". A fee of $1,200 (initial and annual) applies to the following types of activity. Both levels of fee are being increased by the 1982 Budget.

(v) Insurance management and brokerage;
(vi) Other types of business.

Annual fees

Local companies. The annual fees for local companies were increased by the 1982 Budget to a range of $500 to $5,000 p.a. according to the amount of authorised capital.

The annual fees payable by companies licensed to operate under various Acts, such as the Banks Act of 1969 and the Deposit Companies Act of 1974 are also being increased by the new Budget.

Business fees are payable annually to the Registrar of Companies not only for the different types of business carried on by companies, but also for the work of professional *personnel employed in certain activities.* The following fees, which are being increased by the 1982 Budget, applied at the beginning of 1982 –

Insurance manager	$500
Insurance broker	$500
Insurance agent	$500
Insurance salesman	$ 25
Real estate agent	$100
Real estate salesman	$ 10

Betting tax

There is a 20% levy on off-course betting stake-money, and also on football pools stake-money.

International futures exchange tax

A tax, announced in the 1982-83 Budget, is to be imposed on the revenue from futures transactions, but the transactions will be exempt from stamp duties.

1982-83 Budget changes

Broadening the tax base

Some of the measures announced in the 1982-83 Budget are designed to broaden the tax base rather than raise the level of taxation on the existing base. It is intended to extend the *Employment tax* to employees of international companies, at present exempt, and also to extend the *Hospital Levy* to that section of the emoluments of hotel and restaurant employees which comes from mandatory service charges on customers. Both steps are logical ways of making the coverage of the two levies more comprehensive. A new source of revenue will be the charges on international futures transactions mentioned above.

Indexing of existing levies

A number of levies in Bermuda have remained unchanged for some years, and the present Budget is designed partly to do a little catching up, in the case of *vehicle licences* only to the modest degree of a 10% increase, from which small cars will be exempt.

In the case of *land tax,* the revaluation will bring in new values for assessment which will only have the general effect of increasing the tax level by about 15% from 1 January 1983.

Annual company etc. fees are also overdue for increases and the Budget Speech which appears in this edition outlines the general pattern of increase.

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Customs duties

Duties on imported materials used in the manufacture of gases, and shades and awnings are to be exempted, and the exemption is also to be extended to spare parts for agricultural equipment and certain marine navigation equipment.

A switch to ad valorem duties on fuel oils is to be made – the timing is appropriate because the price of such fuels is at present very stable, but when prices rise the tax will rise in parallel. The new rates will be slightly higher on gasolene and diesel oil, but a 50% decrease is being made in the duty on cooking oil and smaller decreases in the duties on kerosene and fuel oil as a sort of social benefit.

BERMUDA:

Budget 1982-83

Extracts from the Budget Speech pronounced by the Honourable J.D. Gibbons, J.P., M.P., Minister of Finance, on 26 February 1982.

To summarise, Mr. Speaker, the Current Account Estimates contain provision for expenditure of $ 139.7 million and the Capital Account Estimates of $15.2 million. The latter sum provides for $ 12.3 million in respect of development projects, both continuation and new, and $ 2.9 million in respect of Capital Acquisitions. Altogether, this brings the total expenditure budget for 1982/83 to just under $ 154.9 million.

Although staff costs, the grant to the hospitals and many other items of current expenditure will be significantly higher in 1982/83, payments on the public debt will be limited to interest and service charges on temporary bank borrowing at a saving of $ 4.6 million, and capital expenditure is also predicted to be $ 0.7 million below expected outlays in 1981/82. This makes the task of balancing the budget somewhat easier than might first have been thought. Some increases in taxation are necessary but not on the scale announced on this occasion last year.

Local company annual taxes have remained unchanged since 1964 and an adjustment is long overdue. An increase which reflected the decline in the value of money over that time would result in at least a trebling of current rates. However, in recognition of the burden imposed on companies from other forms of taxation, fees will be raised to slightly more than twice their current level. Currently the annual tax ranges from $ 240 to $ 1,200 depending on the capitalisation of the company. The new rates will range from $ 500 to $ 2,500 for companies with a capitalisation of less than $ 1 million. For companies with a capitalisation of $ 1 million or more the annual tax will be $ 5,000. The increase in revenue from this source will be around $ 450,000. In addition, licence fees for banks, deposit companies and companies licensed under the 1969 Companies Act will also be increased. The annual licence fee for banks will be increased from $ 7,500 to $ 25,000. For deposit companies the licences issued to companies under the 1969 Companies Act will increase from $ 240 to $ 1,000. Licence fees for real estate agents and salesmen will also be raised. These changes will provide an additional $ 135,000.

An increase in Motor Vehicle Taxes, of about 10%, will take effect from 1 May 1982. However, in order to encourage the use of small cars, the tax on the smallest two classes of private cars will remain unchanged. The rise is expected to yield an additional $ 450,000.

Revised assessments of annual rental values will be in force by 1 January 1983. I intend to bring proposals to this House which will revise the progressive rate schedule so as to yield an additional $ 1 million in a full year, equivalent to about 15% of the current annual yield. Honourable members will wish to note that this increase only partially restores the real value of receipts from this source which have fallen by over one third during the past five years. As I stated earlier, additional revenue is required to finance Government's commitment to provide adequate mortgage money at a reasonable cost to borrowers. It seems only fair that those who have benefited from the low domestic interest rate over the years, and whose land tax bill has largely remained unaltered despite inflation, should be asked to contribute to the resolution of our housing problem.

A number of changes will be made to the Customs Tariff Act. Although their overall effect on revenue will be small, the most significant changes will be made in duties on petroleum products. As I told the House last year, I intend to replace the existing specific rates of duty on bulk fuels with ad valorem duties. The change to ad valorem will also involve a restructuring of existing rates. As a result there will be a 2c per litre increase in the price of gasolene, BELCO fuels, and oil for ships bunkers. Prices of kerosene and fuel oil will, however, fall marginally. Although these changes will, overall, provide a small net increase in revenue, most of this will be offset by a halving of the current 20% duty on cooking gas.

As has been pointed out by the Energy Conservation Committee, cooking gas has up to now been taxed relatively heavily in comparison to competing fuels, once account is taken of its higher thermal efficiency. The reduction in duty will rectify this anomaly. The above

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changes will take effect with the passing of legislation to be introduced during the budget debate.

Tariff concessions will be given for some of the raw materials used in the local manufacture of gases, and of shades and awnings. The range of aids to the disabled or chronically ill eligible for exemption from duty will be brought up to date. An exemption will also be provided for parts of agricultural equipment and certain marine navigational aids. A drawback of most of the dutiable content of fine artwork sold abroad after exhibition will also be introduced. Several amendments of a technical nature will be proposed including clarification of the tariff treatment of dressmaking patterns and a recasting of the present tariff item dealing with the importation of boats.

There will be a further change in the treatment of export liquor packages. Following the decision by U.S. Customs to switch to metric allowances for their returning tourists, provision will be made for 2 litre and 4 litre packages replacing the current standard U.S. gallon package with duty rate of $ 1.00 and $ 1.50 per package respectively. The provisions for storage charges for packages at the Queen's Warehouse at the Airport will be revised to reflect the new metric sizes.

A tax on the trading revenue of the new International Financial Futures Exchange will be instituted. The tax will yield at least $ 100,000 in the first full year of the Exchange's operations due to commence in July. Revenue in later years will depend on the volume of transactions conducted on the Exchange. Transactions on the Exchange will, however, be exempted from Stamp Duty and a bill including the relevant amendment together with several other changes, including a higher level of relief on house purchase, will be introduced shortly.

Taxes associated with timesharing developments also figure prominently in the estimates for the coming fiscal year. Timesharing Occupancy Tax, which is levied on the sale or resale of a timesharing interval, is expected to bring in a further $ 2.1 million. However, receipts in future years will be on a much smaller scale. Timesharing Services Tax, which is levied on the service charge paid by owners of intervals, is expected to yield $ 25,000 in 1982/83.

As the House is aware, Departure tax for cruise ship passengers is to be raised to $ 15 for the coming season. The resulting additional revenue will be of the order of $ 585.000.

Rental charges for postal boxes which were last fixed in 1973 will be substantially increased providing an additional revenue of $ 60,000 per annum.

Preliminary discussions have been held with some representatives of international companies regarding their privileged position in respect of employment tax. It is widely recognized that their exemption from this tax is anomalous and distorts the labour markets, in some cases placing local firms at a disadvantage. Consideration will be given to proposals later in the year which will have the effect of taxing the notional payroll of international companies at an equivalent rate to that currently applied to the payrolls of local companies.

Government's plans to apply Hospital Levy to gratuities paid to hotel and restaurant workers, where these are paid out of a mandatory service charge collected by the employer, are being pursued with the Union and I am hopeful that a solution can be found.

Mr. Speaker, against a background of an assured expansion of economic activity it is relatively easy to budget for a growth in the real level or government expenditure with the confidence that revenue will be sufficient for us to pay our way. However, following a year when real GDP has probably declined, renewed growth in 1982/83 is by no means certain. We have had to trim our expectations to meet economic reality while at the same time concentrating our efforts in those areas, especially housing, where action is required. I am confident that the proposals I have set before you represent a sound financial strategy for the year ahead. However, I trust that the House has a full appreciation of the uncertain times before us and is under no illusion as to the dangers of failing to resolve our differences, particularly in the area of labour relations. Our future prosperity depends on the mutual support of all members of our community. On this cautionary note, Mr. Speaker, I respectfully submit the budget for 1982/83.

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Tax Policy in Middle-Income Countries: Some Lessons of Experience*

by Vito Tanzi**

I. CHARACTERISTICS OF MIDDLE-INCOME COUNTRIES

Many studies have dealt with the tax systems of groups of countries with common characteristics (Hinrichs; Musgrave; Tanzi, 1970 and 1981; Messere); however, they have concentrated either on "poor" countries, alternatively referred to as developing or less developed, or on "developed" or "industrialized" countries, often belonging to groups such as the Organisation for Economic Co-operation and Development (OECD) and the European Economic Community (EEC), or, at times, on countries belonging to the same geographical area. To my knowledge there has been no specific analysis of countries that may no longer be properly called poor but that at the same time may not yet be considered fully developed or industrialized.

Different criteria could be followed in defining these in-between countries. One possibility would be to follow the *World Development Report* of 1980, prepared by the staff of the World Bank. That report defines middle-income countries (MICs) as those which, in 1978, had per capita gross national product ranging from US$390 (for Egypt and Ghana) to US$3,500 (for Israel). According to this criterion, 52 countries can be classified as being MICs. I feel somewhat uncomfortable with this particular definition, as it covers an income range that is much too wide and includes countries that are just too different to be in the same group. Just how broad is the *World Development Report's* definition of an MIC can be seen from the following observation. It covers a group in which the per capita income of the richest country is almost ten times that of the poorest country. By contrast, in the same report the per capita income of the richest country in the group of "low-income" countries is only about four times that of the poorest. The same relative range separates the richest from the poorest of the "industrialized" countries.

The *World Development Report* breaks the group of the MICs into three subgroups: (a) semi-industrialized, (b) mineral economies, and (c) predominantly agricultural economies. In this paper I shall concentrate on those MICs with per capita gross national product (GNP) ranging from US$1,000 to US$3,500 in 1978. This group includes the 24 countries shown in Table 1. Most of these countries are semi-industrialized. Ten of them are from the Western Hemisphere.

Before discussing the tax systems of these countries, it is perhaps useful to outline, briefly, the broad changes that take place in the economic structure of countries when they move from lower-income groups to that of the MICs as defined in this paper (see Chenery and Syrquin; Chenery 1979). On the production side, the share of primary production falls sharply while that of industry (especially manufacturing and utilities) and services rises equally sharply. As we shall see later, this change has important implications for the kind of tax structure that becomes feasible in these countries. The change is also accompanied by some increase in the ratio of imports to GNP, and by increases in exports coming mainly from the manufacturing sector. The allocation of labor also changes although much less dramatically than that of production: the proportion of labor in industry rises while that in the primary sector falls. This change brings into the open the underutilization of labor that may exist in the

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countries and creates pressures on the governments to pursue employment-creation policies. Life expectancy increases significantly and comes close to that of the industrialized countries. This change has obvious implications for social security programs and for payroll taxes. These countries are also much more urbanized than lower-income countries. This factor creates more opportunities for taxation but also more demands for public services, as urban dwellers consume much more of these. Besides the changes outlined above there are three aspects that distinguish the MICs from either lower-income or higher-income countries. These three aspects have important implications for their tax systems.

First, as a group, these countries have experienced much higher rates of growth than other groups *(World Development Report, 1980)*. For the 1960-78 period, their average per capita annual growth rate was 4.0%. Eight of the 24 countries included in this group had per capita annual growth rates over that period of more than 5%. By contrast, the group of countries with per capita income of less than US$390 had an average growth rate of only 1.6; the countries with per capita income ranging from US$390 to US$1,000 experienced a rate of growth of only 2.6; and the industrialized countries had a rate of growth of 3.7. To the extent that these growth rates reflect governmental policies or objectives, there are obvious implications for their tax systems.

Second, these countries have experienced much higher rates of inflation than the other groups. For the 1970-78 period, the group's annual rate of inflation was over 30%, although this average was somewhat distorted by the extreme experiences of Chile, Argentina, and Uruguay. Most of the MICs expierenced annual rates of inflation of more than 10%. When inflation becomes such a serious problem, it can no longer be ignored by the tax authorities. Unless adjustments are made to the tax system, it will end up being distorted to such an extent that it would bear little resemblance to the system that the authorities had originally intended to have.

The third aspect relates to the distribution of income. Several studies have shown that the distribution of income follows a kind of U-shaped curve, as the proportion of national income received by the poorer sectors of the population decreases at first as the level of income rises. It then reaches the bottom of the curve and starts rising again to reach the level common to the industrialized countries (Kuznets; Ahluwalia).

> *As national income rises from the lowest observed level to that of middle-income countries, the share received by the poor [lower 60%] declines on average from 32% to 23% of the total. In a hypothetical country following this average relationship, 80% of the increase in income would go to the top 40% of recipients.* (Chenery, 1980, p. 28)

According to Chenery, the most uneven income distribution is reached at a level of per capita GNP (at 1978 prices) of around US$1,500. After that the income distribution starts improving, first slowly, then more significantly.

Table I – Basic indicators for middle-income countries

	Population (millions)	Area (Thousands of square kilometers)	GNP per capita		Average annual rate of inflation (%)		Adult Literacy rate (%)	Life expectancy at birth (years)	Average index of food production per capita (1969-71 = 100)
			U.S. dollars	Average annual growth (per cent)					
	mid-1978		1978	1960-78	1960-70	1970-78	1975	1978	1976-78
Malaysia	13.3	330	1,090	3.9	-0.3	7.2	60	67	110
Jamaica	2.1	11	1,110	2.0	3.8	16.9	86	70	98
Lebanon	3,0	10	....	....	1.4	....	....	65	85
Korea (Rep. of)	36.6	99	1,160	6.9	17.5	19.3	93	63	116
Turkey	43.1	781	1,200	4.0	5.6	21.5	60	61	110
Algeria	17.6	2,382	1,260	2.3	2.3	13.4	37	56	82
Mexico	65.4	1,973	1,290	2.7	3.5	17.5	76	65	99
Panama	1.8	76	1,290	2.9	1.6	7.5	78	70	103
Taiwan	17.1	36	1,400	6.6	4.1	10.3	82	72	105
Chile	10.7	757	1,410	1.0	32.9	242.6	88	67	94
South Africa	27.7	1,221	1,480	2.5	3.0	11.7	....	60	100
Costa Rica	2.1	51	1,540	3.3	1.9	15.7	90	70	114
Brazil	119.5	8,512	1,570	4.9	46.1	30.3	76	62	117
Uruguay	2.9	176	1,610	0.7	51.1	65.6	94	71	105
Argentina	26.4	2,767	1,910	2.6	21.8	120.4	94	71	114
Portugal	9.8	92	1,990	5.9	3.0	15.2	70	79	82
Yugoslavia	22.0	256	2,380	5.4	12.6	17.3	85	69	117
Trinidad & Tobago	1.1	5	2,910	2.2	3.2	21.3	95	70	94
Venezuela	14.0	912	2,910	2.7	1.3	11.1	82	66	97
Hong Kong	4.6	1	3,040	6.5	2.3	7.7	90	72	30
Greece	9.4	132	3,250	6.0	3.2	13.8	....	73	120
Singapore	2.3	1	3,290	7.4	1.1	6.1	75	70	112
Spain	37.1	505	3,470	5.0	6.3	15.0	....	73	122
Israel	3.7	21	3,500	4.2	6.2	31.0	88	72	113

Source: International Bank for Reconstruction and Development (IBRD), *World Development Report, 1980*, p. 111.

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This pattern of income distribution has at least two important implications for tax policy. First, as the poorer 60% of the population receives a relatively small share of total income, tax policy could concentrate on the richer 40% without any significant effects on tax revenue. This concentration, of course, would considerably reduce administrative difficulties. Second, as income distribution becomes more uneven, the pressure on the government to introduce progressive taxation becomes stronger.

II. ECONOMIC DEVELOPMENT AND TAX STRUCTURE

1. General aspects

Although there is little interest in the subject at the present time, the relationship between economic development and changes in tax structures attracted the attention of several researchers some years ago. The theory of tax structure change during economic development hypothesized that, as countries move from earlier stages of economic development to higher stages, some clearly discernible changes would be witnessed in their tax structure.[1] First, the ratio of direct to indirect taxes would fall at first, as traditional taxes on land would be replaced by other more convenient taxes such as those on foreign trade. Second, as countries develop, foreign trade taxes would progressively be replaced by domestic indirect taxes. And, finally, income taxes would gain in importance. This theory emphasizes the *economic* influences on tax structures, influences associated mainly with the varying importance of tax bases or "tax handles" (Hinrichs; Musgrave).

To a large extent, the theory ignores social, cultural, and political influences. It also ignores technological innovations which may, at particular moments in time, introduce new taxes which, given the proper environment, may become important (Tanzi, 1973). Therefore, given the economic structure of a country, its tax system may vary substantially depending on the relative strength of these political, sociological, or cultural factors. Furthermore, even when the changes in the broad tax categories follow the pattern outlined by the theory of tax structure change, the particular characteristics of those categories may be very different. These characteristics are also very important but have received little attention.

The tax systems of some Latin American countries have been influenced by the tax systems of European Latin countries. Those of other Latin American countries have been influenced by the U.S. tax system. The tax systems of the French-speaking African countries bear a close resemblance to that of France. And the same is true for former British colonies vis-à-vis the United Kingdom. Furthermore, depending on the political coloring of the governments in power, some aspects of the tax systems may reflect greater or lesser concern for the distribution of the tax burden. Keeping in mind these cultural or political influences, one could still postulate a kind of deterministic theory of tax structure change. Such a theory would indicate the general characteristics of the tax systems that one could expect to prevail in the MICs.

To start with, the change in the structure of production gives the MICs more options than are available to poorer countries. As foreign trade still remains very important in these countries, the MICs could continue relying on foreign trade taxes. On the other hand, since domestic production outside of the primary sector, and especially in the manufacturing sector, has become much more important, the MICs have the option of replacing foreign trade taxes with domestic indirect taxes. Furthermore, as the share of gross national income received in the form of wages and salaries or in the form of corporate profits is likely to have increased, they can also rely more on income taxes. Finally, an increasing share of national wealth is represented by buildings in the urbanized areas. The value of these buildings can be assessed much more easily than that of land; therefore, the possibility of relying on property taxes has also increased considerably.

However, even though more possibilities have been created by the changes in the structure of the economy, some new considerations become important, and these may limit somewhat the degrees of freedom acquired by the MICs. For example, some of these countries may attach a lot of importance to the objective of economic growth at a time when income distribution is becoming less even. Therefore, an important consideration in the tax policy of these countries must be the balancing of the growth objective against that of income redistribution. Some countries will want to give more weight to one objective; others will give more weight to the other. These political choices should affect their tax structure.

One of the characteristics of these countries is a higher rate of inflation. As they will often find it difficult to eliminate these inflationary pressures, they will have to pay attention to the impact that inflation will have on taxes. Without an explicit recognition of the problem, some tax sources (for example those on net wealth) might disappear, while others (general sales tax) might become more important. These inflationary pressures may in time bring about an increase in the level of taxation, especially when they are caused by fiscal deficits created by strong middle classes demanding greater expenditures for public services such as education, health, and social security.

For these countries, the temptation of generating revenue through an inflation tax must be tempered against the recognition that inflation will bring about serious distortions in the economy and that these distortions will inevitably affect both the rate of growth of the economy and its international competitiveness. It must also be tempered by the recognition of the effects of the inflation tax on other sources of revenue (Tanzi, 1978).

2. Specific aspects

Let us consider now, briefly, some of the major tax categories and speculate on the differences that one could expect to find between the proper countries and the MICs.

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1. For a brief, critical overview of this theory, see Tanzi, 1973.

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a. Export taxes

In the MICs, there should be little scope for permanent export taxes. These should be eliminated unless they are kept for very specific, non-revenue-related reasons. For example, coffee producing countries that want to stimulate the domestic production of instant coffee might keep an export duty on the export of coffee beans. Temporary export taxes might also be used to reduce the windfalls that exporters may derive from large devaluations. These uses should be infrequent and limited, and one would expect to find little revenue associated with the export taxes in the tax system.

b. Import duties

The pattern that one would expect in a country's use of import duties merits some attention. In less developed countries, import duties represent the most important taxable base. At this level, one expects that a large share of the country's revenue originates from this source. It can also be expected that, to a certain extent, these taxes will be imposed with specific rates rather than with ad valorem ones. As countries begin to develop, the protective role of import duties will gain in importance. Public opinion will generally favor protection at this stage of development. As domestic production of non-primary products rises, the revenue and the productive roles will get mixed together. By the time a country reaches middle-income status, and alternative bases have become available, the revenue role of the import duties should become less important. If they are retained, they should be mainly for their protective role. However, as these countries become more export-oriented, the inefficiencies associated with import duties will begin to be recognized by both the policy-makers and the people at large. Therefore, protection will become a lively issue.

The next step for a MIC might be to replace the highly differentiated and protection-motivated import duties with more uniform rates that would provide some uniform level of protection to all industries rather than highly differentiated protection to specific ones. This seems to be the course followed by Chile at this time. At this point, of course, import duties would be levied with ad valorem, rather than with specific rates. This general level of protection should be progressively lowered and in time should disappear. Incidentally, if this general import duty rate were levied on all imports without exemption, the country might still get substantial revenues from this source even with low rates.

The pattern described above will inevitably have negative effects on some industries. Therefore, it may come about only after strong resistance has been overcome and after countries have already developed well beyond the level where it should have taken place. Undoubtedly, some countries will prevent this change from occurring: (a) for revenue reasons (but this is not a valid argument, as revenues can be generated through other sources), or (b) to continue providing protection for industries already in place. This second reason would be strengthened when the removal or the lowering of duties would lead to some social unrest or to political difficulties for the government in power.

c. Income taxes

At low levels of development, most of the revenues from income taxes are derived from large, and often foreign, corporations. The share contributed by individuals is relatively small and is normally limited to wages and salaries paid by governments or by these large corporations. Other sources of personal income pay almost nothing. At this early stage, income taxes are often schedular. The level of personal exemptions is very high, often amounting to several times the per capita income of the country. The marginal tax rates are reached at extremely high income levels (say 100 times the per capita income), the number of taxpayers is very small, tax incentives and tax evasion are widespread, and the impact of inflation on these taxes is ignored.

By the time the middle-income level is reached, several changes can and should take place. The share of the individual's contributions to total income taxes should increase because of, for example, (a) the broadening of the tax base (especially increases in wages and salaries in national income), (b) the reduction of the level of exemptions, and (c) the improvement in tax administration.

At this level of income, the limitation of the tax incentive legislation in achieving various goals should have been recognized, and the erosion of the tax base caused by incentive legislation and by evasion should have become an issue. At this level, some issues would move to the forefront of the discussion on tax policy.

The first issue should concern the progressivity of income tax. Here, the experience of different countries indicates that *high* marginal tax rates create many problems and they contribute little to revenue. A high marginal tax rate can clearly reduce or eliminate the base on which it is levied. Therefore, a good policy is one of pursuing an income tax with rates that are progressive, but not exceedingly so, and that are levied on as broad a base as possible. This approach not only minimizes the disincentive effects of high tax rates but also reduces the problem of horizontal inequity, a problem that becomes extremely acute when the rates are high on those who cannot evade them while those who can evade them end up paying little or nothing. A consensus seems to be developing that the higher marginal tax rate should not exceed 50-60%.

The structure of the personal income tax should be related to the distribution of income. The basic exemption should be tied to a level of income that would exempt a good share of the population without exempting too much of the total income. This objective is facilitated by the uneven income distribution that characterizes most of these countries (Tanzi, 1966). The level to which the marginal tax rate becomes relevant should also be related to the income distribution. A simple rule could be to make this rate applicable at a level of income near that received by the top 1% of the population.

Another basic issue relates to the use of incentives. As already indicated, by the time countries reach the middle-income level, they should be aware of the futility of trying to promote efficiency and growth by the use of fiscal incentives. Therefore, this is a good time to start dismantling the incentive mechanism that inevitably has accumulated over past years.

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A third issue, which has not really been solved by any country, concerns the difficulty of taxing the incomes of professionals, farmers, traders, independent contractors, and so forth. Perhaps for these incomes, the true or objective income cannot be determined. Therefore, the tax authorities should give up the futile effort to determine true, actual incomes and should instead develop alternative means of taxing these incomes through presumptive or potential taxation. Some experience along these lines is available in a few countries (Uruguay, Costa Rica, Portugal, Israel, etc.). (See Tanzi, 1980.)

Another issue relates to the problem of what to do about the effects of inflation on the income tax. Should these effects be ignored, neutralized, or taken advantage of in order to increase revenue? These effects will be related either to the distortion of income tax bases (interest, profits, capital gains, etc.) or to the progressivity of the rate structure. The effects related to the progressivity are easier to deal with. In all cases, the role played by delayed collections cannot be ignored (Tanzi, 1977).

Two extreme examples of reaction are provided by Uruguay and Turkey. In Uruguay, the authorities came to the conclusion that a personal income tax could not survive an inflationary environment; therefore they abolished it. Turkey ignored the effect of the inflation on the tax liabilities of wages and salaries, so that the rate structure was not adjusted. Given the progressive nature of this tax, the fact that it is collected with hardly any delays, and given the rate of inflation that has prevailed in current years (it averaged 21.5% annually for the 1970-78 period), the share of personal income taxes in GNP increased from 4.5% in 1970 to 9.4% in 1980. As a proportion of total tax revenue, the share of personal income tax increased from 28.7% in 1970 to 51.6% in 1980.

The correction of income tax bases for inflation is very difficult and has been attempted only on a limited scale in some MICs (Brazil, Chile, Israel, Korea and Argentina). One important issue is whether the tax system should be made to recognize the difference between the legal and the economic concept of income. This distinction becomes extremely important in an inflationary environment, especially vis-à-vis interest rates, profits, and capital gains. In many of these countries, the repression of the financial market has caused real interest rates to be negative, thus leaving the government with little choice but to ignore the taxation of interest income. For profits, some countries have attempted to introduce adjustments in depreciation, inventories, and so forth; others have, from time to time, allowed a revaluation of assets (Casanegra).

Another issue that is inevitably very important for the MICs relates to the taxation of retained profits vis-à-vis dividends. Some argue that, to promote the capital market, distributed profits should be taxed at lower rates than retained profits. Others argue that the corporation remains the most efficient instrument for reinvesting profits. In my mind, this is an unsettled issue where more country-related research would be beneficial. I have become less and less convinced that favoring distribution is always an efficient policy, even for MICs.

On the part of those who favor distribution, there is an implicit assumption that the corporation that reinvests profits will do it in the same line of activity. This is not what is happening in places like Korea and other fast-developing Asian MICs. In these countries, the corporations have reinvested their profits in those lines of activities that were most profitable at a particular point in time, and these were often totally different from the traditional ones. Branching out is a common phenomenon and for a time can lead to efficient investment.

One must ask the question about what the receivers of dividends would do with them if more profits were distributed. Unless the capital market is already substantially developed (in the sense that interest rates are not kept artificially low, the stock market is not too narrow and is well regulated, etc.), these dividends may either (a) leave the country, (b) be invested in real estate, or (c) lead to additional consumption. When financial reforms have made interest rates highly positive for savers, so that the dividends can be deposited in savings institutions, if the stock market is still undeveloped, the additional dividends may not lead to more equity financing (through the sales of shares) but may lead to an increase in the debt-equity ratios of companies. This will happen because companies will finance the additional capital needs by borrowing rather than by the sale of shares. Such an alternative might be less attractive and more costly than that associated with direct equity financing through the retention of profits.

d. Taxes on domestic transactions of goods and services

As countries move from the less-developed to the middle-income state, some basic changes in the structure of these taxes should be expected. In a schematic fashion, these changes can be outlined as follows.

At the earliest stage of economic development, domestic transactions may not be taxed at all. When they begin to be taxed, it will be through excises limited to a few products (tobacco, alcohol, gasoline, sugar, cement, etc.). Services will normally be exempted, and the excises will be specific rather than ad valorem. The first change that may take place with economic development will be an expansion in the number of products taxed; the second will be some conversion from specific to ad valorem rates.

Sooner or later the need for additional tax revenue will force the countries to expand the scope of domestic indirect taxation. This will take place also to substitute for some foreign trade taxes. A few countries , following the British tradition, may meet this need through a continuous expansion of the system of selective indirect taxation. But the majority will consider the introduction of some form of general sales tax. The sales tax, once introduced, will soon increase in importance as a revenue source. At this early stage the general sales tax will, most likely, have the following characteristics:

(1) It will be levied at a low rate.
(2) It will be applied at the manufacturer's level.
(3) It will be limited to products and will, thus, exempt services.
(4) It will exempt many products for administrative or social reasons.

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(5) It will also be collected on imports.
(6) In terms of revenue the share derived from imports will be overwhelming.

Because of (a) the exclusion of services, (b) the limitation to few manufactured products, (c) the exclusion of value added generated by the distribution sectors, and (d) the inevitable evasion, the share of total domestic value added subjected to this tax will inevitably be very small. Therefore, one important step to be followed by countries approaching the middle-income level will be to try to broaden this narrow base. This can be done by (a) reducing the range of exempted products, (b) starting to bring some services into the tax base, and (c) trying to capture some of the value added that originates in the distribution channels. At the same time, the rate may be increased. These changes will bring into the open some of the problems caused by cascading. Therefore, steps will generally be taken to eliminate cascading either through the introduction of the ring system or by the explicit introduction of a value-added mechanism.

By the time countries join the middle-income group, they should have either a value-added tax (VAT) or a single-stage tax without the cascading effects of a turnover tax. Furthermore, the coverage should extend beyond the manufacturer's level although probably not all the way to the retail level. The share of the revenue from the general sales tax derived from imports should have fallen to well below 50%. By this time, the excises should be reduced in number and should be levied with ad valorem rates.

At the stage of economic development reached by the MICs, some issues related to domestic indirect taxation are likely to be hotly debated. First is the question of the proper base for the general sales tax. Most countries have exempted some products (unprocessed food, services) for administrative reasons and some others (books, medicines, basic foods, newspapers, etc.), for social reasons. In some cases, exemptions were given to some activities (cottage industry) as an incentive to the producers. In most cases, the granting of an exemption to one product or producer creates pressures for the same treatment by other producers. The result is an erosion of the base. This process of erosion should become controversial at the middle-income stage of development. Attempts are likely to be made to reverse that process and to enlarge the base. But how to accomplish this is likely to be a hot issue.

A second controversial issue is whether to attempt to make the indirect taxes progressive. Some countries have chosen to have a proportional (single-rate) general sales tax accompanied by some high-rate excises on "luxury" products. Others have attempted to introduce progressivity by leaving multiple rates within the general sales tax, the rate being higher the less "essential" the product is considered to be. Some experts now recognize that high rates on luxury goods yield little revenue and contribute only marginally to the progressivity of the overall tax system (Gandhi, 1979). The main justification for these high rates is essentially political. However, this remains a highly controversial area.

A third issue relates to the taxation of services. It is recognized that taxing services is difficult administratively. However, some experts have argued that taxing of services should make the tax system more productive and more equitable especially at the middle-income stage, where the share of services in national income has increased. A recent study, however, has cast doubts on both of these contentions (Gandhi, 1977).

Table 2 provides some information on the type of general sales tax now in use in 22 MICs. The table indicates the popularity of the VAT in recent years. Nine of these countries have some form of VAT. With one exception, all these taxes were introduced during the past decade. Five of the countries (Jamaica, Trinidad and Tobago, Venezuela, Hong Kong, and Singapore) still do not have a general sales tax, and a couple still have turnover taxes. There is a large variation in the rates of these taxes.

Table 2 – General sales taxes in MICs

Country	Nature of tax	Standard rate
Malaysia	manufacturers	5
Jamaica	none	—
Korea (Rep. of)	VAT (1977)	13
Turkey	manufacturers	various
Algeria	manufacturers	25[1]
Mexico	VAT (1980)	10
Panama	VAT (1977)	5
Taiwan	turnover	2
Chile	VAT (1975)	20
South Africa	manufacturers	10
Costa Rica	VAT (1975)	8
Brazil[2]	VAT (1972)	various
Uruguay	VAT (1972)	18
Argentina[3]	VAT (1975)	16
Portugal[4]	wholesale	10
Trinidad and Tobago	none	—
Venezuela	none	—
Hong Kong	none	—
Greece[4]	manufacturers[4]	8
Singapore	none	—
Spain[4]	turnover	2
Israel	VAT (1976)	8

1. Tax-inclusive rate.
2. Brazil has two general sales taxes (one federal and one state) and a tax on services.
3. Argentina has also a provincial turnover tax with rates from 1.6 to 2.2.
4. Within the next few years Greece, Portugal, and Spain are likely to introduce a VAT.

III. SOME COMPARATIVE TAX STATISTICS FOR MICs

Table 3 provides comparative tax statistics for the MICs in our sample. These statistics must be used with caution, as it is difficult to prepare comparable tax data for different countries. The most important problem is that the information normally available relates to central governments. However, in many countries local governments may be very important; furthermore, social security institutions may be outside of the national budget. An attempt was made in the table to use data that were as comparable as possible, but there is no assurance that the attempt was totally successful.

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Table 3 – Tax revenue by type of tax

(in percent of total taxes)

Country	Year	Total taxes	Income taxes				Domestic taxes on production and consumption			
			Total	Personal	Enterprise	Other	Total	General sale; turnover; VAT	Excise	Other
Argentina	1979	100.0	11.24	—	—	—	54.14	31.09	23.05	0.00
Brazil	1978	100.0	16.72	1.08	6.72	8.92	32.81	—	—	—
Chile	1978	100.0	17.57	10.22	7.08	0.27	49.07	35.60	10.76	2.71
Costa Rica	1978	100.0	17.92	17.77	0.15	0.00	33.21	9.41	23.06	0.74
Greece	1976	100.0	17.45	8.96	3.16	5.33	39.46	18.35	10.99	10.12
Israel	1978	100.0	41.34	26.46	11.17	3.71	32.48	28.75	3.17	0.56
Jamaica	1978	100.0	39.09	25.90	13.19	0.00	45.58	—	—	—
Jordan	1977	100.0	17.98	—	—	—	8.31	0.00	7.87	0.45
Korea (Rep. of)	1979	100.0	28.56	14.64	13.92	0.00	48.65	22.51	17.64	8.50
Malaysia	1979	100.0	39.73	9.67	29.99	0.07	23.04	5.75	10.65	6.64
Mexico	1978	100.0	54.12	27.04	26.62	0.47	30.34	10.98	17.83	1.53
Panama	1978	100.0	38.83	—	—	3.20	31.81	14.26	16.07	1.48
Portugal	1978	100.0	21.76	10.96	0.00	10.80	34.02	14.47	15.19	4.39
Singapore	1978	100.0	44.52	—	—	—	22.72	0.00	9.21	13.51
Spain	1978	100.0	23.74	18.30	5.44	0.00	15.06	3.65	7.96	3.45
South Africa	1977	100.0	62.87	28.69	32.64	1.54	23.85	4.92	18.62	0.31
Taiwan	1978	100.0	19.12	6.30	8.09	4.73	40.56	22.45	1.54	16.57
Trinidad and Tobago	1978	100.0[1]	54.10	27.11	21.25	5.74	16.19	6.53	2.03	7.62
Turkey	1978	100.0	47.93	39.16	4.40	4.37	20.15	9.81	2.16	8.18
Uruguay	1979	100.0	8.85	1.50	7.09	0.26	41.88	22.18	15.73	3.97
Venezuela	1978	100.0	71.16	4.68	66.48	0.00	6.98	0.00	4.51	2.47
Yugoslavia	1978	100.0	0.00	0.00	0.00	0.00	22.28	22.28	0.00	0.00
Average			33.08	16.38	16.09	3.80	30.57	16.65	11.48	5.18

Table 3 (continued). Tax revenue by type of tax

(in percent of total taxes)

Country	Year	Total taxes	Foreign trade				Social security	Wealth and property	Other[2]
			Total	Import duties	Export duties	Other			
Argentina	1979	100.0	20.24	19.00	0.62	0.62	—	7.04	7.34
Brazil	1978	100.0	4.46	3.56	0.90	0.00	38.22	0.11	7.68
Chile	1978	100.0	8.18	8.18	0.00	0.00	15.38	3.18	6.62
Costa Rica	1978	100.0	22.06	12.91	9.15	0.00	24.69	1.07	1.05
Greece	1976	100.0	5.36	5.36	0.00	0.00	28.23	9.50	0.00
Israel	1978	100.0	8.67	5.57	0.00	3.10	10.52	1.89	5.10
Jamaica	1978	100.0	6.64	6.33	0.00	0.31	0.00	5.04	3.65
Jordan	1977	100.0	70.56	64.94	5.62	0.00	0.00	0.22	2.93
Korea (Rep. of)	1979	100.0	18.87	18.87	0.00	0.00	1.23	0.45	2.24
Malaysia	1979	100.0	34.99	16.63	18.36	0.00	0.60	0.46	1.18
Mexico	1978	100.0	11.97	4.89	7.08	0.00	0.00	—	3.57
Panama	1978	100.0	20.69	11.16	3.31	6.23	0.00	3.93	4.74
Portugal	1978	100.0	6.51	6.49	0.02	0.00	29.76	1.48	6.47
Singapore	1978	100.0	11.64	11.64	0.00	0.00	0.00	15.37	5.75
Spain	1978	100.0	6.34	6.47	0.00	0.00	49.50	5.15	0.21
South Africa	1977	100.0	8.94	8.19	0.75	0.00	1.26	1.56	1.52
Taiwan	1978	100.0	27.02	27.02	0.00	0.00	0.00	9.30	4.00
Trinidad and Tobago	1978	100.0[1]	26.24	26.21	0.00	0.03	0.54	1.42	1.51
Turkey	1978	100.0	11.01	11.01	0.00	0.00	15.02	5.45	0.44
Uruguay	1979	100.0	14.51	14.36	0.15	0.00	29.31	4.29	1.16
Venezuela	1978	100.0	11.34	—	—	—	7.40	2.67	0.45
Yugoslavia	1978	100.0	19.36	19.36	0.00	0.00	58.34	0.00	0.02
Average			17.07	14.67	4.60	2.06	20.67	3.98	3.22

Source: Country source, central government tax revenue only; International Monetary Fund, Government Finance Statistics; revenue statistics of OECD member countries, 1965-79.

1. Non-oil revenue only.
2. Includes stamp taxes, payroll or manpower taxes, poll taxes, and other unallocable taxes.

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The key question to ask is the extent to which the statistical information in the table reflects the expectations outlined in the previous section. We shall consider in turn each of the major categories:

(1) We speculated in the previous section that the foreign trade taxes should be less important in MICs than in poorer countries. Table 3 bears this out. On average, only about 17% of total tax revenue is derived from foreign trade taxes, a percentage much lower than for all developing countries. This 17%, of course, hides wide dispersions within the group. In a few countries (Jordan, Malaysia, Taiwan, and Trinidad and Tobago), these foreign trade taxes are still quite important. In others (Chile, Greece, Israel, Jamaica, Portugal, Spain, South Africa), these taxes account now for less than 10% of total revenue.

(2) As anticipated, export duties have become relatively insignificant except in Malaysia, where they still account for 18% of total revenue.

(3) Also as anticipated, income taxes have become more important than in poorer countries. On average, they now account for about one third of total tax revenue compared with about one fourth for all developing countries. But, again, the range is very wide, with a few countries getting somewhat higher percentages from this source (Israel, Mexico, Singapore, South Africa, Trinidad and Tobago, Turkey, and Venezuela). On average, the proportion of income taxes collected from individuals and that collected from enterprises is about the same, but this equality hides important differences. In some countries with important mineral and natural resources, such as Venezuela and Malaysia, the taxes on enterprises are very important. On the other hand, in countries such as Turkey, Spain, Israel, and Jamaica, the taxes on individuals are much more important.

(4) The domestic taxes on production and consumption also reflect the discussion in the previous section. These taxes have now become significantly more important than those on foreign trade and account for about one third of total tax revenue. Excises have become much less important than general sales taxes. This is again as one would have anticipated from the previous discussion. However, excise duties do remain very important in some countries, such as Argentina, Costa Rica, South Africa, Jamaica, and a few others.

(5) The table shows also that social security has become of some importance in particular MICs, especially the European ones. Greece, Portugal, Spain, and Yugoslavia derive large revenues from social security taxes. Among the non-European countries, Brazil, Costa Rica, Chile, and Uruguay derive important revenue from this source. Although the table does not provide that information, social security is also important in Argentina.

(6) Generally, taxes on property and wealth are of some importance in a few MICs. Singapore is particularly notable, as it derives more than 15% of its tax revenue from this source. The highly urbanized nature of this country must surely be the main reason for this high proportion.

IV. TOWARD MORE EFFECTIVE TAX SYSTEMS FOR MICs

The purpose of this section is to present some desirable features that the tax systems of MICs should have. Or, alternatively, to emphasize pitfalls to be avoided. More than in the previous section, the discussion will be normative; however, it will not be based on theoretical or abstract reasoning but rather on a realistic assessment, based on the practical experiences of many countries, about what is feasible from an administrative point of view and what is desirable from a real-world point of view. An alternative to this approach would be to propose some theoretically "optimal" tax system that, though perfect in the abstract, could never be implemented in practice. Unfortunately, it has been a rather frequent occurrence in the field of technical assistance for foreign experts, with little practical experience and little understanding of a country's particular administrative, legal, and political constraints, to propose reforms that, though clever in theory, could never survive the test of reality.

At the level of economic development reached by the MICs, it should be possible for their tax systems to show the following characteristics.

a. Revenues from few sources

As countries move from being less developed to being middle income, a process of concentration of tax sources should take place. Taxes that generate, say, less than 1% of total revenues should not be levied. This criterion should apply not just to tax sources but also to rates within particular tax sources. For example, each rate of the income tax schedule should generate at least that percentage. This criterion would reduce the excessive fragmentation of the tax system and would simplify the administration. It could be relaxed only when a tax has been levied specifically to discourage some activity. How low this "concentration index"[2] can be, can be seen by the experience of Argentina, where in 1975-76 the Dirección General de Impuestos was collecting almost 100 different taxes, most of these generating insignificant revenues and costing a lot to administer or to comply with. No wonder that the Argentine taxpayer felt overtaxed, even though the ratio of total taxes to GNP was not excessive for the country.

b. Tax bases as broad as possible so that the tax rates applicable to them could be kept low

One of the basic problems of the tax systems of poor countries is the extent to which tax bases are eroded, not just by evasion but often by legal exemptions of various types. In one country on which I worked recently, the tax base of what was supposed to have been a general sales tax had been reduced to less than 10% of its national income. The same has happened frequently to income taxes for which, because of exemptions, deductions, incentives, and so forth, the income that is actually taxable

2. The share of total revenue coming from, say, the two or three major tax sources could be referred to as the concentration index.

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is a very small share of the potential base. Typically, one also finds that 40 to 60% of total imports are exempted from import duties for one reason or another. This very large erosion of bases brings about the necessity either to increase the number of taxes collected or to increase sharply the rates applicable to the reduced bases. Both of these alternatives are unattractive. Therefore, MICs should set as an objective the implementation of a tax system based on a few large bases levied at relatively low rates.

c. Objectivity in definition of bases

Here, again, a basic distinction should be made between the tax systems of the poor countries and those of the MICs. In poor countries, bases such as income, imports, or property, and, in some cases, even sales, may have an objective or true measure that is often totally different from the measure on which the taxes are actually calculated. For example, for incomes other than wages and salaries, the keeping of records and the accounting may be so bad that guesses replace actual measures; the tax base in these particular cases may end up bearing little relation to the true, objective base. The same is true for import taxes where the import prices used by the customs authorities to calculate the customs duties may be very different from the prices actually paid by the importers; and, of course, the assessed property values used for determining the tax liability bear little relationship to the actual market values.

In the MICs, the difficulties of determining the true tax bases will remain but the countries will have more resources to do it. Unfortunately, in many of them the effort required to bring the taxable bases closer to the true bases has not been made. The end result is that the taxpayer is often left with a feeling of arbitrariness on the part of the tax administration, and this feeling encourages non-compliance.

d. Collection lags minimized

In many countries the time that elapses between the moment a tax event takes place and the moment when the associated tax payment must be made (the "legal lag"), can be quite long (Tanzi, 1977). When there is little inflation this delay does not matter much, but, at the level of inflation now common to most of the MICs, the existence of these long collection lags can dramatically decrease the real value of the tax revenue. In Argentina, for example, in 1975/76 an average collection lag of five to six months for the total tax system, associated with a very high rate of inflation, led to a sharp fall in the ratio of tax revenue to GNP (Tanzi, 1978). Some countries have paid attention to this problem (Argentina, Chile, Brazil, etc.), but in most these lags remain still much longer than they should or need be. Long lags not only reduce tax revenue but create inequities when they are short for some taxpayers (wage earners) and long for others (receivers of capital incomes). In such cases, the effective tax rate for wage earners will become higher than that for other incomes even though the nominal rate may be the same.

e. Severe penalties for delayed payments

One common problem in many MICs has been the accumulation of unpaid tax bills (arrears). In some countries these arrears have reached very large proportions. When the penalties are low and the rate of inflation is high (a common situation in several countries), the taxpayers are given an incentive to postpone paying their taxes beyond the time they are legally due. Borrowing against tax liabilities becomes the cheapest source of credit. These "delinquency lags" become cumulative with the "legal lags" and bring about serious distortions. The problem is that the penalties, which often are in the form of monthly interest rates, were often introduced in periods when there was no inflation so that, for example, a penalty of 1% per month was a stiff one. In today's world, when the monthly rates of inflation for several MICs (Brazil, Argentina, Israel, etc.), are much higher than that, these penalties have lost any meaning. At a minimum, these penalties should reflect the current rate of inflation and should, perhaps, become progressively heavier the longer the payment is delayed. There must be some optimal structure of penalty. This is an unexplored area in which research could make important contributions.

f. Taxes as neutral as possible

Another general aspect of the tax system relates to tax neutrality. At this stage of economic development, the MICs should pay far more attention to tax neutrality, especially since their growth is often export oriented and is thus based on comparative efficiency. The problem of neutrality, of course , becomes less serious the lower the tax rates are. In countries with high export duties on some agricultural products but not on others, taxation has prompted a reallocation of the use of land toward non-taxed crops. And, of course, the export taxes have encouraged domestic consumption while discouraging production. In countries where small cottage-type enterprises are exempted from relatively high sales tax, these enterprises may come to acquire a substantial advantage over the large, more efficient, but higly taxed companies. These examples, which could be multiplied, are common to many countries. As countries become more exposed to international competition, they should become more sensitive to the distortions brought about by inefficient taxes.

g. Public expenditure covered over longer run

If large deficits develop, taxes should be increased or expenditures should be reduced.[3] Unfortunately, as Table 4 shows, in many of these countries the deficits have been extraordinarily large in recent years, and inevitably, these deficits must have been a major cause of inflation. Equally important, recurrent or permanent expenditures should be related to "permanent" tax revenue to avoid that extraordinary tax revenues associated, for example, with temporary export booms lead to permanently higher, and thus unsustainable, expenditure.

3. If a country receives large grants, its expenditure could exceed its tax revenue. But the country should anticipate the day when the grants may no longer be forthcoming. Therefore, it should be careful to avoid expenditures that are permanent.

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Table 4 – Fiscal deficits as percentages of GDP

	1973	1974	1975	1976	1977	1978	1979
Argentina	5.5	6.3	11.0	7.9	4.1	3.7	....
Brazil[1]	-2.5	-1.6	0.2	2.6	2.1	3.7	....
Chile[2]	13.5	5.3	1.7	-3.7	-0.4	-1.6	-4.4
Costa Rica	3.5	2.0	2.7	4.6	3.2	4.6	5.8
Greece	2.3	3.2	3.9	3.8	3.6	3.7	4.1
Israel	20.6	23.6	19.0	17.1	17.6	12.0	....
Jamaica	5.2	7.4	7.8	15.5	14.4	16.8	....
Jordan	9.0	7.5	16.1	17.4	6.9	18.6	17.3
Korea (Rep. of)	1.7	2.3	2.0	-0.1	-0.2	-0.2	-0.6
Malaysia	5.6	6.0	8.5	7.1	8.6	7.9	8.3
Mexico	4.3	4.3	5.4	5.3	3.7	3.0	....
Panama	9.8	10.6	7.7	8.2	4.2	3.1	8.8
Portugal[3]	2.1	3.3	4.9	7.0	5.8	11.4	9.9
Singapore	-1.3	-0.1	-2.1	-0.4	-0.6	-0.3	-0.4
Spain	0.7	1.5	1.9	2.0	1.6	2.4	3.0
South Africa	1.0	2.4	6.1	6.4	5.0	5.1	4.4
Taiwan		-3.4	-1.5	-1.4	-0.9	-1.1	....
Turkey	1.7	2.4	2.3	2.0	6.1	4.3	....
Uruguay	1.2	3.8	4.3	2.2	1.5	0.9	0.1
Venezuela	-1.6	-2.1	-0.6	3.8	6.6	6.0	....
Yugoslavia	0.9	1.5	1.3	2.9	1.8	....	....

Source: International Monetary Fund, International Financial Statistics. For a few countries, the information comes from specific country sources.

1. Not including credit subsidies. Inclusion of these subsidies would increase the size of the reported deficit.
2. Overall public sector including the copper industry.
3. General government overall deficit.

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Taxation of Consultancy Fees in Nigeria

by A.C. Ezejelue*

I. INTRODUCTION

In the Budget Speech of 1980 the Nigerian Federal Government proposed, inter alia, the application of deduction of tax at source or withholding tax to management fees, consultancy fees and such similar fees. The rate of the withholding tax proposed was 20% of gross for residents and 25% of gross for non-residents. The effective date for the operation of the withholding tax was to be 1 April 1980. It will be operated by companies making such payments as well as by all government departments, parastatals, statutory bodies, institutions and other established organisations approved for the operation of the PAYE system that make such payments. It was also proposed that such tax withheld in respect of payments due to companies and non-resident persons should be paid over to the Federal Board of Inland Revenue while those in respect of resident individuals should be paid over to the tax authority of the State in which the beneficiary is resident.

As usual, the proposals in the 1980 Budget statement are, where appropriate, expected to be embodied in the 1980 Finance Bill with retrospective effect from 1 April 1980. However, it is not known if there has been an Act of the National Assembly on the issue of withholding tax on consultancy fees. Yet there have been many cases of some withholding tax on consultancy fees, and this has aroused some doubts among many consultants as to the legality or otherwise of the recent withholding tax on consultancy fees without any supporting legislation.

The purpose of this article, therefore, is to explore the legal and/or practical basis for the withholding tax on consultancy fees in Nigeria.

II. BASIS FOR TAXING CONSULTANCY FEES

A. Relevant legislation

Some foreign consultants have often misconstrued our tax laws. It is the understanding of some of them that profits are taxable in Nigeria only if they can be attributed to an established place of business in Nigeria. Accordingly, if there is no such established place of business in Nigeria, as in the case where services are rendered from overseas, the profits therefrom will not be liable to Nigerian tax. This is erroneous.

The relevant sections of the Nigerian Companies Income Tax Act (CITA) 1979 which make such profits taxable in Nigeria are 8(1)(a) and (f) and 11. Section 8 appears to be too wide for this purpose and should be read in conjunction with Section 11.

Specifically, Sections 8(1)(a) and (f) provide that:

> (1) Subject to the provisions of this Act, the tax shall, for each year of assessment, be payable at the specified rate upon profits of any company accruing in, derived from, brought into, or received in, Nigeria in respect of –
> (a) any trade or business for whatever period of time such trade or business may have been carried on;
> . . .
> (f) fees, dues and allowances (wherever paid) for services rendered.

And Section 11 provides that:

> (1) The profits of a Nigerian company shall be deemed to accrue in Nigeria wherever thay have arisen and whether or not they have been brought into or received in Nigeria.
> (2) The profits of a company other than a Nigerian company from any trade or business shall be deemed to be derived from Nigeria to the extent to which such profits are not attributable to any part of the operations of the company carried on outside Nigeria.

B. Implications of the key terms used in Section 8 of CITA

The meaning attributable to the key terms "accruing in", "derived from", "brought into", and "received in", used in Section 8 of CITA, are worth considering for our purpose.

While "derive" means "to obtain or receive from a source", "accrue" may mean "to come to someone or something as a gain".[1] But in *Commissioner of Taxation v. Kirk*[2], their Lordships attached no special meaning to the word "derived", which they treated "as synonymous with arising or accruing".[3] In this case in which *In re Tinda*[4] was overruled, it was held that income which was

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1. See, for example, *The American Heritage Dictionary of the English Language* (1969-1970), pp. 9 and 356.
2. (1900) AC 588.
3. Op. cit., p. 592.
4. (1897) 18 NSWLR 378.

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in part derived from the extraction of ore from the soil of New South Wales Colony, and from the conversion in the latter Colony of the crude ore into a sellable product was assessable under Section 15(3) and (4) of the New South Wales Land and Income Tax Assessment Act of 1895, notwithstanding that the finished products were sold exclusively outside the Colony. However in *Toufic Karam v. Commissioner for Income Tax*[5] the learned judge said (as it would apply to Nigeria):

> The words "accruing in" and "received in" appear to me to import a clear territorial limitation to *Nigeria;* the words "derived from" appear to me to be designed to meet among other things cases where profits arise from transactions carried out in Nigeria by a non-resident taxpayer.

Under our personal income tax system, income from employment shall be deemed to be derived from Nigeria if the duties of the employment[6] are wholly or partly performed in Nigeria.[7] The emphasis is on "derived from" because derivation in this context implies "obtained" or "acquired" or "got" via working or having worked in or for Nigeria. This is to be distinguished from "brought into" or "received in" or (to some extent) "accruing in", which may not necessarily imply worked or working in or for Nigeria. These terms as they apply to companies appear, by implication, to bring into the tax net profits from transactions carried on outside Nigeria by a Nigerian company,[8] but the tax is restricted to profits actually brought or imported into Nigeria.

C. Import of Sections 8 and 11 of CITA

It can be deduced that Section 8 tends to limit tax liability in a geographical sense to profits derivable in Nigeria and to restrict tax liability in respect of transactions carried on outside Nigeria to profits actually brought into Nigeria. However, Section 11 wraps it up with a distinction between a Nigerian company and a non-Nigerian company.[9] Section 11(1) provides that the tax liability in respect of transactions carried on outside Nigeria by a Nigerian company is not restricted to profits brought into or received in Nigeria, but that the world profit of the company for any year of assessment is assessable in Nigeria. Section 11(2) stipulates that the profits of a non-Nigerian company from trade or business shall be deemed to be derived in Nigeria to the extent to which such profits are not attributable to any part of the operations of the company carried on outside Nigeria.

For our purposes, there does not seem to be much distinction between subsections (1)(a) and (1)(f) of Section 8 – i.e. between trade or business on the one hand, and fees, dues and allowances for services rendered on the other. Rendering of services also amounts to carrying on business. When a company is formed with an established objective (which may be rendering of services) and this objective is in fact carried on, then the company is carrying on business.[10]

It must be emphasized that, as in the case of trade or business, it is the profit arising from the fees, dues and allowances for services rendered that is taxable. Therefore all expenses incurred in earning the fees, dues and allowances will be deducted in arriving at the net taxable fees.

D. Legality of taxing consultancy fees

The legal basis upon which fees on consultancy executed in or for Nigeria by foreign-based consultants or by non-Nigerian companies are liable to Nigerian tax is that the fees are *derived from* Nigeria in accordance with Section 11(2) of CITA. They are deemed to be derived from Nigeria once the services are done in or for Nigeria or are paid for by Nigeria, notwithstanding that part of the services may have been carried out outside Nigeria. The existence or non-existence of a permanent establishment or fixed base in Nigeria for the company is not relevant except under an existing double taxation treaty between Nigeria and the country of residence of the company.

A similar provision exists in our personal income tax in the case of a resident abroad who is deemed to be resident, for tax purposes, in Nigeria if the person has spent in the aggregate at least 183 days in Nigeria.[11] In an article on the subject it was said, inter alia:

> The fact of the 183-day criterion is not based on the existence of an established place of residence. Provided that the person spends an aggregate of 183 days in Nigeria, the availability of a permanent abode is irrelevant. Places of temporary lodging will satisfy this particular condition of residence.[12]

In support of the above statement, the author of the article quoted Rowlatt, J. who said, among other things:

> . . . one must remember . . . that one must not look for an establishment . . . . a tramp has a "residence" . . . . if a man chooses to live at hotels instead of in his own house, or even stay with friends, it really does not affect the question of residence.[13]

It is with this same spirit that Section 11(2) of CITA is construed. But under Section 11(1) of CITA consultancy fees of a Nigerian company are deemed to *accrue in* Nigeria from wherever they may have arisen and notwithstanding that they may not have been brought into or received in Nigeria.

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5. 12 WACA 331. See also *Re John Robert Potter* 11 WACA 144.
6. "Employment" includes any service rendered by any person in return for any gains or profits (see S. 4(2)(d) of the Income Tax Management Act (ITMA) 1961 as amended).
7. See S. 8(1)(a) of ITMA 1961 (as amended).
8. "Nigerian company" means any company incorporated under the Companies Act 1968 or any enactment replaced by that Act. (See S. 78 of CITA 1979.)
9. "Non-Nigerian company", which may be considered identical to "foreign company", may mean any company or corporation (other than a corporation sole) established by or under any law in force in any territory or country outside Nigeria. (See S. 9(8)(c) of CITA 1979.)
10. This view is supported by decided cases. See, for example, *IRC v. Westleigh Estates Co. Ltd.* (1924) IKB 390; 12 TC 654; 40 TLR 208.
11. See paragraphs (e) and (x) of Third Schedule to ITMA. See also S. 8(1)(a)(ii) of ITMA.
12. See A.C. Ezejelue, "Impact of Residence on Tax Liability in Nigeria", 35 *Bulletin for International Fiscal Documentation* (1981), pp. 547-554.
13. *Lysaght v. IRC* (1928) 13 TC 511, 516.

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III. AMOUNT OF WITHHOLDING TAX ON CONSULTANCY FEES

A. Legal or practical basis for withholding 12.5%

The proposal in the 1980 Budget for the introduction of withholding tax on consultancy and other similar fees was to the effect that it would be at the rate of 20% of gross for residents and 25% of gross for non-residents. However, it would appear that in practice what is being withheld for the time being is 12.5%. This has worried the minds of many consultants as the legality of a withholding tax of 12.5% is questionable in view of the fact that the proposal in the 1980 Budget for a withholding tax on consultancy fees is not known to have been passed into law yet. As would have been expected, the proposals would, where appropriate, be embodied in the 1980 Finance Bill with retroactive effect from 1 April 1980.

For all practical purposes, it could be deduced that the idea of withholding tax on consultancy fees seems to be borrowed from the 1980 Budget proposals. However, there is no intention to operate the proposal as if it is already law – otherwise the tax withheld could have been at the rate of either 20% or 25% whichever is applicable. Instead, 12.5% is being withheld.

What then is the legal basis for withholding 12.5%? Strictly speaking, there seems to be none yet. From experience, withholding tax on consultancy fees may eventually become law with a retrospective effect. This notwithstanding, the Revenue does not consider it appropriate to deduct 20% or 25%, as the case may be, as was proposed in the Budget statement. In retrospect, 12.5% appears to be a fair compromise figure which corresponds with the earlier withholding taxes introduced by the Federal Government.[14] Therefore, the working basis of 12.5% on consultancy fees seems to have been borrowed from the withholding taxes introduced earlier.

B. Rationality of basing withholding tax on gross fees

It is clear from Sections 8(1) and 11 that the basis of assessment of income of a company accruing in, derived from, brought into, or received in Nigeria in respect of trade or business, rent, dividends, fees, dues, etc. shall be profit.[15] This is not only reasonable but it is also in accordance with the usual practice. Only profit or its equivalent should attract tax. Nobody should expect a business entity to pay tax on a loss or expense.

In the case of consultancy fee, "contract fee" is not necessarily identical with "profit" except where there are no operating expenses, or where such operating expenses were provided for before arriving at the "contract fee".

However, the 1980 Budget proposal specifically based the withholding tax on consultancy and other similar fees on gross[16] and not net. The same is true of the earlier withholding tax on rent paid by companies.

It appears, therefore, on the face of it, that there is an obvious conflict between the provisions of Sections 8 and 11 of CITA 1979 which is clear on the issue of basing assessment on profits on the one hand, and the 1980 Budget Statement, on the the other hand, which bases the tax withheld on consultancy fees on gross.

C. Withholding tax versus final tax

However, there is a distinction between a withholding tax and a final tax. Withholding tax is in this context a portion of the gross fee withheld as partial payment of tax. It represents only a working basis for determining the actual and final tax payable. Therefore, since the deduction on the gross consultancy fee is only a withholding tax, it may not be right to assume that the final tax when it is determined shall not be based on the profit.

From the nature of consultancy services, instalment payments or remittances (in the case of foreign-based companies) are usually made as the work progresses. Tax on these instalment payments or remittances based on the deemed profit margin on the contract is withheld to meet the tax liability when this is finally determined.

The income statement of the company which is supposed to show the net profit which, after necessary adjustments for tax purposes, will form the basis for the assessment of the company may not have been prepared or presented at the time of the instalment payment or remittance when the tax is withheld. Yet tax has to be withheld on some rational basis at the time of payments and remittances. The most obvious and rational base, and the one which is independently measurable and verifiable at the time the payments and remittances are effected (in the absence of an income statement), is the agreed gross contract fee, reflecting, as much as possible, the deemed profit margin on the gross fee. Any other base may be purely arbitrary and unscientific.

Unless deductions are made by way of withholding tax from payments and remittances, it may be possible that by the time the accounts are presented for the final computation of tax liability, the company may have paid and remitted away part of its tax. Governments usually find it more convenient to owe than to be owed. Therefore, the Government will prefer to refund or credit a company for any excessive tax withheld than to become the creditor of the company for any underdeduction.

Since the tax deducted is only a withholding tax, the final tax to be paid when it is computed may be lower or higher than the withholding tax. This is because the final tax will be based, not on the deemed profit margin on the gross contract fee, but on the actual profit arising from the contract executed.

IV. CONCLUSION

Taxation of consultancy fees is not an entirely new phenomenon in Nigeria. It is covered under Sections 8

14. For instance, 12.5% withholding tax on gross rents paid by companies was introduced in 1979-80 and a withholding tax of 12.5% on dividends paid to shareholders was introduced in 1978-79.
15. Profits may be defined as the return received on a business undertaking after all operating expenses have been met (ibid., American Heritage Dictionary, p. 1045). By implication, profit here is taken to mean net profit and not gross profit.
16. Gross implies exclusive of deductions for expenses; i.e. total or entire fee, unmitigated in any way.

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and 11 of the CITA 1979. The only new dimension to it is the proposal in the 1980 Budget Statement that deduction of tax at source or withholding tax is to apply to interest, rents, royalties, management and consultancy fees and such similar fees. These provisions in the Budget Statement are expected to be passed into law with retrospective effect to 1 April 1980. Hence Revenue is applying the principle of withholding tax on consultancy and such similar fees only in the spirit of the new proposal pending the passing of appropriate legislation.

Withholding tax which is based on the deemed profit on the gross fee is not to be mistaken for the final tax which should be based on the profit of the contract executed.

The former is only an interim measure, a temporary surrogate tax withheld from instalment payments and remittances of the agreed contract fee. When the final tax is determined, it will reflect the necessary adjustments for any under or over deduction of this tax at source. The idea of withholding tax on consultancy and such similar fees is a welcome development which, while safeguarding the interest of the Revenue, does not place the taxpayer at a long run disadvantage.

Confederation of British Industry supports new drive against unitary tax

The Confederation of British Industry is supporting a new drive against American tax laws which are penalising the US operations of British and European-owned multi-national companies. In a move involving the American Supreme Court, the CBI, with other European employers' organisations, is arguing that some of the tax laws enforced by a number of States, including California, Oregon, Alaska and Illinois, infringe the US constitution. The Supreme Court will shortly be asked for a decision.

The challenge which has been mounted concerns "unitary taxation", a system under which a company's tax liability is calculated not on local operations alone, but on a proportion of the world-wide profits of the entire group to which it belongs.

Mr. Bryan Rigby, Deputy Director General of the CBI said today: "Our decision to give our full backing to the statement which has been lodged with the Supreme Court by the Union des Industries de la Communauté Européenne (UNICE) – the confederation of our European sister organisations – is the latest move in the battle over unitary taxation, in which we have now been involved for five years. Our case has the support of the British Government, the European Community, and the US Federal Government."

He said: "We have always argued that unitary taxation is a particularly obnoxious levy. It means some companies will be taxed twice for the same operation. At least 50 British companies with household names – including British American Tobacco, Cadbury Schweppes, Imperial Chemical Industries, Reckitt & Coleman and Unilever – are involved, as well as dozens of French, German, Italian, Dutch and other European multinationals."

Mr. Rigby added: "Not only does it result in multiple taxation. It undermines the arrangements which have been painstakingly built up between governments over the years, specifically to avoid this injustice."

See in this respect: "Identification of the source of income – The unitary system of taxation" by James C. Redmond and the opinion of the Netherlands Federation of Employers VNO and NCW on the unitary system in 35 *Bulletin for International Fiscal Documentation* No. 3/1981 at 99 and 107 as well as "The potential dangerous effect upon international commerce of the "global" or "unitary" basis of assessment", document in which the ICC sets forth its opinion on the unitary system of taxation in 35 *Bulletin for International Fiscal Documentation* No. 4/1981 at 170.

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Offshore Petroleum

Rules of the Ministry of Finance and the General Administration of Customs Concerning the Levy and Exemption of Customs Duties and Consolidated Industrial and Commercial Tax on Imports and Exports for the Chinese-Foreign Cooperative Exploitation of Offshore Petroleum *

(Approved on 28 February 1982 by the State Council, promulgated on 1 April 1982 by the General Administration of Customs and the Ministry of Finance)

In order to encourage Chinese-foreign cooperative exploitation of offshore petroleum, rules for the levy and exemption of customs duties and the consolidated industrial and commercial tax on imports and exports for offshore petroleum exploitation are hereby drawn up as follows:

Article I. The following imported goods shall be exempt from duties and the tax:
1. Machinery, equipment, spare parts and materials verified and approved for direct use in exploration.
2. Machinery, equipment, spare parts and materials verified and approved as necessary imports for direct use in development, in accordance with Article 19 to Article 21 of the "Regulations of the People's Republic of China on the Exploitation of Offshore Petroleum Resources in Cooperation with Foreign Enterprises".
3. Parts, components and materials verified and approved as necessary imports for manufacturing machinery and equipment in China for the exploitation of offshore petroleum (including prospecting, well drilling, well cementing, well logging, mud logging, oil production, work-over, etc.).
4. Machinery and other engineering equipment, temporarily imported for exploitation of petroleum and guaranteed to be re-exported by foreign contractors, shall be exempt from the duties and the tax when imported or re-exported.

Article II. Crude oil received by foreign contractors in accordance with provisions of the petroleum contracts shall be exempt from export duties when it is exported.

Article III. Customs duties and consolidated industrial and commercial tax shall be levied on imports and exports beyond the scope specified in Article I and Article II above according to The Customs Import and Export Tariff of the People's Republic of China and the Regulations of the Consolidated Industrial and Commercial Tax of the People's Republic of China (Draft).

Article IV. All goods imported free of the duties and the tax shall not be used for other purposes without Customs' approval. Breaching of these rules shall be dealt with by the Customs in accordance with "The Provisional Customs Law of the People's Republic of China".

Annex: List of Imported Goods Exempt from the Duties and the Tax for the Chinese-Foreign Cooperative Exploitation of Offshore Petroleum

I. Goods verified and approved as necessary imports for direct use in exploration:

A. For geophysical exploration:
1. Ships for geophysical exploration and accessory equipment thereof.
2. Seismographs, components and accessories thereof, gravimeters and magnetometers and accessories thereof.
3. Hydrophone streamers and accessory equipment thereof.
4. Data processing computers and accessory equipment thereof.
5. Seismic tapes.
6. On-land navigation and positioning equipment and accessory facilities thereof.

B. For well drilling:
1. Various offshore drilling installations, including jack-ups and semisubmersible drilling rigs, floating drilling ships and drilling platforms as well as tender ships, working boats and service vessels.
2. Drilling rigs, and components, accessories or fittings thereof.
3. Well cementing equipment and auxiliary equipment, including cement mixer and feeding equipment.
4. Well logging equipment and auxiliary equipment including electrical logging instrument, mud logging instrument, directional survey instrument and other logging instrument.
5. Production testing equipment, work-over equipment, and components or accessories thereof.
6. Special tools for well drilling, including drilling bits, drill collars, drill pipes, deviation control tools, fishing tools and other tools.
7. Drilling mud treating equipment and chemicals.
8. Materials used exclusively for oil wells, including tubing, casing, wellhead equipment and subsea equipment and tools.
9. Oil well cements and various additives.

C. For safety and lifesaving:
1. Various kinds of equipment, spare parts and materials for blowout prevention.
2. Various kinds of equipment and materials for fire prevention and fire fighting.
3. Various kinds of equipment, accessories and tools for lifesaving.
4. Special labor protection outfits for personnel working offshore.
5. Equipment and materials for diving operations.

D. For transportation and communications:
1. Helicopters and facilities for helipad.
2. Vessels for transportation, communications and convoy, and accessory equipment therefor.
3. Various kinds of equipment and outfits for wire and radio communication.

* Unofficial translation.

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E. For fuels and oils:
Special fuels, lubricating oils and cooling fluids necessary for offshore petroleum operations.

II. Goods verified and approved as necessary imports for development, or, oil field construction:

A. For oil production:
1. Production platforms, including oil production platforms, oil-gas processing platforms, living platforms and flare platforms.
2. Offshore oil loading facilities, including single-point mooring, single articulated leg mooring, oil storage vessels, under-water oil storages and loading berths.
3. Vessels for offshore construction operations.
4. Power generating equipment and accessories thereof, including internal-combustion engines, steam turbines, gas turbines, steam engines, generators and electric motors as well as controlling panels and related installation.
5. Injection equipment and accessories thereof, including water and gas injection as well as facilities for water and gas treatment.
6. Downhole packers and downhole blowout preventors.
7. Cranes, lifting equipment and tools.
8. Oil (gas) transportation equipment, line pipes, and valves and pipe fittings thereof, equipment for pumping and boosting stations and onshore terminal, and valves and pipe fittings thereof, including various kinds of pumps, equipment for liquid separating, heat-exchanging, purifying, and compressing, various kinds of measuring, monitoring and parameter indicating meters, and various kinds of valves and pipe fittings thereof, various kinds of electric instruments and cables.

B. For automation, remote controlling and telemetering:
1. Various kinds of installation and meters.
2. Air-conditioning equipment.

III. Parts, components and materials verrified and approved as necessary imports for manufacturing equipment and machinery in China for the exploitation of offshore petroleum.

IV. The importation of the above-mentioned goods shall be subject to the verification and approval of the Ministry of Petroleum Industry.

LATIN AMERICA

New statute for Andean multinational enterprises introduced

by Pedro Massone

The Commission of the Cartagena Agreement (Andean Group) approved Decision 169 of 1982 containing a statute for Andean Multinational Enterprises (Empresa Multinacional Andina – EMA).

EMAs are enterprises which comply with the following conditions:
(1) have their domicile in a member country;
(2) at least 80% of their capital belongs to national investors from 2 or more member countries (for 10 years the percentage is 60% for Bolivia and Ecuador);
(3) investors from the country where the principal domicile of the EMA is located hold at least 15% of the capital; the same condition is to be complied with as regards investors from at least one other member country;
(4) the majority of Andean capital is reflected in the technical, administrative, financial and commercial control of the EMA; and
(5) the EMA is organized as a corporation and its capital is represented by registered shares bearing equal rights and charges.

EMAs can be established by the creation of a new corporation or by the reorganization of an old enterprise. They are subject to the law of the country where they have their principal domicile and are additionally registered with the Junta of the Andean Group.

EMAs organized under Decision 169 shall enjoy the following benefits:
(1) the advantages of the Andean liberalization program;
(2) the same treatment applicable to national enterprises performing the same economic activities, as regards internal taxes;
(3) access to local credit and financial transactions under the same rules applicable to national enterprises performing the same economic activities;
(4) exemption from authorization requirements for investments and reinvestments to be carried out in the country where the EMA has its principal domicile. Reinvestments are subject to registration. If the investment is carried out in a member country other than that where the EMA has its principal domicile, the investment is subject to registration; moreover, authorization from the recipient country is needed in order to participate in economic sectors reserved to national investors;
(5) the right to establish branches in any member country and to transfer full net profits of those branches to the EMA's head office in foreign currency and with the authorization of the competent authority (this means that the percentage limit established in Article 37 of Decision 24 does not apply);
(6) the right to transfer abroad, in foreign currency and with the authorization of the competent authority, the entire profits of the EMA belonging to foreign or to subregional investors (this means that the percentage limit established in Article 37 of Decision 24 does not apply);
(7) avoidance of double taxation of income, under the following rules:
- dividends paid by the EMA out of profits previously taxed in the member country where the EMA has a branch shall be exempt in the country where the EMA has its principal domicile. Subsequent redistribution made by the investor enterprises (i.e. EMA shareholders) out of the same dividends shall also be exempt as aforesaid; and
- income representing redistributions made by investor enterprises (i.e. EMA shareholders) out of dividends received from EMAs which have previously been taxed shall be exempt in other member countries.

Decision 169 shall enter into force upon the deposit of the instruments of ratification by two countries.

Decision 169 does not revoke the old statute contained in Decision 46 and once Decision 169 enters into force it will be possible to organize EMAs under either of the statutes. The possibility of benefiting from both statutes simultaneously is excluded and it can be expected that the new statute will be preferred.

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Financial institutions in Hong Kong: A reappraisal

By I.W. Harris*

The 1982 Budget introduced by Hong Kong's new Financial Secretary Mr. John Bremridge earlier this year, in February, contained two further major proposals concerning the taxation of interest in Hong Kong. However, before detailing these proposed amendments to the Inland Revenue Ordinance it may be worthwhile to spend some little time, for those who are not familiar with the law, on the history of the taxation of interest in general in Hong Kong and the 1978 amendment in particular.

Hong Kong's tax legislation was introduced in 1947 and was based on the schedular system whereby income from "profits", "salaries", "property" and "interest" was all separately assessed. This departure from the normal full income tax system was due in the main to the local population's traditional opposition to the powers of Governments to probe into personal wealth. A further fundamental concept of the legislation is that it is territorial in nature and thus only seeks to bring into the charge income "arising in or derived from" Hong Kong. Over the years, Hong Kong has grown considerable, not only in terms of population from approximately 1.8 million in 1947 to over 5 million at present, but also in the nature of its trade. In 1947 Hong Kong was struggling to pick up the pieces after the Second World War and to establish itself once again as a premier port in the region, but successive waves of immigration from China not only had the effect of increasing the population but also brought in new skills, particularly the textile manufacturers who had come from Shanghai. Thus Hong Kong's role as an entrepot changed over the years until by the 1960's Hong Kong had emerged as a major manufacturing and trading nation and now ranks among the top 20 in the non-oil producing world. The expansion of the manufacturing sector necessitated a parallel expansion in the financial sector to finance trade and the necessary infrastructure. This vigorous growth coupled with the Hong Kong Government's traditional policy of laissez faire – including a benign tax law as to both its scope (territorial) and rates (from a standard rate of 10% in 1947 to 15% in 1966 and the present corporate tax rate of 16½% – led to Hong Kong becoming what is now considered the third most important financial centre in the world after London and New York.

With the rise in importance of Hong Kong as a financial centre, the importance of interest tax increased with collections rising from HK$ 3M in 1951/52 to HK$ 540M in 1980/81 and thus this is perhaps an opportune moment to stress the practical effect of Hong Kong's schedular system. Although perhaps roughly modelled on the U.K. Schedules contained in the Income and Corporation Taxes Act 1970, the Hong Kong system does, however, give rise to confusion in the minds of many, even in Hong Kong. Thus there is no full income tax in Hong Kong and only in certain restricted instances is a person required to complete one tax return showing all his income from, say, a business, a salary from an employer, rent from a property and interest on a fixed deposit. Instead, each source is assessed separately and different rules apply in relation to each of the 4 schedules. Interest tax is levied at the standard rate "on the recipient of any sum paid or credited to him in that year being (a) interest arising in or derived from the Colony . . ."[1] However, although the interest tax is a tax on the lender, the tax itself is paid by the borrower, ". . . at the time he makes the payment or credit".[2] There are a number of exemptions from interest tax, the 2 most important of which for the purposes of this article are (a) interest paid by banks or public utilities at, or lower than, what is generally known as the savings bank rate and, more importantly, (b) interest paid *to* a bank carrying on business in Hong Kong. Thus banks are exempt from interest tax but, of course, are liable to Profits Tax at the rate of 16½%, which I shall discuss in more detail below. Before leaving interest tax, mention must be made as to what determines whether interest arises in or is derived from Hong Kong. After years of uncertainty the Inland Revenue Department issued guidelines in 1978[3] which laid down that the true test was where the provision of credit was made available to the borrower. The Revenue's support for this view was obtained from a number of Commonwealth tax cases including CIR v. Philips[4] and CIR v. Lever Brothers[5].

We turn now to the Profits Tax which is levied on "every person carrying on a trade, profession or business on the Colony in respect of his assessable profits arising in or derived from the Colony . . .".[6] Assessable profits are defined as "profits in respect of which a person is chargeable to tax . . .".[7] The test for what profits are subject to Hong Kong tax is based on 2 Hong Kong court decisions in the Hong Kong and Whampoa Dock[8] and International Wood Products[9] cases, giving rise to what is known

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1. Inland Revenue Ordinance, Section 28 (1)(a).
2. Id., Section 29 (1).
3. Departmental Interpretation of Practice Notes No. 13.
4. Commissioner of Inland Revenue (NZ) v. NV Philips Gloeilampenfabrieken, 10 ATD 435.
5. CIR v. Lever Brothers and Unilever Limited (1946) 14 SATC 1.
6. Inland Revenue Ordinance, Section 14.
7. Id., Section 2.
8. HKTC 85.
9. HKTC 551.

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as the "operations test". In other words, this test relies on the fact that the source is determined where the majority of the actions leading to the profit actually took place, which of course is very different from the test used for interest tax purposes. It may be easier for the reader to understand the "operations test" principle by a brief discussion of the 2 cases referred to above.

The Dock case concerned a salvage operation in the South China Sea many miles from Hong Kong which was where the company was incorporated and carried on its business. Although much of the initial work, including the contract concerning the salvage operation, was carried out in Hong Kong, nothing would have been earned if the rescue tug had not gone to sea to perform the actual operation. The Court held, therefore, that the profit was earned outside of Hong Kong.

In the Wood Products case the company acted as agent in Hong Kong for 2 companies in the Philippines for the sale of timber. The company appointed sub-agents outside of Hong Kong who sent orders direct to the principals, payment being made direct in most cases. The company received commission and passed on sub-commission and the Court agreed that the "operations test" applied and that the commission did not arise from the carrying on of a business in Hong Kong but as a result of the efforts of the sub-agents of Hong Kong.

Although the tax legislation was very productive of Revenue with yields from the Earnings and Profits Tax rising from HK$ 154 million in the year ended 31 March 1961 to HK$ 778 million in the year ended 31 March 1971 and to HK$ 7,964 million in the year ended 31 March 1981[10], it became clear that there was a need to step back and look at the position in the light of the current trading and economic situation in Hong Kong. Thus in 1976 the Third Inland Revenue Ordinance Review Committee (TIROC) was formed by the Government to "consider the present system of taxation of profits and other forms of income contained in the Inland Revenue Ordinance, and in particular:

. . .

d. the treatment of interest and the relief for interest paid;
e. the territorial ambit of the various charges (having regard, inter alia, to the effects of changing commercial practices and recent case law; . . ."[11]

The Committee issued its report in December 1976 and amongst its many recommendations was one that questioned the application of the territorial source concept as it related to financial institutions. The Committee felt in respect of offshore interest, i.e. interest arising outside of Hong Kong, that, ". . . the temporary reinvestment of money which a depositor places for the time being in the hands of a financial institution is one of the central activities of the institution's business . . .".[12] Thus the Committee argued the interest actually arose in or from Hong Kong and should be assessed accordingly.

To the financial institutions in Hong Kong this proposal came as an unprecedented move. The draft legislation was published as a Bill in March 1978 the main thrust of which was to add a further deeming clause to Section 12 of the Ordinance in the following terms:

(i) sums not otherwise chargeable to tax under this Part, received by or accrued to a bank or other financial institution by way of interest which arises directly or indirectly through or from the carrying on by the Bank or other financial institution of its business in the Colony, notwithstanding that the moneys in respect of which the interest is received or accrues are made available outside the Colony."

In addition, there were definitions of "financial institution" and for the purposes of this definition "associated corporation" was also defined. for those used to the convoluted and lengthy wording of the Australian, United Kingdom or U.S.A. tax acts, the length of the new legislation was perhaps surprisingly short. However, despite Hong Kong's importance as a financial centre and a major trading nation, the Inland Revenue Ordinance still contains only 88 sections and 4 very short shedules.

There followed a series of attacks both in the Legislative Council (Parliament) and in the press with the main focus being on the legislation's discriminatory nature and the apparent abandonment of Hong Kong's territorial source concept of tax legislation and its retrospective effect. In defending the proposals in the Legislative Council, the then Financial secretary, Sir Philip Haddon-Cave, said on 12 April 1978 that, "when a bank or a financial institution obtains funds, whether locally or abroad, through its operations in Hong Kong and places the funds abroad to earn interest, the profits from such interest will be taxed irrespective of the provision of credit test. To determine whether interest on a loan arises, directly or indirectly, through or from the carrying on of business in Hong Kong will require an examination of the totality of the circumstances relating to where and how the deposits are garnered and the funds on-lent. In most cases, the determination will be relatively straightforward, but in the case of some lare foreign currency loans problems may arise". He went on to say that there were a number of misconceptions in that, "it has been suggested that tax will be charged even where the role of the Hong Kong end of the business is negligible (for example, where it does little more than make certain book entries, commonly known as "book" or "garaging"). In these circumstances, the interest clearly could not be said to have arisen in Hong Kong". The Financial Secretary said that another misconception was that, "it has been suggested that the Bill fails to reflect the recommendation of the Review Committee in that, as drafted, it has the effect of bringing to charge a wider range of profits than was envisaged by the Review Committee and that the Bill should only seek to bring to charge profits derived "without the substantial intervention of a branch elsewhere". This is an expression used by the Review Committee to describe profits which it considers should be taxed, but, "if it is shown, on the facts of a particular case, that the profits from interest arise partly from the business in Hong Kong and partly from the substantial intervention of an overseas branch, a reasonable apportionment of the profits will have to be made". As regards the territorial source concept, Sir Philip said it

10. Annual Reports of the Commissioner of Inland Revenue.
11. TIROC, Para 1.
12. TIROC, Para 132.

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was not true that a change had been made from a source to a residence basis and said that, "where a business is carried on in Hong Kong and the profits of that business arise in Hong Kong, such profits clearly have a territorial connection with Hong Kong. However, because case law has established that artificial provision of credit test, some profits from interest have been escaping the charge to tax. The Bill does no more than correct this situation, but is does so by reference to business activities carried on here, and *not* by any arbitrary test related to residence".

On 16 August 1978 when the debate on the Bill was resumed, the Financial Secretary once again defended the Bill against its critics but he did however concede some points to the opposition, including:

(a) an amendment to the definition of "financial institutions"; and
(b) the delection of the words "directly or indirectly" from the main body of the amendments and thus the final version read as follows:
"(i) sums, not otherwise chargeable to tax under this Part, received by or accrued to a financial institution by way of interest which arises through or from the carrying on by the financial institution of its business in the Colony, notwithstanding that the moneys in respect of which the interest is received or accrues are made avaible outside the colony".

For most financial institutions the legislation was retrospective as it became effective as from 1 April 1978 in as much as the majority of them had financial years ending on 31 December or 31 March and thus had already earned profits prior to the passing of the amendment. The attention of the financial community then turned to the Inland Revenue Department in an attempt to obtain some comfort that the soothing statements of the Financial Secretary would be translated into practice by the Revenue despite the somewhat tougher stance reflected in the actual wording of the law. The Revenue did issue a Practice Note which, however, did little to clarify the position and did little else other than asking that the full facts should be disclosed in all cases. This attitude failed to mollify the critics or allay their fears although some commentators including the writer considered that the Revenue would take a reasonable attitude.

And so it turned out to be. Certainly the suggestion made in some quarters that the introduction of the legislation would mean a mass exodus of financial institutions to other centres did not take place. In fact, when the then current moratorium on bank licences was lifted in May 1981, a new surge of international banks arrived on the local scene. The first returns under the new legislation were not submitted until the middle of 1979, and not unnaturally it was some time before any pattern emerged from the Revenue. The Revenue's initial efforts appeared to be merely detailed requests for more information which some tax advisers considered unreasonable and unnecessary, but it was perhaps inevitable that the Revenue were almost as unsure as to how to interpret the new law as the tax advisers. In mid-1981, a change of personnel in the Revenue Department marked, some considered, a change of emphasis although it is probably fairer to say that the fact gathering stage had been completed an the Revenue were now able to issue assessments based on the new law. By the end of 1981, final assessments were being issued and initial indications were that the Revenue were indeed taking a reasonable attitude. One perhaps surprising development was, however, that the question of any apportionment had rarely been considered and what the Revenue was saying in effect was that either the interest was wholly from Hong Kong or wholly from outside, each case being decided on the weight of the facts. This at least avoided taxation problems and was generally welcomed by the financial institutions. In certain circumstances, however, where the Revenue considered that interest arose in Hong Kong, they were prepared to accept an apportionment where there had been a substantial intervention by a branch. A further concession readily accepted by the Revenue was that although the Financial Secretary had referred to the substantial intervention of a "branch", this was extended to include a company. Although most banks operating in Hong Kong operate through a branch, most deposit taking companies operate through a branch, most deposit taking companies operate through a subsidiary.

In the meantime, however, a further piece of legislation was enacted to counter an avoidance device that had been exploited by certain financial institutions. As can be seen from the wording of Section 15(1)(i) quoted above, only so-called offshore interest had been brought into the net. What a number of financial institutions had been tempted to do was to convert interest into discount by offering Certificates of Deposit and other similar instruments generally in U.S. dollars which, provided they were redeemed prior to maturity, did not give rise to any interest payment. Therefore they claimed that the profit was exempt from profits tax. In the writer's opinion, however, some of the schemes offered could have been caught by the existing legislation but nevertheless the Revenue, not unsurprisingly, moved to counteract such blatant avoidance devices and a Bill was introduced into the Legislative Council as a result of the 1980 budget speech. The effect to the proposed amendment was to bring in yet another deeming provision in Section 15(1)(j) which sought to close the 2 loopholes in the previous law:

(a) the disposal by individuals and corporations of Certificates of Deposits prior to maturity whereby the profit received is not interest but a profit on sale of a security which is not taxable unless of course the taxpayer was a dealer in securities;
(b) the purchase of bills of exchange and other similar instruments at a discount and the redemption thereof at face value which, again, if held by persons who were not dealers in securities would not be subject to tax.

It should be noted that there was no mention of the currency of the "instrument" in the law and therefore, although clearly Hong Kong dollar denominated Certificates of Deposits and Bills of Exchange came within the net, those denominated in foreign currency would only be brought in if the provision of credit test showed that the deemed interest had a Hong Kong source. The Bill became law on 28 May 1981 and was operative with effect from 1 April 1981.

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We now come to the 1982 amendments. Despite the number of international banks operating in Hong Kong, many bankers considered that Hong Kong's claim to be a major financial centre still had one major drawback: the interest withholding tax. This was despite the fact that it was relatively simple to avoid Hong Kong withholding tax by ensuring that the provision of credit was made abroad. This enabled Hong Kong depositors to place funds with offshore branches of local banks without incurring any interest tax liability and enabled Hong Kong businesses to borrow funds without the need to withhold tax. The Hong Kong Association of Banks made a submission to the new Financial Secretary, Mr. John Bremridge, and he was persuaded to abolish the withholding tax on foreign currency deposits. This meant that Hong Kong banks were able to accept foreign currency deposits. Under the previous system such deposits would have been booked in offshore banks such as Singapore, Bahrain, Jersey or Nassau. This may have been good news for depositors, but for Hong Kong based banks it meant that the profits earned on such deposits now came within the Hong Kong profits tax net. As a follow-up measure to the abolition of interest tax on foreign currency deposits, the Financial Secretary reduced the standard rate on Hong Kong dollar deposits from 15% to 10%. He said in so doing that unless such a measure was taken it would provide an encouragement for all Hong Kong depositors to switch from Hong Kong dollars to foreign currency with the resultant effect in exchange rates. He considered a 10% rate sufficient to retain Hong Kong deposits without incurring exchange risks.

So this is the position in the middle of 1982 – much has changed in the past 4 years, but it is probably fair to say that on the whole it has been for the good of Hong Kong although individual bankers facing increased tax assessments can hardly be expected to accept this position. The final story on Section 15(1)(i) has still to be written, but at least it can be said that the worst fears of bankers have not materialised, but it will not be until one or more cases come to the Courts, as undoubtedly they will, that the final chapter will be written.

BERMUDA:

Fiscal Structure of a Low Tax Country

By H.W.T. Pepper

The article under this title in the August/September 1982 issue described the Fiscal system in Bermuda. The author wishes to give further elucidation and updating.

Condominiums and time-sharing tax – service tax (P. 406, left column, last para). While Time-Sharing has given scope for sharp practice in some countries, in Bermuda all payments must *initially* go into escrow and then a Trust Fund is set up to protect the interests of investors.

Transportation Taxes (P. 406). The 1982/83 Budget increased the license fees for Motor cars, Commercial Vehicles, and motor cycles and motorised bicycles, respectively from $ 80 to $ 265, $ 175 to $ 1320, and $ 9 to $ 45.

Land Tax (P. 407). The second sentence of the second paragraph dealing with the *Basis of Valuation* should read "Rent control applies to residential units with an ARV of $ 7,500 or less but the land tax payable is taken into account in fixing the controlled rent". The second sentence under the heading *Dates of Payment* should read, "A person who wishes to register a motor car must, when applying, quote the street name and house number or valuation number of his residence. This requirement helps to enforce the rule that there may be only one motor-car per household". The first sentence under *Rates of Tax* should read "Properties with ARV's up to $ 2220 pay tax at 3% and the rates graduate to a maximum of 20%.

The *Transfer tax* (p. 407 last paragraph) of 10% on non-Bermudians referred to under sub-paragraph 2 is regarded as a licence fee.

Stamp Duties (P. 408 first entry) the rate of 0.25% applies to all items mentioned in the second paragraph.

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Property Taxes in the Caribbean Community

by George E. Lent

Caribbean states that now compise the Caribbean Community (CARICOM)[1] provide an interesting study in the diversity of annual taxes on real property. A number of significant features emerge in this comparative study:

(1) All but a few of the states continue to levy rates based on the annual value system implanted by the British.

(2) Several governments have extended what is traditionally a tax on urban buildings to cover agricultural and urban land as well.

(3) Extensive cadastral surveys have been undertaken in many of the islands, some strictly for legal registry of land, others expressly for land tax purposes.

(4) Because of generally low rates, undervaluation and tax relief, property taxes have failed to realize their revenue potential.

(5) In no state does the annual tax on real estate make an important contribution to government revenue.

It is hoped that this survey will point the way to a more rational system of property taxes in this part of the world that will improve their economic and administrative efficiency and enhance revenue.

1. DIVERSITY OF THE TAX BASE

The British rating system, based on the annual rental value of buildings, provided a simple model for transplanting to the West Indian colonies. Similar systems, sometimes called a land or house tax, continue to be in effect in all but a few of these countries and territories. Barbados, Grenada, and Jamaica have replaced rental value and other rates by taxes based on the market value of land or of land and improvements;

Trinidad and Tobago had planned as early as 1962 to replace the annual value system with a modified site value tax but finally, in 1973, decided to retain annual value rating.

Jamaica was the first to rationalize its property tax system when in 1901 it replaced its quit rent based on acreage, a house tax based on annual rental value, and a graduated holdings tax with a tax based on the market value of land and improvements (capital value).[2] Tax was assessed on the value of property declared by landowners (so-called ingivings), which was updated in 1911, 1929 and 1937. By 1943 the chaotic state of the self-assessed property tax led to the appointment of a Commission of Inquiry under the chairmanship of Simon Bloomberg. The Commission recommended replacement of the capital value tax by a tax based on unimproved land value, also to be self-assessed. Work on the project was initiated in 1949 and revived in 1951 but was finally suspended because of the lack of maps and other resources. The unimproved land value principle was challenged in 1954 by the British economists Ursula F. and John R. Hicks who, in a broader study of Jamaica's finances, recommended revitalization of the capital value approach.[3] The issue finally was resolved in favor of unimproved land value when in 1956 a United Nations adviser, J.F.N. Murray, strongly supported it.[4] This concept was incorporated in Jamaica's Land Valuation Act which became effective in January 1957. The first 7 parishes were brought under the new law between 1959 and 1965, but with a change in government in 1962 work on the cadastral survey was suspended and was not resumed until 1972. The important urban parishes of Kingston and St. Andrew were then assessed and the old system finally phased out in 1974. During this period of 15 years, the new and old rating systems existed side by side.

Barbados had long imposed a tax based on annual ratable values when in 1969, following the recommendation of a United Nations report in 1963, it enacted a Land Valuation Act preparatory to introducing a tax based on unimproved land value. After completion of a cadastral survey in early 1973 and enactment of the Land Tax Act, rates under the new law were levied for the fiscal year 1972/73. In 1975, however, the site value system was modified to include tax on improvements with a value in excess of BDS$10,000 (1 BDS$ = U.S.$0.50).

As was indicated above, Trinidad and Tobago introduced a project to replace its annual value system with a modified site value tax.[5] The Valuation Land Act was approved in 1969 and the cadastral survey of the entire country was completed early in 1973. Despite plans to introduce property tax legislation in 1973 that would include a levy on land and the value of improvements exceeding a specified ratio to the site value, vigorous protests in the capital against earlier increases in the house tax deterred action. Sharp increases in the price of oil, produced domestically, then made higher taxes unnecessary, so that Trinidad and Tobago has never replaced its house tax based on annual rental values.

In 1965 Montserrat initiated a series of property tax reforms with replacement of its acreage tax by an annual value system at a rate of 5%.[6] This was revised in 1967 by adoption of a modified site value tax, but the form of annual value rating was retained by converting the market value of land to annual values, first at 15% and later (1974) at 20%. Buildings were taxed only when 5 or 6%

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1. Included are: Antigua-Barbuda, Belize, Barbados, Dominica, Grenada, Guyana, Jamaica, Montserrat, St. Kitts-Nevis-Anguilla, St. Lucia, St. Vincent and Grenadines, Trinidad and Tobago. Also referred to are certain British dependencies in the Caribbean: Cayman Islands, British Virgin Islands, Turks and Caicos.
2. For a brief account, see O. St. Clare Risden, "A History of Jamaica's Experience with Site Value Taxation", in Roy W. Bahl, editor, *The Taxation of Urban Property in Less Developed Countries* (Univ. of Wisconsin Press, Madison, Wis., 1979).
3. J.R. and U.K. Hicks, *Report on Finance and Taxation in Jamaica* (Kingston: Government of Jamaica, 1954).
4. J.F.N. Murray, *Report to the Government of Jamaica on Valuation, Land Taxation and Rating* (Kingston: Government of Jamaica, 1956).
5. Ralph A. Pierre, "Background to the New Rating System in Trinidad and Tobago", Third Regional Conference of Commonwealth Caribbean Tax Administration, Antigua, 1972 (mimeographed).
6. "Taxation of Land and Buildings in Montserrat", First Meeting on Property Tax Administration, Basseterre, St. Kitts-Nevis, 10-11 Nov. 1980 (mimeographed).

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of the value of land and buildings exceeded 20% of the land value; the tax therefore fell most heavily on land. In 1974 graduated rates were introduced at 5% of the first $500 and 10% above that. By 1980 Montserrat considered abandoning its formal annual value structure in favor of modified site value tax which was believed to be more attractive from a rate point of view.

Grenada, in January 1982, was the latest of the Lesser Antilles to reform its annual value rating system. In March 1982 the Government announced a new rate structure based on the market value of land and improvements that were appraised by Government assessors the previous year.[7]

2. ROLE OF THE CADASTRE

Despite long established property taxes, in none of the 3 countries – Barbados, Jamaica, or Trinidad and Tobago – was there a complete official record of land holdings that would make it possible to identify their location, dimensions, and ownership. Indeed, there were no maps of the country that could be used to prepare a cadastre for tax purposes except in Trinidad and Tobago where local ward maps proved useful. Without extensive field work there would be no basis for determining the value of land parcels equitably, ensuring that all properties were covered, and identifying the persons liable for tax. The preparation of a cadastre was therefore indispensable to the administration and control of a national property tax.

It had long been believed that a cadastre of registered titles to land was essential for this purpose; in fact, proposals to introduce a general property tax in Jamaica before the turn of the century were frustrated by the great cost and time required for such a survey. Sir David Barbour, in his report, *Finances of Jamaica* (1899), stated:

> Until a cadastral survey of the Island has been made the assessment of the annual value of all land must be attended with much difficulty . . . . Such a survey was proposed, and strongly supported, in former years, but was ultimately dropped on the ground, apparently, of the cost involved in carrying it out.[8]

In embarking on the land tax projects in these 3 countries it was decided that a detailed cadastre that demarked boundaries and authenticated title was not essential for the proposed levy and would take undue time and cost to carry out. Something less definitive would serve the purpose; this is called a fiscal as distinguished from a legal cadastre.

The major stages in the process of preparing a fiscal cadastre include (1) mapping and editing, (2) referencing, and (3) market analysis and valuation.[9] Working from aerial photographs in Barbados and Jamaica, survey teams prepared valuation index maps (248 in Jamaica); on these maps were plotted the properties for which survey plans were available; missing areas were then filled in by surveys in the field. These maps served as the basis for the numerical referencing of all land parcels, each parcel being identified by map number, grid number, block number, and parcel number. The identification of ownership (or occupancy) and valuation of land was coordinated with the mapping. The Commissioner of Valuation was authorized to place on the roll as the taxpayer the person who on the best evidence available he believed to be the owner.

One of the advantages claimed for unimproved land value taxation is that mass valuation of properties is facilitated. Analysis of sales and other valuation data makes it possible to establish unit values which can be used to value parcels in different areas; weights can be assigned to different locational and physical characteristics of the land by multiple correlation techniques. Computer analysis of these factors in Trinidad and Tobago was based on a sample of 10,000 parcels; about 4,500 parcels were analyzed in Barbados.

Although the United Nations provided substantial support to these projects by underwriting the cost of administrative experts and equipment, the major cost was incurred by the countries themselves in the establishment of land valuation departments. Barbados had a staff of 42 persons, Trinidad and Tobago about 100 technicians and experts; the earlier (1952-62) staff of Jamaica totaled about 80 persons, and the later one (1972-74) about 150 persons.

Once a valuation staff was organized and trained and maps made available, the field work was completed fairly expeditiously. About 48,600 parcels in Barbados were identified, mapped, and valued over a period of about 2 years; in Jamaica 171,240 parcels were completed in 7 parishes over the 4-year period beginning in June 1957; and in Trinidad and Tobago about 160,000 parcels were valued within a period of about 2 years, 1971-73. It is noteworthy that all of these surveys turned up thousands of properties that were not previously on the tax roll. For example, Jamaica's earlier cadastre for 7 parishes included 23,800 parcels not taxed before – about 11.5% of the total. On the other hand, it was not possible to establish the ownership of land for many parcels, almost 10%, in Barbados.

Some indication of the quality of the undertaking is given by the record of objections to the assessed values. Over the entire project in Jamaica, owners of about 9% of the parcels filed objections; the ratio ran as high as 15% in the metropolitan area. This high ratio can be attributed in part to the substantial tax increase involved in most cases in the shift to the new site value tax as against previously self-assessed taxes.[10] This ratio contrasts with an objection rate of less than 3% in Barbados despite an average doubling of the tax on property. The experience of Trinidad and Tobago is moot because its proposed modified land value tax was never introduced.

In contrast to the fiscal cadastres completed in Barbados, Jamaica, and Trinidad and Tobago, legal cadastres have

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7. *Barbados Advocate,* 29 March 1982.
8. Cited by Wilfred Chang, "Recent Experience of Establishing Land Value Taxation in Jamaica", in *International Seminar on Land Taxation, Land Tenure, and Land Reform in Developing Countries* (Hartford: The John C. Lincoln Institute, 1967).
9. See United Nations, *Manual of Land Tax Administration,* 1968, for an excellent exposition of the process.
10. Daniel M. Holland, "Jamaica and Barbados", in The Lincoln Institute of Land Policy, *Property Tax Reform,* Lincoln Institute Monograph No. 77-11, December 1977, p. 70.

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been installed in several smaller islands of the eastern Caribbean with the technical assistance of the Directorate of Surveys of the British Overseas Ministry. These cadastres provide for registration of titles to land, hitherto incomplete, rather than as a basis for taxation. Additional steps therefore needed to be taken for the demarcation of boundaries and authentication of ownership before a certificate of title could be granted. The islands in which work was completed and the time period involved are the following: Turks and Caicos, 1968-72; British Virgin Islands, 1972-74; Cayman Islands, 1972-77; Anguilla, 1974-76; Antigua, 1975-80; and Montserrat, 1978-81.[11] The United Nations has drafted plans for a cadastral survey and land registration project for the Commonwealth of Dominica, but no action has been taken.

3. TAX RATES AND YIELDS

In one of the countries of the CARICOM do property taxes play an important revenue role. Jamaica's land taxes account for less than 4% of total tax revenue (3.6% in 1976/77); Barbados' modified land taxes contributed 3% of total tax revenue in 1980/81; Guyana's property tax amounted to 1% of tax revenue in 1978/79, and Trinidad and Tobago's to a miniscule one quarter of 1% in 1978/79. Of the smaller islands that comprise the Eastern Caribbean common market subregion, only Montserrat's system yielded as much as 5% of total revenue (Montserrat's population is about 12,000); in none of the others did property tax revenue exceed 1% of total revenue over the period 1975-1980.[12]

Realizing the revenue potential of a property tax is inhibited by the sensitive nature of a levy based on administrative assessment. Unlike an income tax or sales tax the payment of which generally reflects some measure of current taxpaying ability, a tax based on gross wealth is not well correlated with current income or liquid assets necessary to meet the payment. This fact places a certain political constraint both on tax rates and the tax base either through underassessment or special relief. It is also true, as in Trinidad and Tobago, that the availability of more important revenue sources relieves pressure on property taxes and they become neglected.

a. Tax rates

The negligible revenue of most of these countries with annual value taxes can be explained by the nominal rates of ½% to 1% that are in effect. Even rates of 7% to 9% that have been levied in Trinidad and Tobago have been unproductive by comparison with countries basing their tax on the value of land or land and improvements. Since capital value is some multiple of annual value, or yield, a multiple of, say, 5 would make an annual value rate of 1% equivalent to only 0.2% of capital value. Such a low capital value rate is rarely found. Montserrat beginning in 1967 calculated the annual value of land at 15% of its market value, and beginning in 1974 at 20%; its 5-10% annual value rate therefore was equivalent to 1-2% of land value – a level of rates found in Barbados. This rate barrier of 5-10% apparently was the main reason why Montserrat intended to replace its annual value rates with a capital value tax structure, thereby permitting a lower apparent rate.

The rate structures of Barbados, Grenada, and Jamaica are graduated with the value of individual properties. Jamaica's basic rate structure starts at a flat J$5 on the first J$2000 of land value; it then increases from 1% on land values between J$2000 and J$6000 to 4.5% on values over J$50,000. (The Jamaican dollar is equivalent to about U.S.$0.56.) These rates are subject to surtaxes which, commencing in 1976/77, ranged from 10% of tax on values between J$12,000 and J$13,000 to 50% of tax on values over J$50,000. Such rates may appear to be relatively high, but in 1975 about 80% of property owners paid only the nominal charge of J$5 and only about 6% (3050) paid the top marginal rate of 4.5% on property assessed to over J$50,000.[13] Moreover, the tax is applied to unimproved land value and would be equivalent to a much lower rate on capital value (including improvements). If, for example, a house were valued at twice the value of the site, the tax rate yielding the same revenue would be one third of that on the land alone, that is, a top marginal rate of 1.5% (plus surtax), rather than 4.5% (plus surtax).

Grenada's rates range from nil on residential property valued under EC$15,000 to a maximum of 0.5% on property valued at EC$200,000 and over. (The Eastern Caribbean dollar is equal to U.S.$.37.) Commercial property is subject to a 0.8% rate, and property used primarily for agriculture, only 0.1%. These rates are surprisingly low for a tax on land and improvements, especially for a leftist government.

Barbados' land tax was introduced in 1972 at a uniform rate of 1%. In 1975 a new concept, "improved site value", was established and differential rates were introduced. Improved site value is the value of all improved properties in excess of BDS$10,000; all improved land with a value under BDS$10,000 was taxed at a site value rate of 1%, while improved land with a value over BDS$10,000 was taxed at only 0.25%. In 1978 the corresponding rates were increased by 0.25 percentage points to 1.25% and 0.5%. In 1979 a graduated rate system was introduced as follows (the BDS$10,000 exclusion for improved land still applies):

Value in BDS$	*Site Value (%)*	*Improved site value*
under 50,000	1.25	–
under 50,000	2.00	–
under 250,000	–	0.5
over 250,000	–	1.0

The lower rate for improved site value has created many anomalies as land was developed. If, for example, plantation land with a site value of BDS$250,000 were improved by a house worth BDS$50,000, property taxes would be reduced by 62% – from BDS$4625 to BDS$1750. Because of various reliefs, tax exempt prop-

11. Records of Directorate of Surveys, Bridgetown, Barbados.
12. Caribbean Community Secretariat, Report of the First Meeting on Property Tax Administration, op. cit.
13. O. St. Claire Risden, "A History of Jamaica's Experience with Land Taxation based on the Site Value System", 1976 (mimeographed), Table I.

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erty, and much property with unidentified owners, the average effective rate in 1981 was only about 0.6%.[14]

b. The tax base

If current market value of property or annual rental value in its highest and best use is accepted as a standard for assessment, the tax base in all these countries falls short of yielding the potential tax revenue at the rates described above. Such deficiencies arise from a bias inherent in the assessment process to undervalue property, the lag in assesment behind changes in property values owing to the assessment cycle, especially in an inflationary period, and the provision of categorical relief for agriculture, resort facilities, certain residential properties, and hardship cases.

In the absence of empirical studies it is not possible to determine the accuracy of asessments in reflecting market value. Inferences may, however, be drawn from the frequency of appeals. While these ran rather high in Jamaica's original reassessment program, especially in the urban areas, Barbados experienced fairly low ratios both in its initial land assessment and in the later valuation of improvements. Because of Barbados' lack of an experienced valuation staff and the haste with which the exercise was completed in 1975, an undervaluation bias would be indicated by the fact that only 884 objections were raised by 13,417 property owners.[15] Barbados has since introduced an intensive training program to improve its valuation techniques.

The length of the assessment cycle is an important factor in underassessment, especially in a developing economy. (The reverse may be true in a depressed economy, such as Jamaica and other countries of the area have experienced.) Some indication of the lag of assessed values behind real values is revealed by the experience of Barbados, which is on a fairly short cycle of 3 years. The following data show the aggregate assessed values since introduction of the new site value tax in 1972:

Revaluation year	*Number of parcels*	*Assessed values (millions of BDS$)*
1972	50,160	637.5
1975	54,389	1402.8
1978	62,117	1507.2
1981	66,515	2540.6

The sharp jump in 1975 can be attributed largely to the inclusion of improvements in the base. Despite a 14% increase in the number of land parcels by 1978, indicating substantial development, the assessment roll increased by less than 7%. Between 1978 and 1981, however, a period of inflation and expansion, assessed values increased by almost 70%. This implies substantial interim undervaluation that is characteristic of property taxation generally.

All of the countries, even those with nominal annual value rates, provide for property tax relief, whether in hardship cases or for certain categories of property owners.

Serious gaps between tax assessed on market value of property and ability to pay are not uncommon. This is especially true of agricultural land located in developing suburban areas. Various techniques have been devised to alleviate this problem, the most common being so-called value in use, that is, value based on estimated yield of the crops. Barbados provides relief for owners of agricultural land if valuation takes into account its potential for subdivision or other commercial use; application is made to a Land Taxation Relief Board and if relief is granted it is valid until the next assessment. Jamaica in effect derates the value of all land that is in agricultural production by an arbitrary 75%. (Hotels are derated by 25%.)

Relief is also generally granted to residential property owners who can show hardship. This is a common situation in the Caribbean Community when land originally acquired by liberated slaves in the early 19th century and now owned by their descendants has sharply risen in value because of its favorable location in developing areas. When the owner of such land does not have an income that reflects its assessed value, he may apply for relief under special provisions of the tax law in most of these countries. In Barbados, for example, the owner of a single family dwelling need not show hardship if the assessment reflects its site value for a hotel, commercial or industrial location, residential apartment, or subdivision.

4. COST OF ADMINISTRATION

It is generally recognized that an effective system of property taxes may entail greater comparative costs of administration than other sources of revenue, especially sales and income taxes. This is due largely to the cost of maintaining a valuation department, but also to the cost of enforcing payments of tax by the great majority of property owners in developing countries with only nominal tax liabilities. Because the valuation department is also charged with other duties, and the collection department's budget sometimes covers other functions as well, it is not easy to derive a pure cost estimate. Data for Barbados in 1981/82 show a gross cost ratio of 13.5%, but arbitrary allocation of costs of both the collection and valuation departments indicate a cost ratio nearer 10-11%.[16]

It should be noted that these data relate to a property tax that includes improvements as well as land, has a modest rate structure, and provides considerable relief. A tax based on site value alone and with appreciable higher rates and yield could be administered much more efficiently. The inclusion of buildings greatly increases the

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14. Following the 1981 revaluation the comparative data for site value and unimproved site value were as follows:

	Site value	Improved value (BDS$ in millions)	Total
Number of parcels	47,162	19,353	66,515
Assessed value	BDS$346.9	2193.7	2540.6
Revenue collectible	BDS$4.3	11.0	15.3

15. C.P. Thompson, "The Property Tax System of Barbados", in Conference on Property Tax Administration, St. Kitts, 10-11 November 1980 (mimeographed).

16. Based on estimated revenue of BDS$14.2 million, a budgeted figure of BDS$956,354 for collection and BDS$96,370 for valuation. The collection department also issues some 30,000 automobile licenses, dog taxes, and other licenses, while the valuation department provides other services to the government.

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burden of keeping up-to-date records of improvements, based on building permits. But more important, their valuation requires on-site inspection by trained valuers and a record made of the building's dimensions, floor plan, building type, quality of construction, age, and condition. Standards must be established for unit values for different types of construction and applied to the valuation of the building. Land, in contrast, can be valued on a mass basis once the land cadastre is established.

The determination of annual value is facilitated where tenancy prevails; serious problems may arise, however, in valuing land and owner-occupied buildings, especially factory and other specialized buildings. It is usually necessary in these cases to derive an annual value based on some arbitrary ratio to the estimated capital value of the property, as was described above for Montserrat. Sometimes standard units of value per square foot or cubic foot are applied to the area or cubic space of a building in arriving at annual values. In Roseau, Dominica, for example, the annual value of owner-occupied property is assumed to range from EC$1.00 per cubic foot for property up to 5 years in age to EC$0.40 per cubic foot for property over 20 years of age, less 40%. Rental property – less than 25% of all parcels – is valued at 10 times the monthly rental. This procedure is simple to apply but of course is fairly crude in that it does not distinguish between different qualities of construction or style of building. Accordingly, a movie theatre of simple frame construction but with large space could be assessed much higher than a masonry bank building.

It is sometimes charged that the property tax in the Eastern Caribbean Community subregion (i.e. the Leeward and Windward islands) is unproductive because the cost of administering the tax on low-valued holdings exceeds the revenue. St. Lucia's experience with its rural land and house tax is cited as an example of inefficiency in this respect. It is claimed that perhaps 80% of all properties on the tax roll, with a rental value of about EC$600 and less, contribute less revenue than it costs to administer.[17] Clearly, the problem lies in the unusually low rate of tax: ½% of annual value; should this be increased to a moderate rate of, say, 5%, the problem would largely disappear. (An annual value tax of 5% is equivalent to a rate of about 0.5% of capital value, assuming a 10% gross rate of return.)

Jamaica largely avoided this problem with its land tax by the levy of a minimum tax on property with an estimated value below J$2000; for such low-valued holdings it also is unnecessary to exercise the usual care of specific valuation. Barbados, on the other hand, does not provide for any special treatment of low-valued holdings. In excluding improvements on land with a value of BDS$10,000 and less, however, the 1.25% rate rather than the 0.5% improved site value rate applies, thereby increasing the collectible tax. Also, Barbados excludes virtually all wooden houses from the tax roll, including so-called chattel houses built on leased land, and thereby reduces the valuation burden for low yield properties. It is said that low-valued parcels do not present any special enforcement problem because payment of tax strengthens the claim of ownership of the property, in which the taxpayer takes pride.

5. REFORM OF THE PROPERTY TAX

The above analysis clearly shows that CARICOM countries are not realizing the revenue potential of their property taxes. The poorest record is that of the states that have clung to the traditional British annual value mode. But the others that have reformed their system – Barbados and Jamaica — have undermined revenue by undue concessions either in rates or base. Grenada's newly adopted capital value tax appears to be following the same path with concessionary rates and exemptions. Reform of property taxes in the CARICOM would therefore appear to warrant serious consideration.

In addressing the problem of reform it might be asked what the proper role of the property tax should be in mobilizing resources by the government. Traditionally, property taxes have been a principal source of local rather than national finance.[18] In addition to CARICOM countries, important exceptions are found in Colombia, Chile and a few small countries such as Mauritius. One objective is the mobilization of resources of the agricultural sector by the state; this approach is especially important when agriculture either is exempted from income tax or an income tax on farmers is difficult to enforce and no alternative approach is introduced.[19] CARICOM countries with no or ineffective income taxes on agriculture either do not tax agricultural land or tax it at preferential rates as in Jamaica and Grenada.

A property tax at the national level presupposes a centralized form of government where cities and towns are dependent on the national government for major support of services normally performed at their level. Local property taxes, however, generally are poorly administered when the jurisdiction is too small to support the technical skills necessary for proper valuation and maintenance of the system. Centralized control or administration better assures the enforcement of objective valuation standards and avoidance of discriminatory practices and other abuses. There is no reason, however, why local governments should not share in centrally administered taxes on property located in their jurisdiction. In Chile, for example, municipalities receive one fourth of the national revenue.

The smaller states of the Eastern Caribbean common market subregion as well as Guyana and Trinidad and Tobago would appear to have most to gain by radical reform of their annual value rates; Belize, with a tax based on land area, also could greatly benefit. Montserrat's experience sets an example for reform by the Eastern Caribbean group although it is questionable whether improvements should be included in the tax base (discussed below).

Annual value, of course, reflects capital value, that is, the value of land and improvements. But an annual value

17. In 1979 the 3,000 lowest valued parcels yielded only EC$10,000, an average of EC$3.33 per parcel. British Development Division, Bridgetown, Barbados.

18. George E. Lent, "The Urban Property Tax in Developing Countries", *Finanzarchiv* 33 (1), (1974), pp. 45-72.

19. See Richard M. Bird, *Taxing Agricultural Land in Developing Countries* (Cambridge, Mass., 1974), passim; George E. Lent, "Taxation of Agricultural Income in Developing Countries", 27 *Bulletin for International Fiscal Documentation* (1973), pp. 324-42.

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tax is bound to be a hybrid because of the necessity of estimating the rental value of owner-occupied property to arrive at uniform assessment with respect to rental properties. This is especially difficult in the case of owner-occupied land. Because most farm land and residential property in these countries is owned by the occupier, the annual value concept is basically incompatible.[20]

One important factor inhibiting revenue is the high level of annual value rates that would be necessary to equate tax with a rate based on capital value or site value. The traditionally low level of annual value rates in the CARICOM – ½ to 1% – yields only a fraction of the revenue that a comparable rate based on improved or site value yields. Moreover, as was noted above, such low rates are unproductive because the cost of administration may exceed the tax collected on a large proportion of the parcels, as in St. Lucia. The effectiveness of overcoming this "rate illusion" is attested by Montserrat's intended strategy of converting annual value rates to rates based on capital value.

If the validity of these objections to annual value rates is accepted, what system offers the best alternative – site value or improved land value (i.e. capital value)? The initial decision of both Barbados and Jamaica was in favor of site value, although only Jamaica has stuck with this decision. Trinidad and Tobago initially declared for a modified site value tax but new conditions militated against a change.

Either site value or capital value is more consistent with land tenure in these countries, where the preponderance of property is owned by the occupier. Assessment of property could be achieved on a more equitable basis by avoiding the intermediate step in annual value assessment of converting capital value of owner-occupied property to annual value by an assumed arbitrary rate of return or other formula. Perhaps a more important factor favoring site value was the administrative convenience of mass assessment of land, which greatly facilitated the transition. Valuation of improvements would have compounded the burden on a limited and virtually untrained staff, greatly delayed implementation of the new tax, and built in greater problems of maintaining future assessment rolls. Barbados' later experience with its modified site value system confirms the difficulties of coping with the additional task of valuing improvements.

Finally, a tax limited to site value is most consistent with economic development objectives in that improvements to land are not deterred by an additional tax on their value. Indeed, a high enough rate would spur more intensive use of idle land.[21] It is true, of course, that the tax rate on land plus improvements would be lower than the rate on site value alone to yield equivalent revenue. The greater investment that might be attributable to a site value tax, however, would induce a greater increase in land values – the "unearned increment" – that could be recaptured by the higher site value tax rate.

The above view assumes that the rate on the value of land and improvements would be the same, unlike Barbados' curious rate structure that reduces the rate applicable to improved site value. The anomaly of this schedule is evidenced by an average rate in 1981 of 0.5% on improved land as against an average rate of 1.25% on site value alone. This rate structure has the effect of placing a premium on low-valued improvements in relationship to the value of land, and thereby militating against optimum allocation of resources. For example, only if the value of the improvement on land worth BDS$500,000 were greater than the value of the land would the property tax be increased. The incremental tax on improvements of much greater value, at a 1% rate, would be much less than the tax increment of a uniform rate on land and improvements. In this respect, Barbados' rate structure places less tax penalty on new investment than an orthodox tax on improved value but more than a site value tax.[22]

It is concluded from the above analysis that reform of annual value rates by CARICOM countries could best take the form of a tax on unimproved site values. A modest rate of, say, 1% would greatly enhance revenue, improve administrative efficiency, improve equity, and provide incentives for new investment. Many of these countries already have in place a legal cadastre that would facilitate the transition; others would require the installation of a property cadastre for fiscal administration. All would require a program for valuation of land under the direction of experienced valuers. Such a program would take time for planning, organizing and training technicians, and installing proper records, preferably computerized.

Countries that have replaced the annual value and other forms of property tax also could improve revenue by reducing or eliminating undue relief provisions for agriculture and hotels and rationalizing their rate structure. Barbados, in particular, should revise its rate structure so as to avoid the anomalous effect of a lower tax on improved land than on land alone. Rather than reverting to a site value tax, one possibility is a two-level tax consisting of a (graduated) rate on site value and a somewhat lower rate on improvements. Another possibility is a modified site value tax patterned on that of Montserrat.

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20. It is estimated, for example, that 93% of Dominica's rural land parcels and more than 75% of its urban land is owner-occupied.
21. In Montserrat it is claimed that the land tax has forced more productive use of land either in agriculture or in subdivision and development. Caribbean Community Secretariat, "Taxation of Land and Buildings in Montserrat", op. cit., p. 8.
22. The reasons for the change to modified site value are stated to be as follows: A site value tax can have little effect on development unless capital is available; improvements that have been made are evidence of access to limited financial resources and should be able to bear tax; and, a larger base would permit a lower tax rate and reduced taxes on vacant land and agricultural land. C.P. Thompson, "The Property Tax System of Barbados", op. cit.

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CUBA

Taxation of Joint Ventures

By M.A. Gª Caballero

I. INTRODUCTION

In order to attract foreign investment to team up with Cuban concerns in selected projects required to fulfill economic development goals, Decree-Law 50/82 of February 15 provides the legal framework within which business collaborations are to be organized in order to be eligible for privileged or special tax treatment.

Decree-Law 50/82 provides the rules applicable to business collaborations between Cuba and foreign enterprises, distinguishing between joint ventures (empresas mixtas) which constitute separate legal entities, and other types of business collaboration (for instance temporary associations) which do not. Either type, however, may receive privileged or special tax treatment: in the case of a joint venture, it is the separate legal entity and its foreign shareholders, directors and employees who benefit; in other types of business association, it is its foreign members, directors and employees.

The discussion below describes the most important foreign investment and tax measures relating to joint ventures.

II. FORMING A JOINT VENTURE

1. Concept

A Cuban joint venture consists of a collaboration agreement between Cuban public or private enterprises and foreign individuals and/or corporate enterprises which contributes to the economic development of the country, especially in the export and touristic sectors.[1] A joint venture is created by a notarial deed and is a seperate legal entity.

2. Requirements

The requirements relate mainly to the capital investment and to labour.

1) Investment requirements

a. the investment project and the by-laws of the joint ventures must be apporved by an "ad hoc Commission" appointed by the cabinet;
b. the joint ventures must be organized as a corporation (sociedad anónima) and domiciled in the Cuban Republic.[2] However, the Cuban joint venture may have permanent establishments and subsidiaries abroad, and may also praticipate in the capital of foreign companies;
c. a majority of locally owned equity is required; foreign shareholding is limited to 49%, unless the cabinet allows greater participation (in exceptional cases). Foreign contributions may be paid in foreign currency or in kind;
d. a legal reserve account must be established out of the annual profits to cover eventual liabilities in the manner established by the State Finance Committee[3];
e. the joint venture must open its business account in a convertible currency with a local bank through which all transactions are to be channelled. The official exchange rate of Banco Nacional de Cuba (the central bank) applies.[4] The joint venture is entitled to borrow in foreign currency from local banks and from foreign sources[5];
f. the notarial deed of incorporation must be registered with the State Chamber of Commerce.[6]

2) Labour requirements

a. The workforce of the joint venture must be hired and paid by hired and paid by the Cuban partner enterprise or by an independent Cuban entity; the workforce must be composed of Cuban nationals. Some of the directors and some highly specialized technical personnel may, however, be foreigners. Subject to the immigration rules, the joint venture may hire the required technical and administrative personnel. The Cuban partner or the independent entity then hires the Cuban workforce to the joint venture for a monthly sum, calculated according to official Cuban wages. Cuban directors and managers, however, earn the remuneration agreed upon by the partners concerned, provided that such remuneration is similar to that earned by the foreign directors and managers.
b. It is compulsory for the joint venture to create an economic incentive fund for its Cuban employees, out of which each Cuban employee receives fringe benefits. The amount which the joint venture is obliged to allocate to such a fund and the manner in which fringe benefits are paid is established by the "ad hoc Commission" when the authorization to create the joint venture is granted.

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1. The same definition applies to other types of business associations, except that no separate legal entity is formed.
2. The Republic of Cuba constitutes an archipelago made up of two main islands (i.e. Cuba and Isla de Pinos) and around 1,600 islets, whose total area is 110,922 km2 (42,823 sq. miles) and whose total population (census of September 11, 1981) is 9,706,369.
3. The address of the Comité Estatal de Finanzas is: Obispo y Cuba, Ciudad de la Habana.
4. The official average rate of the Cuban peso against dollar is P80.1 cents per 1US$. The address of the Banco Nacional de Cuba is: Cuba, 402, Ciudad de la Habana.
5. The members of other types of business associations may also do so.
6. The collaboration agreements of other types of business associations only enter into force after having been registered in such a Registry.

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III. TAXATION OF A JOINT VENTURE

1. Privileged tax treatment for qualified investments

Where a joint venture is engaged in the development of areas which have been declared zones of great interest for touristic purposes by law 33/81 of January 10, the joint venture may benefit from a total or partial exemption from taxes and from customs tariffs and duties. Provided that the investment project in considered to be highly beneficial for the national economy, the State Finance Committee may grant joint ventures[7] a total or partial exemption during a given period from tax on net profits (see taxation of a corporate joint venture below) and from customs tariffs and duties.

In any case, the corporate joint venture and its foreign shareholders, directors and employees[8] are granted special tax treatment. This treatment includes:

(i) an exemption from income tax levied on the gross income of private enterprises, individual shareholders, partners, directors and employees[9];
(ii) an exemption from transfer tax, levied at the rate of 3.6% on the value of alienated real estate, business establishments, and equity capital.[10]

2. Taxation of a corporate joint venture

Where no exemption is applicable, a corporate joint venture[11] is subject exclusively to customs tariffs and duties, to an annual tax on motor vehicles for land transport, to a stamp duty on the application for, obtaining and renewal of certain documents, and to two direct taxes: (i) the net profit tax and (ii) the payroll tax.

The net profit tax (impuesto sobre utilidades)[12]

The net taxable base is calculated by deducting from the annual net profits (i) the portion of profits reinvested in increasing the equity capital of the joint venture or contributed to other types of business associations, (ii) that portion of profits which is allocated to the legal reserve account, as established by the State Finance Committee, and the portion allocated to a voluntary reserve account as agreed by the parties concerned, and (iii) that portion of profits allocated to the economic incentive fund for the Cuban employees, as established by the "ad hoc Commission".

The net taxable base is then subject to tax at the rate of 30%. The tax liability so assessed must be paid before March 1 of the following year. No tax credits are available.

The payroll tax (impuesto sobre nóminas)

This tax was introduced by Law 1213/67 of June 27 and is generally levied on the total amount of salaries, wages and any other type of compulsory remuneration paid by private enterprises to their employees.

As an exception, the payroll taxable base for joint ventures[13] is the total amount of salaries, wages and any other type of compulsory remuneration paid to the Cuban workforce, except the fringe benefits paid out of the economic incentive fund.

The taxable base is subject to payroll tax at the rate of 25% which includes the compulsory social security charges.[14]

The tax liability so assessed must be paid each month, at the same time as the salaries paid to the Cuban workforce.

IV. REMITTANCE ABROAD OF INCOME AND REPATRIATION OF CAPITAL

Foreign employees may freely remit abroad the portion of earned income stipulated by the central bank.

Foreign shareholders in the joint venture[15] are guaranteed by the Cuban State the free remittance in foreign currency of gross dividends, interest and royalties, as well as the portion of the sale or liquidation proceeds corresponding to their participation in the Cuban joint venture, provided that such remittance and repatriation is effected through the central bank.

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7. The members of other types of business associations may also benefit from these exemptions.
8. Also applicable to foreign members, directors and employess of other types of business associations.
9. The Cuban income tax (impuesto sobre los ingresos) was introduced by Law 998/62 of January 5, as amended by Law 1213/67 of January 10. Private enterprises are subject to this tax at the rates resulting from coefficients established by the State Finance Committee for the different types of business activities; the taxable income is the annual gross income without any deduction. Individual taxpayers are subject to this tax on the monthly income from labour and from capital at progressive rates. These rates are as follows:

Monthly income between Pesos$	Pesos$	Rate % to be applied on monthly income (per bracket)
0	250.	11.9
251	300.	14
301	400.	16
401	500.	18
501	600.	20
601	700.	22
701	800.	25
801	1,000.	30
1,001	1,250	35
1,251	1,500	50
1,501	1,750	55
1,751	2,000	60
2,000	2,500	65
2501	. . .	70

10. The transfer tax (impuesto sobre transmisión de bienes inmuebles, establecimientos mercantiles y herencias) was introduced by Law 998/62 of January 5.
11. Also applicable to the members of other types of business associations.
12. The tax is assessed by calendar years, thus the financial and fiscal year coincide with the calendar year.
13. Also applicable to the members of other types of business associations.
14. Employess receive benefits from the state social security fund for sickness, accident, maternity, disability, unemployment and retirement. Public enterprises must pay to the Social Security Fund 10% of the payroll expenses according the Decree-Law 44/81 of July 6.
15. Also applicable to the members of other types of business associations.

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The Tax System of the People's Republic of China – A Short Survey

by Eugen Jehle *

I. INTRODUCTION – SCOPE OF ARTICLE

For about three years now, the People's Republic of China has aroused the interest of the international business community, which, of course, includes the interest of all those who are involved in taxation.

The tax laws that were introduced by the Chinese Government in the early 1950s and later amended in 1958 are now supplemented by new tax laws (and the pertinent regulations) which include the Individual Income Tax Law of 10 September 1980, the Joint Venture Income Tax Law of 10 September 1980, and the Foreign Enterprise Income Tax Law of 18 December 1981.

This article discusses the current tax system of China, and for that purpose, the taxes have been divided into three major categories: direct taxes; indirect taxes; and registration taxes and license duties.

It should be noted, however, that this discussion does not consider the taxation of state-owned enterprises which, until fairly recently, were fully integrated into the State's economic planning. This meant that all profits had to be transferred to the State and that the State had to bear the losses when they occurred. Since 1979, many experiments have been going on to change this situation, and eventually, state-owned enterprises will become subject to tax on profits, fixed assets and other items.

At this stage, however, it is too early to talk about *the* tax system for state-owned enterprises. There will always be differences in the various provinces and municipalities and with respect to different types of activities. In a recent article on this subject,[1] the author concluded that tax experiments in China are so numerous that attempting to obtain a complete understanding of the prospective tax changes is not yet possible.

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II. CLASSIFICATION OF TAXES LEVIED IN THE PEOPLE'S REPUBLIC OF CHINA

A. Direct taxes

1. The foreign enterprise income tax[2]

This tax is part of the most recent tax legislation and may well turn out to be one of the most important taxes, certainly as far as concerns the raising of revenue for the treasury. The purpose of this tax is to tax all Chinese-source income which is not otherwise taxed under other laws such as the Individual Income Tax Law or the Joint Venture Income Tax Law. As the name indicates, the tax concerns exclusively foreign enterprises, and with regard to such enterprises, the tax "takes over" the task previously carried out by the industrial and commercial income tax.

In identifying "taxable persons", a distinction is made between foreign enterprises that are actively engaged in business in China (i.e. enterprises that are present in China) and those that receive "passive income" from China (i.e. enterprises that are not present in China). This distinction is important with respect to the rate of tax that applies (see discussion below).

* Senior Research Associate, International Bureau of Fiscal Documentation. This article is based on a talk which the author delivered on 11 June 1982 at the *Workshop on Chinese Law* organized by the Europe China Association (Square de la Quiétude 7, B-1150 Brussels, Belgium) at the Institut de Recherches Juridiques Comparatives, Section Chine, Centre National de la Recherche Scientifique, Ivry, France.

1. Jap Kim Siong, "China's recent tax experiments to revive the industrial and commercial tax system of state enterprise", 36 *Bulletin for International Fiscal Documentation* 2 (1982) at 66.

2. The Foreign Enterprise Income Tax Law of 18 December 1981; Detailed Rules and Regulations for the Implementation of the Income Tax Law of the People's Republic of China concerning Foreign Enterprises of 17 February 1982.

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The underlying legislation wisely uses the general term "foreign companies, enterprises and other economic organizations" and does not restrict itself to "corporations". Thus, it protects its tax jurisdiction over any entrepreneurial operations that are defined as taxable in this law.

Income of foreign enterprises from the active conduct of business in China includes profits from cooperative production, processing activities and other business operations, such as exploration and other projects performed under a contract. Such income also includes income from independent business operations undertaken through an establishment in China. At this time, however, it is not entirely clear which types of activities of an establishment in China trigger liability to this tax.

"Passive income" is defined as dividends, interest, income from the rental or transfer of property and other income which is not from the active conduct of business.

The following rules are important in determining the taxable income of enterprises that actively engage in business in China:

(i) the relevant accounting method is the so-called "accrual method", i.e. the value of the property of the enterprise at the end of the year is compared to the value at the beginning of the year and the difference is the profit or loss;
(ii) income must be calculated on an annual basis, and as a general rule, the tax year is the Gregorian calendar year; however, other taxable periods may be applied for;
(iii) the procedure for calculating taxable income is precisely set forth in the underlying rules and regulations which distinguish among industry, commerce, service trades and other trades.

The Foreign Enterprise Income Tax Law identifies certain expenses that are either not deductible at all or deductible only to a limited extent. Non-deductible expenses include payment of the national or local income tax, penalties for illegal operations, overdue payments and tax penalties, certain losses covered by insurance, royalties paid to the head office, and other expenses that are not relevant to production or to the business operation.

Expenses which are deductible to a limited extent basically include three types of expenses: administrative, interest, and entertainment expenses. Administrative expenses (also known as overhead expenses) are deductible only if certain requirements are satisfied. For example, any such payment must be for a service rendered directly to the undertaking in China. Interest payments are deductible only if the interest rate passes the test of "reasonableness". Entertainment expenses are deductible only if they do not exceed certain percentages, i.e. a certain percentage of either net volume of sale or the total annual business income. These provisions are clearly designed to combat tax evasion in its various disguises.

The provisions concerning depreciation, treatment of losses, valuation of stock, etc. are precisely set forth in the underlying legislation and they basically follow the schemes commonly employed in other countries.

The Foreign Enterprise Income Tax Law identifies several items of income that are exempt from the tax. Exempt income includes interest payments on loans given by international financial institutions to official Chinese bodies or on loans given by foreign financial institutions to Chinese State Banks which were given at a "preferential" rate. Whether or not the rate is "preferential" is usually specified in the underlying loan agreement.

The rate of tax depends on whether the income is from the active conduct of business in China or is passive income. The former is taxed at progressive rates that vary from 20% (for an annual income of less than 250,000 yuan) to 40% (for that part of the annual income that exceeds 1,000,000 yuan). In addition to this tax, which is in fact a national tax, a local income tax at the flat rate of 10% is levied on the same taxable income. Thus, if taxable income is 250,000 yuan, the actual tax burden is 75,000 yuan, i.e. 30%. If the annual income is 10,000,000 yuan, the total tax burden is 48.75%.

This tax burden may, however, be reduced by claiming the various tax incentives that are provided for particular types of activities. For example, long-term undertakings (i.e. which have been in operation for at least 10 years) in specific fields may apply for a tax holiday for the first year in which they made a profit and for a tax reduction of 50% for the subsequent two years. In addition, depending on various factors, they may apply for a reduction of 15% or 30% for the following ten years. Finally, an exemption from, or a reduction in, the local income tax may be applied for in specific circumstances.

Passive income received by a foreign enterprise is subject to income tax at the flat rate of 20%.

2. The industrial and commercial income tax[3]

The industrial and commercial income tax is levied on the profits of domestic (Chinese) "industrial and commercial enterprises", and until the promulgation of the Foreign Enterprise Income Tax Law, of business activities (in China) of foreign enterprises. With regard to the latter, it was, however, common practice to arrange, in the underlying contracts for a tax holiday, at least a temporary one.

This tax is not levied in a uniform manner all over China, and there are areas where industrial and commercial enterprises are temporarily exempt from this tax. The latest report on this subject indicates that such enterprises in Tibet have been exempt from the industrial and commercial income tax for several years.

Subject to this tax are "industrial and commercial enterprises" such as cooperative societies, industrial and commercial activities of people's communes, mixed enterprises (partially private and partially state-owned; the most prominent example is the Bank of China), and private enterprises. State-owned enterprises and agricultural activities carried on by people's communes are not subject to this tax.

Taxable income is net revenue calculated according to the accrual method. No distinction is made among vari-

3. Provisional Regulations for the Industrial and Commercial Income Tax of 10 December 1950, as amended.

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ous items of income. For example, capital gains, i.e. extraordinary profits from the disposal of fixed assets, are automatically included in the profits.

The following items are deductible in calculating taxable income: production costs, administrative expenses, and other expenses; depreciation using the straight-line method; and the industrial and commercial consolidated tax that was paid (see discussion under "Indirect taxes").

Many exemptions are provided, but it appears that the situation varies from province to province. An exemption may be for an area or for specific branches of industry and commerce, or the exemption may be granted for retained profits and for new industrial enterprises having financial problems.

The industrial and commercial income tax is levied, at the national level, at progressive rates ranging from 5.75% for incomes up to 300 yuan to 34.5% for incomes of 10,000 yuan or more. In addition, a local surcharge may be levied which ranges from 10% to 100% of the national tax.

3. The joint venture income tax[4]

The joint venture income tax is levied exclusively on enterprises that are established under the "Law on Joint Ventures Using Chinese and Foreign Investment" of 1 July 1979. This law states that a joint venture has to be established as a "limited liability company" which is the taxable person. The law also makes it possible for a joint venture to have branches abroad, and if it does, the head office in China will always be the taxable person for tax purposes and will therefore be liable for payment of the Chinese taxes.

Taxable income is the joint venture's world-wide income that represents (i) income from production and business (which covers virtually every activity) and (ii) income from other sources such as dividends, bonuses, interest, royalties, and other sources. Taxable income, determined according to the accrual method, is gross income less costs, expenses and losses. In addition, the following rules apply:

(i) the procedure for calculating taxable income follows closely the procedure in the foreign enterprise income tax, i.e. distinctions are made among industry, commerce, service trade and other kinds of operations;
(ii) the taxable period is the Gregorian calendar year;
(iii) the provisions regarding non-deductible expenses and entertainment expenses also closely follow the provisions in the foreign enterprise income tax;
(iv) losses may be carried forward and set against the profits of the next year; the maximum period for carrying forward losses is five years; and
(v) fixed assets will normally be depreciated using the straight-line method.

The Joint Venture Income Tax Law does not contain any exemptions. However, some tax incentives are available (see discussion below).

The joint venture income tax is levied at a flat rate of 30% which is the national tax. In addition, a local surcharge of 10% of the national tax is levied, and the total tax burden is thus 33%. However, the People's Government of the Province, Municipality or Autonomous Region in which the joint venture is seated may decide to grant a reduction of, or exemption from, the local surcharge on account of special circumstances.

If a foreign participant's share in the profits of the joint venture is remitted to a place outside China, an additional income tax of 10% is levied on the amount remitted.

Tax incentives are available which are very similar to those available under the Foreign Enterprise Income Tax Law, namely, a tax holiday in the first profit-making year and a tax reduction of 50% in the two subsequent years. In addition, a reduction of 15% to 30% may be applied for up to ten more years. Certain conditions must be satisfied in order to qualify for these incentives. For example, the joint venture must be long-term, i.e. have been in operation for at least ten years.

A foreign participant of a joint venture is entitled to a tax refund of 40% of the income tax paid on his share of the income that is reinvested in China for a period of at least five years.

Where a joint venture or its branch derives income from abroad and has paid foreign income taxes thereon, the foreign taxes may be credited against the income tax liability in China. In this regard, it may be noted that, to date, China has not concluded any comprehensive treaties for the avoidance of double taxation, but, reportedly, negotiations are going on with several countries.

4. The individual income tax[5]

On 10 September 1980, the Individual Income Tax Law entered into force. It is a kind of schedular tax (the method of taxation varies with the kind of income) which is in contrast to a global income tax pursuant to which all items of income are added together and taxed at a uniform rate. Before it entered into force, there was no individual income tax in modern China. The only exception referred to those cases where activities were undertaken by an individual (private enterprise) that qualified as an industrial and commercial enterprise and was thus subject to the industrial and commercial income tax.

Taxable persons are individuals who either live in China or who receive income from China, and the law distinguishes between residents and non-residents.

With regard to residents, further distinctions are made depending on how long the person has resided in China. Individuals who have resided in China for more than five years are, from the sixth year of residence, subject to Chinese income tax on their world-wide income. Individuals who have resided in China for one or more years but less than five years are subject to tax with regard to their Chinese-source income and that part of their foreign-source income that is remitted to China. Individuals who have resided in China for less than one year

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4. The Income Tax Law of the People's Republic of China concerning Joint Ventures with Chinese and Foreign Investment of 10 September 1980; Detailed Rules for the Implementation of the Income Tax Law concerning Joint Ventures of 14 December 1980.
5. Individual Income Tax Law of the People's Republic of China of 10 September 1980; Regulations for the Implementation of the Individual Income Tax Law of 14 December 1980.

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are subject to Chinese income tax only on their Chinese-source income.

The individual income tax identifies six types of income that can be classified in three categories:

(i) employment income;
(ii) compensation for personal services; royalties; rental income;
(iii) taxable interest, dividends and bonuses; other kinds of income which the Minister of Finance has identified as taxable.

Employment income consists of wages, salaries, certain bonuses and year-end extras that are paid in the course of an existing employment relationship. However, the following types of income do not constitute taxable employment income: certain retirement and welfare payments; salaries of foreign diplomatic personnel; and remuneration paid by employers outside China to individuals whose period of residence in China does not exceed 90 days.

Employment income is subject to progressive marginal tax rates. The law provides for a basic exemption of 800 yuan per month. Amounts in excess of the exemption are taxed at rates that range from 5% to 45%, and the maximum rate applies to that part of the monthly income that exceeds 12,000 yuan. Thus, the actual tax burden on a monthly net income of 5,000 yuan is 11.70%, and a monthly income of 10,000 yuan is taxed at 20.85%.

Items of income that belong to the second category are, in principle, taxed at a flat rate of 20%. Residents are entitled to a lump sum deduction for expenses of 800 yuan per payment if the payment is less than 4,000 yuan or of 20% of the payment if it exceeds 4,000 yuan. Thus, if the single payment is 2,000 yuan, the effective tax burden is 12%. For payments in excess of 4,000 yuan, the effective tax burden is 16%. Non-residents are not entitled to this deduction, and the 20% rate applies to their income which falls in this category.

Items of income within the third category are, in principle, taxed at a flat rate of 20% and no deductions are allowed. However, some exemptions are available. For example, interest that is defined as interest from a savings deposits in a State or cooperative bank in China or any other bank authorized by the State bank is exempt from the individual income tax. Dividends derived from a joint venture or an urban or rural cooperative organization are also exempt for residents.

5. The agricultural tax[6]

The agricultural tax is levied on agricultural activities undertaken by people's communes, and the taxable person is the production team of the commune. The tax is levied on the "yield of the average harvest" which is a projected amount that is usually fixed for a certain number of years (normally 3-5 years) on the basis of the harvests of previous years. Any yield in excess of the "yield of the average harvest" is exempt from taxable income.

A basic exemption is allowed. In addition, exemptions from, and reductions of, the agricultural tax may be granted when a natural disaster occurs, when new cultivations are being started, or when the agricultural activities take place in so-called "handicapped" areas.

The agricultural tax is levied at a proportional rate, but the actual rate depends on the region and usually varies from 13% to 19%. In addition, a local surcharge of up to 22% of the tax may be levied. Usually this tax is paid-in-kind.

It should be noted that this method of taxation contains a built-in incentive to increase production, and this can be done without creating any additional administrative work. Thus, it might be worthwile for other countries seeking to increase agricultural production to study this method.

6. The urban real property tax[7]

The urban real property tax is a local (i.e. municipal) tax that is generally levied on the value of real property, and the taxable person is the owner, renter or user of real property located in urban areas. Various factors, such as location, condition, etc., must be considered in determining the value of the property. Some property, such as real property used for governmental purposes is exempt from this tax.

The tax rate varies from municipality to municipality. For land, the annual rate is usually about 1.5% and for buildings, it is usually about 1%. Under certain circumstances, this tax may instead be levied on the rental value.

B. Indirect taxes

1. The industrial and commercial consolidated tax[8]

This tax is currently the most important one in China and applies to all kinds of enterprises in China, including state-owned ones. The tax may be classified as a turnover tax that has some of the features of an excise duty.

A taxable transaction arises whenever a taxable item is transferred from one enterprise or person to another enterprise or person or when an item is imported or exported. With respect to imports and exports, the tax question is usually clarified in the underlying contract, i.e. it is common practice for the Chinese enterprise or person to satisfy the tax liability.

For enterprises or persons engaged in industrial or agricultural production or in retail trade, the taxable base consists of the gross receipts. For those engaged in transportation, postal and communication services, the taxable base is gross income, and for those engaged in the service industries, the taxable base consists of the commission earnings.

There are several exemptions from the industrial and commercial consolidated tax. For example, transfers within an enterprise are usually exempt. In addition, certain import items may be exempt, the most recent example being an exemption for items to be used in the exploration and exploitation of offshore petroleum. With re-

6. Regulations governing the Agricultural Tax of 3 June 1958, as amended.
7. Provisional Regulation for the Real Property Tax on Urban Buildings of 8 August 1951, as amended.
8. Regulations and Detailed Rules for the Industrial and Commercial Consolidated Tax of 13 September 1958, as amended.

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gard to transactions that occur in the context of compensation trade, processing trade and cooperative production, it seems to be common practice for the parties to arrange for an exemption in the underlying contracts.

As a general rule, the tax rates reflect the extent to which a particular commodity is necessary to the average consumer. The rate is low for items that constitute basic needs, but it is as high as 69% for luxury items. Industrial and agricultural commodities are taxed at rates that range from 1.5% to 69%. Retail sales are taxed at a uniform rate of 3%, and transportation services at 2.5%. A rate ranging from 3% to 7% applies to commissions earned by those engaged in the service industries. In addition, a surcharge of 1% of the tax due may be levied.

2. The salt tax

The salt tax is reportedly the oldest tax that is levied in China and is administered by the Salt Control Bureau. It is a tax on the production of salt and its rate varies. Certain exemptions are provided for, such as for salt used in agriculture or industry or salt that is to be exported.

3. Customs duties[9]

Although customs duties are usually not classified as taxes, they are briefly mentioned here because they are of great significance to China.

Certain exemptions are provided with respect to customs duties. For example, an exemption applies to the importation and subsequent exportation of equipment used in the exploitation of offshore oil. In addition, an exemption may apply to equipment imported for use in joint ventures and in compensation trade, processing trade and cooperative production.

a. *Import duties*

The tariff on imports is classified into 17 categories which are subdivided into 939 tariff numbers, and a distinction is made between the "minimum tariff rate" and the "general tariff rate". The former is the rate that is generally applied to imports from countries with which China has concluded a trade agreement, and the general tariff rate applies to imports from all other countries. The applicable rates may be as high as 400% for luxury items.

b. *Export duties*

Until very recently, no export duties were levied by China. However, as of 1 June 1982, an export duty is levied on 34 kinds of commodities. The export duty is usually levied on the export value and the rates vary from 10% to 60%. An exception exists with respect to coal which is taxed on a quantitative basis, i.e. 40 yuan per ton. No further details regarding export duties are available at this time.

C. Registration taxes and license duties

Taxes which, in fact, are in the nature of license duties include the slaughtering tax, the cultural and entertainment tax, and the transport means tax. These are all local taxes and the tax amount appears to vary significantly. In terms of revenue, they are of minor importance and are mentioned here only for the sake of completeness.

III. TAX TREATMENT OF SPECIFIC UNDERTAKINGS

A special tax treatment is provided for some types of undertakings and for activities in specific areas. For instance, a specific tax treatment applies to undertakings of any kind that are carried on in so-called Special Economic Zones.

To date, three Special Economic Zones have been established in Guangdong Province, namely Shenzhen, Zhuhai and Shantau. In Fujian Province, there is so far only one such zone, namely Xiamen. For the zones in Guangdong Province, detailed regulations have been released[10] that answer all kinds of questions. As far as taxation is concerned, the income tax rate has been fixed at 15%. There is, however, much room for negotiation for projects that are of specific interest to China.

The regulations for the zone in Fujian Province have reportedly been passed by the legislative bodies, and although no copy has yet been obtained, the regulations are not expected to differ widely from those in Guangdong Province.

Foreign shipping transport enterprises also enjoy a special tax treatment.[11] For them, taxable income is defined as 5% of the gross income from transport services for passengers and cargo within Chinese territory. This amount is then taxed at the rate of 4.025% which consists of 1% foreign enterprise income tax, 0.5% local surcharge thereon, 2.5% industrial and commercial consolidated tax, and 1% surcharge thereon, namely .025%.

There are other undertakings that enjoy a special tax treatment, but those mentioned above are the most important ones.

IV. CONCLUSION

The tax system of the People's Republic of China is, at this time, a mixture of well-established taxes and of newly-introduced tax laws. With regard to the latter, it will naturally take some time before all the details have been worked out.

At any rate, the Chinese authorities must be congratulated for having released, in the course of implementing the four modernizations, tax laws the brevity of which has caused much envy and admiration in the international tax community. Anyone who has to deal with the tax laws of other countries will no doubt agree with this statement.

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9. Provisional Regulations governing the Customs Import and Export Tariffs of 16 May 1951, as amended.
10. Regulations of the People's Republic of China on Special Economic Zones of Guangdong Province of 17 November 1981.
11. See the law and regulations cited in note 2, above, in connection with an announcement of the Ministry of Finance of 26 February 1982.

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The Welfare Cost of Taxation: Its Meaning and Measurement

by Nizar Jetha *

I. INTRODUCTION

Statements such as "the welfare cost of tax X equals a% of its revenue yield" or that "the welfare gain from substituting tax Y for tax Z would equal b% of GNP" are to be found in a growing number of papers on tax reform. They refer to the cost of distortions caused by taxes through their effects on relative prices. All taxes, except the poll tax, distort the allocation of resources in the sense that the allocation of resources would change if the taxes were removed. The concept of the welfare cost of taxation attempts to translate the cost of tax-induced distortions in money terms. The concept is based on the notion of consumer's surplus.

This paper provides an introduction to the concept of the welfare cost of taxation and its measurement. In addition, it derives the basic conclusion of the theory of optimal indirect taxation by taking advantage of the close relationship between the concept of welfare loss and the theory of optimal taxation.

II. CONSUMER'S SURPLUS

The consumer's surplus is simply the difference between the amount a consumer is willing to pay for a quantity of a good and the amount he actually pays for it. Thus, if one is prepared to pay $1 for a can of beer but its price is 40 cents, the consumer's surplus is 60 cents. Every point on the ordinary demand curve represents the sum a consumer is willing to pay for various quantities. When the price of a good X is P_0 and the quantity X_0 is purchased, the amount the consumer is willing to pay for the X_0th unit and the price are equal, but the amounts the consumer is willing to pay for the other units purchased exceeds the (fixed) price of the commodity (see Figure 1). At price P_0, the total sum a consumer is willing to pay for the quantity X_0 is given by $OScX_0$, but the amount he actually pays is given by OP_0cX_0. The area of the triangle P_0Sc, therefore, represents the consumer's surplus.

Now suppose that a tax of Tx per unit of X is imposed. The price rises to P_1 and demand falls to X_1. The willingness to pay for X_1 is represented by $OSaX_1$ but the outlay made is OP_1aX_1. The consumer surplus is now P_1Sa. The reduction in the consumer surplus due to the increase in price is, therefore, P_0P_1ac.

The decrease in consumer surplus due to an increase in price gives the total welfare loss. However, when the price increase is caused by a tax, the additional tax revenues should be subtracted from the total welfare loss because the revenues, when spent, would bring benefits. The tax of Tx per unit of X would bring tax revenues of TxX_1, denoted by the area P_0P_1ab. Hence, we are finally left with the triangle abc as the measure of the welfare cost of taxation. The loss of welfare due to taxation is variously referred to as the "excess burden", "deadweight loss" and "efficiency cost".

III. CONSUMER'S SURPLUS AND COMPENSATING VARIATION

It has been suggested that a price-induced change in consumer's surplus is given by the area to the left of the demand curve between the two prices. Strictly, the change in the consumer's surplus is not given by the area to the left of the ordinary demand curve, but by the area to the left of a compensated demand curve. The present section explains the reason for this as well as the meaning of the compensated demand curve. In the process, further light will be shed on the concept of consumer's surplus.

The upper part of Figure 2 shows income on the vertical axis and purchases of a good X on the horizontal axis. U_1 and U_2 are indifference curves, and $\overline{Y}Z$ is the initial budget line corresponding to price P_1 for X. At the price P_1, the consumer spends $\overline{Y}R$ of his income on X, purchasing the quantity X_1. This gives us one point on the ordinary and compensated demand curves, denoted by a in the lower part of the diagram. When the price rises to P_2, the budget line changes to $\overline{Y}W$, giving a new equilibrium on the lower indifference curve U_2. The purchases of X fall to X_2 and a second point on the ordinary demand curve (b) is obtained. To obtain the corresponding point on the compensated demand curve, we need to ask what quantity of X the consumer would purchase at the higher price P_2 if his income were increased so that he could remain on the original indifference curve U_1. The answer can be found by "moving" the budget line $\overline{Y}W$ to the right, keeping its slope constant, until it touches U_1. As the diagram shows, the answer is that the quantity X_3 would be purchased, and this gives us the second point on the compensated demand curve (c). Other points can be derived by considering different prices. It should be clear that the compensated demand curve is a relationship between prices and quantities when a consumer remains on a given indifference curve (that is, when his utility is held constant).[1]

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1. A simple mathematical derivation of a compensated demand curve may help. Let the utility function be of the form $U = Q_1Q_2$, where Q_1 and Q_2 are the quantities of goods 1 and 2 consumed, respectively. Let P_1 and P_2 be the prices of goods 1 and 2, respectively. Minimizing the expenditure on the two goods $(P_1Q_1 + P_2Q_2)$ subject to the initial level of utility (say U^o) being maintained will give the compensated demand curves. Minimizing the Lagrangean:

$$L = P_1Q_1 + P_2Q_2 + g(U^o - Q_1Q_2)$$

we get

$$\frac{\partial L}{\partial Q_1} = P_1 - gQ_2 = 0; \quad \frac{\partial L}{\partial Q_2} = P_2 - gQ_1 = 0; \quad \frac{\partial L}{\partial g} = U^0 - Q_1Q_2 = 0$$

which give

$$Q_1 = \left(\frac{P_2U^0}{P_1}\right)^{1/2} \text{ and } Q_2 = \left(\frac{P_1U^0}{P_2}\right)^{1/2}$$

the compensated demand curves for goods 1 and 2, respectively. See James M. Henderson and Richard E. Quandt, *Microeconomic Theory* (New York: McGraw Hill, 1980), pp. 20-21.

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The amount of compensation that must be paid to the consumer in order to enable him to remain on U_1 when the price of X rises from P_1 to P_2 is given by $\overline{Y}Y^*$. In general, the amount of compensation paid or received that will leave the consumer in his initial welfare position following a change in price is known as "compensating variation".[2] To put it differently, compensating variation measures the change in utility due to a price change in money terms.[3] But this is precisely what the change in consumer's surplus was supposed to represent. It can be shown, but will not be shown here, that compensating variation equals the area to the left of the compensated demand curve between the two prices.[4] In terms of the diagram, $\overline{Y}Y^*$ corresponds to P_1P_2ca. This provides the rationale for the use of compensated demand curves.

In light of the above discussion, we can define excess burden as compensating variation minus tax receipts.[5] In practice the excess burden is often calculated directly by estimating the area of the relevant triangle under the compensated demand curve (eca in Figure 2).

IV. MEASUREMENT OF WELFARE COST OF TAXATION

Suppose that a tax of Tx per unit of good X is levied. Referring to Figure 1 but treating the demand curve as the compensated demand curve, the excess burden of the tax may be expressed algebraically as:

$$W = -\tfrac{1}{2}(P_1 - P_0)(X_0 - X_1)$$
$$= -\tfrac{1}{2}\, dP\, dX \qquad (1)$$

Multiplying and dividing this expression by dP gives

$$-\tfrac{1}{2}\, dP \frac{dX}{dP} dP$$

Now multiplying and dividing by XP^2 and rearranging gives

$$-\tfrac{1}{2}\left(\frac{dX}{dP}\frac{P}{X}\right) XP \left(\frac{dP}{P}\right)^2$$

But $\frac{dX}{dP}\frac{P}{X}$ (to be denoted by e_D) is the compensated elasticity of demand (elasticity of demand of the compensated demand curve) and $\frac{dP}{P} = \frac{Tx}{P_0}$ is the rate of tax (to be denoted by t). The preceding expression may now be written as:

$$W = -\tfrac{1}{2}\, e_D\, X\, Pt^2 \qquad (2)$$

(1) and (2) are two equivalent formulae for computing the excess burden of a single tax. These partial equilibrium formulations ignore the existence of other taxes. Moreover, frequently we wish to know the welfare gain or loss of increasing or decreasing one tax and changing another tax to keep the tax revenue constant. We, therefore, need a general expression for the excess burden of a given set of taxes. The general expression for the excess burden of N taxes[6] is:

$$W = -\tfrac{1}{2} \sum_{i=1}^{N} \sum_{j=1}^{N} S_{ij}\, T_i\, T_j \qquad (3)$$

where $S_{ij} = \left(\frac{\partial X_i}{\partial P_j}\right)_U$ is the compensated derivative of the demand for the ith commodity with respect to the price of the jth commodity,[7] and Ti is the amount of tax per unit of good i.

The general expression can be reduced to (2) in the case of a tax on a single good, as follows:

$$W = -\tfrac{1}{2}\, S_{11}\, T_1^2 \qquad \text{(since } i = j = 1\text{)}$$

$$= -\tfrac{1}{2}\left(\frac{dX_1}{dP_1}\right)_U (dP_1)^2$$

$$= -\tfrac{1}{2}\left(\frac{dX_1}{dP_1}\right)_U \frac{P_1}{X_1}\frac{X_1}{P_1} (dP_1)^2$$

$$= -\tfrac{1}{2}\left(\frac{dX_1}{dP_1}\right)_U \frac{P_1}{X_1}\frac{X_1}{P_1}\frac{P_1}{P_1} (dP_1)^2$$

$$= -\tfrac{1}{2}\, e_D\, X_1 P_1 t_1^2 \quad \left(\text{where } t_1 = \frac{dP_1}{P_1}\right)$$

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2. For a lucid and more detailed discussion of compensating variation, see Robin W. Boadway, *Public Sector Economics* (Cambridge, Mass.: Winthrop Publishers, Inc., 1979), pp. 47-50.
3. Note that there is no unique measure of utility change in money terms. Equivalent variation could be used instead of compensating variation. See Henderson and Quandt, pp. 49-50.
4. This is not difficult to show using indirect utility functions and expenditure functions, but a discussion of these concepts will take us too far afield. See Henderson and Quandt, pp. 41-45, 49-52.
5. A simple numerical illustration of a compensated demand curve, compensating variation and excess burden will be found in P.B. Dixon, S. Bowles and D. Kendrick, *Notes and Problems in Microeconomic Theory* (Amsterdam: North Holland, 1980), pp. 144-146.
6. The expression is derived in a number of different ways in Arnold C. Harberger, "Taxation, Resource Allocation and Welfare", reprinted in *Taxation and Welfare* (Boston: Little, Brown and Company, 1974), pp. 25-62. It should be noted that one of the assumptions underlying the derivations is that outputs are produced at constant costs.
7. It will be recalled that the relationship between the derivatives of an ordinary (or uncompensated) demand curve and a compensated demand curve is given by the Slutsky equation

$$\frac{\partial X_i}{\partial P_j} = \left(\frac{\partial X_i}{\partial P_j}\right)_{\text{utility = constant}} - X_j \left(\frac{\partial X_j}{\partial y}\right)_{\text{prices = constant}}$$

where X_i = the demand for the ith good, P_j = the price of the jth good and y = income. The expression on the left is the derivative of the ordinary demand curve and the first term on the right is the derivative of the compensated demand curve. We denote the compensated derivative

$$\left(\frac{\partial X_i}{\partial P_j}\right)_{\text{utility = constant}}$$

by S_{ij}. It should be noted for later reference that $S_{ij} = S_{ji}$. For a derivation of the Slutsky equation and its interpretation, see Henderson and Quandt, pp. 25-32.

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V. AN APPLICATION

Laidler[8] has estimated the welfare cost of income tax incentives for owner-occupied housing in a simple partial equilibrium framework.[9] The main features of his approach are illustrated in Figure 3. D represents the demand for housing services. S_1 is the supply curve and denotes the marginal private cost of providing housing services. The subsidy given through the tax system lowers the private marginal cost of housing to the levels represented by S_2. As a result of the subsidy, the consumption of housing services expands by Q_0Q_1.

The net loss of welfare is denoted by the shaded triangle fcg. This can be seen as follows. The expanded consumption of housing services increases the consumer surplus by ebcg. But the cost of the subsidy (ebdg) must be set against it to arrive at the net change in welfare. The net loss of welfare is, therefore, given by cdg. Since cdg and fcg are similar triangles, the area of the triangle fcg also gives the welfare loss. We obviously need to know the size of the subsidy and the increase it induces in the quantity of housing in order to estimate the size of welfare loss.

If a homeowner were taxed in the same manner as other investors, his taxable income would be given by:
Taxable income = (GR–PT–D–M–MI)V
where GR = gross rent,
PT = property taxes,
D = depreciation,
M = maintenance,and
MI = mortgage interest,
all expressed as a percentage of the value of the house (V). Taking the numerical values used by Laidler:
Taxable income = (.11–0.015–0.0225–0.0125–0.06)V (4)

This states that if the homeowner were to rent his house, he would have to charge a gross rent of 11% of the value of the house if he is to meet all expenses. However, tax laws in the United States and many other countries permit the homeowner to exclude gross rent from his taxable income and to deduct property taxes and mortgage interest from his other income. Taxable income from owner-occupied housing is, therefore, given by:

$$\begin{aligned}\text{Taxable income} &= (-PT-MI)V \\ &= (-0.015-0.006)V \qquad (5)\end{aligned}$$

Subtracting (5) from (4) would give the reduction in taxable income due to the special tax treatment of owner-occupied housing. Multiplying this reduction in taxable income by the taxpayer's marginal tax rate then gives the tax saving or subsidy associated with the tax incentive for owner-occupied housing. Thus,

$$\begin{aligned}\text{Subsidy} &= t\,(GR-M-D)V \\ &= .26\,(.11-0.0125-0.0225)V \\ &= .26\,(0.75)V \\ &= 0.0195V\end{aligned}$$

where the marginal rate of personal income tax (t) has been taken to be 26%. Hence the amount of the subsidy is \$0.0195 per \$ of the cost of the house, and the rate of subsidy is 17.7% (0.0195V/0.11V).

To estimate the change in the quantity of housing, we need to know the price elasticity of demand for housing and the stock ot owner-occupied housing. Laidler used an elasticity of –1.5 for his computations.[10] The value of owner-occupied housing owned by persons in the income group \$10,000 – 15,000 was \$61,956 million. Multiplying the rate of subsidy (17.7%) by elasticity of demand (1.5) will give the percent over-invested in housing of 26.6%. This translates into the amount over-invested in housing of \$13,011 million [(26.6/(100 + 26.6)) x 61,956].

The welfare loss may now be computed as follows:[11]

$$\begin{aligned}W &= 0.5 \triangle P \triangle Q \\ &= 0.5\ (\text{subsidy})\ (\text{amount over-invested}) \\ &= 0.5\ (0.0195)\ (13{,}011) \\ &= \$137 \text{ million}\end{aligned}$$

Making similar calculations for other income classes, Laidler arrived at the total welfare cost of the tax concessions for owner-occupiers of \$500 million per annum.

VI. EXCESS BURDEN AND OPTIMAL INDIRECT TAXATION

The concept of excess burden leads naturally to the theory of optimal taxation, and perhaps provides the simplest way of deriving a basic proposition in optimal taxation.[12] Optimal tax rates are defined as the rates that will raise the required revenue by minimizing the excess burden of taxation. We wish to investigate the main characteristic of the structure of optimal indirect taxation. The traditional theory of taxation concluded that an ad valorem tax at a uniform rate on all commodities would minimize the excess burden of taxation. Recent research has shown that this conclusion would only be valid if all final commodities (including leisure) could be taxed. The modern approach is based on the assumption that leisure cannot be taxed. The question that the theory of optimal indirect taxation then poses is: which tax rates will minimize the excess burden of indirect taxation given that a specific amount of revenue must be raised and that at least one commodity cannot be taxed? As will be shown, the answer is that the tax rates should be so chosen that the demand for all taxed commodities is reduced by the same proportion. A single rate for all goods will, therefore, not be optimal.

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8. David Laidler, "Income Tax Incentives for Owner-Occupied Housing", in Arnold Harberger and Martin Bailey (eds.), *The Taxation of Income from Capital* (Washington, D.C.: The Brookings Institution, 1971), pp. 50-76.
9. For studies on excess burdens in the context of two-sector general equilibrium models, see Arnold C. Harberger, "Efficiency Effects of Taxes on Income from Capital", reprinted in *Taxation and Welfare*, pp. 163-170; Michael J. Boskin, "Efficiency Aspects of the Differential Tax Treatment of Market and Household Economic Activity", *Journal of Public Economics*, Vol. 4, No. 1, February 1975, pp. 1-25; and Martin Feldstein, "The Welfare Cost of Capital Income Taxation", *Journal of Political Economy*, Vol. 86, No. 1, part 2, April 1978, pp. S29-S52.
10. Most early studies, including Laidler's, used the elasticity of the ordinary demand curve. For a more recent study using compensated elasticities, see Harvey S. Rosen, "Housing Decisions and the U.S. Income Tax: An Econometric Analysis", *Journal of Public Economics*, Vol. 11, No. 1, February 1979, pp. 1-24.
11. The minus sign vanishes because a subsidy is a negative tax.
12. A simple introduction to optimal taxation will be found in David E. Bradford and Harvey S. Rosen, "The Optimal Taxation of Commodities and Income", *American Economic Review*, Vol. 66, No. 2, May 1976 (Papers and Proceedings, 1975), pp. 94-101.

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To find optimal rates of indirect taxes, we minimize (with respect to tax rates):

$$W = -\tfrac{1}{2} \sum_{i=1}^{K} \sum_{j=1}^{K} S_{ij} T_i T_j \qquad K < N$$

$$\text{subject to} \quad \sum_{j=1}^{K} T_j X_j = R$$

where S_{ij} and T have already been defined, X_j = the quantity of the jth good purchased and R = tax revenue. $K < N$ denotes that at least one good cannot be taxed. The constraint (the second expression) simply states that the chosen tax rates must bring revenue equal to R.

We can simplify this problem without loss of generality. First, define $T_i = t_i C_i$, where t_i = percentage rate of tax on the ith good and C_i = the producer's price (cost) for the ith good. The solution will then contain ad valorem rates, which are of greater interest than specific rates (T_i). Second, let producers' prices for all commodities equal 1 (that is $C_i = 1$ for all i). This will simplify the mathematics by reducing the number of symbols. Note that the relationship between the consumers' and producers' prices will be given by $P_i = (1+t_i)C_i = (1+t_i)$, where P_i is the consumer's price for the ith commodity. Third, assume that there are only three commodities, two goods (X_1 and X_2), which can be taxed, and leisure (X_3), which cannot be taxed. This will make it possible to write out all expressions in full, thereby making the derivation clearer.

Our problem now is to minimize:

$$W = -\tfrac{1}{2} \sum_{i=1}^{3} \sum_{j=1}^{3} S_{ij} t_i t_j$$

$$\text{subject to} \quad \sum_{j=1}^{3} t_j X_j = R.^{13}$$

Recalling that $t_3 = 0$ and noting that $S_{12} = S_{21}$, minimization of W subject to the revenue constraint is equivalent to the minimization of the Lagrangean:

$$L = -\tfrac{1}{2}[S_{11}t_1^2 + S_{22}t_1^2 + 2S_{12}t_1t_2] + g[t_1X_1 + t_2X_2 - R]$$

We obtain

$$\frac{\partial L}{\partial t_1} = -[S_{11}t_1 + S_{12}t_2] + g\left[t_1 \frac{\partial X_1}{\partial t_1} + t_2 \frac{\partial X_2}{\partial t_1} + X_1\right] = 0 \qquad (6)$$

$$\frac{\partial L}{\partial t_2} = -[S_{12}t_1 + S_{22}t_2] + g\left[t_1 \frac{\partial X_1}{\partial t_2} + t_2 \frac{\partial X_2}{\partial t_2} + X_2\right] = 0 \qquad (7)$$

The next step is to transform expressions such as $\partial X_i/\partial t_j$ into S_{ij}. This can be done by noting that:

$$\frac{\partial X_i}{\partial t_j} = \frac{\partial X_i}{\partial P_j} \quad \frac{\partial P_j}{\partial t_j} = \frac{\partial X_i}{\partial P_j} \quad (\text{since } P_j = 1+t_j)$$

and recalling the Slutsky equation

$$\frac{\partial X_i}{\partial P_j} = S_{ij} - X_j \frac{\partial X_i}{\partial y}$$

Substituting the right hand side of the Slutsky equation for $\partial X_i/\partial t_j$ into (6)

$$-[S_{11}t_1 + S_{12}t_2] + g\left[t_1\left(S_{11} - X_1 \frac{\partial X_1}{\partial y}\right) + t_2\left(S_{12} - X_1 \frac{\partial X_2}{\partial y}\right) + X_1\right] = 0$$

Collecting terms in S_{11} and S_{12},

$$(g-1)[S_{11}t_1 + S_{12}t_2] = g\left[t_1 \frac{\partial X_1}{\partial y} + t_2 \frac{\partial X_2}{\partial y} - 1\right] X_1$$

$$\text{or } S_{11}t_1 + S_{12}t_2 = C X_1 \qquad (8)$$

$$\text{where } C = \frac{g}{g-1}\left(t_1 \frac{\partial X_1}{\partial y} + t_2 \frac{\partial X_2}{\partial y} - 1\right)$$

Similarly (7) can be reduced to:

$$S_{21}t_1 + S_{22}t_2 = C X_2 \qquad (9)$$

(8) gives an estimate of the proportion by which the demand for X_1 would decline as a result of the taxes on X_1 and X_2. (9) states that the demand for X_2 should decline by the same proportion. It follows that (8) and (9) together imply that tax rates should be so chosen that the demand for both X_1 and X_2 declines by the same proportion (along compensated demand curves). This proposition, known as the Ramsey rule, is what we had set out to establish.

A special case of the Ramsey rule arises when the demands are independent (that is, when $S_{12} = S_{21} = 0$). The implications of the solution will be more clearly seen if derivatives are replaced by elasticities, and the amounts of tax payable by ad valorem tax rates. To do this, we divide both sides of (8) by X_1 and multiply the left hand side by P_1/P_1. Similarly, we divide both sides of (9) by X_2 and multiply the left hand side by P_2/P_2. We get

$$\left(\frac{S_{11}P_1}{X_1}\right) \frac{t_1}{P_1} = C \qquad (10)$$

$$\left(\frac{S_{22}P_2}{X_2}\right) \frac{t_2}{P_2} = C \qquad (11)$$

$$\text{But } \frac{S_{ii}P_i}{X_i} = \left(\frac{\partial X_i}{\partial P_i}\right)_U \frac{P_i}{X_i}$$

is nothing but the compensated elasticity of demand for the ith good with respect to its price (to be denoted by e_{ii}) and t_i/P_i is simply the ad valorem rate of tax (amount of tax as a proportion of the gross-of-tax price) for the ith good (to be denoted by r_i). Combining (10) and (11)

$$\frac{r_1}{r_2} = \frac{e_{22}}{e_{11}}$$

In words, this states that the tax rates should be inversely related to (compensated) price elasticities. This result is referred to as the inverse elasticity rule.

13. The derivation given here is suggested by an example in Arnold C. Harberger, "Taxation, Resource Allocation and Welfare", *Taxation and Welfare*, p. 48.

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One special case where the conclusion of the traditional theory will hold when leisure cannot be taxed is worth noting.[14] This occurs when the supply of labor (and consequently the consumption of leisure) is fixed. Then, a tax at a uniform rate on all commodities other than leisure will not distort the structure of demand since the relative prices of taxed goods will remain unchanged, and the change in the relative price of leisure and other goods would not matter because the consumption of leisure could not be varied. The assumption that taxes do not affect the work-leisure choice lacks realism, however.

Optimal taxes have been discussed in relation to the allocation of resources. Equity considerations can also be introduced in the framework of optimal taxation.

VII. CONCLUDING REMARKS

The increasing use of welfare cost calculations in applied public finance has stimulated renewed interest in better measures of consumer's surplus.[15] The usefulness of the concept of consumer's surplus for policy purposes has, however, always been surrounded by controversy.[16] The reader alone must, therefore, decide how much importance to attach to excess burden calculations in judging the merits of different tax reform proposals.

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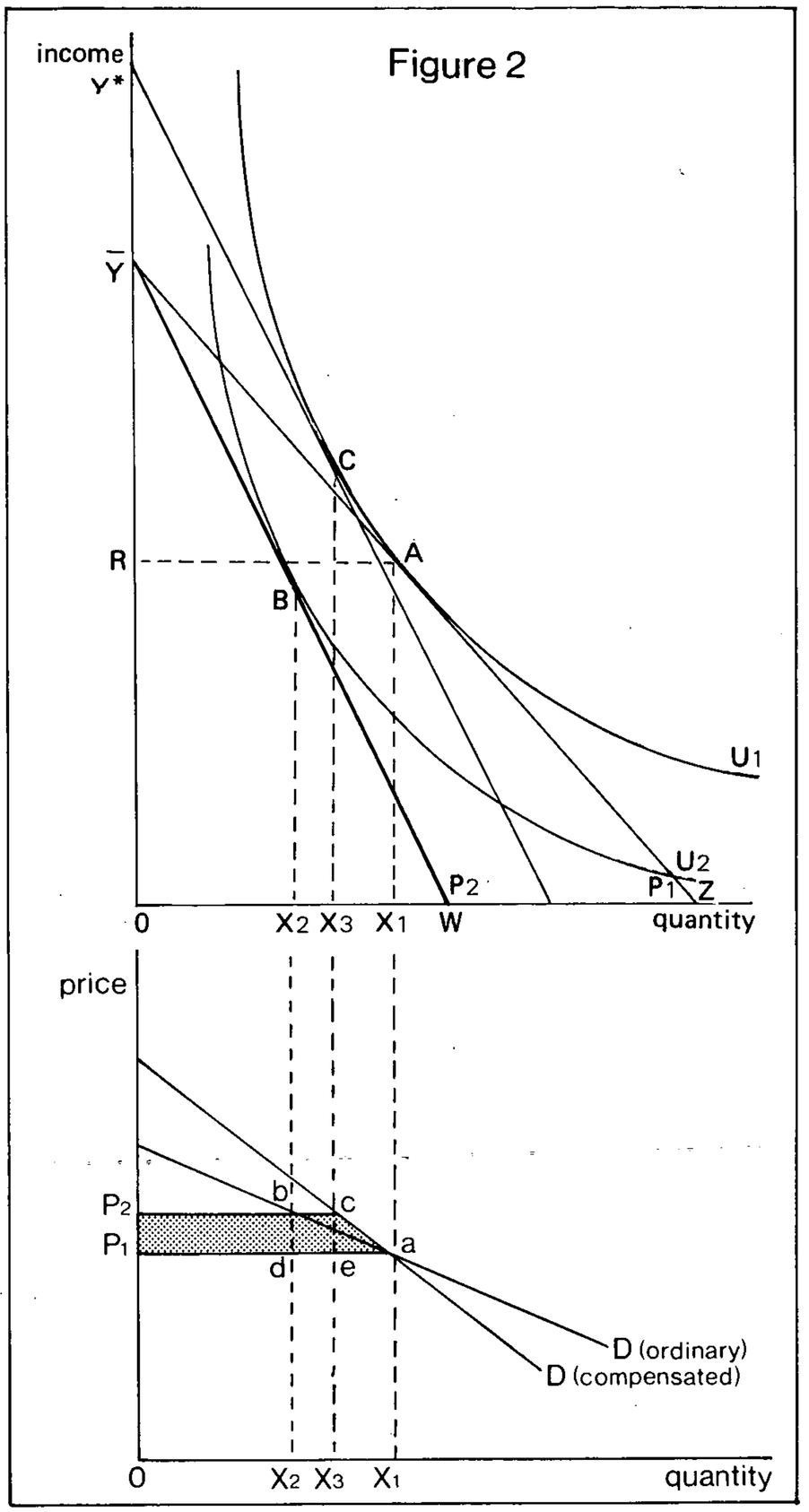
14. We have suggested, but not demonstrated, that a uniform rate of tax would be optimal when all final goods (including leisure) can be taxed. An equivalent expression for (3) when $T_i = t_i C_i$ and $C_i = 1$ is:

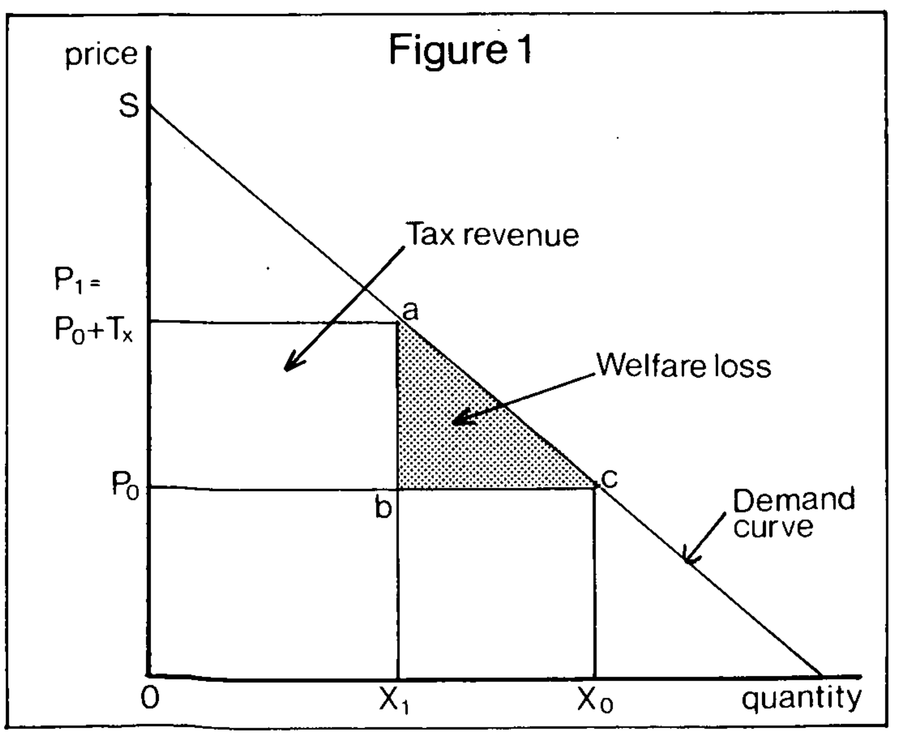
$$W = \tfrac{1}{2} \sum_i \sum_{j<i} S_{ij} (t_i - t_j)^2$$

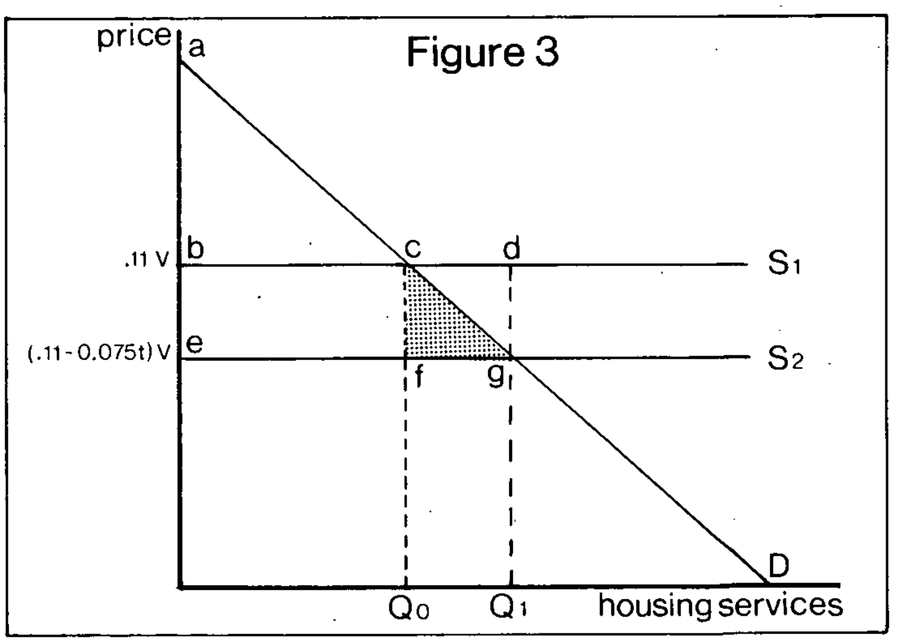
It follows that the welfare loss will be minimum (in this case, nil) when tax rates on all goods (including leisure) are equal. See Arnold C. Harberger, "Taxation, Resource Allocation and Welfare", *Taxation and Welfare*, p. 39.

15. See, especially, Jerry R. Green and Eytan Sheshinski, "Approximating the Efficiency Gain of Tax Reforms", *Journal of Public Economics*, Vol. 11, No. 2, April 1979, pp. 179-196; and Jerry A. Hausman, "Exact Consumer's Surplus and Deadweight Loss", *American Economic Review*, Vol. 71, No. 4, September 1981, pp. 662-676.

16. A useful survey of the controversies is provided in J.M. Currie, J.A. Murphy and A. Schmitz, "The Concept of Economic Surplus and Its Use in Economic Analysis", *The Economic Journal*, Vol. 81, No. 324, December 1971, pp. 741-799.







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AUSTRALIA:

Avoidance of Income Tax: Trust Stripping *

This statement aims to make clear beyond all doubt that trust stripping schemes can no longer have their intended effect of enabling participants to avoid payment of income tax, and that taxpayers who pay fees to promoters for such schemes are simply wasting their money, as well as making themselves liable to heavy penalty taxes.

The essence of a trust stripping scheme is that income of a family trust is diverted, through a chain of trusts, to persons who are associated with the promoter but who do not pay tax on the income, perhaps because it has been moved off-shore to persons who are not residents of Australia for income tax purposes. The family members enjoy the benefit of the income, less the promoter's fee, in a non-taxable capital form.

Anti-avoidance legislation dealing specifically with these schemes has been enacted, with effect from 12 June 1978, and was the subject of amendments of a strengthening nature, operative from 6 March 1980.

The practical effect of that legislation, where it applies, is to tax the income in the hands of the last trustee in the chain, at the maximum rate of personal income tax, 60%. This basis of taxation accords with the general rule of the income tax law that income of a trust to which no beneficiary is presently entitled is taxed in the trustee's hands at the rate of 60%.

Trust stripping arrangements are also within the scope of the new general anti-avoidance provision of the Income Tax Assessment Act, Part IVA. Under that provision a person is taxed on income which might reasonably be expected, but for a tax avoidance scheme, to have been derived by the person as income subject to income tax. The family members from whom income is diverted under a trust stripping arrangement are accordingly taxed as if they had received the income.

Where Part IVA applies to strike down a tax avoidance scheme, the persons concerned are liable to pay not only the amount of tax sought to be avoided but also additional tax by way of penalty of an additional 200% of the basic tax.

It has recently come to the Government's notice that, despite its resolute attacks on these tax avoidance schemes, some promoters continue to market them. An outline of known features of schemes that have come under notice is contained in an appendix to this statement.

While the Commissioner of Taxation has come into possession of details of a number of such schemes, those who promote them make it their business to keep details away from the tax authorities and even, in some critical respects, away from taxpayers to whom the schemes are offered. Their aim in doing this is to delay administrative consideration of the schemes for as long as possible and the payment of tax ulimately found to be payable. It is because of this reticence that some of the examples in the appendix are sketchy.

The attempted exploitation involved in all of these schemes is blatant. A legal opinion used to assist in marketing the first of the schemes runs to some 54 pages and discusses at length the possible obstacles to the success of the scheme.

In discussing the possible impact of Part IVA, counsel writes:

> "The present proposal clearly involves a 'scheme' as defined, and it will be one entered into after 27 May 1981. It is hard to contest the view that it 'would be concluded', after considering the various matters listed in section 177D, that the dominant purpose of those who entered into it and carried it out was to effect a tax saving for the client group. But not all tax savings or adventages are within the definition of 'tax benefit'. For the Part to have an adverse effect upon [the client's trust] or any member of the client group it is necessary for the Commissioner to nominate a particular taxpayer, and a particular amount of assessable income which amount 'would have been included, or might reasonably be expected to have been included' in the assessable income of that taxpayer: section 177C(a). It is only where that can be done that the Part enables the Commissioner to assess."

While in this and other opinions on the matter, counsel put a number of arguments to the effect that the specific and general anti-avoidance provisions do not apply, the key line of argument is that it cannot be said in a number of cases that, but for the scheme, an amount would or might reasonably be expected to have been included in a particular beneficiary's assessable income.

The Government has sought the advice of the Commissioner of Taxation about the likely efficacy of the latest schemes. The Commissioner is strongly of the view that the courts will uphold his contention that it is practicable to find the identity of the persons who would have derived the income, or might reasonably be expected to have derived it, but for the scheme. On that basis there could on one view of things be no need for Government action – in due course persons concerned will be liable to pay the tax along with the penalty tax.

However, the fact remains that promoters are blatantly offering these schemes for sale. Equally, the Government cannot accept that such schemes should have even the remotest chance of success, either to escape payment of tax altogether or to defer its payment until after the process of appeals has been concluded.

The Government has considered whether Part IVA should be amended, but has concluded that it should not. The central test – whether there is an omission of income that otherwise might reasonably be expected to have been included in the taxpayer's assessable income – is, in the Government's view, a correct one. To express it in other terms would probably involve conferring on the Commissioner of Taxation the onerous responsibility of selecting, on a discretionary basis, the person to be

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* Statement of 11 May 1982 by the Treasurer, the Hon. John Howard, M.P.

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taxed. That, in the Government's view, is the least attractive of the possible options.

Rather than adopt such a course, the Government intends to follow a procedure it has followed in relation to what have become known as "expenditure recoupment" schemes of tax avoidance. I indicated in a statement on 24 September 1978 that if further "expenditure recoupment" schemes were to surface, remedial legislation would be brought forward and be effective from that day. The Government has on subsequent occasions given effect to this warning, the most recent occasion being that of my statement of 9 February 1982 about certain tax rebate schemes of the "expenditure recoupment" type.

Accordingly, I now announce that, should existing legislation be found inadequate to strike down any scheme of the trust stripping type, the Government will introduce appropriate remedial legislation. That legislation will have effect after today, that is, it will apply to trust income of the current and subsequent income years, except where the income has been paid to or applied for the benefit of a beneficiary before tomorrow. The legislation will be structured so that tax is borne by the persons who are found to have rights to effectively enjoy the income, whether in a capital form or in any other way. Depending on the structure of the particular schemes, collection of the tax could be from beneficiaries, trustees or any other participants.

Although this action will make it certain that the tax will be paid, participants in trust stripping schemes cannot be allowed to have the advantage of a postponement of the time of payment of the tax. Therefore, I also make it clear that any legislation that it becomes necessary to propose will in addition make the people concerned liable to pay as penalty tax an amount at least as great as that which applies at present under Part IVA.

This statement is a clear and unambiguous warning as to the Government's intention in this matter.

Appendix to Treasurer's Statement of 11 May 1982

Trust strip using Australian and overseas trusts (1)

- The client's family trust makes a distribution of its income to a trust controlled by the promoter which, in turn, distributes the income to a third trust also controlled by the promoter.
- The trustee of the third trust distributes an amount representing the promoter's fee to a further trust controlled by the promoter. The trustee then resolves to hold the balance of its income for the benefit of an Australian unit trust, with the claimed result that the unit trust will in turn be deemed to be presently entitled to that income.
- The trustee of the third trust then enters into arrangements designed to ensure that the amount of the income, net of the promoter's fee, is in reality retained by the client's family trust. This is achieved by the trustee of the third trust lending the equivalent amount, in exchange for a promissory note, to a trust controlled by the client. That trust then uses the funds represented by the loan to purchase assets from the client's original family trust.
- The income to which the Australian unit trust has been made presently entitled (net of the "fee" distribution to the promoter's trust) is, without funds ever leaving Australia, successively applied for the benefit of six trusts each of which is established in Nauru. The income is accumulated in the sixth Nauruan trust.
- It is claimed that the income is no longer attributable to Australian sources. However, in the event that that claim is not successful and section 100A of the Income Tax Assessment Act applies to deem the trustee of the sixth Nauruan trust not to be presently entitled to the income a further mechanism is built into the scheme with a view to ensuring that the trustee of the fifth Nauruan trust is not subject to assessment under section 99A of the Act.
- Under this, a United Kingdom company becomes entitled to the income of the fifth Nauruan trust in the event that the trustee of that trust does not exercise its discretion to apply income for the benefit of the sixth Nauruan trust (i.e. in the event that section 100A applies to deem the sixth Nauruan trust not to be presently entitled to the income). The resultant income of the U.K. company is claimed to be exempt from Australian tax under the double taxation agreement with the U.K. by virtue of the income being "industrial or commercial profits" not attributable to a permanent establishment in Australia. The income is said not to be subject to tax in the U.K. as it is a fictitious entitlement to income that arises solely by the operation of Australian tax law.
- The final stages of the arrangements involve the sixth Nauruan trust lending an amount equal to the accumulated income to a seventh Nauruan trust which then subscribes for units in an eighth Nauruan trust which, in turn, settles the amount on a ninth Nauruan trust, which is capable of being controlled by the client.
- Ultimate beneficial entitlement to the funds represented by the promissory note issued by the client's second trust ends up with the ninth Nauruan trust and arrangements are made so that if the promissory note is presented to the client's trust for payment the client is able to obtain practical control of the trust.

Trust strip using Australian and overseas trusts (2)

- The scheme promoter's finance company makes a loan to an Australian discretionary trust controlled by the promoter by accepting a demand bill.
- The promoter's discretionary trust purchases units in the promoter's fixed unit trust by endorsing the bill to that trust.
- The promoter's fixed unit trust purchases – by further endorsement of the bill – special limited income units in a Northern Territory unit trust presently controlled by the taxpayer through a related discretionary trust holding a controlling interest in ordinary units. The limited income units are capable of being converted to ordinary units by a specified date.
- The Northern Territory unit trust then makes a loan to the client's operating trust, the income of which is to be stripped, by further endorsing the bill.
- The client's operating trust (which in the case of "in-house" arrangements may be the promoter's own trust having income that flows to it under other avoidance arrangements) then distributes its income down a chain of Australian trusts to the promoter's discretionary trust by further endorsements of the bill. The promoter's discretionary trust then repays its debt to the finance company by endorsing the bill.

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- The preceding steps complete a round-robin, the result of which is to ensure that the amount of the income of the operating trust is retained by the trust. As part of the scheme, the right of conversion attaching to the limited income units held by the promoter's unit trust lapses, ensuring that control of the Northern Territory unit trust (and so of the outstanding debt of the client's operating trust in respect of the loan) is retained by the client.
- An Australian unit trust is then made presently entitled to the income of the promoter's discretionary trust, which is represented by its present entitlement from the preceding trust in the chain.
- The present entitlement is then passed down through a number of foreign trusts to a Canadian resident. Again it is claimed that the income is no longer attributable to sources in Australia. The arrangements also incorporate the use of "secondary beneficiaries", similar in nature to those under the preceding scheme.
- The Canadian entity assigns its right to the trust income to a Nauru trust which gifts the right to the income to the promoter's fixed unit trust. This step is designed to ensure that the Australian unit trust and the trusts in the foreign chain are presently entitled to the relevant trust income.

Trust strip using Australian and overseas trusts (3)

- The client's operating trust (which again, under certain "in-house" arrangements, may be the promoter's own trust) distributes its income in the form of a bill of exchange through a chain of Australian trusts associated with the promoter.
- The last Australian trust assigns the bill of exchange to a discretionary trust (controlled by the taxpayer) in exchange for an unsecured note. The discretionary trust makes a loan to the operating trust by endorsing the bill of exchange in its favour.
- The effect of these arrangements is to complete a round-robin, by which money represented by the bill of exchange remains with the client's operating trust.
- The last Australian trust resolves to distribute the income to a tax haven trust in Nauru and holds the unsecured note for that trust.
- The tax haven trust sells its interest in the unsecured note to a second Nauru trust which in turn sells the note to a foreign company controlled by the client, or associates of the client, ensuring that there is no outstanding liability on the part of the client. The net result of this and the round-robin of the bill of exchange is to ensure that the amount of the income is in reality retained by the client's operating trust.
- The tax haven trust borrows from an associated tax haven trust and distributions of income in the form of a bill of exchange occur down a chain of foreign trusts. It is claimed that the income is no longer attributable to sources in Australia or, if that claim is not successful, that the income is exempt from Australian tax by virtue of the "business profits" article of Australia's double taxation agreement with Canada – the country of residence of the last two entities in the chain.
- The final entity in the foreign chain – a Canadian company – claims to avoid any liability to tax in that country offsetting assessable trust distributions by deductible interest payments which arise as part of the scheme. In addition no Canadian interest withholding tax is said to be payable because of the terms of the particular loan agreements.
- The off-shore arrangements, including the interest commitments, are financed by a complex series of round-robin transactions using a tax haven company.
- The client's operating trust passes a fee to the promoter by way of a second and parallel set of trust distributions down a second trust chain.

Trust/gift distribution scheme

- The operating discretionary trust distributes its income to a related discretionary trust, the beneficiaries of which are the same or substantially the same as those of the operating trust.
- The related trust invests the whole of the amount of the income in subscribing for special "A" class redeemable preference shares in a newly established private investment company, thereby acquiring control of that company.
- The company then lends an amount equivalent to the amount subscribed for the shares back to the operating trust.
- The preceding steps complete a round-robin, the net result of which is that the income of the operating trust is in reality retained by that trust.
- The beneficiaries of the related trust are made presently entitled to the income of the trust (now represented by the special "A" class redeemable preference shares), subject to their using that present entitlement to acquire the preference shares.
- The beneficiaries are "invited" to donate those shares to a charity, gifts to which are deductible for income tax purposes. The deduction claimed in respect of the gift is equal to the amount of the assessable trust distribution.

Trust strip through use of charitable trusts

- The client's discretionary trust distributes its income to a trust controlled by the promoter. The beneficiaries of that trust are the unborn children of the client and a further trust controlled by the promoter.
- The promoter's trust then distributes the income to the second trust controlled by the promoter, which in turn distributes the income to a "charitable trust".
- The charitable trust distributes the income to a second "charitable trust", the income of which is claimed to be exempt from income tax.
- The second charitable trust distributes a minor part of the trust income to a charity. The major part of the income is distributed to a specied individual beneficiary. It is claimed that the income from the exempt trust retains its exempt character in the hands of the beneficiary.
- A separate promoter entity reimburses the client's discretionary trust by way of a collapsible loan, i.e. a loan not intended to be repaid.

Family trust stripping scheme

- The trustee of a new discretionary trust is introduced as a beneficiary of a family trust.
- The initial beneficiaries of the new discretionary trust are the family members and the trustee of a trust controlled by the promoter.

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- Subsequently, the family members are excluded as beneficiaries both of the family trust and of the new discretionary trust.
- The original family trust then derives income from a distribution from a family company, which is in turn distributed to the new discretionary trust.
- The new discretionary trust then enters into arrangements designed to return the amount of the income to the family. These involve the trustee subscribing for special redeemable preference shares in a company, which are subsequently forfeited. The company then reimburses the family interest, either directly by the settlement of trusts for the benefit of the family members, or by settlements in favour of an associate which will acquire (and forfeit) redeemable preference shares in a company controlled by the family group.
- A further promoter's unit trust is then made "presently entitled" to the income of the new discretionary trust, which is represented by its present entitlement to the original family trust's income.
- The second promoter's unit trust "deals" with the distribution in ways that have not been disclosed.

Conference Diary

NOVEMBER 1982

Management Centre Europe: 11th International Finance Conference: Changes in international finance and their implications for business (including: Financial and tax incentives aimed at attracting investments). Geneva (Switzerland), November 3-5 (English).

Horizon International Tax Management: Tax and legal counseling for the foreign client (Seminar). Los Angeles California (U.S.A.), November 5 (English).

International Tax Planning Association: Singapore Seminar (including: South East Asia as a base for international transactions; current developments in international tax planning). Singapore (Republic of Singapore), November 10-12 (English).

Management Centre Europe: Leasing; techniques and analyses (including: Tax aspects of leasing). Brussels (Belgium), November 17-19 (English).

Tax Affairs Foundation of the Philippines: 2nd International Tax Convention. Singapore (Republic of Singapore), November 26-30 (English).

Steuer-Telex-Seminar: International Tax Law; (in particular business relations between Germany and Austria from a tax point of view). Vienna (Austria), November 19-20 (German).

DECEMBER 1982

Management Centre Europe: Taxation of International Group Companies and Branches (including: Taxation of branches and subsidiaries; taxation of shareholders; domestic and tax treaty "anti-avoidance" measures) (Seminar). Brussels (Belgium), December 2-3 (English).

Terzake Belastingen: Tax aspects of Doing International Business. Amsterdam (Netherlands), December 2 (Dutch).

Management Centre Europe: International cash management (including: International tax aspects in cash management). London (United Kingdom), December 6-8 (English).

Management Centre Europe: Stanley B. Lubman on China (including: The joint venture income tax law; the tax on individual income; the tax on foreign enterprises; recent regulations and interpretations by central and local tax authorities). Brussels (Belgium), December 9-10 (English).

U.K. Tax Congress: 2nd Annual U.K. Tax Congress (including: Current uses of U.K. offshore tax havens; taxation of commercial interest; tax deferral opportunities for individuals). London (United Kingdom), December 9-10 (English).

OCTOBER 1983

The Taxation Institute of Australia: Sixth National Convention (including: The role of the High Court in interpreting tax statutes; taxation of technology; tax shelters and planning for the '80s). Melbourne (Australia), April 10-15 (English).

37th Annual Congress of I.F.A.: I. Tax avoidance/tax evasion. II. International problems in the field of turnover taxation. Venice (Italy), October 10-15 (English, French, German, Spanish).

FOR FURTHER INFORMATION PLEASE WRITE TO:

Horizon International Tax Management, Ltd.: 410 Linden Road, Bellingham, Washington 98225 (U.S.A.).

International Tax Planning Association: 33A Warwick Square, London SW1V 2AD (United Kingdom).

International Fiscal Association (I.F.A.): General Secretariat, Woudenstein, Burgemeester Oudlaan 50, P.O. Box 1738, 3000 DR Rotterdam (the Netherlands).

Management Centre Europe: Avenue des Arts 4, B-1040 Brussels, Belgium.

Steuer-Telex-Seminar: Dr. Peter Deubner Verlag GmbH, Abteilung Seminare. Postfach 410268. 5000 Köln 41 (Federal Republic of Germany).

Tax Affairs Foundation of the Philippines, Inc.: 32 Catanduanes Street - West Avenue (near the Mobil gas station) Quezon City. P.O. Box 100 PA, Manila (Philippines).

Terzake Belastingen: VNU Data publishing International bv. Antwoordnummer 18007, 1000 VB Amsterdam (Netherlands).

The Taxation Institute of Australia: 113 Swanson Street, Melbourne VIC. 3000 (Australia).

U.K. Tax Congress: 20 London Road, Horsham, West Sussex RH12 1AY (United Kingdom).

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In memoriam

Professor Dr. J.C.L. Huiskamp



IFA announces with great sorrow the untimely death of its Assistant Secretary General, Professor Dr. J.C.L. Huiskamp, on 13 September 1982. His health had been indifferent during the last years but this did not prevent him from accomplishing the many tasks he imposed on himself. IFA is in particular grateful for the work he performed on its behalf.

Professor Huiskamp started his career in 1952 as a research associate with the International Bureau of Fiscal Documentation, where he worked with an interruption of some time for 15 years. He was the Editor-in-Chief of the *Bulletin for International Fiscal Documentation* and in 1967 he became one of the Bureau's deputy directors. In 1971 he left the Bureau and accepted a post as associate professor at the Erasmus University in Rotterdam and deputy director of the *Institute for Fiscal Studies*. Later he became a full professor and the director of that Institute.

His friends know that Joop Huiskamp had many adversities in his life and that only in the last few years did he again find happiness with his wife Lenie. We all mourn a dear friend whose capability and integrity were above question.

Some Highlights from the Secretary General's 1981-82 Report Presented at the Montreal Congress 1982

BERLIN CONGRESS 1981

The 35th Congress of IFA took place in September 1981 in the International Congress in West Berlin under the supervision of Dr. Karl Beusch, Chairman of the German Branch of IFA, assisted by Mr. Arnold Willemsen and Dr. Karl-Dieter Wingert.

With respect to Subject I – "Mutual agreement – Procedure and practice" – Prof. Dr. H. List (Federal Republic of Germany) acted as Chairman of the Working Session, Prof. Dr. P. Fontaneau (France) as discussion leader, Dr. K. Koch (Federal Republic of Germany) as General Reporter and Messrs. P.E. Coates (U.S.A.), J. de la Villa Gil (Spain), D.A. Ward (Canada) and J. Westenburgen (Netherlands) as panelists.

With respect to Subject II – "Unilateral measures to prevent double taxation" – it was Mr. J. Olinger (Luxembourg) who acted as Chairman, Prof. Dr. E. Höhn (Switzerland) as discussion leader, Dr. D. Juch (Netherlands) as General Reporter and Messrs. A. Timbart (France), G. Hill (Australia), R. Aguirre (Mexico) and H. Roe (United Kingdom) as panelists.

Chairman of the Seminar on "Taxation of the income arising from the international seabed" was Prof. Dr. K. Vogel (Federal Republic of Germany) and panelists were Messrs. C.M. Bruce (U.S.A.), Dr. P. Kirthisingha (UNCTAD), Dr. K. Oetting (Federal Republic of Germany) and Mr. J.C. Delespaul (France). These gentlemen were also instrumental in writing background papers to the Seminar provided to the participants in their congress kits.

MITCHELL B. CARROLL PRIZE

Dr. Moris Lehner (Federal Republic of Germany) won the Mitchell B. Carroll Prize 1981 for his work entitled *Möglichkeiten zur Verbesserung des Verständigungsverfahrens auf der Gundlage des EWG-Vertrages* (Possibilities of improving the mutual agreement procedure within the scope of the EEC Treaty).[1]

1. See 35 *Bulletin for International Fiscal Documentation* (1981) at 519.

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IFA OFFICERS COME AND GO

The Executive Committee regretfully announces the premature death of its member, Dr. Robert Bechinie, Chairman of the Austrian Branch. Two new members were appointed: Mr. M. Marin Arias (Spain) and Mr. R. Koch-Nielsen (Denmark). Dr. Antal (Netherlands) was replaced by Prof. A. Nooteboom, currently the Chairman of the Dutch Branch.

Mr. Graeme Herring (Australia) will be due for statutory retirement at the Montreal Congress.

NATIONAL BRANCHES

At the Berlin Congress the Singapore Branch was recognized. Sri Lanka is also interested in forming a branch and Mr. Ambalavaner has submitted a draft constitution for approval. A number of branches have faithfully sent reports on their branch activities and it is hoped that other branches will follow suit. There have been a number of bilateral meetings, e.g. the Belgo-Luxembourg Branch held a joint seminar with the German Branch.

MEMBERSHIP FEES

IFA will recommend – for the second consecutive year – not to increase the membership fees for 1982-83. Thus they will remain:

- US$ 38 for individual members of IFA branches;
- US$ 40 for direct individual members of IFA;
- US$ 90 for corporate members, both direct and of national branches.

MONTREAL CONGRESS 1982

At the time of writing the 1981-82 Report, preparations for the Montreal Congress were nearing completion. General Reporters are Prof. E. Höhn (Switzerland) and Me. G. Coulombe (Canada) for Subject I and Subject II respectively. The discussion leader will be Mr. R.M. Hammer (U.S.A.) and Prof. I. Claeys Bouuaert (Belgium). The Chairmen of the Resolutions Committees are Prof. Dr. H. Vogel (German Federal Republic) and Dr. R. Casas (Mexico).

The Seminar to be organized by IFA will have as its subject "Imputation Systems – Objectives and Consequences", and it will be chaired by Mr. D.A. Ward (Canada). Panelists will be Mr. P. den Boer (Netherlands), Mr. D.R. Tillinghast (U.S.A.), Dr. S. Mayr (Italy), Mr. S. Wright (U.K.), Mr. S. Poddar (Canada), Dr. P. Franken (German Federal Republic), Prof. P. Fontaneau (France), and Mr. A. Buelinckx (Belgium).

The Canadian Branch will organize two seminars, one on the Canadian tax system and one on the draft Canadian–U.S.A. tax treaty. Booklets containing background information will be prepared by Canadian tax experts.

FUTURE CONGRESSES

1. Venice Congress 1983

During its spring meeting the Permanent Scientific Committee discussed the directives for the Venice Congress. The subjects are:

Subject I: Tax avoidance/Tax evasion.
General Reporter: Prof. V. Uckmar (Italy).

Subject II: International problems in the field of general taxes on sales of goods and services.
General Reporter: Prof. DDr. H.G. Ruppe (Austria).

2. BUENOS AIRES CONGRESS 1984

The subjects which were selected for the Buenos Aires Congress are:

Subject I: Tax factors affecting the international flow of capital between the parent and its subsidiary.
The General Reportership is still under discussion, and will be known finally during the Montreal Congress.

Subject II: Social security contributions as a tax factor for enterprises engaged in international activities.
General Reporters: Profs. E.J. Reig and J. Macón (Argentina).

COLOMBIAN BRANCH OF IFA

Recent activities

The Colombian Branch of IFA currently has 41 active members including many leading experts in tax matters. Since June 1981 the Executive Committee has accepted five new members who have had a distinguished career in taxation. Some of its active members have been called upon to serve their country in high positions. For instance, Dr. Bernardo Ortiz has recently been appointed President of the Council of State and Dr. Simón Rodríguez President of the Administrative Court of Cundinamarca. The present National Director of Taxes has also been a member of IFA for serveral years. In addition, the Colombian Branch includes a number of former Finance Ministers, former directors of taxes and leading lawyers and professors specialized in taxation and public finance among its members.

The Executive Committee, which was appointed in June 1981, considered the legal regime for foreign investments of utmost importance and therefore focussed its efforts on organizing a seminar on this subject. This seminar was held on 26 February 1982 and lasted 10 hours and attracted 80 participants. Papers were read by five members of the Colombian Branch on the following subjects:

- The development of the institutional framework and foreign investment policy;
- Legal and exchange regimes;
- Tax treatment of profits; accounting and tax relations with the head office;

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- Technical assistance and services, know-how and royalties;
- Public contracting – consortia and their tax treatment.

Other activities included the organizing of luncheon meetings which were devoted to the discussion of selected subjects. At one of these meetings members of the Bird-Wiesner Commission were invited to discuss a number of interesting issues dealt within their report on public finance which was prepared at the request of the national government. In November 1981, Dr. Carlos Ramírez presented his report on the "Tax treatment of interest in international economic transactions" which he prepared for the Montreal Congress.

These luncheons serve, in addition, to inform the members on subjects selected for future IFA congresses as well as to examine and comment on other activities of the Colombian Branch. A special task undertaken by the Branch is the publication of a bibliography and articles on tax subjects, including comparative tax law. For this purpose the *Bulletin for international fiscal documentation* has been of valuable assistance. Unfortunately, however, due to language barriers, these articles cannot be as widely distributed and used as they deserve.

MALAYSIAN BRANCH

On 11 June 1982 the Malaysian Branch of IFA held its inaugural meeting. On that occasion, Mr. Angel Q. Yoingco, Director of the National Tax Research Center, Republic of the Philippines, delivered a talk on Regional Cooperation in Taxation. The major part of this talk is reproduced here.

It does feel grand to be given the honor of being the guest speaker for the inaugural luncheon meeting of the Malaysian chapter of the *International Fiscal Association*. In the Philippines, we term this privilege as "buena mano." In commercial parlance, he is the first morning buyer. Normally, he is supposed to bring good luck to the business. I hope I brought all the luck with me. It may interest you to know, that I have a high batting average when it comes to being a lucky "buena mano."

I cannot help but entertain some suspicions however, on why I was extended this invitation by Mr. Lee Beng Fye, Secretary General of 12th SGATAR meeting and Tan Sri Lim Leong Seng, former Director General of your Tax Department and now Chairman of IFA, Malaysian chapter. Let me reflect aloud on two possible reasons.

First, being Mr. Lee Beng Fye's personal friend, I strongly suspect that he virtually pressured you in having his friend as the guest speaker.

Second, I would like to think that being the only participant who has been with the Study Group on Asian Tax Administration and Research (SGATAR) from the day it was conceived in 1970 until today, gives me enough experience to speak before a group of learned men.

Given the prerogative to make the choice, I shall take the last reason as the most plausible rationale why you have invited me. It is also for this reason why I chose to speak on a topic that is close to my heart and is of concern and interest to you: *Regional Cooperation in Taxation*. Let me warn you at this point that my ghost writer differed in his opinion of what I should talk about. Thus, he prepared a speech for me on an entirely different topic. I was therefore left on my own to prepare my short discourse for this afternoon.

The opening remarks of the Mayor of Copenhagen to the 1979 IFA meeting lucidly summarized the dilemma of many developing countries: The appetite of the public for paying taxes is not as strong as their demand for government services. Governments constantly face the problem of financing their continuously rising budgets. Quite commonly this situation will be met either through the increase in existing tax rates or through the enactment of new taxes. This process cannot go on indefinitely as there is a limit to taxation. At some point in time, taxation will affect incentives to work and invest. Already, we witness an evidence of people's aversion to taxes through non-compliance with tax laws. Policy makers must therefore find other avenues to increase the productivity of their tax systems. It is along this need that regional cooperation in taxation aside from bilateral tax treaties finds relevance. Through regional organizations countries can share information on tax policies, practices and experiences. They can also provide a forum where policy makers and administrators can learn from one another through study groups and regular meetings especially with regard to the improvement of tax administration.

A more concerted effort is also needed in confronting the problem of taxing multinational companies effectively. Given the lack of resources to adequately check the financial records of these corporations, countries, especially developing ones, should get more organized to draw up tax laws and measures to face the MNC's strategies in minimizing tax liabilities like the use of tax havens.

The other area calling for regional cooperation in taxation is the needed tax coordination for the elimination of trade barriers and the promotion of investments through the tax instrument. EEC countries for example tend to harmonize their tax laws to promote the free flow of goods and services in the region.

Among others, these could have spurred the organization of regional tax organizations. For the 20 Latin and American countries, there is the Centro Interamericano de Administradores Tributarios (CIAT) which was organized in 1967. The Caribbean Organization for Tax Administrators (COTA) organized in 1970 services the needs of countries in the Caribbean like Jamaica and the Dominican Republic. For members of the Commonwealth, the Commonwealth Association of Tax Administrators (CATA) has recently been founded. In Asia and the Pacific, we are proud of the SGATAR which had its first meeting in Manila in 1971.

A cursory look at the charters of these organizations reveal that they have common objectives. They purport to improve tax administration in member countries

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through the mutual exchange of ideas and experiences; they aim to promote tax research and the conduct of studies on the various tax systems. They are also intended to review and exchange information about the tax policies and tax structures of member countries.

The fact that the said regional organizations have continued to function justifies their existence. I can speak more easily on SGATAR because I have seen it grow and mature. Although the structure of its membership has changed due to political developments in the region, the SGATAR now boasts of nine member countries as follows: Australia, Indonesia, Japan, Republic of Korea, Malaysia, New Zealand, Philippines, Singapore and Thailand. The SGATAR has provided an appropriate venue for cooperation and discussion in taxation among these member countries. In its annual meetings, member countries have freely discussed their ideas, practices and experiences on about 41 major topics in taxation such as direct taxation, incentive taxation and tax administration.

The problem of tax evasion has been discussed in almost three meetings. In the 1979 Manila meeting, the member countries identified the following as the most common forms of tax evasion:

1. Unreported income of taxpayers through non-filing of returns, omission of certain types of income like dividends and interest.
2. Understatement of income through reduction in or non-recording of sales and incorrect accounts.
3. Improper and unallowable deductions; and
4. False allocation of income through, among others, false charges for salaries and diversions to fictitious partners.

Member countries exchanged experiences in coping with evasion practices. Indonesia and Malaysia conduct inspection of business and residential premises, as well as examination of books of accounts. Japan resorts to auditing of books and other evidential documents, books of the taxpayer's business counterparts and simultaneous auditing of the head office and its branches. New Zealand and Japan use counterpart audit of bank accounts to check cases of tax fraud.

In the 1978 Wellington meeting, member countries acknowledged common problems with regard to the taxation of multi-national corporations. The difficulties as shared were mainly brought about by the following factors:

1. Insufficient information held by the resident company or subsidiary on the methods applied by the overseas parent company in fixing prices and other charges;
2. Lack of expertise on the part of tax officials in handling tax audits and investigations;
3. Inadequate comparative information, particularly where the MNC is in a monopoly situation; and
4. The processing of accounting information through highly sophisticated computer systems which are programmed and controlled within the parent company's country of residence.

To overcome the above problems, most SGATAR countries employ the "arm's length" method in determining the taxable income of MNC's. This means that the profit ratios expected are those that would have been derived had the parties to the tansactions been independent. Another technique employed by participating countries is the introduction of withholding tax systems at source with respect to payment of interest, dividends, and royalties to the parent companies. The Wellington meeting ended with an agreement of the need for greater cooperation and discussion among them in the exchange of information relative to MNC's.

The grant of fiscal incentives has also been a favorite topic for discussion in SGATAR as it has been studied in about three meetings. The dynamism of SGATAR and its response to the changing needs of the countries within the region are evident on the changing concept about tax incentives. In the 1971 Manila meeting, the participating countries were unanimous in acknowledging that fiscal incentives contribute to economic development by attracting investments into those areas which need to be developed. A minority pointed out however the disadvantages of granting liberal incentives which could cause, among others, undue competition among developing countries, in particular. This thinking became more pronounced in the 1975 Bangkok meeting. The delegates generally recognized that all concessions and incentives should be open to review and change with clearly stated time limits on measures such as tax holidays and deferred tax payments. It was also recognized that if all countries in the region were to use fiscal measures to promote exports, a conflict of interest may arise where two or more countries are exporting the same product. The 1975 meeting cautioned that developing countries should not compete excessively with one another in the grant of export concessions.

The attitude towards fiscal incentives radically changed in the 1980 Jakarta meeting. Some participants especially those from Singapore expressed doubt on the effectiveness of fiscal incentives in encouraging development and in attracting foreign investments. Malaysia and Japan could not say with certainty as to the extent the locational incentive was contributory to industrial development. The meeting concluded with the need of member countries to review their respective investment schemes.

Regional meetings in taxation such as the SGATAR do not only end up in conclusions and recommendations. The latter only serve as spring-boards in the introduction of improvements in the tax system of the participating country. They also serve as stimuli for regional projects and activities. Allow me to illustrate both.

1. An instance where one country learns from another is typified in the expansion of the tax withholding system of the Philippines. I have no doubt that the discussion of the Japanese withholding system during the 1976 Singapore meeting has given new insights to the Philippine participants. The Japanese delegation explained a comprehensive withholding scheme in Japan which covers wages, retirement allowances, interest, dividend and remunerations for almost every type of profession. The scheme as mentioned reduces administrative and compliance costs as well as assures a steady flow of government revenues.

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The Philippine government introduced the expanded withholding system in 1978 which is similar in many respects to the Japanese system. Various forms of incomes are subject to a withholding tax ranging from 2½ to 35%. A feature has been added, however, in that the withheld tax is creditable.

2. The SGATAR has had opportunities for regional projects. Joint undertakings have been quite successful because of the cooperation of member countries. To date, SGATAR, has completed three publications which contain basic information about the tax systems in the region:

a. The *Glossary of Tax Terms* which is a handy compendium of the definitions of tax terms and phrases commonly used in SGATAR countries. It is intended to serve as a convenient reference material in international conferences, tax treaties and research studies.
b. The *Tax Systems of Selected Countries in Asia and the Pacific* is a synopsis of the tax systems in each of the SGATAR member countries and is aimed at providing information to investors, public officials, members of the academe and students.
c. The *Tax Administration Procedures of Selected Countries in Asia and the Pacific* analyzes the various stages of tax administration procedures in SGATAR countries and recommends measures to improve the efficiency in tax administration.

Cooperation among member countries has also been conducted informally. We have had chances of sending our personnel to train in taxation in other countries, such as in Singapore. The Philippine government, my office in particular, has also invited some of the tax personnel from SGATAR member countries including some junior tax officials from Malaysia to share our experience in policy formulation and research.

There are various areas in taxation through which countries in the region can help one another. SGATAR is one of the more effective tools for harnessing regional cooperation. It was in fact in the 1974 Malaysian meeting that the decision to continue SGATAR was firmed up due to the following reasons:

1. Immeasurable benefits are derived from the exchange of information among participating countries.
2. SGATAR meetings are opportunities for member countries to a) discuss problems and their possible solutions; b) keep abreast of new tax legislations and developments in other countries; c) share their experiences.

It is along these reasons that your chapter, the Malaysian IFA, International Fiscal Association, is looked upon with significance. In the IFA, you will study international and comparative law in regard to public finance. In connection with this objective, the birth of the Asian Pacific Tax and Investment Research Centre (APTIRC) based in Singapore is of common concern to us.

The speaker then went on by mentioning the International Bureau of Fiscal Documentation based in Amsterdam and founded by the IFA in 1938. The Bureau, so Mr. Yoingco said, is involved in the setting up of a similar research institution in Singapore. Mr. Yoingco, who is a member of that institution's founding committee, outlined some of the activities it may perform once it is established. He then continued:

Given your interest in fiscal matters not only in Malaysia but in Asia and the Pacific, I am positive that you will find APTIRC's objectives complementary to yours and its services as relevant to your needs. Prof. van Hoorn, in fact wishes your association success in a message to you which he requested me to relay. Let me quote a part of it:

On behalf of the International Bureau of Fiscal Documentation, a "child" of IFA born shortly after its mother's birth, I wish to congratulate the Malaysian chapter and to extend to all members my cordial greetings. The Bureau was originally meant to serve the members of the IFA. Now, it has a much broader objective, but my colleagues and I shall be at your disposal whenever you need our assistance. As a first token of friendship, I gave instructions to send to each member listed in the Yearbook of IFA a copy of the Bureau's annual report 1981. If it has not yet arrived, it should reach you shortly.

I wish the branch and each member a successful future in the field of our common interest.

In a way, I am more privileged than Prof. van Hoorn as I have this opportunity to personally wish all of you and the IFA, Malaysian chapter, success in all your undertakings. I hope that through a short discussion of the significance of regional cooperation in taxation, I have given you insights on how you can be of mutual assistance to each other within your organization and how you can reach out to others who are engaged in taxation outside Malaysia who may share your goals, interests and needs.

Thank you and Mabuhay.

SWISS BRANCH OF IFA

Overview of the activities in 1981

In 1981 the management of the Swiss Branch of IFA met three times. These meetings immediately preceded the general meetings of the members at which the subjects of discussion were current national and international developments. The management stresses the good relationship with the General Secretariat of IFA in Rotterdam (the Netherlands).

By the end of 1981 the Swiss Branch had 319 members (254 individual persons and 65 legal entities), i.e. 26 more than at the end of 1980. On 30 January 1980 Mr. Fritz Branderet (Head of the Legal Service of the Federal "Wehrsteuer" Division (income tax and net wealth tax)) of the Federal Revenue Service and Prof. Dr. Ernst Höhn, St. Gallen, read papers on "Income from capital and capital gains in income tax law". The discussion focussed on the practice of the Federal Court which considers tax-free capital gains as taxable income from capital. A number of delegates expressed their doubts whether this practice has a sound legal basis.[1] Another

1. F. Banderet: Vermögensertrag und Kapitalgewinn in 36 *Steuer Revue* No. 9 (1981) at 383; E. Höhn: "Die Abgrenzung von Vermögensertrag und Kapitalgewinn im Einkommensteuerrecht", in 50 *Archiv für Schweizerisches Abgaberecht* No. 10 (1982) at 529.

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subject which was discussed was an initiative taken by the Parliament of the canton of Graubünden with respect to the computation of the income of electric power stations working in more than one canton. The motives of the initiative were explained by Dr. T. Russi, Head of the Legal Service of the Tax Administration of Graubünden. The standpoint of the electric power stations and distributors of electricity was clarified by Mr. C. Hertig, notary and director of the Bernsche Kraftwerke AG. The problems have certain tax aspects and will also affect the users of electricity. The discussion showed that the problems could not be solved through the application of the Constitutional provisions prohibiting double intercantonal taxation.[2]

At the general meeting of 19 June 1982, Dr. K. Locher, Director of the Federal Revenue Service, Dr. Maurice Aubert, banker , and Dr. Lionel Frei, Division Head of the Federal Police Department, read papers on "Exchange of information in taxation". It was shown that the restrictive policy followed up to now by the Federal authorities has substantially changed. These changes are mainly based on Art. 3(3) of the new Federal Law on international aid in criminal cases of 20 March 1981 which will take effect on 1 January 1983. This provision will enable foreign States to obtain assistance from the Swiss authorities in cases of tax fraud, provided that a number of conditions have been met.[3]

During the meeting of 13 November 1981, Mr. Ludwig and Dr. Constantin reported on the results of the 1981 IFA Congress held in Berlin. The national reporters for the 1982 IFA Congress in Montreal presented their report. Dr. Alphons Schmid (Basel) treated the subject: "The tax treatment of interest in international economic transactions". In this connection it is noted that Prof. Dr. E. Höhn will be the General Reporter on this subject. Mr. George Muller (Lausanne) discussed the subject: "Taxation of payments to non-residents for independent personal services". Mr. Cl. Brélaz, President of the Appeal Committee of the canton Vaud, gave an overview of the work accomplished in harmonizing Swiss taxation.

2. T. Russi: "Die Standesinitiative des Kantons Graubünden über die steuerliche Gewinnberichtigung bei Partnerwerken der Elektrizitätswirtswirtschaft" in 36 *Steuer Revue* No. 4 (1981) at 137; G. Hertig: "Die Standesinitiative des Kantons Graubünden über die steuerliche Gewinnberichtigung bei Partnerwerken der Elektrizitätsschaft" in 36 *Steuer Revue* No.4 (1981) at 146.

3. K. Locher: "Internationale Zusammenarbeit in Fiskalsachen in Schweizerischer Sicht, insbesondere die internationale Amts- und Rechtshilfe in Steuerstrafsachen" in 50 *Archiv für Schweizerisches Abgaberecht* No. 3 (1981) at 97; M. Aubert: "L'échange d'informations fiscales dans le traité d'entraide judiciaire enb matière pénale entre la Suisse et les Etats-Unis in 50 *Archiv für Schweizerisches Abgaberecht* No. 7 (1982) at 347. See also F. Zuppinger: "Probleme der internationalen Amts- und Rechtshilfe in Steuer-, insbesondere in Fiskalstrafsachen 50 *Archiv für Schweizerisches Abgaberecht* Nos. 1-2 (1981) at 5.

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OECD ACTIVITIES IN THE FIELD OF TAXATION

(January–June 1982)

During this period a number of important projects relating to tax policy issues and international cooperation have been completed. These are mentioned in the following paragraphs. In addition, the OECD Committee on Fiscal Affairs has continued to provide a forum where tax authorities of the OECD Member countries can meet regularly and exchange views on the current tax policy issues.

INTERNATIONAL COOPERATION

New OECD Model Double Taxation Convention on Estates and Inheritances and on Gifts

On 3 June 1982, on the proposal of the Committee on Fiscal Affairs, the OECD Council agreed to the derestriction of the new OECD Model Double Taxation Convention on Estates and Inheritances and on Gifts and recommended to Governments of OECD Member countries that they conform to the model when concluding new conventions or revising existing ones (see text in Annex below). This text will be published shortly.

Draft Multilateral Administrative Assistance Convention in Tax Matters

The Committee adopted on 7 July 1982 a draft Multilateral Administrative Assistance Convention in Tax Matters containing 35 Articles and the accompanying Commentaries which are for the use of the Council of Europe. It is expected that this draft will be forwarded to the Council of Europe in the Autumn when the OECD Council has approved its transmission. The draft will then be taken as a basis for the elaboration of an international convention.

Transfer Pricing, Corresponding Adjustments and the Mutual Agreement Procedure

A report on "Transfer Pricing, Corresponding Adjustments and the Mutual Agreement Procedure", which complements the 1979 OECD report on transfer pricing has been completed. The report assesses the legal and practical considerations involved in making use of provisions similar to those of Articles 9 and 25 of the 1977 OECD Model Convention and sets out the views of tax authorities of OECD Member countries on possible improvements in the mutual agreement procedure. The question is of considerable importance to private business. The text of the report will be available upon request as from the Autumn 1982 and is expected to be issued in printed form next year.

Specific activities

Other work related to international cooperation underway in the Working Parties deals with double taxation issues related to specific activities, such as leasing and improper use of tax conventions; on transfer pricing, the allocation of central costs, the tax treatment of foreign exchange gains and losses and transfer pricing in the banking sector are being examined. On tax evasion, key projects deal with the taxation of operations involving low-tax countries; consequences of bank secrecy for the administration of taxes and international cooperation; taxation of itinerant activities and hiring-out of labour and entertainment.

TAX ANALYSIS AND TAX STATISTICS

A new interpretative guide to the OECD Revenue Statistics series has been finalised and will be used for the 1983 data collection round. A report on tax collection lags will provide internationally comparable data on the lags between the collection of income taxes and the earning of the income which gave rise to the tax liability. It will be published next year but is already available on request. Reports on taxes on immovable property and on the macro-elasticity of the individual income tax will be finalized towards the end of 1982.

In July 1982, the Committee approved a new work programme for its Working Party No. 2 on Tax Analysis and Tax Statistics. The priority topics are: the interaction between inflation and the personal income tax systems; the use of tax expenditure budgets; quantitative illustration of corporate income systems; a review of the methods available to compare effective corporate tax burdens. The Group will continue to undertake international statistical comparisons on revenue statistics[1] and on the tax/benefit position of different income groups.[2]

Towards the middle of 1981, the Committee launched a new series entitled "OECD Studies in Taxation". It will be used to publish some of the more technical studies, mainly carried out by Working Party No. 2. The studies are, however, addressed to a wide audience and non-technical summaries are provided. To date, the following publications have been issued:

- The Impact of Consumption Taxes at Different Income Levels (June 1981);
- Income Tax Schedules: Distribution of Taxpayers and Revenues (November 1981);
- Long-term Trends in Tax Revenues of OECD Member Countries 1955-1980 (January 1982).

It is intended to publish in this series also the tax collection lags report and the macroelasticity report referred to above.

1. Last publication: Revenue Statistics of OECD Member Countries, 1965-1981, OECD, September 1982.
2. In October 1982 "The 1981 Tax/Benefit Position of a Typical Worker" will appear.

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Zugleich Bericht über den 33. Fachkongreß der Steuerberater der Bundesrepublik vom 2.–4. 11. 1981. Herausgegeben im Auftrag des Fachinstituts der Steuerberater von Wp. und Stb. Prof. Dr. Rudolf Curtius-Hartung, Stb. Dipl.-Kfm. Dr. jur. Dr. rer. pol. Ursula Niemann und Stb. Prof. Dr. Gerd Rose. 473 Seiten DIN A 5, Ln. 85,– DM.
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Das neue Steuerberater-Jahrbuch enthält wiederum alle Beiträge, die auf dem 33. Fachkongreß der Steuerberater gehalten wurden, in ungekürzter, zum Teil über den gegebenen Rahmen eines Vortrages hinaus erheblich erweiterter Form, sowie eine wörtliche Wiedergabe der Diskussion zu dem im Zentrum der Tagung stehenden Thema der Unternehmensbewertung. Auch für den 33. Band ist abermals kennzeichnend die Reichhaltigkeit der behandelten Themen sowie ihre gutdurchdachte Auswahl im Hinblick auf das, was derzeit im Vordergrund des Interesses von Wissenschaft und Praxis steht. Die hohes Fachwissen ausstrahlenden Beiträge zu den aktuellen steuerlichen Fragen sind nicht nur Wegweiser zur Fortentwicklung dieses Rechtsgebietes, sondern auch Marksteine einer bereits abgeschlossenen Bildung von Meinungen. Das gewohnt sorgfältig bearbeitete, differenzierte Stichwortverzeichnis bietet wieder eine praktische Hilfe, wenn es um die Lösung aktueller Steuerprobleme geht.

Aus dem Inhalt:

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RA Dr. Wienand Meilicke:
Abzugsfähigkeit von Schuldzinsen – Ein Beitrag zur Vermeidung von Fehlern bei der Finanzplanung

Unternehmensbewertung

Dr. Carl Zimmerer:
Die Unternehmensbewertung in der Praxis

Prof. Dr. Walther Busse von Colbe:
Die Resonanz betriebswirtschaftlicher Erkenntnisse zur Unternehmensbewertung in der zivilrechtlichen und steuerlichen Rechtsprechung

Podiumsdiskussion
(Ltg. Dr. R. Curtius-Hartung):
Die steuerlichen Grundsätze der Unternehmensbewertung, insbesondere bei Anteilen von Kapitalgesellschaften

*

Stb. und RA Dipl.-Kfm. Horst Langel:
Ausgewählte Risiken bei der Umsatzsteuer zivilrechtlich – steuerrechtlich

Gustav Hübner, Ministerialdirektor im Bayerischen Staatsministerium der Finanzen:
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RA Dr. Klaus Brezing:
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Praktische Erfahrungen mit dem Außensteuerrecht aus der Sicht des Bundesamtes für Finanzen

RA Helmut Becker:
Praktische Erfahrungen mit dem Außensteuerrecht aus der Sicht des Steuerberaters

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TAXATION IN VENEZUELA.
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ERRATUM

Article by Prof. Frans Vanistendael entitled: *Cutting Taxes on Business and Investment Income* in Bulletin for International Fiscal Documentation of July 1982.

On page 302, left column, fifth full paragraph, part of the first sentence was left out which completely changes the meaning of the text. This sentence should read: "Dividends distributed on the newly issued shares are exempt from corporate income tax up to 8% of the capital actually paid in."

The error is very much regretted.

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Tax System Components and Economic Development: An International Perspective

By Sohrab Abizadeh* and J.B. Wyckoff**

Research in the area of public finance has traditionally focussed on the economic impact of taxes and government expenditure upon a region or a country. In recent years much of the applied and theoretical work has been related to the task of constructing tax systems suited to the particular economic and social conditions prevailing in a given year. In the most recent studies, however, the emphasis has been placed upon the relationship between tax ratio and the degree of economic development.

The following reports on an international study of the government direct and indirect tax revenues in different countries at different stages of economic development. The methodology consists of a number of short-run as well as long-run analyses. Pooled cross-section time series data are used. It is observed that, in the majority of cases studied, the structure of the tax system changes towards more intensive use of direct taxes as the nation's economy develops.

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INTRODUCTION

Developing countries have long been frustrated by the dilemma of developing a system of taxation which will provide the necessary resources to develop the infrastructure necessary for economic development, while providing incentives in the private sector for increased investment and output. Attempts to provide policy formulas through scientific studies of tax ratio differences and changes in tax components within given developing countries have taken different forms.

Martin and Lewis (1956) compared the revenues and expenditures of 16 countries at different levels of economic development. Their main objective was to see how patterns of expenditure and sources of revenue varied with economic development and what patterns of taxes and expenditure are appropriate to different levels of development.

Williamson (1961) in a follow-up of Martin and Lewis' study took more countries and a longer time period (1951-1956), including 17 developed countries with tax ratios (total tax revenue divided by gross domestic product) ranging between 20 and 35% and 15 LDCs ranging between 9 and 21%. Both of these studies concentrated on public expediture and revenue and their relationship to per capita national income.

Hinrichs (1965) questioned the former findings and tried to present a "better" explanation for the tax changes through a multiple regression study of 60 countries using data from the years 1957-60. He implicitly assumes that per capita income is the only factor needed to estimate the degree of economic development. Consequently, if there are other variables which explain tax ratio changes better than per capita national income, the conclusion that the tax ratio is related to the degree of economic development, as reflected by per capita income, should be rejected. He states:

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> Conventional wisdom holds that government revenue shares of gross national product increase with economic development. This is obvious when contrasting the level of government revenue shares between developed and less-developed countries. However, when observing differences among less-developed countries only, this proposition is misleading at the best or worst just plain wrong (p. 564).

Hinrichs (1966) in his more thorough study of taxes attempted to deal with both tax ratio and tax component changes during the course of economic development. He performs a multiple regression study of 60 countries for the period 1957-60 in order to identify the determinants of government revenue as a share of gross national product. Regional factors played an important role in his analysis of structural tax changes. The final outcome of past studies was the development and acceptance of the hypothesis that there exists a direct relationship between the degree of economic development and total tax ratio (see Abizadeh 1979). Despite all these efforts, analysis leading to policy recommendations on an improved combination of components within a tax system at differing stages of economic development has not been forthcoming.

RATIONALE

The position that, "Generally, however, tax systems have tended to be more of a determined than determining factor" (Hinrichs 1966, p. 63) is frequently found in writings on economic development. Bangs (1968) makes even a stronger assertion stating, "the tax changes are, in the main, effects rather than causes of economic progress" (p. 15). He further indicates that direct taxes are applicable only to those economies which have passed a certain stage of development (pp. 15-16). Hinrichs (1966) supports this, observing that the extent of reliance on direct taxation usually increases with greater economic development.

This would seem logical in examining the feasibility of direct tax collection in less developed countries compared with that of more developed countries. In general, corporate taxes are levied at a flat rate on all companies in less developed countries. The revenue yield generated by such a levy would be low because (a) company income is often only a small part of national income; (b) the tax rate must be low to encourage private investment; (c) developing companies do not have any revenue to be taxed; and (d) more importantly,

> . . . there takes place a substantial avoidance of the tax on corporate profits in underdeveloped countries because of the "loophole" in the law in the form of the system of prerequisites such as office-provided cars, living accommodation, travel expense accounts in general which are charged off to business expenses (Thripathy 1968, p. 201).

Direct taxation of capital values, whether land or personal property, would be expected to have a relatively less adverse effect upon incentives. The problem in underdeveloped countries has been that the owners of capital assets have had a high degree of control over political institutions, through which they could influence tax legislation in their favor. Goode (1964) points out that, "Intensive use of the property tax is blocked in most Latin American countries by a small but politically powerful group of large landowners" (p. 178). This is true in most underdeveloped countries - especially if land reform has not taken place. Inadequate records and appraisals of properties lead to comparatively low tax yields. "In many countries taxation of agriculture, particularly land tax, does not yield amounts considered adequate when compared with taxation of other sectors" (Basch 1964, p. 95). Unless there are some changes in the social, economic, and political institutions within underdeveloped countries, adoption of capital and wealth taxes - without wholesale evasion - would seem unlikely.

The use of personal income taxes has also generally been very limited in underdeveloped countries. In LDCs the agricultural sector is frequently exempted for constitutional or administrative reasons. Since agriculture is usually the main source of income for much of the population, the personal income tax plays a less significant role in the tax structure of LDCs than has been the case in the more developed countries.

Other reasons for the radically different performance of the personal income tax in underdeveloped as compared to developed countries include the following. First, there are the widely recognized problems in defining income. Second, there are difficulties in determining individuals' income, even after income is defined. In underdeveloped countries, a large sector of the economy is nonmonetary or unrecorded. Wage-earners, independent craftsmen, and small shopkeepers cannot read and write well enough to maintain accounts or complete even the simplest income tax return. Sometimes, even literate income earners do not keep reliable records of their income. As in developed countries, more than one set of income records may be kept in order to avoid taxes (see Goode 1964). With unsophisticated banking and credit systems, it is difficult to trace cash and barter business transactions.

A third reason for the radically different performance of the personal income tax is related to the application of tax rates and allowances. It is difficult to fully apply the taxation rates of developed countries to less developed countries. This is because of the difference between the income distributions. If the tax rates found in the U.S. were applied to, say, Egypt or Iraq, the key to the revenue yield would depend upon whether they are applied at the same absolute level of income or at the same relative level of income.

The fourth difficulty relates to the collection of taxes. Voluntary tax payment is not common in underdeveloped countries. The alternative is a pay-as-you-earn system. Such a system would cover only a small percentage of income earners, i.e. those whose income, wages, and salaries can be identified and, therefore, raises the question of equity (i.e. only part of the country's income earners are subject to tax).

Thus, it is no accident that the more developed countries have usually progressed from indirect taxes such as customs duties, property taxes, and excise taxes during the early stages of their development, to the more sophisti-

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cated forms of direct taxation, such as personal and corporation income taxes (Bangs 1968, pp. 135-136).

HYPOTHESIS

On the basis of this previous work, a general hypothesis was formulated: as a nation's economy develops, the structure of the tax system changes toward intensive use of direct taxes, i.e. the relative proportion of direct and indirect taxes changes toward a higher and higher direct tax ratio.

This hypothesis was tested by a model containing variables representing and reflecting the degree of economic development as independent variables and the direct tax ratio (total direct tax revenue divided by total tax revenue) as the dependent variable. The general hypothesis was tested by the model for different time periods for the same group of countries and different groups of countries for the same time period.

The countries were selected with a view toward giving representation to a broad range of institutional conditions as well as stages of economic development. Countries from different regions of the world were selected, although the original analysis did not involve a regional factor.

GROUPING COUNTRIES BY FACTOR ANALYSIS

The task of selecting variables to indicate the degree of economic development was most difficult. The 1973 and 1976 studies by Irma Adelman and Cynthia Taft Morris were consulted. Based upon these studies a decision to employ quantitative information while avoiding qualitative measures seemed appropriate. Data were obtained from sources such as the United Nations and the International Monetary Fund.

Data were collected for a 23-year period (1950-1972). The period was divided into two sub-periods, a "first decade" (1950-1959) and a "second decade" (1960-1972). Forty-one countries were included in the analysis of the first decade and 46 in the second decade.

Although many researchers have classified countries according to their stage of development, none has developed a method universally acceptable to economists. Per capita income and its substitutes have been a widely used criteria (see Chelliah 1971, p. 277). Hinrichs (1966) groups countries on the basis of per capita GDP, the natural rate of population increase, and energy consumption per capita, with a relatively heavy reliance on per capita GDP. He states:

> Although GDP/N tends to be an unreliable estimate of the welfare of the consumers of a nation, and the statistics themselves are usually somewhat inaccurate, they are useful data for stage classification. . . Although GDP/N is a poor estimate of welfare, it is, in relative terms, a good measure of development (p. 130).

Because of the important role assigned to the grouping of countries in this study, a more comprehensive approach was employed. A multi-variate statistical technique, factor analysis, was used to perform this grouping function. Ten variables were selected for the factor analysis:

(1) per capita GDP in U.S. dollars;
(2) international trade tax ratio (defined as trade taxes divided by total tax revenue);
(3) percentage of total government expenditure on health (defined as total government expenditure on health divided by total government expenditure);
(4) percentage of total government expenditure on education;
(5) proportion of national income generated in agriculture, forestry, and fisheries;
(6) demand deposit ratio (defined as demand deposit divided by total money supply);
(7) export plus import divided by GDP in U.S. dollars;
(8) net balance on current account divided by GDP in U.S. dollars;
(9) exports divided by GDP in U.S. dollars; and
(10) imports divided by GDP in U.S. dollars.

Each of these variables was hypothesized to directly or indirectly represent the degree of economic development within a country.

The factor analysis identified 3 "factors" in each time period which accounted for virtually all of the variations (Tables 1 and 2). The grouping of countries was done for each decade with the same analysis being used to facilitate the possibility of interdecade as well as inter-country comparisons. Tables 3 and 4 show the respective country groupings for decade 1 and decade 2.

TABLE 1

Cumulative percentages of 4 factors for the first decade

Factor	*Eigenvalue*	*Percent of variation*	*Cumulative percentage*
1	17.195	42.2	42.2
2	13.137	32.3	74.5
3	7.887	19.4	93.9
4	2.482	6.1	100.0

TABLE 2

Cumulative percentages of 4 factors for the second decade

Factor	*Eigenvalue*	*Percent of variation*	*Cumulative percentage*
1	16.918	38.9	38.9
2	12.457	28.6	67.5
3	8.463	19.5	87.0
4	5.654	13.0	100.0

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TABLE 3

Grouping of the countries by factor analysis, first decade

Group I	*Group II*	*Group III*
1. Egypt	1. Brazil	1. South Africa
2. Ghana	2. Colombia	2. Canada
3. Costa Rica	3. Ecuador	3. United States
4. El Salvador	4. Israel	4. Venezuela
5. Guatemala	5. Japan	5. Austria
6. Chile	6. Jordan	6. Denmark
7. Peru	7. Lebanon	7. France
8. Burma	8. Turkey	8. Netherlands
9. Ceylon	9. Finland	9. Norway
10. India	10. Ireland	10. Sweden
11. Iraq	11. Italy	11. Switzerland
12. Philippines	12. Spain	12. United Kingdom
13. Syria		13. Australia
14. Thailand		14. New Zealand
15. Portugal		

TABLE 4

Grouping of the countries by factor analysis, second decade

Group I	*Group II*	*Group III*
1. Egypt	1. Ghana	1. South Africa
2. El Salvador	2. Kenya	2. Canada
3. Peru	3. Tanzania	3. United States
4. Burma	4. Costa Rica	4. Brazil
5. Ceylon	5. Dominican Rep.	5. Colombia
6. Iraq	6. Guatemala	6. Venezuela
7. Malaysia	7. Chile	7. Japan
8. Syria	8. Ecuador	8. Austria
9. Thailand	9. India	9. Denmark
	10. Iran	10. Finland
	11. Israel	11. France
	12. Jordan	12. Italy
	13. Lebanon	13. Netherlands
	14. Philippines	14. Norway
	15. Turkey	15. Spain
	16. Ireland	16. Sweden
	17. Portugal	17. Switzerland
		18. United Kingdom
		19. Australia
		20. New Zealand

THE MODEL

The relative importance of tax components (groups of taxes) may be analyzed either as their percentage in total tax revenue or as their ratio to GNP. Chelliah believes that the first alternative more clearly defines the differences in the patterns of taxation between different countries, irrespective of the level of taxation (1971, pp. 267-368).

In this study, the tax components were analyzed in terms of the percentage of direct taxes in total tax revenue. It was hypothesized that, as an economy develops, the tax structure of the country changes toward more intensive use of direct taxes, i.e. the relative proportion of direct taxes in total tax revenue tends to increase. It was decided to test the hypothesis using long-run data to insure that sufficient time for a transition, in terms of economic development, was involved.

The following relationship was postulated to test the hypothesis:

$$TR^d_{it} = b_1 + b_2 (Y^p_{it,2}) + b_3 (OP_{it,3}) + b_4 (TPR_{it,4})$$

$$-b_5 (ER_{it,5}) - b_6 (AR_{it,6}) + b_7 (DDR_{it,7})$$

where

- i = 1,2, . . ., N(number of countries in the particular group in the model)
- t = 1,2, . . ., T (number of years, depending on the decade being analyzed)
- TR^d = direct tax ratio (defined as total direct tax revenue divided by total tax revenue)
- Y^p = per capita GDP in U.S. dollars converted using market exchange rates
- OP = openness (defined as exports plus imports divided by GDP)
- TPR = transfer payment ratio (defined as government transfers divided by government expenditures)
- ER = ratio of expenditure on education
- AR = proportion of income generated in agriculture, forestry, and fisheries
- DDR = demand deposit ratio (defined as demand deposit divided by total money supply).

Openness was specifically included because of its relationship to direct taxes emphasized by Hinrichs who states:

> . . . personal income taxes may be based primarily on civil servants . . ., the army . . ., and/or employees of large mineral and/or export companies, especially foreign ones. Thus, the openness of the economy would normally affect the amount of personal income collected (1965, p. 556).

If this relationship was maintained, openness should have carried a positive sign in the models.

Multiple linear regression analysis was applied to test the relationships hypothesized in the model. The results obtained for different groups of countries at different points in time were tested using the Durbin-Watson Statistic. The test indicated that it was not possible to reject the hypothesis that auto-regression was present. The Durbin procedure then was used to correct for the possible autoregression. Table 5 summarizes the results obtained from the corrected multiple linear regression models.

The first regression equation reported in Table 5 shows results for 41 countries for the 10-year period using pooled cross-section, time series data. Regression 2 used the identical model for 46 countries for the 13-year period. The remainder of the regressions reported were estimated to determine if the specified relationships hold for the different groups of countries during the first and/or second decade.

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TABLE 5

Summary of regression analyses for direct tax ratio (TR^d), original model[1)]

	Constant	*Y^p*	*OP*	*TPR*	*ER*	*AR*	*DDR*	*R^2*	*F Value*	*Durbin-Watson St.*
First decade, all countries	.0402 (.008)	.0000611$^+$ (.0000353)	−.0455 (.0604)	−.109$^+$ (.0656)	−.109 (.184)	.008 (.131)	−.0134 (.109)	.028$^\times$	1.22$^\times$	2.00^b
Second decade, all countries	.00883 (.00199)	.0000144$^\times$ (.0000105)	−.01741 (.0480)	−.0348 (.0702)	.078 (.0857)	.048 (.0668)	.116* (.0487)	.020$^\times$	1.63$^\times$	1.84^b
First group, both decades	.0416 (.00905)	−.0002741^o (.00013)	.0478 (.0821)	−.130$^\times$ (.095)	−.141 (.182)	.223^o (.102)	.0219 (.0976)	.076^o	2.13$^\times$	1.56^c
First group, first decade	.429 (.0186)	−.000149 (.000178)	.151 (.133)	−.208$^\times$ (.128)	−.225 (.268)	.145 (.173)	.0757 (.197)	.097$^\times$	1.29$^\times$	1.78^b
First group, second decade	.0529 (.0172)	−.000057 (.000261)	.0117 (.099)	.174 (.199)	.011 (.268)	.177$^\times$ (.129)	−.146$^\times$ (.111)	.077$^\times$	1.07$^\times$	1.24^a
Second group, both decades	.0106 (.00267)	.0000538$^+$ (.0000297)	−.0119 (.0446)	−.0491 (.0586)	.165$^+$ (.0952)	−.187^o (.0882)	.0542 (.058)	.049^o	2.11^o	1.82^b
Second group, first decade	.0352 (.0068)	−.0000437 (.000047)	−.135* (.0577)	−.0091 (.066)	.44$^+$ (.243)	−.115 (.203)	−.143 (.118)	.140$^+$	1.99$^+$	1.62^b
Second group, second decade	.0085 (.0034)	.0000922* (.0000369)	.0663 (.066)	−.101 (.102)	.133 (.108)	−.154$^\times$ (.0995)	.110$^\times$ (.069)	0.84**	2.50**	1.99^b
Third group, both decades	.0912 (.0048)	(.0000367) (.0000129)	−.222** (.0675)	−.053 (.0762)	−.0407 (.183)	−.107 (.243)	.26^o (.116)	.05*	2.73*	2.22^b
Third group, first decade	.0807 (.0227)	.0000277 (.0000606)	−.204$^+$ (.115)	−.0543 (.143)	−.437 (.483)	−.266 (.498)	.0442 (.222)	.067	1.11	2.14^b
Third group, second decade	.011 (.004)	.00000409 (.0000109)	−.221* (.0911)	−.0148 (.0938)	.080 (.162)	−.0484 (.246)	.356** (.104)	.069*	2.64*	2.07^b

1) Corrected for auto-regression by Durbin Procedure.
** Significant at the 99% level
* Significant at the 97.5% level
o Significant at the 95% level
+ Significant at the 90% level
× Significant at the 80% level
a Do not reject the hypothesis that the auto-regression is present at the 99% confidence level.
b Reject the hypothesis that auto-regression is present at the 99% level.
c The Durbin-Watson Statistic is inconclusive.
Figures in parentheses are standard error of the regression coefficients.

INTERPRETING THE RESULTS

The results obtained from analyzing the 41 countries' data for the 1950-59 period did not provide an unequivocal answer to the hypothesis tested. Y^p (per capita GDP) assumed a positive sign and was significant at the 90% level of confidence. However, TPR, the only other significant variable in the model, did not carry the expected sign. Although the coefficients were not significant, neither did OP, AR, or DDR carry the expected sign. It was concluded that due to the sharp differences in direction of direct taxes at different stages of development during the first decade, a regression including all of the countries was not able to provide a satisfactory explanation of the variation in the direct tax ratio associated with the degree of economic development.

The analysis of the data from the second decade for the 46 countries provided an improved explanation for direct tax ratio changes. It was concluded that, during the second decade, the more developed the country, the more direct taxes were collected relative to other sources of taxation. This held only when the total group of developed and developing countries and/or underdeveloped countries were combined.

Underdeveloped countries (Group I)

When the data for both decades were used for the group of underdeveloped countries (Group I), it was strongly maintained that TR^d had been decreasing during the period. Variables ER, OP, and DDR had the expected sign to support the general hypothesis even though they were not statistically significant. The regression equation relating to Group I countries in the first decade was

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less clear than that using both decades. Y^p carried a negative sign and was not significant. The same was true for AR, with a positive sign. Given the full model, it was concluded that TR^d dropped the first decade for the group of underdeveloped countries.

The results obtained from analyzing the data for underdeveloped countries during the second decade strongly indicate that TR^d had been decreasing for this group during the 1960-72 period. Per capita GDP (Y^p) carried a negative sign along with DDR. The latter was significant at the 80% level of confidence. OP and TPR, with positive signs, were not significant. Neither was ER with a positive sign.

Developing countries (Group II)

The results obtained from the regression analysis for Group II in both decades provided evidence that for the group of developing countries, the direct tax ratio is related to the degree of economic development. Y^p and AR and DDR carried the expected signs. Y^p was significant at the 90% level of confidence with AR being significant at the 95% level of confidence. ER carried a positive sign (contrary to our expectations) and was significant at the 90% level of confidence.

Analysis of the data for developing countries during the 1950-59 period revealed that the relative importance of direct taxes in total tax revenue decreased. Six of the 12 countries in the group relied on indirect sources of taxation more heavily during this period. These were the countries that shifted to the developed group (Group III) during the second decade. This is not contrary to the general result obtained from analyzing the developing countries during both decades since direct tax collection only became possible for this group of countries during the second decade.

Examination of the results for the group of developing countries for 1960-72 provided firm support for this position. Per capita GDP was significant at the 97.5% level of confidence and was positive. AR and DDR assumed expected signs and were significant at the 80% level of confidence. OP also carried the expected sign but was only significant at the 70% level of confidence.

Developed countries (Group III)

For the group of developed countries (Group III) TR^d did not increase as the economy developed. Analysis of the data from both decades for this group revealed that TR^d has been decreasing for the group of developed countries. Although Y^p carried a positive sign in this equation, it was not statistically significant. OP and TPR carried negative signs contrary to our hypothesis. ER and AR had negative signs but were not significant. DDR was significant at the 95% level of confidence but carried a positive sign contrary to our expectations.

When the data for the first decade were used, almost identical results emerged. While the F value was significant at approximately the 50% level of confidence, the model was not effective in explaining the direct tax ratio.

The analysis of the data for 1960-72 for the developed countries showed that direct taxes have been losing their relative importance in these countries. OP, TPR, ER and DDR carried signs contrary to those hypothesized. However, only OP and DDR were statistically significant.

THE "BEST" MODEL

Because the original model had many coefficients that were not statistically significant, a "best" model was analyzed which included only those variables significant at the 80% or higher levels of confidence (Table 6). The "best" model for the 41 countries for the period 1950-59 included only variables Y^p and TPR. Each of these variables was significant at the 90% confidence level with opposite signs. It again was concluded that the sharp differences in the direction of change in direct taxes at different stages of development during the first decade prevented the model from providing a satisfactory explanation of the variation in direct tax ratio associated with the degree of economic development.

For the second decade in the 46 countries, only per capita GDP and DDR remained in the "best" model with the expected sign. They were significant at the 80 and 97.5% level of confidence respectively. It was concluded that, for this decade, the more developed the country, the more direct taxes were collected relative to other sources of taxation.

Underdeveloped countries (Group I)

When data for both decades were used the "best" model included variables Y^p, TPR, and AR. Each of these variables were significant at the 97.5, 80, and 95% level of confidence respectively. The signs for these variables indicate that TR^d not only did not increase but decreased as the economy developed. This decrease was due to the reliance of countries on trade taxes. The decrease in TR^d did not result in a decrease in TR. What is shown was that the relative importance of direct taxes has been decreasing in these countries and the relative share of trade taxes in total tax revenue (and possibly other indirect taxes) has been increasing. Some of these countries were, in fact, using other indirect sources during the first decade and shifted to the second group in the second decade, a group where the stage of development permits direct tax collection to be practiced.

By way of comparison Chelliah analyzed the relationship between the share of direct taxes (TR^d) and per capita income for 50 countries for the period 1966-68. His results were as follows:

$$TR^d = \underset{(5.575)}{33.08} - \underset{(1.059)}{0.052}\ (Y^p) \text{ with an } R^2 = 0.005$$

for the countries with per capita income below U.S.$ 200 (the figures in parentheses are t-ratios) (1971, p. 314).

Had it been possible for these countries to collect direct taxes, they might have done so. Direct tax collection has been and still is practically impossible for countries at this stage of development. Invariably, attempts to shift

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TABLE 6

Summary of regression analyses for direct tax ratio (TR^d), "best" model [1)]

	Constant	*Y^p*	*OP*	*TPR*	*ER*	*AR*	*DDR*	*R^2*	*F Value*	*Durbin-Watson St.*
First decade, all countries	.037 (.00428)	.0000632* (.0000334)		−.109+ (.0648)				.024°	3.23°	1.98[b]
Second decade, all countries	.00903 (.00189)	.0000146× (.0000104)					.113* (.0483)	.016*	3.91*	1.83[b]
First group, both decades	.0416 (.0063)	−.000281* (.000124)		−.124× (.0939)		.222° (.100)		.071**	4.03**	1.57[c]
First group, first decade	.429 (.0084)		.195+ (.121)	−.236° (.115)				.073+	2.98+	1.83[b]
First group, second decade	.0526 (.0109)					.212+ (.120)	−.135× (.100)	.063+	2.71+	1.22[a]
Second group, both decades	.0111 (.00227)	.0000567° (.0000288)			.172+ (.0937)	−.192° (.0879)		.043*	3.73*	1.80[b]
Second group, first decade	.0319 (.00597)		−.123° (.0545)		.483° (.235)		−.172× (.113)	.127*	3.68*	1.59[c]
Second group, second decade	.009 (.003)	.000087* (.000035)				−.159× (.099)	.120+ (.068)	0.72*	3.74*	1.90[b]
Third group, both decades	.0912 (.00402)		−.224** (.0666)				.264* (.116)	.047**	7.85**	2.21[b]
Third group, first decade	.0869 (.00909)		−.222° (.108)		−.491 (.435)			.059+	3.01+	2.11[b]
Third group, second decade	.0124 (.00312)		−.223* (.0889)				.357** (.103)	.067**	3.01+	2.08[b]

1) Corrected for auto-regression by Durbin Procedure.
** Significant at the 99% level
* Significant at the 97.5% level
° Significant at the 95% level
+ Significant at the 90% level
× Significant at the 80% level
[a] Do not reject the hypothesis that the auto-regression is present at the 99% confidence level.
[b] Reject the hypothesis that auto-regression is present at the 99% level.
[c] The Durbin-Watson Statistic is inconclusive.
Figures in parentheses are standard error of the regression coefficients.

to direct taxes meet with serious administrative, political, and social obstacles.

The "best" model for the underdeveloped countries for the first decade includes OP with a positive sign, significant at the 80% level of confidence, together with TPR with a negative sign significant at the 95% level of confidence. The negative per capita TPR reinforced our preceding conclusions. The positive sign for OP during this period supports Hinrich's assertion that underdeveloped countries may collect income taxes on import/export companies.

The "best" model for the underdeveloped countries for the second decade included AR, and DDR with a positive and negative sign respectively. AR was significant at the 90% level of confidence and DDR at the 80% level. The signs of the "best" model variables suggest an actual decrease in TR^d as the economy develops. This sustains the conclusion that the group of underdeveloped countries has been decreasing its reliance on direct taxes. That means that the relative importance of direct taxes decreased for the group of underdeveloped countries during this stage of development.

Developing countries (Group II)

Based upon the "best" model for the second group for both decades, it was concluded that the direct tax ratio had increased in connection with their economic progress. The positive signs for ER were the result of its appearance in the model during the first decade. In fact, based upon results obtained, it was not until recent years (1960-72) that the group of developing countries started increasing their reliance on direct taxes and, as a result, increased the relative importance of this type of tax in the government revenue system.

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The "best" model for the developing countries for the periods 1960-72 introduced Y^p, AR, and DDR as the variables most closely associated with the direct tax ratio. They were significant at the 97.5, 80, and 90% level of confidence respectively. It was concluded that the hypothesis held strongly for the developing countries during the period. This indicates that developing countries can rely more and more on direct taxes as their economy develops. This supports our earlier conclusion that the reliance and employment of direct taxes becomes possible at this stage of economic development.

Developed countries (Group III)

The "best" model for the Group III developed countries included OP and DDR. It indicates that the relative importance of direct taxes has been decreasing in total tax revenue for developed countries.

The "best" model for the first decade for developed countries was not promising. The only variable which remained in the model was OP with a negative sign and significant at the 95% level of confidence. However, ER was also included and carried a negative sign significant at approximately 70% level of confidence.

The analysis of the second decade for the developing countries produced evidence that the development and use of taxes other than conventional direct taxes are responsible for this type of relationship between TR^d and the degree of economic development.

There is no doubt that the absolute amount of direct taxes collected in developed countries has been and is increasing. It is the variation in the collection of such taxes that results in such a "poor fit" for our models. Factors other than just the degree of development have affected direct tax collections in developed countries. In addition to those factors mentioned earlier, other factors affecting direct levies are the types of dominant business sector in the economy (partnership, proprietorship, or corporation), the type of government, and the size of public sector relative to the total economy. In the case of the latter, the larger the public sector the higher the amount of payroll taxes collected.

The results obtained from the analysis of data for developed countries invites the quotation of a statement by Chelliah.

> On an analogy with the course of evolution in the now developed countries, it is generally argued that with the growth of the economy and the rise in income the share of direct taxes, which could be levied more in accordance with the individual's ability to contribute, would begin to rise. Such a transformation of the tax system is yet to come (1971, p. 269).

CONCLUSIONS AND GENERALIZATIONS

The general hypothesis of this study was not rejected in total, but a wide range of exceptions were observed. The analytical results have led us to the following conclusions and generalizations.

1. Due to the sharp differences in the tax components of countries at different stages of development, the general study of all of the countries during the first decade did not provide a satisfactory explanation for the variations in direct tax ratio an its relation to the degree of economic development.
2. Use of the data in recent years (1960-72) for all the countries did support the hypothesis.
3. There is no hard evidence, based on the result obtained, that the group of underdeveloped countries has increased its relative reliance on direct taxes as their economy developed. However, based on the maintained hypothesis that the total tax ratio has been increasing, it was concluded that tax components have shifted towards a more intensive use of taxes other than direct taxes.

   The direct tax ratio decreased during the last two decades for this group of countries. It was concluded that the imposition and collection of direct taxes are practically impossible and encounter numerous administrative as well as political and social obstacles.
4. The group of developing countries in both decades did rely more and more on direct taxes as their economies developed. However, it was not until the second decade that these countries could experience a systematic increase in their direct tax ratio along with their economic progress.

   The results from the regression for the second decade support the above assertion. It is concluded that direct tax collection, and the increase in its relative importance compared to other types of taxes, becomes possible when a country is in its "developing" stage. However, reliance on indirect taxes remains desirable to increase tax revenue because a lag exists between the time that a country enters this stage of development and the time it can actually rely more heavily on direct taxes.
5. Direct taxes have been losing their relative importance in the budgets of the governments in developed countries.
6. The term "better tax system", which has always been associated with a higher relative reliance on direct taxes, is somewhat misleading. A "better tax system" with respect to an economic development objective would be the one that results in higher taxes as a proportion of GDP, implicitly assuming no disincentive in the private sector, and investment yields in the public sector at least equal to private investment. Consequently, it makes little difference from this perspective as to what type of tax sources, direct or indirect, are being used more intensively.

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Zambia's 1982 Budget

by A.B.C. Emmanuel *

The Budget, as expected, was a belt-tightening one.[1] The worsening world economic conditions had and were having their adverse effects on the economy of Zambia, mainly because the demand for copper, which is the prime foreign exchange and revenue earner for Zambia, was dropping steadily. In addition, the copper consuming countries tended to hold smaller stocks of copper in order to reduce the costs of stock-holding. The average price of copper, which was 1,692 K per tonne in 1980, dropped to 1,554 K in 1981 representing a decline of 8.2%. Copper earnings declined from 884,000,000 K to 840,000,000 K, decline of 5%. The foreign exchange earnings from the mining sector fell from 1,200,000,000 K to 942,600,000 K. At the time, the demand for cobalt, the other revenue and foreign exchange earner, also fell badly leaving the mining companies a stock pile of about 8 months' production.

The mining industry, which is the mainstay of the country's economy, was thus afflicted by serious problems with the result that the industry's value added declined by 52.3% and the contribution of the mining sector to Gross Domestic Product declined from 16.2% in 1980 to 7.6% in 1981. In 1980, the mining companies contributed approximately 41.0 million K to Government revenue whereas in 1981 their contribution was virtually nil.

The manufacturing industry's contribution also fell during this year, mainly due to the lack of foreign exchange which had severe repercussions on those industries which are dependent on imported inputs. These difficulties were further increased by labour unrest and other factors which caused production to fall. The worsening financial position of the mining companies had their adverse effects on some of the manufacturing companies who relied a lot on the mines for their progress and prosperity. The industries depending on foreign inputs registered a drop ranging from 27% to 12%. Those who depended on local raw material did show a slight growth in the rate of production.

Against this gloomy background, there was, however, one ray of sunshine, which was in the agricultural sector. The performance in the agricultural sector was quite heartening and encouraging. The agricultural sector responded well to the call of His Excellency the President to boost the production of food in the country. This sector recorded an estimated growth rate of 9.8% in 1981. There was a significant increase in marketed maize of 3.5 million bags over the 1980 production, bringing in a total production of 7.7 million bags. In other fields of agricultural production, such as wheat, sunflowers, soya beans, etc., there were significant increases. There was thus a positive response by the farming community to the Government's agricultural policy which gave them various incentives.

One of the greatest problems facing the Government was the deteriorating balance of payments position. This position has been brought about by declining foreign earnings and worsened by the rising costs of imports, especially oil. The external payment arrears stood at 420,000,000 K. Exports amounted to 961,600,000 K in 1981 as compared to 1,027,000,000 K in 1980, a reduction of 6.4%.

In spite of the strict import controls, imports increased from 884,500,000 K in 1980 to 907,200,000 K in 1981. As a result of the critical shortage of foreign exchange, the rate of growth has been hindered, and it has provided exteremely difficult to build up foreign reserves and reduce the payment arrears.

* Tax Manager, Price Waterhouse & Co., Lusaka. See for an extract of the Budget Speech, 36 *Bulletin for International Fiscal Documentation* 3 (1982) at 130.

1. The Budget proposals were enacted in the Income Tax Amendment Act No. 12 of 1982.

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"In the light of this grim scenario and bleak outlook, the immediate and vital lesson for the nation is clear", said the Hon. Minister of Finance as he presented the Budget. "The nation must brace itself for more sacrifices and hard work." The economy of the country had to be restructured so as to reallocate the scarce resources away from consumption toward production. Consumption had to be curbed by means of strict controls, which in turn would curb inflationary tendencies. It was essential to bring about a reduction in subsidies which were a heavy drain on the nation's financial resources. It was also essential to promote industrial production based on domestic resources and also expand agricultural and food production.

Keeping all this in mind, the Hon. Minister of Finance's main idea in his Budget proposals was to raise the additional revenue required through indirect taxation. The burden of direct taxation was fairly heavy on the few who paid taxes and hence by means of indirect taxes as a whole society would bear their share of the sacrifice which was necessary to enable the nation to recover from the crisis in which it finds itself.

Excise duties were raised on cigarettes, tobacco, liquor and petroleum products. Customs duties were also raised on various items.

As far as income tax on individuals was concerned, considering the high incidence of income tax in Zambia and the rising cost of living, the Hon. Ministry of Finance did not raise income tax but instead gave concessions in the form of increased personal allowances. He also gave a welcome relief to married women who had been making representations to the Government to reduce the tax burden borne by them. Under the system prevailing at the time, it was the husband who got the benefit of the married allowance of 1,700 K. Hereafter, he announced, the husband and wife could by election 6 months before the commencement of the charge year ask for the married allowance to be apportioned between them, specifying the amount in which the married allowance is to be divided.

Regarding tax on companies, the Budget introduced a new system of paying corporation income tax. According to the prevailing practice, companies paid provisional tax in two instalments, on 14 August and 14 December following the end of the tax year. Hereafter, under the new proposals in the Budget, all business will now have to estimate in advance what their taxable income will be for the current year and pay provisional income tax on that estimated amount in four instalments before the end of the tax year. In short, this means the payment of the 1981/82 and 1982/83 taxes before the end of March 1983.

This proposal that two years' income tax will have to be paid in one year raised objections from the entire business community, who pleaded that the business enterprises lacked the cash resources to pay two year's taxes in one year. Many of them, in view of the current foreign exchange shortages, did not get their full allocations of import quotas and were finding it difficult to run their businesses profitably. This new system, they said, would have grave consequences on the viability of many businesses and also seriously retard investment and expansion in the economy as a whole.

The Hon. Minister, after considering all the representations made to him, did not, however, alter his original proposal, but to alleviate the tax burden on the business enterprises, he extended the time limit for the payment of the taxes over a period of 1½ years. He also gave the Commissioner of Taxes the power to extend the time limit in case of hardships and also the power to waive the penalties for late payments of tax, considering each case on its own merits.

The undistributed profits tax, which was introduced in 1979 and amended in the 1980 and 1981 Budgets due to severe and widespread criticism, was repealed this year and replaced by a new regulation which went back to the old system of "deemed" distribution of dividends. Where the Commissioner of Taxes considers that a company, in order to avoid or reduce tax, has not declared a dividend or declared a dividend inadequately, he will "deem" a dividend to have been declared and such deemed dividend will be taxable in the hands of the shareholder. The business community preferred this "deemed" distribution regulation to the undistributed profits tax which was regarded as a penal provision. The new regulation removes the indiscriminate penalty for non-distribution and identifies those companies who do not declare dividends or plough back their profits into the business.

The agricultural sector was given further incentives in order to boost the agricultural output of the country. The rate of tax on farming income, which was reduced to 25% in 1981, was further reduced to 15%.

Accelerated depreciation on farming machinery implements and equipment at 50% of the cost of the assets on a straight line basis was also granted.

There were proposals to grant incentives to the industrial sector: these were not implemented as such in the Amendment Act, but the Hon. Minister of Finance hopes to implement some of these when changes are made in the Industrial Development Act. An effort is being made to encourage rural development with a view to reversing the existing rural/urban disparity as well as the deteriorating terms of trade between primary producers in the rural areas and the urban consumers. The poor rural areas will not be allowed to subsidise the urban areas and the Government hopes to achieve this by a sustained implementation of appropriate pricing and credit policies.

The Budget is a remedial one with a view to correcting the economic ills of the nation. The call is for economic revival and self-reliance. the principal message in the Budget is the "restructure of the economy, deliberate diversion of resources from non-productive to productive uses, thereby promoting the resumption of self sustaining economic growth while achieving progressive improvements in the balance of payments". It is hoped that the nation will respond to this call by the Hon. Minister of Finance who is hopeful that the nation will.

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Recent Changes in the Philippine Taxation of Individuals*

By Corazon P. Paredes**

INTRODUCTION

Beginning calendar year 1982, a new individual income tax system is in force in the Philippines. The so-called modified gross income tax scheme became part of the Philippine National Internal Revenue Code of 1977 (Tax Code) when Batas Pambansa Blg. 135[1] was finally approved by the President on 18 December 1981. The new system constitutes a significant departure from the old system whereby individuals, irrespective of their types of income, were generally taxed on a net income basis. The following are the important changes introduced by the new law: (a) categorization of income; (b) modified gross taxation of compensation income; and (c) retention of itemized deductions with respect to business income.

The modified gross income tax scheme was designed to eliminate administrative problems connected with the old system. Accordingly, certain specific objectives were identified with the adoption of the new system. These are: (a) simplification of income tax administration; (b) minimization of discretion in the determination and allowance of deductions by the taxpayer and tax examiner; and (c) rationalization of the income tax treatment of different types of income.

The manner of taxation of gains derived by individuals, whether citizen or alien, as well as corporations, domestic or foreign, from the sale of shares of stock classified as capital assets have likewise been modified by Batas Pambansa Blg. 221 which was approved on 25 March 1982.

The following is a summary of the recent changes in the Philippine taxation of individuals.

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II. REVISED TAXATION OF SALES OF SHARES OF STOCK

I. NEW MODIFIED GROSS INCOME TAX SYSTEM

A. Categories of income

1. Under the new system

Individual incomes are currently divided into three principal categories, namely, compensation income, business income, and passive income. Classification is based on the nature of the income derived and all three categories are meant to cover the entire range of individual incomes.

a. Compensation income

Briefly, compensation income covers all income arising from an employer-employee relationship, whether monetary or non-monetary. However, the Tax Code itself provides for a specific definition of the term "gross compensation income", which includes all income payments received as a result of an employer-employee relationship, such as salaries, wages, honoraria, bonuses, pensions, allowances for transportation, representation, entertainment, fees (including directors' fees) and other income of a similar nature, including compensation paid in kind.

The share of a partner from a general professional partnership for services is not considered as part of gross compensation income but as a partner's distributive share of ordinary business income.

* As of 31 July 1982.

** Tax Manager, SyCip, Gorres, Velayo & Co., Philippines.

1. Batas Pambansa may be loosely translated as "Parliamentary Act" in Pilipino while "Bilang/Blg." means "number".

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b. Business income

Business income refers to income derived from engaging in a trade, business or profession as well as all other income derived from any source whatsoever not classified as compensation income or passive income. The Tax Code specifically uses the term "gross income" for this category of income which broadly includes gains, profits and income derived from professions, vocations, trades, businesses, commerce, sales, or from dealings in property, whether real or personal, or growing out of the ownership or use of property or any interest therein; and from interest, rents, dividends, securities, or the transactions of any business carried on for gain or profit, or gains, profits and income of whatever kind and in whatever from derived form any source.

c. Passive income

Passive income includes interest, dividends, royalties, prizes and other winnings which are subject to a final withholding tax.

2. Under the old system

Under the old global income tax system, there was only one general category of income. Thus, as defined, the term "gross income" included gains, profits and income derived from salaries, wages, or compensation for personal service of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, sales, or dealings in property, whether real or personal, derived from the ownership of or use of or interest in such property; also from interest, rents, dividends, securities, or the transactions of any business carried on for gain or profit, or gains, profits, and income derived from any source whatsoever. In effect, all items of income were lumped together.

As under present law, certain types of passive income like dividends and interest were also subjected to a final withholding tax. Other types of passive income, like royalties and prizes, were merely subjected to a creditable withholding tax. In other words, these types of income were consolidated with the other income of an individual and the tax thereon was computed accordingly. Any withholding tax paid could then be credited against the income tax as finally computed. Nevertheless, these special types of passive income were not recognized as falling under a separate category of income.

B. Exclusions from gross income

The following items are currently treated as exclusions from gross compensation income:

1. Actual, moral, exemplary, and nominal damages received pursuant to a final judgment or compromise agreement arising out of an employer-employee relationship.
2. Proceeds of life insurance policies paid upon the death of the insured.
3. Amounts received by the insured as return of premiums paid by him under life insurance, endowment or annuity contracts.
4. Value of property acquired by gift, bequest, devise, or descent.
5. Interest on government securities.
6. Amounts received through accident or health insurance or under the Labor Code of the Philippines, as compensation for personal injuries or sickness plus the amount of any damages received on account of such injuries or sickness.
7. Income exempt under treaty.
8. Retirement benefits, pensions, gratuities received under certain conditions.
9. Other miscellaneous items such as income received from investments in the Philippines or interest on deposits in Philippine banks by (a) foreign governments, (b) financing institutions owned, controlled, or enjoying refinancing from foreign governments, and (c) international or regional financing institutions established by governments.

The same items of exclusion above enumerated are also excludable under the category of business income. In addition, compensation income as well as passive income which have already been subjected to a final tax are also entitled to be excluded from the coverage of business income.

Under the old system, the same excludable items were recognized for determining gross income.

C. Allowance for deductions

Another highly significant change introduced by the modified gross income tax system is the restriction on deductions. Under current law, no other deduction is recognized for the purpose of arriving at one's taxable compensation income except for the so-called personal and additional exemptions. The usual deductions previously allowed to a taxpayer for computing his net taxable income are presently still allowed but only for the purpose of computing one's taxable *business* income. Aside from limiting the itemized deductions to the category of business income, such items must also be business-related in order to be deductible.

1. Under the new system

a. Personal and additional exemptions

Whether an individual is deriving purely compensation income or business income or both under current law, he is still entitled to the personal and additional exemptions. The rates of personal exemption that may be availed of by such individual depends upon his status as single or married person or head of a family. A single individual or a married person judicially declared as legally separated is entitled to claim a personal exemption equivalent to ₱ 3,000. A married person may deduct ₱ 6,000 while an individual who qualifies as head of a family is allowed ₱ 4,500 as personal exemption. Head of the family means an unmarried person with one or both parents, or with one or more brothers or sisters, or with one or more legitimate, recognized natural or adopted children living with and dependent upon him or her for their chief support where such brothers, sisters,

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or children are not more than 21 years of age, unmarried, and not gainfully employed, or where such children are incapable of self-support because of mental or physical defect.

Additional exemptions equivalent to ₱ 2,000 may be further claimed by the taxpayer for each legitimate, recognized natural or adopted child wholly dependent upon and living with the taxpayer if such dependents are not more than 21 years of age, unmarried, and not gainfully employed or if they are incapable of self-support because of mental or physical defect. However, the Tax Code limits the number of dependents for which additional exemptions may be claimed. Such number must not exceed 4 dependents so that the maximum additional exemption is ₱ 8,000.

In view of the categorization of incomes, an individual who receives both compensation and business income is required to deduct first the amount of his personal and additional exemptions from his gross compensation. If there is any excess exemption, the same could then be deducted from his business income.

b. Itemized deductions

The availability of itemized deductions is presently restricted to the category of business income. Thus, for the purpose of arriving at net taxable income of taxpayers deriving business income, the following items may still be deducted:

1. Ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.
   Entertainment, travel, and representation expenses associated with the taxpayer's trade, profession or business may be allowed as deduction subject to certain substantiation requirements.
2. Interest paid or accrued on indebtedness incurred within a taxable year in connection with the taxpayer's profession, trade or business.
3. Taxes paid or accrued within the taxable year in connection with the taxpayer's profession, trade or business, except: (a) income tax, (b) income, war profits, and excess profits taxes imposed by a foreign government (this deduction will be allowed for a taxpayer who does not wish to avail himself of the foreign tax credit provision); (c) estate and gift taxes; (d) taxes assessed against local benefits of a kind tending to increase the value of property assessed; and (e) electric energy consumption tax.
4. Losses actually sustained during the taxable year, not compensated for by insurance or otherwise and incurred in the exercise of the trade, profession or business or incurred in a transaction entered into for profit though not connected with the trade or business.
5. Bad debts which are actually ascertained to be worthless and charged off within the taxable year in connection with the exercise of the profession, trade or business.
6. Depreciation of property arising out of its use in the profession, business or trade, or out of its not being used.
7. Depletion of oil and gas wells and mines.
8. Charitable and other contributions actually paid or made within the taxable year to certain institutions which may be deductible in full or limited to an amount not in excess of 6% of the taxpayer's net income as computed before the deduction for charitable contributions, depending on the classification of the donee-institution.
9. Payments for pension trusts.

Medical care expenses and basic tuition fees which were deductible under the old system (subject to certain limits and conditions) are no longer deductible items.

c. Optional standard deduction

Except for non-resident alien taxpayers, an individual reporting business income may elect a standard deduction not exceding 10% of his gross income, instead of availing himself of the itemized deductions. His intention to elect the optional standard deduction must be signified in the income tax return.

2. Under the old system

At the time the modified gross income tax scheme was introduced, the same rates of personal and additional exemptions were allowed under the old law for individual taxpayers depending also upon their status. Therefore, no change has been introduced in this regard.

Since there was only one category of income under the global approach, itemized deductions were generaly allowed unless the taxpayer elected the standard deduction. Generally, the same items of deductions were available in case the taxpayer chose itemized deductions for reporting his income. However, certain items were not required to be business-related in order to qualify as deductions. Thus, interest, taxes and bad debts, though not connected with trade or business, were nevertheless deductible in arriving at net taxable income under the old system.

Previously, any individual taxpayer other than a non-resident alien could also elect to take the standard deduction, not exceeding 10% of his gross income, in lieu of the itemized deductions. As under current law, unless the taxpayer signified his intention to use the optional standard deduction in his return, he was considered to have availed himself of the itemized deductions.

If the gross income reported by the taxpayer in his return included that of his wife, a standard deduction of 10% of the gross income received by his wife, but not to exceed ₱ 500, was allowed as an additional deduction regardless of whether such taxpayer used the itemized deductions or the optional standard deduction. This standard deduction for working wife has been deleted under the current system.

D. Tax rates

1. Under the new system

a. Compensation income

The following tax rates are in effect under the modified gross income tax system.

The taxable compensation income (gross compensation

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income less only personal and additional exemptions) received by a citizen or resident alien from world-wide sources is subject to the following rates:

Pesos	*Pesos + percentage of excess over lower amount*
Not over 2;500	0%
2,500 – 5,00	0 + 1%
5,000 – 10,000	25 + 3%
10,000 – 20,000	175 + 7%
20,000 – 40,000	875 + 11%
40,000 – 60,000	3,075 + 15%
60,000 – 100,000	6,075 + 19%
100,000 – 250,000	13,675 + 24%
250,000 – 500,000	49,675 + 29%
Over 500,000	122,175 + 35%

The tax rates imposed on compensation income are much lower as compared to the hold rates of 3% to 70% in force under the net income tax system. Previously, the 36% tax bracket was reached when one's net income exceeded ₱ 32,000. As a general rule, therefore, fixed income earners are favored under the gross income tax scheme because of the 50% reduction in the maximum tax rates and the increase in the taxable income base.

b. Business income

As a result of the categorization of incomes, the taxable net business income of a citizen or resident alien from world-wide sources is presently subject to a separate schedule of tax rates ranging from 5% on the first ₱ 10,000 to 60% on the excess over ₱ 500,000. The complete schedule of such tax rates is as follows:

Pesos	*Pesos + percentage on excess over lower amount*
Not over 10,000	5%
10,000 – 30,000	500 + 15%
30,000 – 150,000	3,500 + 30%
150,000 – 500,000	39,500 + 45%
Over 500,000	197,000 + 60%

There is only a slight reduction of the old maximum tax rate of 70% to 60% which is currently imposed under the new system, but the taxable income base has been increased.

c. Passive income

Passive income, consisting of dividends, interest, royalties, prizes and other winnings, is subject to the final withholding tax at varying rates. Dividends received by a citizen or resident alien from a domestic corporation and the share of an individual partner in a partnership which is treated as a corporation for tax purposes are subject to a 15% final withholding tax. Interest received by a citizen or resident alien on a savings deposit is subject to a 15% final withholding tax. Interest on time deposits and yields from deposit substitutes[2] and from trust funds and similar arrangements are subject to a 20% final withholding tax. However, if the aggregate amount of interest on a deposit account maintained by a depositor alone or with another in any one bank at any time during the taxable period does not exceed ₱ 1,000 a year or ₱ 250 per quarter, the same is exempt from tax. Royalties, prizes (except prizes amounting to ₱ 3,000 or less which should be taxed as business income) and other winnings received by a citizen or resident alien are subject to 15% final withholding tax.

2. Under the old system

Under the old system, only one schedule of tax rates was prescribed for items of income which came within the definition of the term "gross income". The rates ranged progressively from 3% on the first ₱ 2,000 of net taxable income to 70% on the excess over ₱ 500,000. However, dividends and interest from a savings deposit were subjected to the 15% final withholding tax. The same was true with respect to yields from deposit substitutes and interest from time deposits which likewise were subjected to the final withholding tax of 20%.

E. Classification of taxpayers

Individual taxpayers are generally divided into two classes, namely, citizens of the Philippines and aliens. Citizens of the Philippines can further be classified as residents or non-residents. Likewise, alien individuals may be classified as resident aliens or non-resident aliens. The same rules on classification of taxpayers recognized under the old law are currently being followed.

1. Citizens and aliens

Citizens and resident aliens are taxed on the basis of their world-wide income. The schedule of tax rates applicable will depend on the type of income earned by the taxpayer. However, in the case of non-resident citizens deriving income from sources outside the Philippines, a dollar schedule ranging from 1% to 3% based on the taxpayer's "adjusted gross income" is applied. Adjusted gross income means gross income from foreign sources less the total of personal exemptions allowed and the entire amount of foreign income tax paid by him.

Non-resident alien individuals are subject to tax only on the basis of their Philippine-source income. Non-resident aliens may further be classified into: (a) those engaged in trade or business in the Philippines; and (b) those not engaged in trade or business in the Philippines. A non-resident alien who comes to the Philippines and stays for an aggregate period of more than 180 days during any calendar year is deemed to be doing business in the Philippines. If his stay is 180 days or less, he is considered as not engaged in trade or business in the Philippines.

Non-resident aliens engaged in trade or business in the Philippines are generally subject to tax on their compensation and business incomes received from Philippine sources in the same way as resident citizens and resident aliens. However, dividends, shares in the net profits of a partnership (which is taxed like a corporation), interest,

2. As defined under the Tax Code, the term "deposit substitutes" means an alternative form of obtaining funds from the public, other than deposits, through the issuance, endorsement, or acceptance of debt instruments for the borrower's own account, for the purpose of relending or purchasing of receivables and other obligations. These include promissory notes, repurchase agreements, similar instruments with recourse authorized by the Central Bank of the Philippines for banks and non-bank financial intermediaries.

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royalties, prizes and other winnings (except prizes of ₱ 3,000 or less which shall be taxed as business income) are subject to a 30% final withholding tax.

On the other hand, interest, dividends, rents, salaries, wages, premiums, annuities, compensation, remuneration, emoluments, or other fixed or determinable annual or periodical or casual gains, profits, and income from Philippine sources received by non-resident aliens not engaged in trade or business in the Philippines are subject to a final withholding tax of 30%.

However, capital gains realized by non-resident aliens, whether or not engaged in trade or business in the Philippines from the sale of Philippine shares listed in the dollar or any acceptable foreign currency on a stock exchange are currently exempt from income tax.

2. Residents and non-residents

The principles for determining whether or not an alien is a resident or non-resident remain the same whether under the old or new system.[3]

An alien individual's residency or non-residency status depends on the nature and length of his stay in the Philippines. A mere floating intention, indefinite as to time, to return to another country is not sufficient to constitute one a transient. If he lives in the Philippines and has no definite intention as to his stay, he is a resident. One who comes to the Philippines for definite purpose which in its nature may be promptly accomplished is a transient. But if his purpose is of such nature that an extended stay is necessary for its accomplishment, and to that end he makes his home temporarily in the Philippines, he becomes a resident, though it may be his intention at all times to return to his domicile abroad when the purpose for which he came has been fulfilled or abandoned.[4]

F. Taxation of certain expatriates

As part of the incentives granted to certain businesses which help promote the Philippine economy, foreign employees hired by them are also entitled to preferential tax treatment vis-à-vis other expatriates.

Thus, alien individuals employed by regional or area headquarters established in the Philippines under Presidential Decree No. 218, offshore banking units established under Presidential Decree No. 1034 and service contractors or their subcontractors engaged in petroleum operations under Presidential Decree No. 87 are subject to a final tax of 15% based on their gross salaries including other emoluments.

G. Tax administration

1. Withholding system

The Philippine withholding tax system may be divided into four types, namely, withholding tax on wages, basic withholding tax at source, the "expanded withholding tax" and other special types of withholding. The growing use of the withholding tax as a mode of ensuring tax collection has been very apparent in recent tax laws. To further strengthen the system, a penalty is imposed upon the withholding agent if it fails to perform its obligations as such. Accordingly, any amount paid or payable by the withholding agent which is allowable as a deduction from gross income will be disallowed if it fails to deduct and withhold the tax in accordance with the law.

The withholding tax on wages is imposed on all forms of compensation arising from an employer-employee relationship, whether monetary or non-monetary. Specifically, the term "wages" is defined to include all remuneration for services performed by an employee for his employer unless specifically excepted under the law.[5] Thus, all amounts paid to an individual which fall within the category of compensation income will be subject to this type of withholding system.

Some relevant rules in this connection are: the basis upon which the remuneration is paid is immaterial in determining whether it constitutes wages. Thus, it may be paid on the basis of piecework, or a percentage of profits; and may be paid hourly, daily, weekly, monthly, or annually. Wages may also be paid in money or in some medium other than money, as, for example, stocks, bonds, or other forms of property. If services are paid for in a medium other than money, the fair market value of the thing taken in payment is the amount to be included as wages subject to withholding. Thus, as a general rule, pensions and retirement pay are considered wages subject to withholding. The same is true with respect to vacation allowances paid to an employee. However, amounts paid specifically - either as advances or reimbursements - for traveling or other bona fide ordinary and necessary expenses incurred or reasonably expected to be incurred in the business of the employer are not wages and are not subject to withholding. Traveling and other reimbursed expenses must be identified either by making a separate payment or by specifically indicating the separate amounts where both wages and expense allowances are combined in a single payment.

Ordinarily, facilities or privileges (such as entertainment, medical services, or "courtesy" discounts on purchases) furnished or offered by an employer to his employees generally are not also considered as wages subject to withholding if such facilities or privileges are of relatively small value or are offered or furnished by the employer merely as a means of promoting the health, goodwill, contentment, or efficiency of his employees.

The term "wages" includes remuneration for services performed by a citizen or resident of the Philippines, as employee of a non-resident alien individual, foreign partnership or foreign entity engaged in trade or business within the Philippines. Likewise, any person paying wages on behalf of a non-resident alien individual, foreign partnership, or foreign corporation not engaged in trade or business in the Philippines is constituted as the withholding agent.

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3. See Gison and Salvador, "Philippine Taxation of Alien Individuals", 35, *Bulletin for international fiscal documentation* 5, p. 223 (1981).
4. Income Tax Regulations, Section 5.
5. Revenue Regulations No. 20-81, "Withholding Tax for Compensation Income Under the Gross Income Tax System".

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Compensation paid for services rendered in the Philippines irrespective of place of payment received by a non-resident alien not engaged in trade or business in the Philippines is subject to a final withholding tax of 30%. Every person who has the control, receipt, custody, disposal or payment of the income is constituted as the withholding agent.

2. Filing of returns and payment of tax

Citizens and resident aliens deriving purely compensation income must file their returns on or before 18 March of each year, covering income for the preceding taxable year. Individuals deriving business or professional income must file their returns on or before 15 April of each year. If the taxpayer derives both compensation and business incomes at the same time, the return covering both incomes must be filed on or before 15 April of each year.

II. REVISED TAXATION OF SALES OF SHARES OF STOCK

Gains of individuals, whether citizen or alien, or of corporations, domestic or foreign, from the sale of shares of stock classified as capital assets are currently subject to tax depending on whethert or not shares of stock are listed and traded on a local stock exchange. Previously, net capital gains from the sale, exchange, transfer or similar transactions intended to convey ownership of or title to any share of shares of stock were subjected to a final tax of 10%. However, if the shares of stock involved were that of a closed corporation, the tax rates were 10% on the first ₱ 50,000 of net capital gains and 20% on the excess.[6]

Under the present law, if the shares of stock sold or exchanged are listed and traded through the local exchange, a rate of 0.025% of the gross selling price is applicable. The stockbroker is constituted as withholding agent in this case.

On the other hand, if the shares of stock sold, exchanged or transferred are not traded through a local stock exchange, net capital gains derived therefrom are subject to a final tax of 10% on the first ₱ 100,000 and 20% on the excess. The seller must file the return and pay the tax on a per transaction basis, i.e. within 30 days following each sale or disposition of the shares of stock. An adjustment return is required to be filed after the close of the taxable year.

The net capital losses sustained during the taxable year are allowed as capital loss deductible in the same taxable year only. Moreover, the entire amount of capital gains and capital loss are considered without taking into account the period or duration during which the stocks were held by the seller up to disposition for purposes of computing net capital gains.

No sale, exchange, transfer or similar transaction intended to convey ownership of, or title to, any share of stock may be registered in the books of the corporation unless the receipt of payment of the tax is already filed with or recorded by the stock transfer agent or secretary of the corporation. The stock transfer agent or corporate secretary must also inform the Bureau of Internal Revenue in case of non-payment of the tax.

6. PD No. 1739.

Residency Concept and Employment Income in Nigeria

By A.C. Ezejelue*

INTRODUCTION

Although something may have been written generally on "residence" for tax purposes in Nigeria, this narrow aspect of the concept as it applies to employment[1] income requires fairly detailed and isolated treatment. The emphasis will be on foreign nationals who are deemed to be resident in Nigeria for tax purposes in respect of their employment income. The relevant Nigerian tax law on this is often not well understood or is misconstrued by non-resident taxpayers.

Therefore this short article is an attempt to construe the relevant tax law on the matter, for the guidance of foreigners whose employment incomes are deemed to be liable to Nigerian tax. Any interpretations offered here are by no means conclusive; they are open to challenges, even by the author himself, in the light of any new facts.

RELEVANT SECTIONS OF THE RELEVANT ACT

The relevant law for the subject under consideration is contained in Sections 4 and 8 of our Income Tax Management Act (ITMA) 1961 (as amended).

The pertinent provisions of Section 4 are as follows:

> *Section 4(1).* The tax shall, subject to the provisions of the Act be payable for each year of assessment upon income accruing in, derived from, brought into, or received in, Nigeria in respect of –
>
> . . .
>
> (b) any salary, wages, fees, allowances or other gains or profits from an employment including gratuities, compensations, bonuses, premiums, benefits or other perquisites allowed, given, granted by any person to an employee.

And the following subsections of Section 8 are apposite for our purposes:

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1. "Employment" includes any service rendered by any person in return for any gains or profits. See Sec. 4(2)(d) of Income Tax Management Act (ITMA) 1961 (as amended).

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Section 8(1). The gains or profits from an employment shall be deemed to be derived from Nigeria if –

(a) the duties of the employment are wholly or partly performed in Nigeria, unless–
  (i) the duties are performed on behalf of an employer who is in a country other than Nigeria; and
  (ii) the employee is not in Nigeria for 183 days or more in a year of assessment; and
  (iii) the remuneration of the employee is liable to tax in that other country.
(b) the employer is in Nigeria unless the duties of the employment are wholly performed, and the remuneration paid, in a country other than Nigeria save during any temporary visit to or leave in Nigeria.

. . .

(3) The gains or profits from any employment exercised in Nigeria shall be deemed to be derived from Nigeria whether the gains or profits from such employment are received in Nigeria or not.

A MATTER OF CONSTRUCTING RELEVANT LAW

It seems that the spirit behind Section 8 of ITMA on the concept of "residency" is to give the Revenue authorities a wide scope of collecting as much tax as possible under Section 4 of ITMA while at the same time making allowance for what may appear to be the minimum acceptable practice elsewhere.

Section 4(1)(b) is very wide, and does not give any exclusionery conditions when read in isolation. However, apart from being subject to other provisions of the Act, Section 4 must be read in conjunction with Section 8 which introduces some qualifying and ameliorating provisions. At the same time, all subsections of Section 8 should be read together partly for possible interpretative purposes and partly for resolving any appartent conflicts.

Section 4(1)(b) tends to rope in all kinds of income whether accruing in, derived from, brought into, or received in,[2] Nigeria if considered in isolation. But Section 8 stipulates the conditions under which an income shall be deemed to be derived from Nigeria. The emphasis is on "derived from" because derivation in this context implies "obtained" or "acquired" or "got" via working or having worked in or for Nigeria.[3] This is to be distinguished from "brought into" or "received in" or (to some extent) "accruing in", which may not necessarily imply worked or working in or for Nigeria.

The first general condition[4] is that an income from employment shall be deemed to be derived from Nigeria (and therefore subject to Nigerian tax) if the duties of the employment are wholly or partly performed in Nigeria. Thereafter, it introduces some counter-conditions under which the general condition shall not hold, i.e. if:

(i) the duties are performed on behalf of an employer who is in a country other than Nigeria; *and*
(ii) the employee is not in Nigeria for 183 days or more in a year of assessment; *and*
(iii) the remuneration of the employee is liable to tax in that other country.[5]

It must be emphasized that the above three counter-conditions must operate together in order to exclude the operation of the general condition under Section 8(1)(a).

Therefore, if, for example, (i) and (iii) above are true but (ii) is not true, the general condition will be expected to apply.

Section 8(3) emphasizes that once the principle of derivation from Nigeria is associated with any employment income in accordance with the provisions of subsection (1), that income shall be subject to Nigerian income tax, notwithstanding that the income may not have been received in Nigeria.

There is no conflict between subsections (1) and (3) of Section 8. Rather, they tend to complement each other. A taxpayer who is subject to Nigerian income tax under subsection (1), i.e. the "derivation principle", cannot claim that he is exempt simply because the income is not received in Nigeria. Similarly, a taxpayer who is subject to Nigerian income tax by virtue of subsection (3), i.e. "concept of received in", cannot claim that he is exempt simply because the income is not derived from Nigeria.

Again, subsection (3) of Section 8 does not overrule its preceding subsection (1)(a). It merely re-inforces it, and brings out the independence of the "concept of received in" from the "principle of derived from". Subsection 3 explains that income from *employment exercised in Nigeria* shall be deemed to be derived from Nigeria. This is a restatement of subsection (1)(a) which emphasizes that income from employment shall be deemed to be derived from Nigeria if the *duties of the employment are wholly or partly performed* in Nigeria. If an employment is exercised in Nigeria under subsection (3) it is similar to saying that the duties of that employment are performed in Nigeria (wholly or partly) under subsection (1)(a).

"Received in" and "derived from" are under two different categories. They are not mutually exclusive. An income which may not qualify for Nigerian income tax because it is not deemed to be derived from Nigeria may qualify for Nigerian tax on the ground that it is "brought into" or "received in" Nigeria. This is the implication of taking up Sections 4(1)(b) and 8(3) together.

GENERAL HYPOTHETICAL ILLUSTRATION

A general hypothetical example may prove useful to illustrate all the foregoing theories.

Assume that a Dutchman, Mr. A, resident in the Netherlands – thus a non-resident of Nigeria – is sent by his Dutch firm (employer) to work temporarily in Nigeria. A receives a salary for the work performed in Nigeria. Is A liable to Nigerian tax?

The position will be that if A stays in Nigeria for 183 days or more, his income, whether or not it is received in Nigeria, will be subject to Nigerian tax. But if he stays for less than 183 days (in the aggregate) there is no doubt

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2. For possible implications of the terms: "accruing in, derived from, brought into, or received in", see A.C. Ezejelue, "Taxation of Consultancy fees in Nigeria", 36 *Bulletin for International Fiscal Documentation* 8-9 (1982), pp. 421-424.
3. Id.
4. See Sec. 8(1)(a) ITMA.
5. Sec. 8(1)(a)(i-iii).

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that his income will not attract Nigerian tax, provided also that the conditions under Section 8(1)(a)(i) and (iii) hold.

If we assume that A is not liable to Nigerian tax on the ground that his income is not deemed to be derived from Nigeria under Section 8(1)(a), what happens if A receives part of his salary in Nigeria to pay for living and other personal expenses? On the basis of the foregoing construction, this part of A's salary would have been received in Nigeria, and would therefore attract Nigerian income tax under Section 4(1)(b). An income may be liable to Nigerian tax simply because it is received in Nigeria notwithstanding that the income may not have been derived from Nigeria.

CONCLUSION

The issue of the determination of residence, generally, for tax purposes, in Nigeria is a very important one.[6] But it seems that the concept of residency as it affects employment income of non-residents is of greater importance because it tends to apply more to foreign nationals who are apt to misconstrue the position. Therefore, some efforts have been made in this article to highlight certain basic and vital issues. It is hoped that this will stimulate the interest of both academicians and practitioners.

6. For a detailed discussion of this, see A.C. Ezejelue, "Impact of residence on tax liability in Nigeria", 35 *Bulletin for International Fiscal Documentation* 12 (1981), pp. 547-554.

Conference Diary

DECEMBER 1982

Management Centre Europe: Taxation of International Group Companies and Branches (including: Taxation of branches and subsidiaries; taxation of shareholders; domestic and tax treaty "anti-avoidance" measures) (Seminar). Brussels (Belgium), December 2-3 (English).

Terzake Belastingen: Tax aspects of Doing International Business. Amsterdam (Netherlands), December 2 (Dutch).

Management Centre Europe: International cash management (including: International tax aspects in cash management). London (United Kingdom), December 6-8 (English).

Terzake Belastingen: Tax problems arising from mergers. Amsterdam (Netherlands), December 9 (Dutch).

Institut für Ausländisches und Internationales Finanz- und Steuerwesen der Universität Hamburg: Current problems in international tax law (including: development trends of double taxation treaties). Hamburg (German Federal Republic), December 9 (German).

Management Centre Europe: Stanley B. Lubman on China (including: The joint venture income tax law; the tax on individual income; the tax on foreign enterprises; recent regulations and interpretations by central and local tax authorities). Brussels (Belgium), December 9-10 (English).

U.K. Tax Congress: 2nd Annual U.K. Tax Congress (including: Current uses of U.K. offshore tax havens; taxation of commercial interest; tax deferral opportunities for individuals). London (United Kingdom), December 9-10 (English).

JANUARY 1983

British Branch of I.F.A.: Recent tax cases. London (United Kingdom), January 18 (English).

FEBRUARY 1983

British Branch of I.F.A.: Tax treatment of non-residents (Tax workshop). London (United Kingdom), February 8 (English).

MARCH 1983

British Branch of I.F.A.: Tax aspects of interest (Tax workshop). London (United Kingdom), March 2 (English).

Management Centre Europe: Managing and developing foreign subsidiaries (including: tax in international operations). Brussels (Belgium), March 28-30 (English).

APRIL 1983

The Taxation Institute of Australia: Sixth National Convention (including: The role of the High Court in interpreting tax statutes; taxation of technology; tax shelters and planning for the '80s). Melbourne (Australia), April 10-15 (English).

OCTOBER 1983

37th Annual Congress of I.F.A.: I. Tax avoidance/tax evasion. II. International problems in the field of turnover taxation. Venice (Italy), October 10-15 (English, French, German, Spanish).

FOR FURTHER INFORMATION PLEASE WRITE TO:

British Branch of I.F.A.: Secretariat c/o Williams & Glyn's Bank Ltd., New London Bridge House, 25 London Bridge Street, London SE1 9SX (United Kingdom).

Institut für Ausländisches und Internationales Finanz- und Steuerwesen der Universität Hamburg: Grindelhof 38, 2000 Hamburg 13 (Federal Republic of Germany).

International Fiscal Association (I.F.A.): General Secretariat, Woudenstein, Burgemeester Oudlaan 50, P.O. Box 1738, 3000 DR Rotterdam (the Netherlands).

Management Centre Europe: Avenue des Arts 4, B-1040 Brussels (Belgium).

Terzake Belastingen: VNU Data publishing International bv. Antwoordnummer 18007, 1000 VB Amsterdam (Netherlands).

The Taxation Institute of Australia: 113 Swanson Street, Melbourne VIC. 3000 (Australia).

U.K. Tax Congress: 20 London Road, Horsham, West Sussex RH12 1AY (United Kingdom).

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Tax Changes in Jamaica: The 1982-83 Budget

By H.W.T. Pepper

For the second year in succession the new Government in Jamaica has been able to introduce a Budget imposing no new taxes, partly because of increases in collection of tax arrears in the previous year.

Income taxes

Various changes in existing taxes have been announced although income taxes on companies and individuals have been deferred for future consideration.

Certain exemptions from income tax are, however, to be granted with effect from 1 January 1983. In the case of agriculture exemption is to be extended to all agricultural income derived from the growing of crops. (See below, "Agricultural income").

Exemption is also to be granted in respect of the employment income of all registered disabled individuals certified as substantially handicapped by injury, disease or congenital deformity where the handicap will be of indefinite duration.

Payroll contribution

A 3% levy on wages paid by employers is to be made with effect from 1 June 1982 to provide funds for H.E.A.R.T. (Human Employment and Resources Training) to train 16-to-20-year-olds who will be selected for training for periods up to 3 years.

Employers may deduct wages paid to the trainees from the H.E.A.R.T. contributions due from them, and wages and residual dues will be deductible from taxable profits.

In the second and third years instead of a deduction employers will receive tax credits of 75% of male trainees' wages (80% for female trainees' wages) a more generous allowance to encourage continuance of training programmes.

If the H.E.A.R.T. levy works as planned it will confer a net benefit, rather than a net liability, upon employers and so will rank as a kind of training subsidy rather than new taxation.

Property tax

As regards property tax, a re-valuation exercise is to be commenced in June 1982 and in due course small properties valued at $ 2,000 or less, which formerly paid a minimum tax of $ 5.00 are to exempted.

Other properties will be classified according to the type of land use and the rate structure will be adjusted so that there will be no material increase in the existing tax liability on properties.

Once the new values are established, an indexing system will be introduced so that in future values, and the tax yield, will rise with prices, creating buoyancy in the revenue from property tax.

Taxpayers whose properties are mortgaged will be afforded the facility of paying their property tax in monthly instalments to the mortgage institutions along with the monthly capital, interest, and insurance payments. The institutions will be required to pay over the tax to the collector quarterly, a system which will provide an "easy-payment plan" for taxpayers and also assist the Tax Collection Department.

Stamp duties

To cut down the amount of work involved both in the private sector and the Stamp Duty Office it is proposed to change the stamp duty on receipts from an ad valorem levy (which varies from 1 cent to 20 cents) to a flat rate levy of 3.5 cents per receipt. The levy was formerly paid by gumming postage stamps on receipts but will in future be paid by monthly composition payments.

Many other duties will also be paid by way of composition instead of by having thousands of individual documents embossed by stamping machines.

Vehicle and drivers' licences

To reduce administrative work the licensing system is to be computerised and driving licences will be issued for 3-year terms (at $ 24.00, i.e., 3 times the annual cost) instead of yearly. There will be an additional levy of $ 5.00 to cover the cost of a laminated plastic licence containing a photograph of the driver.

In the case of vehicle licences (called road tax in some countries) the fee will be payable annually without the option to pay quarterly. The owner of a vehicle will be able to retain the vehicle's licence plate throughout his life-time. When a vehicle is sold the old licence plate will be removed and a new one fixed in respect of the new owner.

Individuals' vehicle licence fees will be payable, and renewable on the first day of the month in which the individual was born, while other vehicles' licences will be renewable each 1st January.

Levies on imported vehicles

A major fiscal improvement arises from the rationalisation of initial duties and taxes on motor cars formerly subject to levies totalling 173% of c.i.f. value, with exemptions for self-drive car hire agencies and former residents of Jamaica returning to the country with a motor car.

The exemptions have now been abolished thus broadening the tax base, and the total taxation on cars not exceeding 2,000 c.c. engine capacity (petrol-driven) or 2,200 c.c. (diesel-driven) is now 75% of the c.i.f. value comprised of 45% customs duty and the remainder retail sales tax.

Cars of higher engine capacity will, however, continue to be taxed at the old rates.

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Trucks, lorries, and other commercial vehicles used for agricultural purposes will continue to enjoy the exemption from all initial duties and taxes conferred in last year's Budget. Other commercial vehicles will continue to be exempted from all levies except the 45% customs duty on c.i.f. value.

Agricultural income

The considerable incentives to agriculture have been rationalised as far as the income tax exemption is concerned. Instead of specifying a period of tax holiday, a complete exemption is to be accorded, with effect from 1 January 1983, for profits from the growing of crops.

Losses incurred in exempt agricultural activities will not be available to be offset against other income and separate accounts are to be prepared for the exempt operations.

"Free trade" facilities

Jamaica's entitlement to export commodities to other countries which will accept the commodities as duty-free imports or within established quotas is likely to be extended from the CARICOM free trade area, the A.C.P. arrangements, the G.S.P. (Generalised System of Preference) agreements with Canada and the U.S.A., and other schemes by the inauguration of President Reagan's C.B.I. plan.

The C.B.I. (Caribbean Basin Initiative) arose partly from talks held by the Hon. Edward Seaga, M.P., P.C., Jamaica's Prime Minister and Minister of Finance, with President Reagan in 1981.

Basically the C.B.I. provides, for a period of 12 years, duty-free import facilities for Jamaica's (and many other Caribbean countries') exports to the U.S.A. of all goods except most textiles and garments. Textiles and garments will, however, receive favourable treatment falling short of duty-free entry. In addition the C.B.I. will give incentives to U.S. investment in the Caribbean to produce more goods for export and to finance imports of such goods by U.S. importers.

The C.B.I. scheme will come into effect when passed by the U.S. Congress.

Double taxation relief

Jamaica has double taxation treaties with the U.K. and the U.S.A., and also with Canada, Denmark, West Germany, Norway and Sweden. The treaty with Sweden is being updated and negotiations are under way for new treaties with other countries.

Erratum: Bulletin February 1982: page 52 (Section III), delete "New Zealand".

JAMAICA:

Budget 1982-83

Extracts from the Budget Speech pronnounced on 22 April 1982 by the Hon. Edward Seaga, Prime Minister and Minister of Finance and Planning.

Members of this Honourable House will recall that in the Budget Presentation of last year I indicated that among the priority objectives of my Government was the promotion of increased economic activity and towards that end tax administration and policy changes would be introduced on a phased basis.

. . .

Income tax relief

Where any person provides training and employment for one or more registered participants he will be permitted to deduct the amount of the remuneration paid to the participant from the amount of HEART Contributions[1] for which he is liable. The net HEART Contributions, if any, remaining after deduction of the participant's remuneration will be payable to the Collector of Taxes. The Net HEART Contributions and the participant's remuneration will be deductible expenses for purposes of income tax.

Where a person liable to HEART Contributions does not provide training and employment for registered participants the Gross Contributions will be payable to the Collector of Taxes and will be deductible for income tax purposes.

In order to induce continued employment of registered participants after the end of the first year of training, it is proposed that instead of treating the participant's remuneration as a deductible expense, the employer be given Tax Credits for the Second and Third years equivalent to a prescribed percentage of the participant's remuneration, which Credit would be a greater tax benefit than the effect of a deductible expense.

For the Second and Third years the prescribed percentage will be 75% and in recognition of the need to compensate for the higher rate of unemployment experienced by females in the Labour Force vis-a-vis males, the Tax Credits for the Second and Third years in respect of female participants will be 80%.

The grant of Tax Credits will be subject to certification by the HEART Fund that the participant performed satisfactorily during the relevant year and that the employer met all obligations.

. . .

1. Human Employment and Resources Training, see the preceding article by H.W.T. Pepper.

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Property taxation
Land revaluation programme 1982-83

In accordance with the provisions of Section 11 of the Land Valuation Act all parcels of land in Jamaica are now due for revaluation, but apart from this fact the significant changes in the level of property values during the past eight (8) years following the date of the last revaluation now render the early revaluation of land an urgent necessity in order to establish an equitable base for the taxation of property.

Government has therefore decided that the programme of revaluation will commence in May, 1982 and the whole exercise is expected to be completed by 31st January, 1983.

The main objectives of the revaluation programme are:

(i) To update the property tax base to reflect current market values.

(ii) To establish a system of land use classification and coding of each parcel of land to facilitate taxation based on the dominant land use categories, namely:
   (a) agricultural;
   (b) residential;
   (c) commercial;
   (d) industrial.
   Establishment of a land use classification will provide the basis for development of a more equitable tax structure, thereby obviating the necessity for time-consuming derating and relief procedures.

(iii) To create an inventory of agricultural properties of 50 acres and over. This size category covers 1.3 million acres or 46% of all farm land. Pilot studies have already been undertaken for the parish of St. Mary.

(v) To create an inventory of land owned by Government. The information derived from revaluation will be computerised and will include: location, area, title reference, use occupation and tenurial status, the nature of improvements and the unimproved values.

(v) To refine the existing fiscal cadastre especially in relation to enclosure maps and plans.

(vi) To code land in foreign ownership.

Tax liability after revaluation

Members should note two important aspects of the revaluation programme namely:

(i) The tax rates will be adjusted so that there should be no significant increases in the existing tax liability of property owners.

(ii) There will be no property tax on any parcel of land valued at $ 2,000 and under. Approximately 300,000 taxpayers across the island will benefit from this exemption.

Buoyancy of the property tax

On the defects of the present site value system of land taxation is its lack of buoyancy in the sense that Government derives no tax advantage from changes in the market values of land. This defect will be remedied by introducing a Land Value Indexing System concurrently with the establishment of the updated land values under the revaluation programme. This means that following the conclusion of the forthcoming revaluation exercise, there will be a continuous programme for monitoring and analysing property transactions in order to determine changes in the level of values in each land use category. The information derived under this Land Value Indexing System will:

(i) enable Government to review, as and when it deems necessary, the rate structure applicable to each use category; and

(ii) enable the Land Valuation Department:
   (a) to effect future revaluation exercises in a much shorter time period and at considerably reduced cost;
   (b) to improve the valuation roll maintenance operations by effecting on a regular basis changes relating to the ownership, use and subdivision of land.

. . .

Revision of the Stamp Duty Act

In continuation of the programme of revision of the provisions of taxing statutes to facilitate improvements in assessment and collection procedures, arrangements have been made for a comprehensive revision of the Stamp Duty Act which requires substantial updating in many respects having been enacted as long ago as July, 1937.

. . .

There are a number of stamp duties such as those on Life Insurance Policies and Bills of Lading which can be collected more efficiently by the method of composition. Government has, therefore, decided to facilitate the making of agreements in the future by amending the Act to empower the Stamp Commissioner to enter into agreements for the composition of stamp duties, as he thinks fit, but subject to the same terms and conditions as are applicable to the instruments now under composition arrangements.

. . .

Income tax concessions - income tax exemption: Agricultural Income

Members will recall that in the last Budget Presentation, I announced that the Agricultural Incentives Act would be amended in order to:

(i) Expand the range of agricultural crops in respect of which tax concessions were granted under the Act.

(ii) Extend the tax holiday period from 5 to 9 years on the basis of the amount of "value added" in the process of production.

. . .

Government is convinced that the initiatives for economic recovery, especially in the area of agriculture, can best be served by an exemption from income tax of the profits derived from agriculture, instead of the proposed amendments to the Agricultural Incentives Act. Initially, the exemption will be confined exclusively to the growing of agricultural crops.

. . .

Proposal for the integration of the system of collection for all items of revenue and statutory contributions

. . .

Government has, . . . decided that a more effective method of collection would be achieved if the Collection and Compliance Activities in relation to all items of Revenue and Statutory Contributions are centralized in a single Agency within the Collector General's Department adequately staffed with trained personnel and involving the establishment of an integrated Computer System.

This programme of development will be carried out on a phased basis as follows:

(i) The responsibility for the collection and enforcement of income tax in the Corporate Area will be transferred to the Collector General's Department. This will enable the Commissioner of Income Tax to concentrate on the primary functions of identifying and assessing the large number of taxpayers instead of dissipating the efforts of his organization in carrying out collection and compliance functions more appropriately executed by the Collector General's Department which is already provided with the nuclues for the centralized system of collection and compliance.

(ii) The collection of NHT contributions will be transferred from the Commercial Banks to the Collector General's Department.

(iii) The compliance activities in relation to NHT and NIS Contributions will be transferred to the Collector General's Department. This will facilitate compliance activities. This will mean the establishment in each Collectorate of a small Unit to carry out the compliance activities in relation to Income Tax, National Housing Trust and National Insurance Contributions.

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BOTSWANA:

THE FINANCIAL ASSISTANCE PROGRAMME

By D.K. Uttum Corea*

Contents

I. Productive employment development fund
II. Classification, by scale, of projects recommended for financial assistance
III. Nature of assistance recommended for the various types of projects
IV. Other types of assistance
V. Linking industries
VI. Local reference
VII. Evaluation and monitoring
VIII. Production employment development fund policy proposals for amendment to income tax legislation
IX. Other main features of the proposed Income Tax Amendment Bill referred to in the Budget Speech

A "white paper" entitled "The financial assistance policy" was presented during the April 1982 sessions of the National Assembly of Botswana. The paper sets out a policy for the development of productive employment and deals with various proposals to provide financial assistance to certain new ventures and expansions of certain existing ventures to achieve this end.

This article is based on the proposals contained in the white paper and the report of an inter-ministerial working group. The income tax amendments, mentioned in the Budget Speech for 1982/83, which have yet to be detailed in an income tax amendment bill, are also discussed in the light of the white paper. This article should be regarded as providing guidelines only. The proposals are subject to introduction of related income tax legislation in the next sessions of the National Assembly, and the information contained herein is based on my interpretation of "the financial assistance policy" and proposals for amendment of the income tax act.

I. PRODUCTIVE EMPLOYMENT DEVELOPMENT FUND

Financial assistance is to be provided by way of specific grants to eligible projects from the above fund. P5 million is included as an appropriation in the 1982/83 budget towards the funds. This is considered to be an initial appropriation toward the fund.

II. CLASSIFICATION, BY SCALE, OF PROJECTS RECOMMENDED FOR FINANCIAL ASSISTANCE

(a) small scale projects: those involving an investment of up to P10,000;
(b) medium scale projects: those involving an investment between P10,000 and P750,000;
(c) large projects: those involving an investment of more than P750,000.

Access to funds for small projects will be limited to citizens and these are likely to be most important in the rural areas.

Assistance in respect of medium and large projects is intended to primarily favour citizen-owned businesses though it would appear that foreign-owned businesses will not be excluded from consideration, thereafter. In fact it is my opinion that medium and large scale projects will invariably require foreign collaboration and that the financial assistance policy will therefore apply to all eligible ventures.

III. NATURE OF ASSISTANCE RECOMMENDED FOR THE VARIOUS TYPES OF PROJECTS

Small scale projects:

(i) The proposed assistance is to be in the form of *grants* towards capital investment and working capital of small scale industries (e.g. hammer milling, bee-keeping, cement block manufacturing, black-smithing, etc.) which have reasonable expectation of being financially viable;
(ii) The grants are to be based on a percentage of total investment cost favouring owner-operated activity in rural areas. Preference is also given to female entrepreneurs;
(iii) The grants are to be limited to a maximum of P2000 per job to be created by the project.

Medium scale projects:

(i) In the case of *new manufacturing industries* the following *automatic grants* are recommended:
   1. *A five-year "step down" tax holiday* involving reimbursements to a business of 100% of its income tax liability in each of the first two years after commencement of production, and 75%, 50% and 25% in the third, fourth and fifth years, respectively;
   2. *A "step down" reinbursement* of *unskilled labour costs* of 80% in the first two years, and 60%, 40% and 20% in the third, fourth and fifth years respectively;
   3. *A training grant* in reimbursement of 50% of off-the-job training costs in the first five years of operation (in place of existing training allowances

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for tax purposes. However, those businesses which are not eligible for training grants will retain their eligibility for training allowances for tax purposes).

Note: The grants in 2 and 3 above will be included in income for tax purposes but not the reimbursement of tax in 1 above.
Alternatively an entrepreneur contemplating investment in a new manufacturing industry may apply for substitution of the tax holiday described in 1 above with a *capital grant* and a *sales augmentation grant*, as described below, together with the automatic employment and training grants mentioned above.

(ii) In the case of all *other* expansions of existing *productive activities* and for all new investments in eligible sectors other than manufacturing the following assistance has been recommended after approval on a *case-by-case* examination basis:

(Productive activities: have been defined for the purpose of this policy to be activities for the production of goods which can either substitute for imported items or can be exported. These, however, exclude the cattle industry and large scale mining ventures. Effectively this limits the activities to manufacturing, medium and small scale mining and agriculture other than cattle.)

1. *Capital grants* of P1000 per job to be created in non-agricultural sectors and P500 per job to be created in agriculture.
   This grant is to be subject to the following limits:
   40% of capital investment in urban areas
   45% of capital investment in peri-urban areas
   50% of capital investment in non-urban areas
   60% of capital investment in rural area east
   70% of capital investment in rural area west;
2. *Sales augmentation grants* up to a maximum of 8% of sales revenue in each of the first two years, and 6%, 4% and 2% in years three, four and five respectively;
3. *A "step down" reimbursement of unskilled labour costs* – as detailed in the earlier section;
4. *A training grant* – as described in the earlier section.

Note: The case-by-case eligibility of the other productive activities will be evaluated by economic analysis so as to establish whether the project is in the overall economic interests of Botswana. The project would be expected to yield an economic return of at least 6% in real terms after adjustment for certain economic factors such as unskilled labour costs, import inputs, export credits, training costs, income tax and foreign investment in flows and out flows relating to the project. The economic analysis would cover a period of five years excluding any significant pre-production stage.

Large scale projects.

1. The same package of automatic assistance would apply to all *new* large scale *manufacturing* industries as in the case of similar medium scale projects.
2. A case-by-case evaluation would apply to all *other* expansions of existing *productive activities* and for all new investments in eligible sectors other than manufacturing as in the case of similar medium scale projects. A similar package of assistance is also envisaged.

Note: However, in view of the minimum size of the large scale projects the economic evaluation again based on 6% minimum yield will be over a period approximating the expected life of the initial investment generally up to a maximum of 20 years. Discounted Cash Flow (DCF) analysis would feature in the evaluation.

IV. OTHER TYPES OF ASSISTANCE

As a general rule the package of assistance will consist of those grants specified in the foregoing sections. However, some degree of flexibility is envisaged given the complex nature of some large scale projects. It is considered that for some projects protection under the terms of the Southern African Customs Union Agreement may be appropriate. Some other forms of direct and indirect assistance may be identified and requested by the potential investor.

V. LINKING INDUSTRIES

These have been described as industries which provide a marketing or collecting function for the productive sectors discussed above, e.g. Botswanacraft Marketing Co. The importance of such linking industries to the development of small scale industries has been recognised and such industries will qualify for grants after evaluation by standard methodology with some degree of flexibility given the unusual nature of such activities.

VI. LOCAL PREFERENCE

Local businesses tendering for Government contracts are currently given 12½% price preference over foreign suppliers of similar goods provided that the local product has at least 25% Botswana value added.

Businesses which are in receipt of financial assistance grants will not be eligible for local preference in Government and Parastatal procurement.

VII. EVALUATION AND MONITORING

Approval and monitoring of projects which are to be assisted by the Productive Employment Development Fund is to be carried out by:

- Local authorities - for small scale projects.
- Technical inter-ministerial committee (with later delegation to local authorities and line ministeries) - for medium scale projects.
- Committee at Permanent Secretary level – for large scale projects.

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In addition to prior analysis of projects for decision making there will be follow-up evaluation to ascertain the extent to which both the policy and individual projects approved under it are meeting their objectives.

VIII. PRODUCTION EMPLOYMENT DEVELOPMENT FUND POLICY PROPOSALS FOR AMENDMENT TO INCOME TAX LEGISLATION

It has been recommended that the existing lump sum capital allowances and investment allowances be replaced by straight line depreciation for all new and second-hand capital investment. This is in accordance with the budget which proposed a change in the system of capital allowances to make them neutral as between capital-intensive and labour-intensive industry.

The recommended rates of straight line depreciation are as follows:

Buildings:

(i) All buildings of industrial undertakings	15% initial allowance and the balance to be depreciated at 2½% per annum
(ii) Commercial buildings	2½% per annum;

It would appear that depreciation will not be allowed in respect of residential buildings.

Plant and machinery:

Short lived P & M (such as motor vehicles)	25% p.a.
Medium life P & M (6 - 7 years)	15% p.a.
Durable machinery	10% p.a.

I must stress, however, that any changes to income tax legislation are subject to an income tax amendment bill being presented in the National Assembly at its next sitting and debate thereon.

IX. OTHER MAIN FEATURES OF THE PROPOSED INCOME TAX AMENDMENT BILL REFERRED TO IN THE BUDGET SPEECH

(a) The extension of taxation of gains made on the transfer of certain business assets to all such assets. I interpret this as a proposed introduction of capital gains tax;
(b) A phased move to a system of current, quarterly income tax payments by the business sector;
(c) Correction of an error in the error in the provision for averaging of farming income;
(d) Revision of the provisions relating to secrecy with a view to facilitating the discovery and prevention of revenue frauds.

The detailed Income Tax Amendment Bill should be presented at the next sitting of the National Assembly.

Revised Double Taxation Convention between Australia and the United States of America *

I am pleased to be able to announce that a revised double taxation convention between Australia and the United States was signed today in Sydney. When it enters into force, this important new agreement will replace the one which has been in operation since 1953.

While the primary object of the new agreement is the avoidance of double taxation and the prevention of fiscal evasion, there are nonetheless a number of other important reasons for entering into the treaty. For example, it is an expression of accord between our Governments and reflects the close ties and goodwill that exist between our countries.

The Government has been aware of a number of shortcomings in the existing agreement, brought about largely by amendments over the years to the taxation laws of both countries and by changes in the commercial dealings. In overcoming these difficulties, the new agreement should be particularly welcomed by businessmen in both countries. Indeed, it is the Government's wish that the new agreement will not only facilitate, but will act as an incentive to, trade and investment between Australia and the United States.

The new agreement contains provisions for allocating taxing rights between the countries which are substantially similar to those obtained in Australia's other modern double taxation agreements. To the extent that the existing agreement accords with those principles of allocation, the new agreement will not result in any significant practical changes in the basis of taxing the income concerned.

For example, the taxation treatment of dividends is basically unchanged, and each country will continue to reduce its withholding tax on dividends paid to residents of the other to 15% of the gross dividend.

In somewhat similar vein, business profits which arise from the operation or maintenance of a branch that a resident of one country has in the other will continue to be taxed in the country where the branch is located. The agreement recognizes the Australian branch profits tax on branches here of U.S. and other foreign firms.

Because the new agreement, unlike the old, treats the Australian continental shelf as part of Australia for purposes of the treaty, Australia's ability to tax income of U.S. firms operating on our continental shelf is made secure.

Changes of significant practical importance which the

* Statement by the Australian Treasurer, the Hon. John Howard, M.P., 6 August 1982.

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new agreement will effect include those relating to the taxation of interest and royalties. Unlike Australia's (and other countries') modern agreements, the existing Australia/U.S. agreement does not contain provisions dealing with the taxation of interest. Nor, apart from rules under which copyright royalties are taxed only in the country of residence, are there existing provisions dealing with rights to tax royalties.

In line with modern practice the new agreement expressly recognizes the right of the country of source to tax interest and royalty income flowing to the other country but limits source country tax to 10% of the gross payment. As is customary, this limit will not apply to income effectively connected with a branch that the recipient has in the country of source. The country of residence of the recipient will also tax interest and royalties liable to tax of 10% in the country of source, but will allow a credit against its own tax for the tax paid to the country of source.

Other examples of income which may be taxed by the country of source include income from real property (including income from the exploitation of natural resources) or from the disposal of real property and most social security and government pensions.

Income from employment (including directors' fees) will be taxed in full in the country where the work is carried out, except that in specified circumstances income derived during visits of short duration to one of the countries will be taxed only by the country of residence of the particular employee.

Australia has, by the new agreement, bettered its ability to tax visiting U.S. entertainers. The new agreement provides for income derived by visiting public entertainers to be taxed in the country visited where the total income received by them in respect of their performances, including expenses, exceeds US$10,000 or its equivalent in Australian dollars. Under the existing agreement, entertainers are not taxed in the country visited unless their visit exceeds 183 days, or they are employed by a resident of the country visited or of a third country.

The new agreement provides that some types of income may be taxed only by the country of residence of the recipient. Items falling into this category include shipping and airline profits derived from international operations; pensions (other than social security and government pensions), annuities and other similar remuneration; and payments to students undertaking full-time education, made for their maintenance or education.

Unlike the existing agreement, the new treaty does not include provisions specifically covering taxation of the remuneration of professors and teachers of one country who are visiting the other. Under the new arrangements, this income will be dealt with in accordance with the general provisions covering income for services rendered.

There are also a number of changes of a more technical kind.

A special provision of the new agreement, aimed at attempted abuse of treaty provisions will limit, in specified circumstances, the benefits available under the agreement where companies are used in an attempt to exploit those benefits.

Yet other provisions of the agreement call for the allocation of income between a permanent establishment and its head office, and between associated enterprises, to be on the "arm's length" basis. In particular, Australia's right to apply its recently enacted anti-profit shifting provisions is specifically safeguarded.

Another new feature in the agreement is the inclusion of an article expressing each country's best intentions that, in enacting taxation measures, it will not treat citizens or residents of the other country, and enterprises or companies owned wholly or partly by them, in a less favourable way than it treats its own citizens or residents, enterprises or companies. This article will not affect the operation of existing provisions of the income tax law, or similar provisions enacted after signature of the convention, or provisions designed to prevent avoidance or evasion of taxes.

While the article will not be able to be called in aid by a taxpayer in an objection against a taxation assessment, it does provide for consultation between the Governments of both countries where any taxation measures are considered to infringe the principles of the particular article.

As is the case at present, the new agreement contains provisions outlining procedures to be followed where a taxpayer considers that his taxation is not in accordance with the agreement and for the relief of double taxation where, under the agreement, income may be taxed in both countries.

For example, Australia is to give credit – as it does now – for United States tax on dividends received by Australian individuals, Australian companies being effectively tax-free on dividends from the United States.

As is customary, the legislation giving the force of law to the agreement in Australia will provide for the credit method of relief to apply to interest and royalties derived by Australian residents where the United States tax on the income is limited by the terms of the agreement to 10%. Other non-dividend income that Australian residents derive from the United States will continue to be exempt from Australian tax if taxed in the United States.

The exchange of information provisions of the new agreement represent yet another area of change. This valuable aid to the taxation administrations of the two countries now will extend to information appropriate in the general enforcement of each country's income tax laws.

The new agreement will enter into force upon exchange of instruments of ratification, which can only occur after the Australian parliament and the U.S. Senate have approved the agreement. Once the agreement has been ratified, the new arrangements covering income flows between the United States and Australia will have effect with respect to dividends, interest and royalties derived on or after the first day of the second month following the date of entry into force and, in relation to other forms of income, for taxation years commencing on or after the first day of the second month following the date of entry into force.

Copies of the agreement will be made available to interested persons at Taxation Offices in the capital cities.

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UNITED STATES:

Overview of Federal Excise Taxes

INTRODUCTION

This pamphlet, prepared by the staff of the Joint Committee on Taxation, provides a summary of present Federal excise taxes. It also shows recent historical trends in Federal excise tax collections and projected excise tax revenues. The pamphlet is intended to provide summary information on Federal excise taxes for Members of the House Committee on Ways and Means, the Senate Committee on Finance, and other Members of Congress.

Part I of the pamphlet is an overview of Federal excise taxes, with a brief discussion of the types of Federal excises and how some of the excises are earmarked for certain expenditure purposes. Part II is a summary of present Federal excise taxes by category: organized into 13 categories, plus a category of miscellaneous excises. The summary of each excise tax category indicates whether the revenues from the tax go into the general fund or into a trust fund or other special fund. Part III presents data on recent trends in Federal excise tax revenues for selected fiscal years, 1970-1981, and estimated revenues for fiscal years 1982 and 1983 under present law.

A forthcoming staff pamphlet will provide additional background information regarding Federal excise taxes, including an historical survey of major Federal excise tax changes, a more detailed description of present law excise taxes and the applicable trust funds, and legislative history of the specific excise taxes.

I. OVERVIEW OF FEDERAL EXCISE TAXES

Types of Federal excise taxes

The Internal Revenue Code of 1954, as amended, provides for more than 50 different excise taxes (Code subtitles D and E). In general, these are taxes imposed on the manufacture, sale or use of a particular commodity or service. Occupational taxes and penalty taxes[1] imposed on certain other activities (e.g., certain prohibited transactions of pension plans and self-dealing transactions of private foundations) are also provided as excise taxes.

Where an excise tax applies to a manufacture, sale or use, the rate of tax is a prescribed dollar amount per commodity unit (e.g., 4 cents per gallon of gasoline), a prescribed percentage of the selling price, or a variant of these basic structures. A partial listing of commodities or services to which an excise tax applies includes certain diesel fuel, truck bodies and parts, gas guzzling automobiles, tires, inner tubes, gasoline, lubricating oils, coal, fishing equipment, bows and arrows, firearms and ammunition, telephone service, airline passenger tickets, wagers, certain chemicals, crude oil, distilled spirits, wines, beers, cigars, and cigarettes.

Where an excise tax is an occupational tax, the tax is imposed as an annual amount (e.g., $123 per year for wholesale dealing in beer). Such taxes apply to certain occupations involving wagers, alcoholic beverages, and firearms.

Excise tax revenues

In fiscal year 1980, Federal excise tax revenues (excluding the windfall profit tax) amounted to $18.37 billion. Eighty percent of this amount was collected from the six excise taxes imposed on gasoline, distilled spirits, cigarettes, airline passenger tickets, beer, and telephone service. Excise tax revenues for fiscal year 1980 including the windfall profit tax were $24.33 billion.

The relative importance of excise taxes (other than the windfall profit tax) to the Federal budget has diminished over the past two decades. In fiscal year 1960, excise tax collections accounted for 13 percent of net budget receipts. By fiscal year 1970 this figure had declined to 8 percent, and by 1980, to 4 percent. This trend has been influenced by the repeal of numerous excise taxes in 1965: constant, per-unit tax rates or reduced tax rates for many other excise taxes; and the relative growth of payroll and individual income tax revenues over the period.

State governments have relied on excise taxes more heavily than the Federal Government. In 1980, State government revenues from excise taxes on selected products (principally gasoline, tobacco products, alcoholic beverages, insurance premiums, and public utility services) and general sales amounted to $68.86 billion. These collections accounted for 32 percent of the own-source revenue of State governments.

Local governments collected $12.07 billion, or 8 percent of their own-source revenue, from excise taxes on selected products and general sales in 1980.

Transfer of revenue to trust funds

In some cases, excise tax revenues are transferred to a trust fund in order to finance specified trust fund expenditures. The general intent of such trust fund excise taxes is to place the excise tax burden on persons who are most likely to benefit from such expenditures or on persons whose activities may have necessitated the expenditures.

Trust funds currently financed (in whole or in part) by certain excise tax revenues are the Black Lung Disability Trust Fund, the Hazardous Substance Response Trust Fund, the Highway Trust Fund, the Inland Waterway Trust Fund, the Land and Water Conservation Fund, and the National Recreational Boating Safety and Facilities Improvement Fund. Present law also provides for the future funding of the Deep Seabed Revenue Sharing Trust Fund and the Post-Closure Liability Trust Fund with certain excise tax revenues. Excise tax collections funded the Airport and Airway Trust Fund from July 1, 1970, through September 30, 1980.

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III. Federal Excise Tax Revenues

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* Prepared by the Joint Committee on Taxation staff for the House Ways and Means and Senate Finance Committees.

1. The various penalty excise taxes (chapters 41-44 of the Code) make up 16 of the total excise taxes.

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II. SUMMARY OF PRESENT FEDERAL EXCISE TAXES

A. Alcohol Excise Taxes

Overview

Under present law, excise taxes are levied on the production or importation of three types of alcoholic beverages: distilled spirits, wine, and beer. Also, an occupational tax is imposed on the persons involved with the production or marketing of alcoholic beverages.

Revenues collected from the alcohol excise taxes, most of which are from the tax on distilled spirits, go into the general fund of the Treasury.

Tax rates

Tables I and II are a summary of the excise tax rates imposed on alcoholic occupational taxes.

B. Tobacco Excise Taxes

Overview

Excise taxes are imposed on cigars, cigarettes, and cigarette papers and tubes manufactured in or imported into the United States.

Revenues collected from these tobacco excise taxes, most of which are collected from the tax on small cigarettes, go into the general fund of the Treasury.

Tax rates

Table III is a summary of the excise tax rates imposed on tobacco products.

C. Highway Trust Fund Excise Taxes

Overview

Excise taxes are imposed on certain motor fuels, lubricating oil, trucks and truck trailers, truck parts, tires and tubes, tread rubber, and the use of heavy duty highway vehicles. In general, exemptions from these taxes are provided for nonhighway use.

Under present law, revenues from these highway-related excise taxes are deposited into the Highway Trust Fund through September 30, 1984, after which time these taxes are scheduled (unless otherwise extended) to decline (generally to pre-Trust Fund rates) or to expire.

Tax rates

Table IV is a summary of present highway-related excise tax rates.

D. Aviation Excise Taxes

Overview

The Airport and Airway Revenue Act of 1970 imposed or increased the aviation excise taxes

Table I – Alcohol Beverage Taxes

Item	Tax rate
Distilled spirits	$10.50 per proof gallon.
Beer	$9.00 per barrel generally.[1]
Still wines:	
Up to 14% alcohol	17 cents per wine gallon.
14 to 21 percent alcohol	67 cents per wine gallon.
21 to 24 percent alcohol[2]	$2.25 per wine gallon.
Champagne and sparkling wines	$3.40 per wine gallon.
Artificially carbonated wines	$2.40 per wine gallon.

1. $7 per barrel for certain small brewers.
2. Wines containing more than 24 percent alcohol are taxed as distilled spirits.

Table II – Alcohol Occupational Taxes

Item	Tax rate
Brewers	$110 a year: $55 for less than 500 barrels a year.
Still manufacturers	$55 a year, plus $22 per still.
Wholesale dealers:	
Liquors and wines	$255 a year.
Beer	$123 a year.
Retail dealers:	
Liquors and wines	$54 a year.
Beer	$24 a year.

Table III – Tobacco Excise Taxes

Item	Tax rate
Cigars:	
Small cigars	75 cents per thousand.
Large cigars	8½ percent of wholesale price, up to $20 per thousand.
Cigarettes:	
Small cigarettes	$4 per thousand (8 cents per pack).
Large cigarettes	$8.40 per thousand.
Cigarette papers	½ cent per 50 papers.
Cigarette tubes	1 cent per 50 tubes.

Table IV – Current Highway User Excise Taxes and Scheduled Rates of Tax under Present Law

	Rate of tax, present law	
Tax	Before Oct. 1, 1984[1]	After Sept. 30, 1984[2]
Petroleum products:		
Gasoline	4 cents/gallon	1.5 cents/gallon.
Diesel fuel	4 cents/gallon	1.5 cents/gallon.
Special motor fuels	4 cents/gallon	1.5 cents/gallon.
Lubricating oil	6 cents/gallon	6 cents/gallon.
Trucks and truck parts:		
Trucks and trailers	10 percent of manufacturer's sale price	5 percent of manufacturer's sale price.
Parts and accessories	8 percent of manufacturer's sale price	5 percent of manufacturer's sale price.
Tires, tubes and tread rubber:		
Tires for highway vehicles	9.75 cents/pound	4.875 cents/pound.
Laminated tires	1 cent/pound	1 cent/pound.
Other tires	4.875 cents/pound	4.875 cents/pound.
Inner tubes	10 cents/pound	9 cents/pound.
Tread rubber	5 cents/pound	No tax.
Use tax on heavy vehicles	$3 per 1,000 pounds per year, if more than 26,000 pounds.	No tax.

1. Revenues are deposited into the Highway Trust Fund.
2. Revenues would be deposited into the general fund of the Treasury, unless the Trust Fund is extended.

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for a 10-year trust fund period, 1970-1980. The Act also established the Airport and Airway Trust Fund for deposit of the aviation-related excise taxes. On October 1, 1980, many of the aviation excise taxes expired or were reduced, and the deposit of the aviation tax revenues into the Trust Fund was terminated at that time.

Currently, there is a 5-percent excise tax on domestic air transportation of persons, the revenues from which go into the general fund of the Treasury. There are also taxes applicable to gasoline used by noncommercial aviation and taxes on aircraft tires and tubes; these revenues currently go into the Highway Trust Fund.

Tax rates

Table V shows the present law aviation excise tax rates and the prior law Trust Fund tax rates.

E. Environmental Excise Taxes

1. Taxes for Hazardous Substance Response Trust Fund

Overview

Under present law, excise taxes are imposed on crude oil and certain chemicals, and the revenues from these taxes are deposited into the Hazardous Substance Response Trust Fund. These provisions were enacted in the Comprehensive Environmental Response, Compensation, and Liability Act of 1980.

The crude oil tax of 0.79 cent per barrel is imposed on the receipt of crude oil at a U.S. refinery, the import of crude oil and petroleum products, and the use or export of domestically produced crude oil (if the tax has not already been paid).

The tax on chemicals is imposed on the sale or use of 42 specified organic and inorganic substances if they are produced in or imported into the United States. The taxable chemicals generally are chemicals that are hazardous or chemicals the use of which may create hazardous products or wastes. The rates vary from 22 cents per ton to $4.87 per ton. (See table, following.)

The taxes generally will terminate on September 30, 1985. However, the taxes will be suspended during calendar years 1984 or 1985, if, on September 30, 1983, or 1984, respectively, the unobligated trust fund balance exceeds $900 million, and the unobligated balance on the following September 30 will exceed $500 million, even if these excise taxes are suspended for the calendar year in question. Further, the authority to collect taxes will terminate when cumulative receipts from these taxes reach $1.38 billion.

Tax rates on chemicals

The excise tax rates on certain chemicals are as shown in the following table.

Excise Tax Rates on Certain Chemicals

Chemical	Tax per ton
Acetylene	$4.87
Benzene	4.87
Butane	4.87
Butylene	4.87
Butadiene	4.87
Ethylene	4.87
Methane	3.44
Napthalene	4.87
Propylene	4.87
Toluene	4.87
Xylene	4.87
Ammonia	2.64
Antimony	4.45
Antimony trioxide	3.75
Arsenic	4.45
Arsenic trioxide	3.41
Barium sulfide	2.30
Bromine	4.45
Cadmium	4.45
Chlorine	2.70
Chromium	4.45
Chromite	1.52
Potassium dichromate	1.69
Sodium dichromate	1.87
Cobalt	4.45
Cupric sulfate	1.87
Cupric oxide	3.59
Cuprous oxide	3.97
Hydrochloric acid	.29
Hydrogen fluoride	4.23
Lead oxide	4.14
Mercury	4.45
Nickel	4.45
Phosphorus	4.45
Stannous chloride	2.85
Stannic chloride	2.12
Zinc chloride	2.22
Zinc sulfate	1.90
Potassium hydroxide	.22
Sodium hydroxide	.28
Sulfuric acid	.26
Nitric acid	.24

Table V – Aviation Excise Taxes under Present and Prior Law

Tax	Present rate[1]	Prior Trust Fund rate (July 1, 1970-Sept. 30, 1980)
Air passenger ticket tax	5 percent	8 percent.
Air freight	No tax	5 percent.
International departure tax	No tax	$3 per person.
Fuels tax for noncommercial (general) aviation:		
Gasoline	4 cents/gallon	7 cents/gallon.
Nongasoline	No tax	7 cents/gallon.
Aircraft use tax (annual)	No tax	$25 per plane, plus weight tax.[2]
Aircraft tires tax	4.875 cents/pound	5 cents/pound.
Aircraft tubes tax	10 cents/pound	10 cents/pound.

1. Under legislation reported by the House Committee on Ways and Means (H.R. 4800, H.R. Rep. No. 97-510), the following aviation excise taxes and rates would apply for the period, July 1, 1982 to December 31, 1983 (and the revenues would go into the Airport and Airway Trust Fund for the same period):

Air passenger ticket tax	5 percent.
Air freight waybill tax	5 percent.
International departure tax	$5 per person.
Fuels tax for noncommercial aviation - (gasoline and nongasoline)	12 cents/gallon.
Aircraft tires tax	4.875 cents/pound.
Aircraft tubes tax	10 cents/pound.

2. 3½ cents per pound for turbine-powered (jet) aircraft and 2 cents per pound for nonturbine-powered aircraft for each pound in excess of 2,500 pounds of "maximum certificated takeoff weight."

2. Tax for Post-Closure Liability Trust Fund

Effective after September 30, 1983, an excise tax of $2.13 per dry weight ton will be imposed on hazardous waste which is received at a qualified hazardous waste disposal facility and which will remain at the facility after its closure. These tax receipts are to be deposited into the Post-Closure Liability Trust Fund. These provisions were enacted in the Comprehensive Environmental Response, Compensation, and Liability Act of 1980.

Authority to collect the tax will be suspended for any calendar year after 1984, if the unobligated balance in the Trust Fund exceeds $200 million on the preceding September 30. Further, authority to collect the tax will terminate when cumulative receipts from the crude oil and chemical excise taxes described in the previous section reach $1.38 billion.

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F. Black Lung Trust Fund Excise Taxes

Overview

Present law imposes a manufacturers excise tax on domestically mined coal (other than lignite) which is sold or used by the producer of the coal. Amounts equal to the revenues collected from this tax are automatically appropriated to the Black Lung Disability Trust Fund.[2] The coal excise tax was enacted in the Black Lung Benefits Revenue Act of 1977, and increased in the Black Lung Benefits Revenue Act of 1981.

Tax rates

The rate of tax is the lesser of (1) $1 per ton for coal from underground mines and 50 cents per ton for coal from surface mines or (2) 4 percent of the price for which the coal is sold. Present law provides that the rate of tax is to be reduced to the pre-1982 tax rates on January 1, 1996, or, if earlier, on the first January 1 after 1981 as of which there is no balance of repayable advances made to the trust fund from the general fund of the Treasury and no unpaid interest on such advances. This reduced tax rate will be the lesser of (1) 50 cents per ton for coal from underground mines and 25 cents per ton for coal from surface mines or (2) 2 percent of the price for which the coal is sold.

G. Gas Guzzler Tax

Overview

Present law imposes an excise tax on passenger automobiles that fail to meet prescribed fuel efficiency standards. The tax was enacted as part of the Energy Tax Act of 1978, applicable to 1980 and later model year automobiles. The tax is imposed at annually increasing rates through model year 1986. (See Table VI.) Revenues from the gas guzzler tax go into the general fund of the Treasury.

The tax does not apply to certain emergency vehicles or automobiles classified as nonpassenger automobiles under rules precribed by the Secretary of Transportation. Small manufacturers of automobiles (those who produce fewer than 10,000 vehicles a year) may apply to the Secretary of Treasury for special treatment for a model year, if it is not possible for the manufacturer to meet the applicable tax-free fuel economy standards with respect to some or all of its models for that year.

Tax rates

Table VI shows the gas guzzler tax for the applicable fuel economy standards in each model year for model years 1982-1986.

Table VI – Rate of Gas Guzzler Tax by Model Year

Model year	Fuel economy rating (in miles per gallon)	Tax
1982	At least 18.5	0
	At least 17.5 but less than 18.5	$200
	At least 16.5 but less than 17.5	350
	At least 15.5 but less than 16.5	450
	At least 14.5 but less than 15.5	600
	At least 13.5 but less than 14.5	750
	At least 12.5 but less than 13.5	950
	Less than 12.5	1,200
1983	At least 19	0
	At least 18 but less than 19	350
	At least 17 but less than 18	550
	At least 16 but less than 17	650
	At least 15 but less than 16	800
	At least 14 but less than 15	1,000
	At least 13 but less than 14	1,250
	Less than 13	1,550
1984	At least 19.5	0
	At least 18.5 but less than 19.5	450
	At least 17.5 but less than 18.5	600
	At least 16.5 but less than 17.5	750
	At least 15.5 but less than 16.5	950
	At least 14.5 but less than 15.5	1,150
	At least 13.5 but less than 14.5	1,450
	At least 12.5 but less than 13.5	1,750
	Less than 12.5	2,150
1985	At least 21	0
	At least 20 but less than 21	500
	At least 19 but less than 20	600
	At least 18 but less than 19	800
	At least 17 but less than 18	1,000
	At least 16 but less than 17	1,200
	At least 15 but less than 16	1,500
	At least 14 but less than 15	1,800
	At least 13 but less than 14	2,200
	Less than 13	2,650
1986 and thereafter	At least 22.5	0
	At least 21.5 but less than 22.5	500
	At least 20.5 but less than 21.5	650
	At least 19.5 but less than 20.5	850
	At least 18.5 but less than 19.5	1,050
	At least 17.5 but less than 18.5	1,300
	At least 16.5 but less than 17.5	1,500
	At least 15.5 but less than 16.5	1,850
	At least 14.5 but less than 15.5	2,250
	At least 13.5 but less than 14.5	2,700
	At least 12.5 but less than 13.5	3,200
	Less than 12.5	3,850

H. Crude Oil Windfall Profit Tax

Overview

The windfall profit tax is a temporary excise tax on the removal of domestically produced taxable crude oil from the premises on which it was produced. All domestically produced taxable crude oil is classified in one of three tax tiers. The method of determining the tax is essentially the same for all tiers: the tax is equal to the taxable windfall profit multiplied by the applicable tax rate. The taxable windfall profit is generally equal to the selling price of the oil minus an adjusted price and an adjustment for State severance taxes. The windfall profit on any barrel of crude oil cannot, however; exceed 90 percent of the net in-

2. Misuse of a black lung benefit trust due to self-dealing (sec. 4951), expenditures for an improper purpose (sec. 4952) or excessive contributions to a trust (sec. 4953) by the producer triggers certain penalty excise taxes. Amounts equal to the revenue collected under these penalty taxes, which historically have been very small, are also automatically appropriated to the Black Lung Disability Trust Fund.

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come attributable to that barrel. The applicable tax rate differs among the various tiers, as does the adjusted base price. All base prices are adjusted for inflation. Certain kinds of producers are either exempt from the tax, or are eligible for reduced rates of tax on all or part of their production. The tax was enacted in the Crude Oil Windfall Tax Act of 1980.

Oil subject to tax and rates of tax

Tier one oil generally is all oil which whould have been lower or upper tier oil had previous price controls been continued, and any other oil not included in tiers two or three. Tier two oil is all oil which qualifies as stripper oil or which is attributable to production from a Petroleum Reserve.[3] Tier three oil is newly discovered oil, heavy oil, and incremental tertiary oil.

The tax rate applied to the windfall profit is 70 percent for tier one oil, 60 percent for tier two oil, and 30 percent for tier three oil. Newly discovered oil is subject to a reduced windfall profit rate. This rate which is currently 27.5%, will be reduced to 15 percent by 1986. Independent producers are allowed reduced rates on up to 1,000 barrels a day of their combined production of tier one and tier two oil from working interests. For tier one oil, the reduced rate is 50 percent, and for tier two oil the reduced rate is 30 percent.

Exemptions. – State and local governments, certain qualifying charitable medical facilities, educational institutions, and certain qualifying child care facilities, and Indian tribes and Indians over whom the United States exercises trust responsibilities are exempt from the tax. There also are exemptions for new oil produced in most of Alaska, for front-end tertiary oil, for independent stripper oil, and for a certain amount of royalty owners' production.

Phaseout of tax. — The windfall profit tax phases out over a 33-month period beginning after December 31, 1987, or when cumulative revenues raised by the tax reach $227.3 billion, whichever is later. However, the phaseout will begin no later than January, 1991.

I. Inland Waterways Fuel Tax

Overview

Present law imposes a retailers excise tax on diesel and other liquid fuels used by commercial cargo vessels on 26 specified inland or intracoastal waterways of the United States. Included among the 26 waterways are the Mississippi River upstream from Baton Rouge, the Mississippi's tributaries, and the Gulf and Atlantic Intracoastal Waterways. The revenues from this tax are deposited into the Inland Waterways Trust Fund. The tax was enacted in the Inland Waterways Revenue Act of 1978.

The tax does not apply to fuel used by deep-draft ocean-going vessels, recreational vessels, or noncargo vessels such as passenger vessels and fishing boats. In addition, fuel used by tugs in moving LASH and SEABEE ocean-going barges carrying international cargoes is exempt.

Tax rates

The present tax rate is 6 cents per gallon. That rate was first effective on October 1, 1981. On October 1, 1983, the rate is scheduled to increase to 8 cents per gallon. On October 1, 1985, the tax will increase to 10 cents per gallon.

J. Land and Water Conservation Fund Taxes; National Recreational Boating Safety and Facilities Improvement Fund

1. Land and Water Conservation Fund

Present law provides for the transfer of certain tax and other government receipts to the Land and Water Conservation Fund. There are no separate taxes imposed specifically for this purpose. The amounts transferred to the fund are:

(1) An amount equal to the 4-cents-per-gallon tax on gasoline and special fuels derived from such fuels used in motorboats (except for certain amounts transferred to the National Recreational Boating Safety and Facilities Improvement Fund, described below, for fiscal years 1981-1983);[4]

(2) Generally, proceeds received from any disposal of surplus real property and related personal property under the Federal Property and Administrative Services Act of 1949, as amended;

(3) Certain miscellaneous receipts under the Outer Continental Shelf Lands Act; and

(4) Revenues from Federal recreation fee collections (since January 1, 1981).

2. National Recreational Boating Safety and Facilities Improvement Fund (Boating Safety Fund)

The Secretary of the Treasury is authorized to pay into the Boating Safety Fund amounts equivalent to the motorboat fuel taxes on gasoline and special motor fuels (4 cents per gallon) received on or after October 1, 1980, and before October 1, 1983. The aggregate amount transferred to the Fund during any fiscal year is not to exceed $20 million, and no amount is to be transferred if such transfer would result in increasing the amount in the Fund to a sum in excess of $20 million. Any amount received in the Highway Trust Fund which is attributable to motorboat fuel taxes and which is not transferred from the Highway Trust Fund under these provisions is to be transferred into the Land and Water Conservation Fund provided for in Title I of the Land and Water Conservation Fund Act of 1965.

K. Sporting Goods and Firearms Excise Taxes

Overview

1. Excise taxes on sporting goods and regular firearms

Under present law, there are excise taxes imposed on the sale by a manufacturer, producer, or importer of certain fishing equipment, bows and arrows, pistols or revolvers and other regular firearms, and ammunition (shells and cartridges). Revenues attributable to these taxes are distributed in grant programs to States for certain fish and wildlife restoration and development projects.

Tax rates

Table VII is a summary of the excise tax rates on sporting goods and regular firearms.

Table VII – Excise Taxes on Sporting Goods and Regular Firearms

Item	Tax rate
Fishing equipment (rods, creels, reels, and artificial lures, bait and flies)	10 percent.
Bows and arrows (and accessories)	11 percent.
Pistols and revolvers	10 percent.
Firearms (other than pistols and revolvers)	11 percent.
Ammunition (shells and cartridges)	11 percent

3. The reference continued in the Crude Oil Windfall Profit Tax Act of 1980 should have been to a "Naval" Petroleum Reserve. This reference is proposed to be corrected in the Technical Corrections Act of 1982 (H.R. 6056), which has been ordered reported by the House Committee on Ways and Means.

4. See also summary of the excise taxes on gasoline and special fuels included in section C. on the Highway Trust Fund Excise Taxes.

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2. Excise taxes on non-regular firearms

Overview

There are also special excise taxes imposed to regulate machine guns, destructive devices (e.g., bombs, grenades, mines, etc.) and certain other firearms (e.g., shotguns or rifles under a certain length). These consist of occupational taxes (annually), transfer taxes, and a "making" (producing) tax.

Tax rates

Table VIII is a summary of excise taxes on non-regular firearms.

Table VIII – Excise Taxes on Non-Regular Firearms

Item	Tax rate
Occupational taxes:[1]	
Importers	$500 per year
Manufacturers	$500 per year
Dealers	$200 per year
Transfer taxes:	
Generally	$200 per transfer
Certain concealable weapons (sec. 5845(e))	$5 per transfer
Making tax	$200 per firearm

1. An importer, manufacturer, or dealer in certain concealable weapons only are taxed (under sec. 5845(e)) as follows: $25 per year per place of business for importers and manufacturers; and $10 per year per place of business for dealers.

L. Communications (Telephone) Excise Tax

Present law imposes a 1-percent excise tax on amounts paid for local telephone service, toll telephone service and teletypewriter exchange service. Revenues from the tax go into the general fund of the Treasury.

Exemptions from the tax are provided for communications services furnished to news services (except local telephone service to news services is not exempt), international organizations, the American National Red Cross, servicemen in combat zones, nonprofit hospitals and educational organizations , and State and local governments. Other exemptions include amounts paid for installation charges and for certain calls from coin-operated telephones.

This excise tax is scheduled to terminate, effective with respect to amounts paid pursuant to bills first rendered on or after January 1, 1985.

M. Wagering Excise Taxes[5]

Under the present law, a two-percent excise tax is imposed on the amount of certain wagers. For this purpose, a wager means (1) a wager placed with a person who is in the business of accepting wagers on the outcome of a sporting event or contest, (2) a wager with respect to a sporting event or contest placed in a wagering pool conducted for profit, and (3) a wager placed in a lottery conducted for profit (including the numbers and similar types of wagering). However, this excise tax is not imposed on (1) wagers placed with a parimutuel wagering enterprise licensed under State law, (2) wagers placed in coin-operated gaming devices, such as slot machines, and (3) State-conducted wagering, such as sweepstakes and lotteries. Under present law, the two-percent excise tax is imposed on so-called off-track betting authorized by State law.

In addition, an occupational tax of $500 per year is imposed on each person who is liable for the two-percent excise tax on wagers and on each person who is engaged in receiving wagers for or on behalf of such person.

N. Miscellaneous Excise Taxes

Overview

There are several miscellaneous excise taxes under present law, including penalty excises on certain transactions or activities of certain tax-exempt organizations or other trusts, an excise tax on net investment income of private foundations, a deep seabed excise tax on certain minerals, and an excise tax on foreign insurance policies.

Specific miscellaneous excise taxes

1. Penalty excise taxes. – A number of penalty excise taxes are imposed on certain organizations or trusts if they engage in certain transactions or activities, or if they fail to take particular required actions. These excise tax sanctions (at varying rates) are imposed on certain lobbying activities of public charities, certain private foundation activities, and on black lung benefit trusts, qualified pension, etc. plans, and real estate investment trusts. Revenues from these penalty excise taxes go into the general fund of the Treasury.

2. Excise tax on private foundation net investment income. – There is a 2-percent excise tax imposed on a private foundation's net investment income. A foreign organization which is a private foundation is subject to a 4-percent excise tax on gross investment income derived from sources within the United States. Revenues from this tax go into the general fund of the Treasury.

3. Deep seabed excise tax. – An excise tax is imposed on the removal from the deep seabed of certain hard mineral resources pursuant to a deep seabed permit issued under the Deep Seabed Hard Mineral Resources Act of 1980. Hard mineral resources are mineral nodules lying on or just below the surface of the deep seabeds, which contain one or more specified minerals (manganese, nickel, cobalt, or copper).

The tax is equal to 3.25 percent of 20 percent (or 0.65 percent) of the fair market value of the commercially recoverable minerals removed. Revenues will go into the Deep Seabed Revenue Sharing Trust Fund. (No revenues are currently expected to be received prior to 1988.)

This excise tax will terminate on the earlier of the date on which an international deep seabed treaty takes effect with respect to the United States, or 10 years after the date of enactment of the Tax Act (June 28, 1980).

4. Excise tax on foreign insurance policies. – An excise tax is imposed on certain policies issued by any foreign insurer or reinsurer to or for a U.S. corporation, partnership or individual with respect to risks wholly or partly within the United States, or to or for any foreign personel engaged in business within the United States with respect to risks within the United States.

The tax is imposed at the rate of: (1) 4 cents per dollar of premiums paid on the policy of casualty insurance or the indemnity bond; (2) 1 cent per dollar of premiums paid on a policy of life, sickness, or accident insurance, or annuity contract (unless the insurer is subject to tax under Code section 819); and (3) 1 cent per dollar of premiums paid on the policy of reinsurance covering any of the contracts taxable under (1) or (2) above. Revenues from the tax are deposited in the general fund of the Treasury.

5. There is a Senate amendment to H.R. 4717, currently pending in a House-Senate conference committee, which would reduce the two-percent tax to 0.25 percent for wagers authorized by State law. Also, the $500 occupational tax would be reduced to $50 in the case of persons authorized by State and local law to accept wagers in a wagering business authorized by State law. Otherwise, the present two-percent and $500 taxes would continue to apply.

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III. FEDERAL EXCISE TAX REVENUES

Budget Receipts From Federal Excise Taxes for Selected Years, By Fund and By Tax, Fiscal Years 1970-1983

(Millions of dollars)

	Actual			Estimated		
Excise tax	1970	1975	1980	1981	1982	1983
	Federal (General) Funds					
Alcohol taxes:						
Distilled spirits	3,445	3,830	3,919	3,819	4,182	4,080
Beer	1,076	1,305	1,545	1,604	1,672	1,644
Rectification tax[1]	25	22	8	([2])	—	—
Wines	180	172	211	244	243	245
Liquor occupational taxes	20	22	21	21	21	21
Refunds	–136	–113	–104	–82	–84	–87
Total alcohol taxes	4,610	5,238	5,601	5,606	6,034	5,903
Tobacco taxes:						
Cigarettes	2,036	2,261	2,403	2,539	2,694	2,622
Cigars	57	51	40	40	40	40
Cigarette papers and tubes	1	1	1	1	1	1
Other	1	1	3	3	3	3
Refunds	–1	–3	–4	–3	–3	–3
Total tobacco taxes	2,093	2,312	2,443	2,581	2,735	2,663
Manufacturers (non-trust fund) excise taxes:						
Gasoline	28	29	31	32	30	30
Passenger automobiles[3]	1,753	—	—	—	—	—
Firearms, shells, and cartridges	33	51	75	97	90	99
Fishing rods, creels, etc.	14	22	34	23	37	40
Pistols and revolvers	7	11	22	27	27	30
Bows and arrows	—	4	6	7	7	7
Gas guzzler tax	—	—	2	([4])	1	1
Windfall profit tax	—	—	5,959	23,220	24,196	21,275
Refunds	–6	–12	–6	–18	–98	–48
Total manufacturers excise taxes	1,829	105	6,122	23,459	24,290	21,434
Miscellaneous excise taxes:						
General and toll telephone and teletype service	1,470	2,024	1,118	999	796	656
Transportation of persons	251	—	—	—	—	—
Wagering taxes, including occupational taxes	5	6	12	13	16	20
Employee pension plans	—	—	3	5	3	3
Sugar tax[4]	113	104	—	—	—	—
Coin-operated gaming devices[5]	14	7	—	—	—	—
Interest equalization tax[6]	86	2	—	—	—	—
Tax on foundations	—	65	68	90	80	78
Foreign insurance policies	9	19	75	75	86	97
Other (including repealed taxes)	3	1	2	1	1	1
Refunds	–24	–23	–32	–75	–20	–10
Total miscellaneous excise taxes	1,926	2,204	1,246	1,108	962	845
General fund collections associated with aviation taxes[7]	—	—	—	1,180	1,265	1,458
Undistributed Federal tax deposits and unapplied collections	–106	–460	152	194	143	222
Total Federal (general) fund excise taxes	10,352	9,400	15,563	34,128	35,429	32,525

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(continued)

Budget Receipts From Federal Excise Taxes for Selected Years, By Fund and By Tax, Fiscal Years 1970-1983

(Millions of dollars)

Excise tax	Actual			Estimated		
	1970	1975	1980	1981	1982	1983
	Trust Funds					
Highway Trust Fund:						
Gasoline	3,447	4,069	4,011	4,016	3,978	3,928
Trucks, buses,[8] and trailers	700	602	912	664	847	1,184
Tires, inner tubes and tread rubber	643	797	680	644	653	662
Diesel fuel used on highways	263	402	523	561	575	613
Use tax on heavy highway vehicles	137	221	277	237	264	270
Truck parts and accessories	87	143	253	234	305	338
Lubricating oil	109	100	105	101	105	105
Refunds	–32	–146	–142	–152	–145	–143
Total Highway Trust Fund taxes	5,354	6,188	6,620	6,305	6,582	6,957
Airport and Airway Trust Fund:[7]						
Transportation of persons	—	779	1,601	—	—	—
Waybill tax	—	54	92	—	—	—
Tax on fuels	—	54	70	—	—	—
International departure tax	—	55	92	—	—	—
Aircraft use tax	—	20	21	—	—	—
Tires and innertubes taxes	—	1	1	—	—	—
Refunds	—	–1	–3	—	—	—
Total Airport and Airway Trust Fund taxes[7]	—	962	1,874	21	—	—
Black Lung Disability Insurance Trust Fund	—	—	272	237	507	612
Inland Waterways Trust Fund	—	—	—	20	58	67
Hazardous Substances Response Trust Fund	—	—	—	128	283	299
Total trust fund excise taxes	5,354	7,151	8,766	6,711	7,43	7,935
Total Excise Taxes	15,705	16,551	24,329	40,839	42,859	40,640

Note: Details may not add to totals because of rounding.

1. The rectification tax was repealed in the Trade Agreements Act of 1979.
2. $500,000 or less.
3. The excise tax on passenger automobiles was repealed in the Revenue Act of 1971.
4. The excise tax on sugar expired in 1975.
5. The tax on coin-operated gaming devices was repealed in the Revenue Act of 1978.
6. The interest equalization tax expired in 1974.
7. The aviation excise taxes going into the Airport and Airway Trust Fund (July 1, 1970 through September 30, 1980) either expired or were reduced on October 1, 1980. The revenues from the current 5-percent air passenger ticket tax now go into the general fund; and the revenues from the 4-cents a gallon tax on general aviation gasoline and taxes on aircraft tires and tubes now go into the Highway Trust Fund. (The figures for 1982 and 1983 do not include the revenue effects of proposed legislation affecting the aviation excise taxes; neither Administration proposal nor H.R. 4800 as reported by the House Committee on Ways and Means.)
8. The tax on buses was repealed in the Energy Tax Act of 1978.

Source: The Budgets of the United States Government for Fiscal Years 1972, 1977, 1982, and 1983.

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BANGLADESH:

Budget 1982-83

Extracts from the Budget Speech pronounced by Mr. A.M.A. Muhith, Minister of Finance and Planning, on 30 June 1982.

A detailed discussion of the Bangladesh tax system appears in the International Bureau of Fiscal Documentation's publication: TAXES AND INVESTMENT IN ASIA AND THE PACIFIC.

. . .

Now I would present the policy and decisions regarding fiscal measures for the coming financial year. The role of foreign aid in the development of the economy is undoubtedly very important, but for bringing about economic transformation of an economy, the overall fiscal policy of the Government is a fundamental element. For increasing the investment for productive purposes with reduced dependence on foreign aid, increased mobilisation of internal resources is necessary. But it is to be borne in mind that we have a very limited number of people having surplus income and the vast majority of the people can hardly make their both ends meet and languish in miseries.

2. The following basic principles have been adopted in formulating proposals for the fiscal measures of the Government:

- To provide relief for the poor people as far as possible from the burden of taxes.
- To help the domestic industry to expand and augment production and introduce measures in conformity with this policy.
- To bring about rationality and equity in the tax administration.
- To simplify the method of tax collection making it comprehensible to the common taxpayers.
- To reduce the area of discretion with a view to ensuring logical and rational approach thereby saving the taxpayers from avoidable harassment.
- Multiplicity of taxation points to be reduced. Customs duty and sales tax should be realised at import point, excise duty should be realised at production premises and similarly all direct taxes should be realised at one point.
- Tax policy should be geared up as a tool for accelerated mobilisation of internal resources.
- All surplus and taxable income should be brought under tax net. While there is a necessity of effective and equitable tax administration, there should be inducements for increasing the willingness on the part of the taxpayers to pay taxes.

3. For formulating a correct and balanced fiscal policy, I have received suggestions and advice from different sections of the society. Chief Martial Law Administrator, his Ministers and other advisors have also offered guidelines and suggestions. In many cases, in harmonisation of different objectives the ideal solutions could not be achieved. Formulation of a fiscal policy is not a matter of few months, it requires continuous study and exercise throughout the whole year. We have decided to utilise the newly formed Consultative Committee for Mobilisation of Internal Resources more fruitfully in future. For simplification of the principles and procedures adopted or applied in realising tax, considerable time is required. My effort was to make a beginning of the process of simplification and rationalisation and to widen the process in those areas where the work of simplification has already initiated.

4. We believe that, for changing the lot of the people, establishment of new industries and increase of industrial production side by side with increase in agricultural produces is a must. In order to simplify the process to achieve this goal, decisions have been taken for rationalisation and simplification involving major changes in customs duties. In taking these decisions, the rate of augmentation of internal resources, ability to pay tax by the people, overall need of the country, stabilisation of the price level and steady flow of commodities have been taken into account.

CUSTOMS DUTY

5. In order to eliminate the existing stagnation in the field of production of the domestic industries and to transform it into a viable, productive and income generating sector by utilising the idle capacity, the duty on many imported raw materials have been reduced quite substantially. In the cases of those commodities where domestic production is not adequate to meet the requirement of the economy, the duty rates on such imported finished goods have been adjusted reasonably. These measures, it is hoped, will protect the interest of the domestic industry on the one hand and ensure adequate availability of goods within the country on the other. I believe that the industrialist of the country will take full advantage of these facilities and make an all-out effort to augment the domestic production of these articles. The increase in production will have a favourable effect on the efficiency of the production method bringing about reduction in the cost of production and increase in profit. The policy of protecting the interest of the domestic industry has not been kept confined in the sphere of customs alone, but has also been equally applied in the field of excise and the price control. The facilities thus given are quite substantial and the nation expects that the industrialists of the country will take full advantage of this policy not only to advance their own interest but also extend the benefit to the vast masses of the country. Government shall expect from the producers of the essential commodities to fix the retail price of their products and notify those to the general public:

(1) In consideration of the fact that thermoplastic moulding compound is a raw material for a wide range of industries and extensive use thereof is capable of having a salutory effect on the economic development of the country, the duty on the item is reduced to 40% from the existing 75%. Duty on shoe and cable grade PVC however has not been changed in view of their domestic production. On the same ground duty on urea formaldehyde adhesive has been raised to 100%.

(2) In order to help domestic industry produce more at a reasonable cost, the duty on bright, medium and high carbon steel wire and wire rods have been reduced to 40% from the existing 60%. On the other hand, duty on pipes, tubes, nuts, bolts, screw, rivet, welding electrodes, etc. have been enhanced from 35% and 100% to 50% and 150% respectively.

(3) In order to protect the interest of the domestic producers, the duty on sanitary wares of iron and steel has been raised to 150% from the existing 100%.

(4) The existing duty differential between the imports of CKD and finished trucks and buses being not adequate, the duty on built-up trucks and buses has been raised to 50% from the existing 35%. However, in order to ease problems of transportation in the urban area duty on mini-buses has been reduced to 20%.

(5) In order to save the domestic industry engaged in production of pumps from the uneven competition with the imported goods, duty on pumps have been raised and unified at 50%.

(6) With a view to encouraging the domestic assemblers, duty on CKD refrigerators and deep-freezers is reduced to 75% from existing 100% and that on built-up sound recorders and reproducers has been raised to 100% keeping the duty rate on CKD imports of the same at 75%.

(7) There is a sizeable capacity within the country for production of milk and milk products which remains under-utilized because of the uneven competition with the imported goods. In order to provide advantage to the local dairy products, duty on aluminium foil and polythene film is reduced to 10% from the existing 50% and 100% on certain conditions. Further, duty on imported liquid and semi-liquid milk is raised to 20% from the existing 10% and that on cheese and butter to 40% from the existing 25%.

(8) For the benefit of the domestic film industry, the duty on the imported exposed cinematographic film has been raised and fixed at Taka 5.00 per metre.

(9) With the commencement of domestic production of the items, duty on acetyle salicylic acid B.P. and piperazine citrate has been raised to 50% from the existing 10%. This will be applicable to the imports of pharmaceutical industries also.

(10) To help attain self-sufficiency in its domestic production the duty on mosquito coil and napthalene ball has been raised to 50% and 75%, respectively.

(11) It is in the interest of the economy of the country to take necessary measures to protect the interest of the domestic textile industry. In order to achieve this objective, duty on wool and synthetic tops and nylon chips has been reduced to 20% from the existing 75%, on the other hand duty on imported cotton yarn has been

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reduced to an unified rate of 20% from the existing 25% and 35%. In order to help domestic spinning industry to reduce its cost of production, the total incidence of duty and sales tax on raw cotton has been reduced and fixed at 10% customs duty with no sales tax.

(12) Measures have also been taken to help the ailing cycle industry of the country by way of increasing the duty on imported built-up bicycle to 75% from the existing 50% and rationalising the duty on the components and parts of bicycle by fixing it at 20% in lieu of the existing 15% and 50%. Duty on writing and duplicating ink has also been enhanced to 155%.

(13) In order to boost up the production of tar obtained from petroleum it is necessary to refix the duty on the imported coal tar. As such the duty on the later has been raised to 50% from the existing 25%.

(14) Encouragement of assembling of cassettes domestically is necessary for saving foreign exchange spent on account of import of cassettes. To help this industry, duty on parts and components of cassettes has been reduced and fixed at 50%.

(15) In order to encourage domestic production of pesticide and insecticide in a greater scale, duty on the raw and packing materials of the industry engaged in its production has been fully exempted in case of raw materials and reduced to 20% in case of packing materials.

(16) Pulp is the basic raw material of the domestic paper mills, for safeguarding the interest of which, duty on the item is reduced to 10% from the existing 15%. Similarly, the duty on the imported finished spectacle frames has been enhanced to 100% from the existing 75%.

(17) With a view to protecting the interest of the steel mill, the customs duty on imported billets has been raised to 50% from the existing 40%.

(18) Duty on copra, which is a raw material for production of coconut oil is reduced to 10% from the existing 40%.

(19) Duty on finished medicines and allied goods has been raised to 20% from the existing 10% in view of their local production.

6. It is the declared policy of the Government to simplify, rationalise and modernise the tariff structure. In order to achieve this objective, a number of steps have been taken in this year's budget. I believe that these steps would go a long way in alleviating many anomalies, disputes, misunderstandings paving the way for introduction of a smooth, simple and understandable customs administration:

(1) At present there are more than 23 rates of customs duties which have now been reduced to 12. There, however, remain a few exceptions which could not be removed because of revenue consideration or protection to domestic industry. In due course, further simplification will be considered.

(2) Vegetable oils excepting palm karnel, coconut and crude degummed soyabean oil which attracted the duty rate of 25% have now been subjected to duty @ 40%. Duty on coconut and crude degummed soyabeen oil has been reduced to 20% while that on palm karnel oil has been enhanced to 50%. Duty on Horlics and Ovaltine has been rationalised to the rate of 40% from the existing 5%.

(3) Medical, surgery and hospital equipments attracting duty rates of 10%, 15% and 25% have now been subjected to a unified duty rate of 20%.

(4) Fabrics in which the total content of cotton is 85% or more at present attract different rates of duties of 30%, 75%, 125% and 150% depending on various factors. These rates have now been unified at 75%.

(5) The ship-builders in the nationalised sector enjoy a conditional duty free facility which has been abolished bringing them at par with the ship-builders in the private sector. Now they will have to pay the duty on their imports and on production of proof of the use of their imported materials in the building of ship, shall get refund of duty paid in excess of 20%. M.S. plate, however, shall not be entitled to this refund facility.

(6) The duty on man-made fibre has been rationalised and up-dated at Taka 2.20 per kg. from the existing Tk. 1.00 per lb and 150%.

(7) Duty on essential oils and its mixtures has been made uniform at 200% from the existing 125%, 150% and 200% depending on its tariff classification.

(8) The duty rates of factory ships and trawlers have been rationalised and made uniform at 2½% from existing 15% and 2½% respectively.

(9) The tariff values on coloured and black and white television and refrigerator and deep-freezer have been enhanced and up-dated at Taka 500.00, Taka 200.00 per inch and Taka 500.00 per cft. respectively.

(10) The duty on scraps of iron and steel, rerollable scraps and ship for breaking purpose have been enhanced and unified at 20% from the existing 12½% and 17½%.

(11) The conversion rate between the foreign currency and Bangladesh currency often gives rise to the necessity for raising demand subsequent to the clearance of the goods because of the non-availability of day-to-day exchange rate by the customs authority. With a view to removing this nagging problem, necessary amendment in law has been made enabling the customs authority to accept the average monthly exchange rate of the preceding month. Certain other amendments in law have also been made to rationalise and modernise certain provisions of law.

(12) From now on, in case of the machinery imported for the initial installation of an industry, the transaction value will be accepted by the customs authority for assessment purpose. It is hoped that this measure will remove lot of dispute and misunderstanding.

7. The wide imbalance in the export earnings and import bills of the country is one of the biggest problems faced by us. All possible efforts should be made to reduce the import by increasing the industrial capacity to produce more within the country, by restricting the import of non-essential articles. The steps that have been taken in this regard are aimed at achieving this objective. The efforts that have been initiated in the Export Policy have been stated in details by the Minister of Commerce and Industry a few days back. I would like to mention only about three steps taken in the budget to boost up the export. Total exemption of duty has been accorded on the exports of tea and raw jute. In order to give a boost to the export of finished leather, a system has been devised under which the exporter of the finished leather who has been able to raise his export by 20% over that of the previous year will be entitled to export wet blue leather also at a special concessionary rate of 2½%. Further, with a view to augmenting export of frozen fish, duty on imported factory ships has been reduced to 2½% from the existing 15%.

8. While the need for mobilization of domestic resources remains paramount, duty on many non-essential goods are comparatively quite low. In consideration of greater national need for mobilization of domestic resources, duties on these articles have been raised:

(1) Duty on petrol motor-car having engine capacity of over 850 c.c. but not over 1000 c.c. has been raised to 100% from 75% duty on petrol motor-cars up to 1300 c.c. has been raised to 150% from existing 125%. Motor-cars having engine capacity over 1300 c.c. will now be dutied @ 300%. The luxury cars having air-conditioners and other luxury gadgets will continue to attract higher rates of duty.

(2) For the benefit of thousands of villagers producing betelnuts, the duty on this item has been increased to Taka 20.00 per kg. from the existing Taka 11.00 per kg. The duty on plants and parts of trees required for pharmacy has been fixed at 10% withdrawing the existing full exemption. Duties on fishing hooks, grease and lubricating oil have also been enhanced respectively from existing 30% and 20% to 100% and 40%. In view of the ban imposed on the import of dry-cell batteries, the tariff value fixed earlier on the item has been withdrawn.

(3) Duty on cigarette paper has been raised to 150% from the existing 100% but at the same time the sales tax on the item has been reduced to 10% from the existing 20%.

(4) Last year in order to meet the deficit in the budget, development surcharge @ 1% was imposed on all dutiable imports. This year also similar necessity exists for which this rate of surcharge has been enhanced to 2%. This measure is likely to yield an additional revenue of Taka 30 crores.

9. The fiscal measures which have been discussed above are likely to yield a gross revenue of Taka 62.83 crores and would entail a revenue loss of Taka 21.8 crores giving net revenue gain of Taka 41.75 crores in customs duty.

SALES TAX

10. Sales tax law has been completely recast. The new Ordinance will invest the Customs Department with the administration of sales tax in its entirety. From the coming financial year, sales tax will exclusively be levied on the imported goods and there will be only two

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rates of sales tax, i.e. 20% and 10%. In the present budget substantial exemptions and reductions of sales tax have been accorded as a result of which the revenue loss of the exchequer on this account will be Taka 36 crores. On the other hand, sales tax have been imposed on certain items of raw materials which enjoy exemption from excise duty. Besides, as a consequence of the decisions taken in respect of customs duty, the collection of sales tax on certain items will also increase. The total gain in sales tax as a result of the aforesaid measures has been estimated at Taka 44 crores bringing the net gain on this account at Taka 8 crores.

EXCISE DUTY

11. I would like to draw your attention to a few of the steps that we have taken with regard to excise duties. A number of changes has been made in the rates of duties and their underlying principles are as follows:

In the first place, to stop harassment of small traders and producers excise duty has been withdrawn from autogarages, wooden furniture, services rendered by decorators and caterers, tanned leather and leather products (except footwear), syrups, squashes and fruit juices, banking services excepting cheques, bottling of unscented cocoanut oil, ultramarine blue and dyes. To encourage cottage industries the range of excise duty exemption has been widened. The ceiling of capital has been raised from Taka 10,000 to Taka 50,000 for such cottage industries. For purposes of income tax assessment the same definition will be applicable.

Secondly, for administrative efficiency excise duty has been withdrawn in some cases, and in some other cases, duties have been merged. For example, duty has been withdrawn on cellophane, plastic and resin materials excepting four items. These four items are: PVC pipes, Rexin cloth, insulation boards and telephone sets on which duty @ 30% and ad val. has been retained. In case of rubber products duty has been retained @ 30% ad val. on three items rubber belt, pipes and foam, and duty has been withdrawn from the rest of the items. On glass and glasswares three rates have been fixed: 30% for glass sheet, 5% for amber glass bottles and 10% for others by replacing the different rates of duty (5%, 10%, 20% and 30%). The existing exemptions will, however, continue. The other aim of allowing such concessions is to help boosting of production. Duty rates on metal containers used in production process have been merged and reduced to 10% ad val.

Thirdly, duty has been exempted or reduced on some items for the convenience of the people, specially the lower income group. Duty on paper has been reduced from 15% to 10% ad val. and on motor-cycle from 7½% to 5% ad val. Duty is also withdrawn from bitumen emulsion and Alkatra made out of local bitumen.

Fourthly, after complete abolition of sales tax on local produced or manufactured goods, arrangements have been made to maintain Government revenue through excise duties. Cutlery, stainless steel crockeries, steel pine, G.I. pipe, asbestos pipe, sheet and other asbestos products, oxygen and other gases, sodium silicate and glycerine will now be subjected only to excise duty at the rate of 20% ad val. The other four items, viz., mechanically propelled four-wheeled vehicles, tarpaulin, steel billets and steel ingots will be subjected to excise duty at the rate of 10% ad valorem.

Fifthly, as I have aready stated all sales tax will be collected at the import stage. Some raw materials are now exempted from payment of sales tax. With the change in this condition excise duty has been reduced to lighten the burden of tax:

(a) Excise duty on vanaspati ghee and edible oil payable respectively, at the rate of Taka 50 and Taka 5 per cwt. is completely withdrawn.
(b) Duty on paints, pigments and varnishes has been reduced from 30% of the retail price to 20% of the retail price.
(c) Duty on mechanically manufactured soap has been reduced from the existing 20% and 10% to 5% of the retail price, and that on non-mechanically produced soap payable at the rates of 20% and Taka 20 per maund has been fully exempted. Duty on detergents has been reduced from 20% to 10% of the retail price, and that on jute batching emulsifier has been fixed at 5% of the retail price.
(d) Duty on electric bulbs has been reduced from Taka 12, 15 and Tk. 36 per dozen to Tk. 6, Tk. 7.80 and Tk. 18 per dozen respectively. Similarly, duty on fluorescent tubes has been reduced from Tk. 10.75, Tk. 8, Tk. 8.50 and Tk. 5.50 per tube to Tk. 5.50, Tk. 4, Tk. 4.25 and Tk. 2.725 per tube respectively.
(e) The existing duty of Tk. 9, Tk. 7.20 and Tk. 6 per dozen of primary cells and batteries has been reduced to Tk. 4.80, Tk. 3.60 and Tk. 3 per dozen respectively.
(f) Various rates of excise duty on man-made fibres and yarn have been totally withdrawn and this item has been made fully exempted from excise duty.
(g) Duty on perfumery, cosmetics and toilet preparations has been reduced from the existing 35% and 25% to 20% of the retail price, and in some cases it has been reduced from 25% to 10% of the retail price.

Sixthly, steps have been taken to simplify procedure in certain respects. For example, the duty and licence fee which used to be collected on narcotics and liquors has now been merged into duty. The excise duty and Development Surcharge on petroleum products have been merged. Duty on diesel oil, kerosene and furnace oil has been raised by five poisha per gallon. In place of the existing four rates of 2½%, 5%, 10% and 15% on hotels and restaurants, two rates of 10% and 20% have been fixed. The exemption ceiling of duty in case of hotels and restaurants has been made realistic. If the rent per room per day exceeds Tk. 50 in place of Tk. 10 and if the gross sale exceeds Tk. 50,000 per month in case of hotels and restaurants respectively, they will be assessable to duty.

12. Some steps have been taken to increase revenue:

(i) Existing excise duty of Tk. 1 per lb. on tea has been refixed at Tk. 3 per kg. Additional duty of 10% and 15% which is leviable on relatively costlier packet tea will, however, continue.
(ii) Duty-rate on sugar has been fixed at 10% ad val. in place of the existing Tk. 70 cwt.
(iii) Duty-rate on matches has been fixed at Tk. 3 in place of the existing Tk. 2 per gross.
(iv) In case of gold jewellery the capacity duty rates haves been refixed in place of–
(a) Tk. 15,000 + Tk. 1,000 for every 100 tolas or fraction thereof at Tk. 24,000 + Tk. 1,000.
(b) Tk. 15,000 at Tk. 24,000.
(c) Tk. 10,000 at Tk. 15,000.
(d) Tk. 6,000 at Tk. 9,000.
(e) Tk. 3,000 at Tk. 4,500.
(f) Tk. 1,000 at Tk. 1,500.
(g) Tk. 500 at Tk. 700.

Similarly, in case of bullion dealers the rates have been refixed in place of:

(a) Tk. 15,000 + Tk. 2,000 at Tk. 25,000 + Tk. 2,000.
(b) T. 15,000 at Tk. 22,500.
(c) Tk. 10,000 at Tk. 15,000.
(d) Tk. 6,000 at Tk. 9,000.
(e) Tk. 4,000 at Tk. 6,000.
(f) Tk. 2,000 at Tk. 3,000.

(v) At present natural gas is used in a few cities and industries. Gas users are getting a lot of advantages in respect of price in comparison to those to whom gas is not available. As such duty on gas has been raised from Tk. 14.00 to Tk. 17.50 only per one thousand cft., and for power generation and fertilizer production the rate has been refixed at Tk. 9.00 in place of Tk. 6.00 per 1000 cft.
(vi) Pharmaceutical industry has reached a stage where the question of its remaining untaxed no longer seems justified. Excise duty has been imposed on allopathic medicine (except vaccines and contraceptives) at the rate of 5% on the retail price.
(vii) Duty has been imposed on insecticide, pesticide, germicide and antiseptic other than those used for agricultural purposes at the rate of 5% of the retail price.
(viii) Glucose, dextrose and starch are being produced in the country on a large scale and these industries have become quite profitable. It has therefore been decided to impose excise duty at the rate of 10% ad val. on these products.
(ix) Welding electrodes used mainly in industries, are being produced in the country on quite a large scale and its remaining out of tax net does not appear to be reasonable. Excise duty at the rate of 20% ad val. has therefore been imposed on welding electrodes.
(x) Chinawares and porcelainwares are paying excise duty at the rate of 30% ad val. at present. But glazed claywares, similar in appearance and use to chinaware and porcelainware, are offering a good enough competition to China and porcelain products. But there is not duty on this item. As such, excise duty at the rate of 30% ad val. is imposed on glazed potteries.
(xi) A regulatory duty on comparatively higher quality cigarettes is imposed at the rate of 5% of the retail price if such price exceeds Taka two and poisah eighty per packet of ten sticks of cigarettes.

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(xii) Duty on foreign liquor, country liquor, mritasanjibani sura, ganja, bhang and opium has been enhanced slightly over the present rate. The rate of duty on rectified spirit has also been enhanced slightly. But the concessionary duty rate on rectified spirit, used in homeopathic and allopathic medicines, has been retained. At the same time, steps have been taken to stop the tendency on large-scale misuse of this concessionary rate.

13. Sales tax has been exempted fully on the following items, viz.:
(a) Brass and copper sheet and zinc sheet, (b) table lamp, (c) wall-clock and time piece, (d) musical instruments, (e) chocolates, toffees and lozenges, (f) sweet-meats, (g) slacked and unslacked lime, (h) brass and copper handicrafts, (i) industrial chemicals, (j) ice-cream, (k) decorated brass and copper light fittings, (l) tea trolleys, (m) torch-light, torch-light case, and hook rings, (n) printing ink, (o) R.C.C. pipe, (p) conduit pipe, (q) electrical fittings.

14. There is some talk on entertainment tax. It is said that the arrangement is really old-fashioned and there is no correlation between the duty-rates and reality. It is possible to fix entertainment tax on the capacity of cinema halls. We want to have discussions with the cinema hall owners and the film exhibitors. Under these circumstances, no change in the rates of duty on entertainments has been considered.

15. An amount of nearly Tk. 22 crores will be collected less on account of exemption and reduction in the rates of excise duty. Of course, for new impositions and few enhancements of the rates of duty, nearly Tk. 45 crores will be collected. As a result, there will be a net increase in revenue of Taka twenty three crores approximately.

INCOME-TAX AND OTHER DIRECT TAXES

16. At present there are only two lakh eighty thousand assessees in our country. The direct taxes constitute only a small portion of the total revenue earnings. The corporate sector contributes nearly 75% of the income-tax.

The income-tax laws are complex and the Act itself is outdated. The procedure of determining income is complicated. The system of tax collection is not particularly streamlined. The improvement of the system will be both difficult and time consuming:

- We hope to re-write the Act in the near future and public opinion in this regard will be solicited.
- Last year, attempts were made to bring new assessees into the tax-fold through the introduction of self-assessment scheme and reduction in the rate of tax.
- The same effort will continue this year also. Proposals have been taken for the simplification of the method of calculation of tax.
- A number of measures have also been taken to encourage investment.
- The Estate Duty Act has been repealed.
- The responsibility of collection of income-tax, gift-tax and wealth-tax will be entrusted to the same authority.
- Stamp duty leviable on the transactions in the shares market has been exempted.
- Rates or scope of gift-tax, wealth-tax and urban immovable property tax have been substantially reduced.
- Efforts to merge urban immovable property tax with other prevalent rates will be taken up in the near future.

17. In order to reduce the burden of tax the following measures have been adopted:

(1) In the context of inflationary situation, the maximum exemption limit of income seems to be low. It is, therefore, decided to enhance the present limit from Tk. 15,000 to Tk. 20,000 to alleviate the hardship of the lower income group.
(2) In order to reduce the burden of tax the personal taxation rates have been substantially scaled down. As a result, an individual having income of Tk. 50,000 will now pay tax of Tk. 2,750 only as against Tk. 4,000 payable under the existing rate provided the benefit of maximum investment is allowed in both the cases. But without any investment allowance the tax on the same income will be Tk. 8,500 and Tk. 6,750 under the old rates and new rates respectively. The tax rates in the case of registered firms have also been reduced. The maximum rebate of tax on export sales has been enhanced.
(3) In order to remove the difficulties of the small investors, the restrictive provision regarding the initial allowance of Tk. 5,000 and 60% on the balance of investment has been withdrawn.
(4) Considering the increase in the cost of conveyance, the rates of conveyance allowance in the case of salaried persons have been raised from Tk. 1,800 to Th. 2,400, Tk. 2,400 to Tk. 3,200 and Tk. 4,200 to Tk. 6,000.
(5) The rate of tax on capital gains arising from the sale of assets after 2 years but within 5 years of acquisition and after five years of acquisition have been reduced from the existing 35% and 30% to 25% and 20% respectively. Besides, the rate of tax on capital gains arising after 15 years of acquisition of the asset has been fixed at 15%. It has also been decided to withdraw the provision of exempting of capital gains from sale of assets acquired before the 14th August 1947.
(6) Gratuity has been totally exempted from the payment of tax in line with the exemptions already granted to pensions.
(7) A new provision has been made in the Act for exemption on payments made to Zakat Fund and contributions made to the Charitable Fund established under the Zakat Fund Ordinance, 1982.
(8) By the Finance Act, 1980, a provision was made for obtaining licence on payment of Tk. 100 by all persons carrying on business, profession or vocation from a premise, whether their income is below or above the exemption limit. This provision has been withdrawn for the benefit of traders and professionals with income below the exemption limit.

18. The following measures have been taken with a view to facilitate investment:
(1) In the interest of the country's industrialisation the capital gains arising out of sale proceeds of land and buildings have been exempted from payment of tax provided these are invested in the setting up of new industrial undertakings.
(2) Royalty and technical know-how fee have also been exempted from payment of tax in order to encourage industrialisation.
(3) The conditions required to be fulfilled for the admissibility of bonus as an expenditure have been waived in the case of festival bonus.
(4) The provision of accelerated depreciation introduced by the Finance Ordinance, 1977 which expires on the 30th June, 1982 is extended for another five years in the interest of industrialisation.
(5) For the purpose of exemption of cottage industry the maximum investment limit has been raised from Tk. 10,000 to Tk. 50,000.

19. The measures taken for the rationalisation and simplification of assessment procedure are as follows:
(1) In order to simplify the assessment procedure earned income relief, children education allowance and personal allowance have been withdrawn. However, the consequential loss has been made good through adequate reduction in the tax rates.
(2) To widen the scope of self-assessment, the present maximum limit of Tk. 25,000 has been raised to Tk. 50,000. The salaried directors of limited companies have also been made eligible for self-assessment.
(3) the provision of presumptive assessment introduced by the Finance Act, 1980 has failed to achieve the desired result. It has also become redundant after the reintroduction of self-assessment scheme. Hence, the provision of presumptive assessment has been withdrawn.
(4) In order to alleviate the hardship of the lower income group the present limit of income for advance payment of tax has been raised from Tk. 25,000 to Tk. 50,000.
(5) In order to exclude the lower income group from the requirement of filing a statement of assets and liabilities along with the return of income, the present limit of income for this purpose has been raised from Tk. 25,000 to Tk. 50,000.
(6) The rate of interest payable by the Government on the excess payment of advance tax has been raised from 10% to 13½% per annum.
(7) In view of the rising prices of real estate the present requirement for obtaining clearance certificate where sale value exceeds Tk. 50,000 has been raised to Tk. 100,000.
(8) The restrictive provision regarding the date of commencement of construction for the purpose of exemption of newly constructed residential building has been withdrawn.
(9) In order to simplify the calculation of annual value of self-occupied property, a suitable amendment has been made in the Act.
(10) In future income from bus, truck and launch will be computed on the basis of capacity of each transport. This will remove a lot of misunderstanding.
(11) A new system will be evolved for realisation of taxes from the travel agencies.

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Airlines having business transaction with the travel agencies will be made responsible for deduction of tax at source at the time of making payments to such agencies.

(12) The Income-tax Appellate Tribunal will hear appeals in the concerned districts where necessary.

GIFT TAX

20. As regards gift tax, the following measures have been taken:

(1) In order to rationalise the present provisions of tax free gifts to father, mother, real sons and daughters up to Tk. 300,000 and to spouse up to Tk. 100,000 it has been decided to merge these two exemptions into one. The maximum limit has been fixed at Tk. 400,000.

(2) Considering the rising cost of living, it has been decided to raise the exemption limit of gift from Tk. 20,000 to Tk. 25,000 per year.

(3) In order to simplify the existing rate structure, it has been decided to reduce the number of slabs from 6 to 4. The rate of tax on each slab has also been modified.

WEALTH TAX

21. The following measures have been taken with a view to reducing the burden of wealth-tax:

(1) The present exemption limit in the case of self-occupied residential house has been raised from Tk. 1,500,000 to Tk. 2,500,000 in view of the present inflationary situation and to alleviate the hardships of the persons of limited means.

(2) Under the present provisions the aggregate of income-tax and wealth tax can not exceed 60% of the total income of an assessee, only if his taxable income exceeds Tk. 150,000. This restrictive provision is unnecessary and hence withdrawn.

ADVERTISEMENT TAX

22. At present employment and tender notices published in daily newspapers are exempt from advertisement tax. It has been decided to extend this exemption so as to include any notice connected with employment and also advertisements made by the educational institutions such as notice of admission, notices of commencement of examinations, academic sessions etc.

URBAN IMMOVABLE PROPERTY TAX ACT

23. At present holdings with annual value not exceeding Taka 6,000 are exempt from urban immovable property tax. In order to give some relief to the owners of small holdings the ceiling of exemption has been raised to Tk. 18,000 for holdings within the Dacca Metropolitan area and to Tk. 12,000 for holdings in all other areas. Moreover in order to reduce the tax burden on the owners of holdings the rate of tax has been reduced in the case of holdings not being self-occupied from 4% to 3% of annual value and in case of self-occupied holdings from 2% to 1½% of the annual value.

24. The reduction in the burden of tax and the simplification of the collection procedure have been made with the hope that these will motivate larger number of taxpayer to pay their taxes. These are also expected to curb the tendency and the scope of evasion of tax and also to augment the revenue collection. The provision of declaration of untaxed income is also expected to yield additional revenue. It is, therefore, estimated that the total collection of revenue only from income-tax will amount to Tk. 300 crores.

STAMP DUTY

25. At present the rate of share of transfer fee under Stamp Duty Act, 1899 is 1.5% on the value of the shares. This transfer fee acts as a deterrent to the transactions of shares in the Stock Exchange. It is decided to remit the duty chargeable under the said Act on the shares of Public Limited Companies listed in the Stock Exchange with effect from 1-7-82. A separate order will be issued in this respect.

MOTOR VEHICLE TAX

26. The existing rates of motor vehicle taxes and fees are very low. Tolls are collected from a very few bridges. Hence it has been decided to enhance the rates of tax on motor vehicles and to abolish the system of collection of toll from bridges. An additional collection under this head is estimated to be Tk. 2.25 crores.

FOREIGN TRAVEL TAX

27. In order to remove the burden of the wage-earners, it has been decided to exempt return tickets purchased abroad in foreign currency from payment of foreign travel tax.

LAND DEVELOPMENT TAX

28. The provision of tax collection introduced by the Land Development Tax Ordinance, 1976 is unrealistic. Agricultural development has been the mainstay of our economy during the last decade. The present pace of development leaves scope for further improvement and requires increased investment in the agricultural sector. Land is our main asset. Unless we can tap adequate revenue from this sector it would not be possible to generate enough savings for further investment. Agriculture contributes nearly 56% of our Gross Domestic Product. It would not be possible to accelerate development process unless savings are generated from this sector. Most of the landed properties are controlled by a limited number of people. Farmers having four to six bighas of land are considered to be self sufficient, while those having land exceeding fifteen bighas are considered to be surplus farmers and fairly rich. But a person owning lands upto 25 bighas is required to pay land development tax at Tk. 1 only per bigha. This state of affairs needs a radical change. The rate of tax on land should be progressive and the landowners should pay tax at an increased rate. The best way is to impose tax on the basis of productivity of land. But this cannot be done because of the dearth of necessary documents and administrative machinery.

29. We have long been talking about raising the rate of land development tax. We also believe that this will ensure efficiency in the use of land. We have, therefore, decided to increase the rate of land development tax with effect from 1-7-82. Measures have been taken to realise more revenue from both urban and rural lands. The revenue yield from urban land will be about Tk. 13 crores. There will be three rates of tax: one for Dacca, Chittagong and Khulna, another for the District towns and yet another for the rest of the towns. The rate of tax will also be different for residential and commercial lands. Different slabs have been prescribed for agricultural land namely, upto 6 bighas, then 6 to 15, in excess of 15 to 30, in excess of 30 to 45, in excess of 45 to 75 and exceeding that quantum of land being highest slab. The rate of tax has been made progressive. The tax on 15 bighas, 30 bighas, 45 bighas, 75 bighas and 100 bighas of land will be Tk. 51, Tk. 231, Tk. 531, Tk. 1,421 and Tk. 2,641 respectively. This new rate is expected to yield Tk. 49 crores. Revenue collection from land development tax would be around Tk. 45 crores. The introduction of this new meaure will usher in a new horizon which, I am sure, would lead to gradual development in the agriculture sector and increased savings therefrom.

TURNOVER TAX

30. People frequently talk about value-added tax. This tax is very reasonable and progressive. But its administration is rather complex. Particularly in our socio-economic context, it is difficult to introduce the system of value-added tax. Hence, we have introduced a new tax called the Turnover Tax. The application of this tax will be easy and, to begin with, it will cover a limited number of goods and services. It will be realised from specified big establishments. And it will extend to both manufactured goods and sales of goods. It will be imposed on such goods and services which are exempt from excise duty. This tax is leviable only on those individuals or establishments who are income-tax assessees or where the capital investment exceeds Taka 1 lakh. After the initial experiment, this tax will be levied on the basis of capacity. We want to impose this tax initially on four types of establishments, namely: workshops, sweetmeat, manufacturers and dealers, printing industries and dock-yards. To start with, this tax will be limited to establishments in the big towns. We hope to get a total revenue of Taka 5 crores from this source. I believe that in the near future, this tax will emerge as a popular tax resource and all the manufacturing and selling concerns of the country will contribute to increase the domestic savings, through this tax.

31. In determination of the size of the Annual Development Programme we have adopted a very conservative approach this year. This is due to severe strain on our balance of payments position. Restraint has also been exercised in non-development expenditure. Attention has been given to estimation of non-tax receipts on an objective and rational basis. Care has been taken in projection of foreign aid disbursement. Our taxation system is such that its quantum is substantially dependent on external aid and foreign exchange earnings. In spite of these constraints we have estimated tax receipt of Taka 117 crores from new measures out of which about 50 crores are expected from imports on account of customs duty and sales tax.

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Loose-leaf services 45,93,141,188,238,285,335,476

IFA NEWS

DUTCH BRANCH

On 23 October 1982 the Dutch Branch of IFA held its Annual Meeting. After the normal proceedings – Prof. J. van Hoorn was reelected as honorary treasurer – the reports for the 1983 IFA Congress in Venice were discussed. The reporter on Subject I (Tax avoidance/tax evasion) is Prof. A. Nooteboom and the reporter on Subject II (International problems in the field of turnover taxation) is Mr. A.C. Simons. The time available for the discussion proved to be too short as a result of the overwhelming interest shown for the subjects, in particular the first one. The possibility of organizing a second meeting will be investigated.

HONG KONG BRANCH

The Hong Kong Branch of IFA reports that during 1982 a number of meetings were held during which topics of special interest were discussed.
On 8 March members were invited for an evening meeting dedicated to a discussion of income taxation in the People's Republic of China. Three subjects were presented: (i) the special zones, (ii) joint ventures and (iii) ordinary offices in the People's Republic.
On 3 May a meeting was dedicated to the current tax treatment of financial institutions (speaker Mr. David Flux).
The subject of the meeting of 5 July was the taxation aspects of overseas investment in Canada.
The Third Annual General Meeting was held on 18 October 1982 during which, among other things, the Accounts were considered and the Executive Committee was elected. After the proceedings, Mr. Rufus von Thulen Roades, Member of the California and New York Bars, spoke on certain aspects of U.S. taxation.

SWISS BRANCH

The Swiss Branch of IFA announces that it will held a special meeting on 5 November 1982 at which the 1982 IFA Congress in Montreal will be discussed. Dr. A.R. Schmid will report on the first subject (The tax treatment of interest in international economic transactions) and Maître J.M. Rivier on the second (Taxation of payments to non-residents for independent personal services).
The meeting will further be devoted to a discussion of the reports prepared for the 1983 Congress in Venice, i.e. Tax avoidance/tax evasion (Prof. Dr. F. Zuppinger) and International problems in the field of turnover taxation (Dr. W. Haring).
Maître J. Béguelin will speak on some recent developments in French-Swiss relations with respect to international double taxation.

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Am 12. November 1982 wurde das "Asian Pacific Tax and Investment Research Centre" als gemeinnütziges Institut nach dem Recht der Republik Singapur registriert. Das neue Centre hat eine ähnliche Funktion wie das Internationale Steuerdokumentationsbüro; es wird seine Aktivitäten auf die Länder Asiens und des pazifischen Raumes konzentrieren.

P.K. Bhargava und A.K. Jain:

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M.P. Dominic:

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Ahmed Al-kadi:

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SINGAPORE

Asian Pacific Tax and Investment Research Centre



A significant event has taken place in Singapore which will contribute to a balanced development in South-East Asia and the Australian and Pacific region.

On 12 November 1982,the *Asian Pacific Tax and Investment Research Centre* was incorporated as a legal charity under the laws of the Republic of Singapore, with headquarters at No. 2, Nassim Road, Singapore 1025, opposite the end of Orchard Road.

The concept emanated from the four seminars on Foreign Investment and Tax Administration held in Manila (1974), Tokyo (1976), Sydney (1978) and Bangalore, India (1980), which were hosted by the countries where they were held and chaired by the Bureau's Chief Executive. They were attended by the heads of Tax Departments and Investment Boards from the countries in the region.

There were two important recommendations at the seminars. As a result of the first, the International Bureau at Amsterdam launched a major effort on behalf of the region by producing an eight-volume loose-leaf publication entitled *Taxes and Investment in Asia and the Pacific,* which is now available commercially and is regularly updated. It is the only service of its kind covering all taxation in the area of Asia and the Pacific.

The second recommendation was for the formation, within the region of Asia and the Pacific, of an institution similar to the International Bureau of Fiscal Documentation at Amsterdam. The centre should be an entirely independent charity modelled after the Bureau in Amsterdam, and sponsored and assisted by it so as to benefit from the Bureau's 45 years' experience. The centre should, in particular, deal with the tax aspects of economic development in the Asian-Pacific countries.

The first discussions were held as early as 1978 with representatives of governments and the business and professional communities in the region. These discussions resulted in a well-defined project which was submitted to the Bureau's Board of Trustees for their approval of the Bureau's sponsorship. In its annual meeting held on 7 May 1981, the Board approved the project and agreed to give any assistance necessary in setting up the Centre in Singapore and to help it in its formative period by providing technical and professional assistance.

A founding committee met in Singapore during the week of 16 November 1981 to work out the details. Members of this committee were:

(1) Professor J. van Hoorn, Jr., Chief Executive, International Bureau of Fiscal Documentation, Chairman;
(2) S. Ambalavaner**, Attorney-at-law, Colombo;
(3) Alun G. Davies*, CBE, Trustee of the Bureau, London;
(4) Graeme L. Herring**, FCA, of Peat, Marwick, Mitchell & Co., Sydney;
(5) N.M. Qureshi**, Executive Director, Asian Development Bank, Manila;
(6) Sidney C. Rolt**, Financial Consultant, Singapore; and
(7) Angel Q. Yoingco**, Executive Director, National Tax Research Center, Manila.

* Trustee of the Bureau.
** Member of the Bureau's Advisory Council.

Objects of the Centre

According to the Memorandum and Articles of Association, the objects of the Centre are:

- to carry on and promote systematic studies relating to tax and investment particularly in the countries of the Asian and Pacific Region;
- to provide training programmes in tax law and administration and tax and investment policies;
- to carry out surveys, provide information, and submit reports and recommendations to governments and the private sector on tax and investment matters which are relevant to the socio-economic development of countries in the Asian and Pacific Region;
- to sponsor and conduct conferences, seminars, group studies, public lectures and courses on tax and investment matters of particular interest for countries of the Asian and Pacific Region;
- to carry on any other activity which may seem to the Centre capable of being usefully and conveniently pursued for the purpose of promoting the above objects.

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How the Centre operates, and for whom

The Centre will be equipped to collect, analyse and publish up to date information on taxation and investment matters relating primarily to the countries of the region and, where necessary, to other parts of the world. This will be of assistance and importance to:

- governments,
- business firms,
- banks and financial institutions,
- firms interested in investment in the Asian and Pacific Region, and
- professional firms of lawyers, accountants, tax and investment consultants.

The Centre will have a specialised team of researchers and correspondents and keep members informed of developments on important current problems of tax, fiscal policy and investment pertaining to international trade and investment.

A register of experts will be maintained at the Centre.

Persons interested in helping the Centre as correspondents, researchers and experts are invited to send their names, addresses and bio-data.

Seminars and training programmes

Seminars and training programmes will be organised in the region where government and business representatives are given the opportunity to discuss crucial problems with oustanding experts. Suggestions for topics of discussion from members will be particularly considered.

Research programmes

Research programmes will focus on those aspects of taxation and investment that are of particular interest to the countries in the region and to those engaged in international trade and investment involving these countries and the region as a whole. Special attention will be given to such areas as:





- tax incentive rules and policies in relation to investment flows and the transfer of technology; through its publications – see below – these will be made known to all members
- the research will continuously focus on the effect of measures in developed countries on tax and investment policies in the Asian and Pacific region
- special attention will be given to the question of tax compliance and the effect of high effective tax burdens resulting from high rates or broad tax bases
- aspects of harmonisation of tax legislation and procedures which will ease international trade and investment, particularly in the area of transfer pricing
- the role of tax treaties in encouraging investment flows to the Asian-Pacific region
- the crucial problem of alieviating double taxation and double economic tax burdens in the case of cross-border transactions

Information service

There will be a tax and investment information service to supply members with specific information needed. This information will be made available by the professional staff at the Centre. Where necessary, this service will be rendered in close cooperation with the International Bureau of Fiscal Documentation in Amsterdam. Personal discussion at the Centre will also be possible by prior appointment. Questions may be asked by letter, telephone or telex.

Library

The Centre's library will be open to all members at no extra cost. Members are entitled to request the library staff for information and assistance in tracing materials relating to taxation and investment.

Publications

Apart from other publications the Centre will publish:
(a) The Asian Pacific Tax & Investment News Service
(b) Asian Pacific Tax & Investment Bulletin
These will be sent free to all members.

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Board of Governors

The Centre's first Board of Governors is composed of:

Chairman
Prof. J. van Hoorn Jr.,

Honorary Treasurer
Sidney C. Rolt

Chief Executive
S. Ambalavaner

Members
Graeme L. Herring
N.M. Qureshi
Angel Q. Yoingco

and will shortly be joined by
Alun G. Davies, C.B.E.
Raymond E. Moore, Solicitor and Notary Public, Director of Jardine, Matheson & Co., Hong Kong.
Sutadi Sukarya, Chairman of the Capital Market Executive Agency, Jakarta, Indonesia.

Subscribers – Constitutional Members

The following have subscribed to the Centre's Memorandum and Articles of Association:

J. van Hoorn Jr.	Amsterdam
S. Ambalavaner	Sri Lanka
Alun G. Davies	United Kingdom
Graeme L. Herring	Australia
N.M. Qureshi	Philippines
Sidney C. Rolt	Singapore
Angel Q. Yoingco	Philippines
Adiya Vikram Birla	India
Arvind N. Lalbhai	India
Sutadi Sukarya	Indonesia
Benjamin Abela	Philippines
Raymond E. Moore	Hong Kong

It is intended to increase the Constitutional Members to fifty, and to include amongst them members of the judiciary, the tax administrations, major industrial and commercial organisations, and the universities in the region.

Contributions

The Centre will be glad to receive donations of books, journals and other material on tax, fiscal policy and investment. Authors and publishers of books, periodicals and journals on the above subjects are invited to send one copy of each publication to the library and for indexing and review in the Bulletin.

The Government of Singapore has already assisted the Centre by making available premises at No. 2, Nassim Road, Singapore for a nominal rent. Several Governments, as well as professional firms and corporations in the area of banking, industry and commerce, both in the region and elsewhere, have already contributed considerable sums to the Centre in order to enable it to commence its operations as soon as possible.

Subscriptions – Membership

The subscriptions for the Centre for its publications and other facilities are as follows:

(a) FOUNDING-PATRON MEMBERS – US$ 30,000 payable in instalments of US$ 10,000 in the years 1983, 1984 and 1985, the first payment to be made forthwith. Founding-Patron Members will be entitled to one copy each of all publications of the Centre, and the right to information and answers to questions. An additional set of publications will be supplied on request without charge. This facility will be available for the year 1983 and all subsequent years.

(b) FOUNDING MEMBERS – subscription of US$ 15,000 to be paid now. Members will be entitled to one copy each of all publications of the Centre for 25 years and the right to information and answers to questions. An additional set of publications will be supplied on request without charge. At the end of 25 years the Governors may continue these facilities taking into account the then current costs.

(c) ASSOCIATE MEMBERS – subscription of US$ 7,500 to be paid now. Members will be entitled to one copy of the Centre's publications and the right to information and answers to questions for a period of 15 years. At the end of 15 years the Board of Governors may extend these facilities taking into account the then current costs.

(d) CORPORATE MEMBERS – membership will be US$ 250 per year. This membership will be open to corporations, institutions and firms. Corporate Members will be entitled to a copy of each of the publications for the year.

(e) INDIVIDUAL MEMBERS – membership will be US$ 60 per year. Such members are entitled to one copy of the publications of the year.

THE CENTRE SEEKS FINANCIAL AND OTHER ASSISTANCE FROM GOVERNMENTS, INSTITUTIONS, CORPORATIONS AND INDIVIDUALS TO ESTABLISH AND MAINTAIN THE CENTRE.

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Personal Income Taxation and Equity in India

by P.K. Bhargava and A.K. Jain *

Progressivity is an essential feature of a modern tax system. It is essential for two reasons: to reduce inequalities in the distribution of wealth and income and to ensure built-in-flexibility in the tax structure. There are two aspects of progressivity: equal treatment of equals (horizontal equity) and unequal treatment of unequals (vertical equity). The object of this paper is to examine the extent to which personal income tax in India fulfills the criteria of horizontal and vertical equity.

HORIZONTAL EQUITY

There is equal treatment of equals with respect to personal income tax in India in so far as a system of "global" tax rates and not "schedular" tax rates is followed. However, there are some important features of the personal income tax structure where this criterion is violated. Exemption of casual and non-recurring income from the tax base is a glaring example of such an anomaly. Prior to the amendment made in 1972, receipts which were of a casual and non-recurring nature were exempt from tax except where the receipts constituted capital gains or arose from a business or the exercise of a profession, vocation or occupation or were by way of additions to the remuneration of an employee. Consequently, a number of receipts which resulted in increased wealth of the taxpayer were excluded from the tax net. The tax base also did not embrace receipts like punitive damages (though not amounting to recovery of capital), found property or accidental receipts, amounts received by way of lottery, crossword puzzles, races, or of embezzlement, blackmail, extortion and other criminal activity.[1] Winnings from State or other lotteries in the case of non-corporate taxpayers were subjected to tax by the Finance Act, 1972. However, casual and non-recurring receipts up to 1000 Rs. were exempt from the tax base and this provision continues to date. There appears to be no justification for such an exemption. Equity considerations demand that all accretions to personal income or wealth should be included in the tax base.[2] It may also be emphasized that the inclusion of recurring receipts in the tax base is not only wrong in principle but also leaves much to the discretion of tax administration and law courts to decide which receipts are occasional and which are regular.[3] In this context, a number of conflict decisions can be seen in India. "Thus, where the taxpayer received an annual allowance payable solely in the discretion of the taxpayer, the receipt was held to be non-recurring even though paid regularly over the period of a number of years. . . On the other hand, where a retired judge agreed to arbitrate a dispute for a fixed fee, the fee was held to be taxable."[4]

The criterion of horizontal equity is also violated in view of the fact that agricultural income is not taxed at all under the Central income tax. The anomaly has been partly rectified by the scheme of "partial integration" introduced by the Finance Act, 1973. Under this scheme, the agricultural income of a taxpayer is considered only to determine the rate of tax on his non-agricultural income and agricultural income still goes untaxed. The only advantage of this reform is that if a taxpayer has both agricultural and non-agricultural income, the latter attracts a higher rate of tax. However, it would still be advantageous for non-agriculturists to show a part of their income originating in the agricultural sector because it is only at the margin that assessees with similar aggregate income are taxed similarly.[5] Further, agricultural income is considered only to determine the rate on non-agricultural income if non-agricultural income exceeds the exemption limit. It may be emphasized here that under the Indian Constitution the State Governments are empowered to levy agricultural income tax. However, all the State Governments, even the richer States like Punjab and Haryana, have not exercised this power.[6] Also, in States where agricultural income is taxed, the tax rates are so varied that one is included to conclude that income taxation in general and agricultural income tax in particular do not fulfill the equity criterion.

VERTICAL EQUITY

Capital accumulation is a growing necessity of developing economies like India. With increasing capital accumulation, marked inequalities in the distribution of wealth and income also develop. However, in a welfare state inequalities in the distribution of wealth and income are neither desirable nor can they be tolerated for long. It is, therefore, necessary that people with higher incomes should not only pay more tax but they should also pay tax at a higher rate so that vertical equity is achieved. This necessitates a progressive rate structure on a "slab system" basis.

India always had the distinction of having a schedule of progressive income tax rates. However, from an equity point of view what is important is the effective tax rate and not the statutory tax rate. With the increase in schedular progressivity, the average income tax burden for all income tax payers should have shown a consistent increase but the available data clearly indicate that the average burden has generally shown a decline.

---

* Readers in Economics, Banaras Hindu Univerity, Varansi.

1. V.V. Borkar, *Income Tax Reform in India,* 1971, p. 91.
2. Anil Kumar Jain, "The Concept of Income under the Indian Income Tax", *Public Finance/Finances Publiques,* Vol. 30, No. 1, 1975, p. 88.
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4. World Tax Series (WTS), *Taxation in India,* 1960, p.229.
5. P.K. Bhargava, "The Raj Committee Report – A Comment on Agricultural Tax Reform Problems in India", *Public Finance/Finances Publiques,* Vol. 29, No. 2, 1974, p. 205.
6. For details see, P.K. Bhargava, *Taxation of Agriculture in India,* 1976, pp. 33-47.

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TABLE 1

Tax demanded under personal taxation *

Year	Total assessed income	Total tax demanded	Average tax rate (3 as % of 2)
(1)	(2)	(3)	(4)
1951-52	582.9	103.9	17.8
1956-57	647.8	106.5	16.4
1961-62	1024.3	136.5	13.3
1966-67	1605.6	226.0	14.1
1971-72	2567.2	432.7	16.8
1972-73	2220.8	357.6	16.1
1974-75	2534.4	405.0	16.0
1975-76	2742.8	426.3	15.5
1976-77	3066.0	507.0	16.6
1977-78	3405.4	540.1	15.9
1978-79	2930.6	499.5	17.0

* Personal taxation includes tax on individuals, Hindu undivided families, unregistered firms, associations of persons and others and thus excludes tax on registered firms and companies. 1 crore = 10,000,000.

It is clear from Table 1 that the average income tax rate (ratio of total tax demanded to total income assessed) declined from 17.8% in 1951-52 to 13.3% in 1961-62. Thereafter, it increased to 16.8% in 1971-72 but declined again to 16.0% in 1974-75 which was still lower than the average rate of tax for 1951-52. These findings are in sharp contrast to the fact that there has been a tendency to increase the statutory marginal tax rates over the period: the highest marginal tax rate (including surcharge) during the assessment year 1974-75 was as high as 97.7% on slabs of income exceeding 200,000 Rs. whereas in 1951-52 it was 82.3% on incomes exceeding 150,000 Rs. On recommendation of the Wanchoo Committee, the highest rate of income tax (including surcharge) was reduced to 77% by the Finance Act, 1975 and further to 66% by the Finance Act, 1976. In subsequent years, the marginal rate of income tax continues to be 60% but there have been changes in the surcharge on income tax which was reduced from 20% to 10% by the Finance (No. 2) Act, 1980. It may also be noted that the increase in the average tax rate to 17% in 1978-79 is indicative of the fact that more income was taxed in the higher income slabs.

That vertical equity among different income tax payers is not achieved is also clear from the fact that the effective income tax rates for different income groups are much lower than the corresponding statutory tax rates. Table 2 presents the available data on the effective rates of income tax for each income class for selected years. It is clear from the table that the effective tax rate for income tax payers with taxable income exceeding 70,000 Rs. declined during the period 1951-52 to 1978-79. For the income slab of 70,001-100,000 Rs., it declined from 46.0% to 44.4% and for taxable income of 100,001-200,000 Rs., the corresponding rate declined from 59.0% to 54.7% during the same period. For incomes exceeding 200,000 Rs., there has been a greater decline from 73.4% to 69.0%. The existence of very high rates on the statutes over a considerable period can possibly be explained in terms of increasing tax evasion and avoidance, increase in the number of tax incentives which benefit mostly the people in relatively higher income brackets and inefficient tax administration. The advantages of tax evasion in India have been enormous. For example, when the highest marginal tax rate was 97.7% during the assessment year 1974-1975, the net profit on concealment was as high as 4,300% of after-tax income.

TABLE 2

Income assessed and tax demand in different income ranges for individuals
(Crores of Rs.)

	1951-52			1961-62			1971-72			1978-79		
Grades of income	Income assessed	Total tax	3 as % of 2	Income assessed	Total tax	6 as % of 5	Income assessed	Total tax	9 as % of 8	Income assessed	Total tax	12 as % of 11
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)
Below 5,000	94.3	2.4	2.5	143.7	1.3	0.9	86.7	1.2	1.4	2.6	0.3	11.5
5,001 – 10,000	128.8	6.2	4.8	241.0	6.6	2.7	566.1	27.5	4.8	206.9	7.9	3.8
10,001 – 15,000	59.9	5.2	8.7	127.3	7.4	5.8	429.7	33.8	7.9	828.3	56.9	6.9
15,001 – 25,000	56.7	8.0	14.1	133.3	13.5	10.1	465.8	54.4	8.6	766.4	84.6	11.0
25,001 – 50,000	57.4	15.2	26.5	127.4	28.3	22.2	357.9	88.0	24.6	578.1	125.4	21.7
50,001 – 70,000	18.8	6.3	33.5	36.6	13.2	36.1	96.3	36.4	37.8	122.5	41.0	33.5
70,001 – 100,000	15.2	7.0	46.0	26.8	12.1	45.1	68.8	31.3	45.5	81.6	36.2	44.4
100,001 – 200,000	18.8	11.1	59.0	28.3	16.1	56.9	71.0	39.5	55.6	68.6	37.5	54.7
Over 200,000	25.6	18.8	73.4	20.1	13.9	69.1	69.5	45.7	65.7	70.7	48.8	69.0

The variation between the statutory tax rates and the effective tax rates can also be partially explained by the increasingly larger tax reliefs which have been provided in the Indian Income-tax Act. With the passage of time, the number of incentives, and the number of taxpayers taking advantage of those incentives, has increased. This is clearly borne out by the fact that total deductions as also the ratio of total deductions to total income assessed

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have increased over the period as is clear from Table 3.

TABLE 3

Ratio of total deductions * to total income assessed
(Crores of Rs.)

Year	*Total deductions*	*Total income assessed*	*2 as % of 3*
(1)	(2)	(3)	(4)
1953-54	36.8	781.0	4.7
1956-57	48.8	936.7	5.2
1961-62	132.6	1575.4	8.4
1966-67	160.3	2532.2	6.3
1971-72	252.5	4389.8	5.7
1972-73	216.6	3611.8	6.0
1974-75	257.5	4120.6	6.2
1975-76	288.3	4706.2	6.1
1976-77	376.6	5266.1	7.1
1977-78	424.0	5862.8	7.2

* Includes rebates and double income tax relief, as well.

Table 3 shows that there has been a phenomenal increase in the quantum of total deductions during the period 1953-54 (Rs. 36.8 crores) to 1977-78 (Rs. 424.0 crores). During the same period, the ratio of total deductions to total income assessed also increased from 4.7% to 7.2%, except for the year 1961-62 when the corresponding percentage was 8.4. This is perhaps because of the fact that the total assessed income increased at a relatively slower rate as compared to the increase in the rate of total deductions during the period 1956-57 to 1961-62. The Indian income tax incorporates a number of tax incentives to encourage savings, investment, exports, etc. Two forms of incentives have been offered. Certain types of income and investments have been totally excluded from the purview of taxation such as interest received on deposits in the post-office savings bank, interest on post office National Savings Certificates, National Defence Certificates, etc. On the other hand, certain types of income on specified investments are either exempt to a certain extent or they are deducted from taxable income while computing total income, such as contributions towards provident funds, life insurance premia, public provident funds, 10 or 15-year Cumulative Time Deposit Schemes, Unit linked insurance plans, etc. Similarly, 50% of the investment in the shares of new companies may also be deducted. Income from certain categories of investments such as dividends from companies, interest on bank deposits, etc. is exempt up to 3,000 Rs. per annum (increased to 4,000 Rs. in the Union Budget for 1982-83). Further, income from Units of the Unit Trust of India is exclusively exempted up to 2,000 Rs. (raised to 3,000 Rs. in the Union Budget for 1982-83). Incentives have also been granted to promote agriculture, exports, particular industries or areas.[7] Prior to the assessment year 1968-69, these incentives were generally granted in the form of rebates from income tax but from the assessment year 1968-69 most of them have taken the form of deductions from total income. These incentives have reduced the tax burden to a great extent, and have mostly benefitted the high income group people as their capacity to save is greater and the tax advantage to them is also greater. As we have a progressive rate structure in India and incentives take the form of deductions from total income, the taxpayer gests the benefit at the rate of tax applicable to the highest slab of income. The gross rate of return depends upon the slab of income in which an assessee falls. The gross rate of return is as high as 37.1% for Units, 38.7% for 6-year National Savings Certificates and 32.3% for fixed deposits with banks. Even in the case of savings deposits with post offices where the rate of interest is only 5.5% per annum, the gross rate of return is as high as 17.7% for incomes above 100,000 Rs. and it is profitable for a taxpayer with an annual income of more than 30,000 Rs. to keep his money in the post office savings bank rather than to deposit it in banks and earn 10% interest.[8] These tax concessions have made the effective tax rates much different from the statutory rates and the pity is that "the differential operates regressively in favour of the high income groups as against low income groups".[9]

Finally, a word must be said about the changes in the rate and quantum of the standard deduction available to salaried taxpayers and the exemption limit. The provision of the standard deduction at the rate of 20% of the salary up to 10,000 Rs. and 10% of the salary in excess thereof, subject to a maximum deduction of 3,500 Rs., was introduced by the Finance Act, 1974. The Finance Act, 1981 made the rate of standard deduction uniform at 20% and also raised the monetary limit to 5,000 Rs. The Union Budget for 1982-83 has increased the rate to 25% without a change in the maximum monetary limit for standard deduction. There has also been a tendency to increase the exemption limit of income tax: from 4,000 Rs. to 5,000 Rs. from the assessment year 1971-72, to 6,000 Rs. by the Finance Act, 1974, to 8,000 Rs. by the Finance (Amendment) Act, 1975, to 10,000 Rs. by the Finance Act, 1977, to 12,000 Rs. by the Finance Act, 1980 and to 15,000 Rs. by the Finance Act, 1981. The successive increases in the exemption limit have increased the operative limit which at present ranges from 25,000 Rs. to 30,000 Rs. This has not only reduced the effective rate of income tax but also the number of income tax assessees.

CONCLUSION

The above discussion amply demonstrates that the personal income tax structure in India has been designed to achieve both horizontal and vertical equity. In practice, it does not fully achieve either of the two, although horizontal equity is achieved to a relatively larger extent. There are mainly two grounds on which the criterion of

7. For details see, Anil Kumar Jain, *Taxation of Income in India,* 1975, Chapter 6.
8. Provided the income from bank deposits, dividends, etc. exceeds 3,000 Rs. in a year.
9. I.S. Gulati, "Growth Oriented Budget: An Analysis of Major Suggestions", *Economic and Political Weekly,* March 1976, p. 419.

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horizontal equity falls: firstly, favourable treatment is accorded to causal and non-recurring incomes, and secondly, agricultural incomes are excluded from the Central income tax base.

The personal income tax structure also does not adequately satisfy the effective requirements of unequal treatment of unequals mainly due to four reasons: firstly, the discrepancy between the effective tax rates and statutory marginal tax rates has been found to be increasing with increased levels of income. Secondly, tax evasion has increased as the income tax rates have gone up. Thirdly, relatively richer persons have been taking more and more advantage of various tax concessions and incentives, thus bringing down the effective tax rate. Fourthly, a number of administrative problems such as arrears of assessment and collection, pendency of appeals, delays in granting refunds and strained public relations, etc. have further reduced the effectiveness of income tax as an equity measure.

IFA NEWS

Montreal Congress 1982

Results of the Discussions

At the end of the Montreal Congress of IFA (12-17 September 1982) the following resolutions were adopted. Note that they were originally drafted in the German and French languages, respectively. We reproduce here the approved English translations.

SUBJECT I:

The tax treatment of interest in international economic transactions

RESOLUTION (German original)

Whereas:

a) The avoidance of double taxation in the international flow of capital is in the interest of all countries and their taxpayers.
b) Both the debtor's and the creditor's country of residence should make a reasonable contribution towards the avoidance of double taxation and the reduction of the total burden of taxes.
c) There should be no discrimination between international and national movement of capital.
d) The rules on interest in the OECD model agreement of 1977 have not yet been incorporated into all double taxation agreements and that these solutions should be further developed.

Now IFA proposes:

1. Arm's length interest paid to non-resident creditors should be a deductible expense in the same way as domestic interest paid in the debtor's country.
2. Insofar as the debtor's country wishes to assess tax, this should not be effected by way of disallowing the interest expense, but instead by levying a non-resident withholding tax.
3. The deduction of interest to non arm's length persons should only be disallowed to the extent that the conditions and the rate of interest are obviously in excess of the going market rate or normal market conditions. Individual cases should be decided on a case by case basis after taking all circumstances into consideration. Fixed ratios of debt to capital and the incidental normal interest rates should not be laid down, but should only have the character of a "safe havens" clause.
   The double taxation agreements ("DTC") should contain a clause which provides that interest disallowed as being in excess of normal market conditions, and therefore treated as a dividend in the debtor's country, should also be treated as a dividend in the creditor's country. It should be ensured that the creditor will be entitled to the same tax relief as would be applicable to intercorporate dividends under domestic legislation or the respective DTC.
4. Insofar as the payor or debtor country assesses non-resident tax on the interest paid abroad, it should be considered that the creditor has usually considerable refinancing and other expenses. This should be effected by unilaterally providing for a low rate of non-resident withholding tax.
   In the case of interest received from a foreign country the double taxation should be avoided in the creditor's country through unilateral measures providing tax credits or exemptions. The mere deduction of the foreign tax from income does not give sufficient relief. In cases where the tax credit method is used for foreign non-resident withholding tax, full credit for the taxes deducted should be allowed. This requires that if the creditor country grants credit on the net income basis only the expenses directly connected with the interest are taken into account and that the overall limitation is applied. Furthermore, the excess of foreign non-resident tax levied over the applicable tax in the creditor's country (excess credits) should be allowed to be carried forward or back to prior periods or should be allowed in some other way.
5. In cases where the contracting states of DTC are not prepared to allow for the total exemption from non-resident withholding tax, both the debtor's and creditor's country should make a reasonable contribution towards the avoidance of double taxation and the total incidence of taxation.
   On the one hand, the debtor's country should provide for a low rate of non-resident withholding tax, on the other hand the creditor's country should allow the credit of the remaining non-resident withholding tax against its own tax liability or exempt the interest from taxation. As to the measures to fully avoid double taxation in the creditor's country see paragraph 4 above.
   It could be in the interest of the contracting states and their taxpayers in order to encourage investments in

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the developing countries that the creditor's country allows a tax sparing credit.

6. Where a double taxation agreement provides for a reduction of the withholding tax on interest, this reduction should be effective on payment immediately and should not only be granted in a subsequent refund procedure.
   Where a permanent establishment is subject to tax in a country which has a double taxation agreement, the agreement should provide that such permanent establishment can claim the limitation of non-resident withholding tax and the tax credit provided in the agreement between the source country and the country in which the permanent establishment is located.
7. The problem of the taxation of interest income which contains to a considerable extent a compensation for losses caused by inflation should become the subject of a special study.

SUBJECT II:

Taxation of payments to non-residents for independent personal services

RESOLUTION (original version: French)

1. Considering:

1.1. That the free flow of, and access to, professional, technical, cultural, and athletic skills and information is conducive to the promotion of the social and economic well-being of all people, particularly in the context of the rendering of independent personal services by non-residents;

1.2. That in today's world trade and business environment it is becoming more and more difficult to distinguish between income from the sale of goods and information and income from the rendering of independent personal services, especially since such income may be derived both by individuals and by companies;

1.3. That conflicting rules determining the source of income from independent personal services exist among countries, and that furthermore it is increasingly difficult to determine where the services giving rise to the income are performed or utilised;

1.4. That taxation by a country of the income of a non-resident person from such services without a clear and sufficiently strong economic connection with that country entails a serious risk of double taxation; and

1.5. That taxation of the income from such services on a gross basis is in conflict with the generally accepted principles of income taxation and may result in an arbitrary and excessive tax burden;

2. Recommends:

2.1. That domestic legislation adopt a rule subjecting non-residents performing independent personal services to taxation only if such services are performed in that country in spite of difficulties of practical application;

2.2. That bilateral double taxation conventions be concluded in order to further promote the free flow of, and access to, professional, technical, cultural, and athletic skills and information and that to that end such conventions limit wherever possible the right to tax of the country where the services are performed by a non-resident in cases where
   (i) there is a fixed base in that country; or
   (ii) the person performing the services stays in that country for more than a minimum period of time;
   (iii) the income derived from such services exceeds a minimum threshold;
   it being understood that said period of time and/or threshold shall be fixed in each convention by negotiation and mutual agreement between the signatories of the convention;

2.3. That, if a withholding tax is levied on the gross income of a non-resident from independent personal services, the rate of such tax or the determination of the taxable base should recognize that usually substantial direct and indirect expenses have been incurred in producing such income;

2.4. That in double taxation conventions, the non-resident who is subject to tax on income from independent personal services should be given the right to be taxed on the basis of net income by filing a return and establishing evidence of deductible expenses in a manner at least as favourable as that which would apply under the convention to non-resident persons earning business profits;

2.5. That if, in the negotiation of a double taxation convention, it becomes apparent that the two countries have a different understanding of the term "income from independent activities", the convention or a protocol thereto should attempt to define that term and distinguish it from other terms used in the convention that may overlap it, such as "profits of an enterprise", "remuneration from employment", "royalties", etc.
   In particular, the contracting states should make it clear whether they intend the article dealing with income from independent activities to apply to companies;

2.6. That the article in the double taxation convention dealing with the income from independent personal services should contain provisions to indicate the priority of application in cases where an item of income is also covered by another article;

2.7. That, although in double taxation conventions the inclusion of separate rules dealing with artists and athletes is justified, the recommendations outlined above should be made equally applicable to artists and athletes;

2.8. That in domestic law and in double taxation conventions, consideration be given to applying to non-resident artists and athletes measures mitigating the unduly harsh effects of progressive tax rates in cases of very irregular income, if similar measures apply to residents; and

2.9. That in double taxation conventions, the application of articles giving the countries the right to tax the income derived by a non-resident person other than the performer, from the performance of personal services by an artist or athlete, be restricted to situations where the performer and the other person are not dealing at arm's length.

[continued on page 559]

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NEW ZEALAND BUDGET 1982:

Tax Proposals

By Dr. M.P. Dominic

The Budget presented by the Minister of Finance, the Rt. Hon. R.D. Muldoon, on 5 August 1982 contains a number of proposals relating to personal income tax, tax avoidance, life assurance, superannuation, and building societies.

The scope of the tax proposals is limited by the overriding priority of reducing inflation. These proposals incorporate some of the changes proposed by the Task Force on Tax Reform which was established after the last Budget to examine the system of Central Government taxation, both direct and indirect. In the time available, the Task Force identified the areas of most immediate concern and suggested options for reform. Further study was proposed for other areas such as inflation adjustment of business income and taxation cooperation. The areas suggested for immediate reform include personal income tax and indirect consumption taxes.

Personal income tax

The objectives of the proposed changes are:

- first, to lessen substantially the fiscal drag in the present scale. Fiscal drag is the phenomenon by which, under a progressive tax scale and rising nominal incomes, tax paid rises faster than the growth in those incomes. Its effect is to erode disposable incomes and destabilise the economy;
- the second objective is to minimise the disincentive impact of high marginal tax rates on work, savings, and investment decisions;
- the third objective is to minimise the incentive for tax evasion and avoidance caused by high marginal tax rates;
- the fourth objective is to reduce the imbalance between the tax paid by single-income families and two-income families with the same total income;
- the fifth objective is to reduce the difference in the tax burden between taxpayers with steady incomes and those with fluctuating incomes.

(a) Housekeeper rebate

The present housekeeper rebate will be retained and increased, from 1 October 1982, in recognition of the additonal costs of child care incurred by two-income families, especially those with pre-school children. The maximum rebate will be increased from $156 to $310 a year, at a rate of 31 cents in the dollar on qualifying expenditure up to a maximum of $1,000 a year. This rebate will be available only on an end-of-year basis.

(b) Child rebate

The present rebate is $78. From 1 October 1982, it will be increased to $156. Assuming the marginal tax rate is 20%, the increased rebate will be equivalent to tax-free savings of $780 in a full year, compared with $538 at present. This rebate was introduced in 1978 to avoid the need for pre-school and school children to pay tax on small amounts of income.

(c) The overtime, shiftwork and back pay rebates

These rebates will be abolished from 1 October 1982 as a consequence of introducing a reduced income tax scale structure. They were originally introduced to minimise the effect of the present steeply progressive tax scale.

(d) First-home mortgage interest rebate

The rebate rate will be reduced from 1 October 1982 from 50% to 31% of qualifying interest, reflecting the new standard marginal tax rate of 31% for most taxpayers. This would mean that the maximum amount of qualifying interest will be increased from $2,000 to $3,225 in a full year.

The maximum level of the rebate will continue to be $1,000 a year.

(e) Dependent relative rebate

The rate of rebate will be, with effect from 1 October 1982, 31% rather than 40%. The maximum level of this rebate will remain $60 a year. The rebate may be claimed only in respect of two dependent relatives.

(f) Charitable donations and school fees rebate

The rate of rebate will be 31% rather than the present 50% of eligible donations and fees, reflecting the new standard tax rate of 31% for most taxpayers. The maximum level of rebate will be increased to $200 a year. This would mean the maximum qualifying expenditure will increase from the present $350 to $645 in a full year.

(g) Home vendor mortgage rebate

This rebate, which was introduced in 1978, will be abolished. Only a small number of taxpayers have claimed this rebate. The rebate will continue to be available to taxpayers holding approvals before 6 August 1982.

(h) Family rebate

A family rebate of $1,404 a year will be given from 1 October 1982 to all families with dependent children and an annual threshhold income of up to $9,800. Where the threshhold income ranges between $9,800 and $19,160 a year, the rebate will abate at the rate of 15 cents in the dollar. This will replace the present low-income family, young family and spouse rebates.

(i) Use of private dwelling in connection with employment

The deduction allowed in the Fourth Schedule to the Income Tax Act for expenditure or losses incurred in the use of a private dwelling in connection with the employment of a taxpayer will be restricted to the additional ex-

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penditure incurred in the use of the specified room or defined area for purposes relating to the taxpayer's employment.

(j) Family rebate and principal income earner rebates for persons entering or leaving New Zealand during a year

Where a person enters or leaves New Zealand, the income of that person during that part of the year in which he is resident in New Zealand will be grossed up to its full-year equivalent in order to determine the appropriate level of family and principal income earner rebates.

(k) Superannuation schemes for individuals

In future, superannuation schemes for individuals under Part II of the Superannuation Schemes Act will be approved by the Government Actuary only if at least one of the following criteria is met:

- they provide at least 75% of their benefits in pension form;
- the trustees and contributors are arm's length parties.

Existing schemes not meeting one of the above criteria will be given the option of converting to a pension scheme or winding up without additional tax liability. Alternatively, they may continue without the present tax advantages.

In addition, changes will be announced shortly to reduce the tax advantages arising from the present tax treatment of superannuation schemes for individuals. The Government considers that at present individuals are able to transfer large amounts of cash and capital assets, often the business assets of the contributor, to these schemes but at the same time maintaining effective control of these assets.

(l) Tax rates

From 1 October 1982, the personal income tax rates will be:

Taxable income	Rates
up to $6,000	20%
$ 6,000 – $24,000	31%
$24,000 – $30,000	41%
$30,000 – $38,000	51%
above $38,000	60%

As a result of these changes, the marginal tax rate for approximately 90% of all taxpayers will be 31% or less. The 31% marginal tax rate will apply to over 60% of all taxpayers. At present, they are subject to marginal tax rates ranging up to 60%.

(m) Transitional measures

There will be some transitional problems with the introduction of the new scale, both at the lower and upper ends of the income range. At the lower end, some people who do not qualify for the family rebate would pay more tax as a result of the change in the scale. At the upper end, a small number of taxpayers would receive very large tax cuts. This latter effect is justified to a large extent, given that in recent years the higher tax rate thresholds have been less effectively adjusted for inflation than the lower thresholds.

To minimise these problems and to ensure that virtually all principal income earners receive a tax cut from 1 October 1982, the following two transitional measures will be introduced from 1 October 1982:

(1) Temporary surtax

A temporary surtax of 10% of the marginal tax rates applying to all income above $24,000 will be imposed.

The effect of this temporary surtax on the marginal tax rates will be as follows:

income	*rate*
up to 6,000	20 (unchanged)
6,000 – 24,000	31 (unchanged)
24,000 – 30,000	45.1
30,000 – 38,000	56.1
above 38,000	66

These rates will be reflected in new PAYE tax tables applying to pay periods ending on or after 1 October 1982, and will become the annual rates in respect of income from 1 April 1983. The combined effect of the present and the new tax rates will be taken into account in determining the annual tax rate scale on income earned during the year ending 31 March 1983.

(2) Rebate

A rebate of 5.5% of taxable income, up to a maximum of $312 a year, will be given to all taxpayers – other than children, spouses of principal income earners, national superannuitants – and principal income earners eligible for the new family rebate. The full rebate of $312 will be given to all eligible taxpayers earning between $5,673 and $12,000 a year and it will abate against principal income at 12 cents in the dollar over the income range $12,000 to $14,600 a year.

Leasing

New provisions apply to financial leases entered into after 5 August 1982 placing financial leasing on the same footing for tax purposes as other forms of financing the acquisition of assets. The new provisions are:

- financial institutions will no longer be able to treat financial leases in the same manner as short-term hire contracts for income tax purposes. Instead, they will be required to follow generally accepted accounting practice and record their leasing transactions on the same basis as if they were loans;
- the lessor will be excluded from claiming depreciation allowances on assets subject to financial leases;
- the lessor will be permitted to deduct an amount equivalent to tax depreciation allowances for the particular leased asset, including first-year depreciation allowances if applicable, together with an amount equal to the interest content of lease payments.

No change is made to the existing tax treatment of leases of land and buildings and short-term hire contracts.

Film industry

A new tax regime incorporating the main features of the present tax treatment but without the tax shelters arising

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from the use of non-recourse loans and other leveraging arrangements will be introduced. But, in recognition of the effect of the change in the tax treatment, the Government will give $1.75 million in 1982-83 to the Film Commission and this grant will be reduced progressively to zero over a period of 5 years.

Farming and property investment

The following anti-avoidance measures were announced and will be implemented in respect of the income year beginning 1 April 1982 or equivalent accounting year:

- under the present provisions, where a farm or fish farm is sold at a profit within 5 years of purchase and deductions have been allowed for development expenditure on the farm, that profit is treated as assessable income up to the extent of the deductions allowed. In order to discourage the purchase and development of farms for capital gain rather than for productive use, the period of farm or fish farm ownership necessary to avoid recovery of the development expenditure deductions will be extended from 5 years to 10 years;
- interest deducted in respect of any land used in the production of income will become assessable for income tax to the extent of profits made on the sale of that land within 10 years of its acquisition;
- new farmers and those purchasing additional land will be required to write down the value of livestock purchased from cost to standard or nil values progressively over a period of 3 years;
- losses created by the writing down of livestock to standard or nil values may in future be written off against farming income, but not against income from other sources;
- the period for determining basic livestock numbers under the nil or standard value scheme will be extended from 2 to 4 years, or such shorter period as the Commissioner of Inland Revenue may determine;
- partnerships and syndicates of more than 6 persons engaged in farming, fish farming, horticultural and property owning ventures will be treated as companies for income tax purposes.

The provisions relating to the recovery of prior year expenditure apply to property sold after 5 August 1982.

Investment allowances

After a comprehensive review of investment allowances granted in New Zealand, the Government is of the view that:

> Experience with these schemes indicates that they are not effective in achieving their original goals, and waste money in subsidising activities that are not intended targets. Frequently their purpose has been fulfilled by broader policy moves or other events. Research, both in New Zealand and overseas, indicates that these incentives have had little impact on firms' investment decisions.

The Government has decided not to extend the following investment allowances after the current expiry date of 31 March 1983:

- the regional investment allowance;
- the export investment allowance;
- the fishing investment allowance.

High priority investment allowance

The high priority activity scheme under the high priority investment allowance will be terminated on 28 October 1983, but no further applications for new approvals or for extensions of high priority status will be accepted after 5 August 1982. The existing approvals will be allowed to run their course.

Industrial development plan investment allowance

The terminating date will be extended to 31 March 1986 to allow the existing commitments to the wine and plastics industries and the New Zealand Steel expansion to be met.

Farming and agricultural investment allowance

It will be extended for a further year to 31 March 1984. Its future will be considered in the next year's budget in the context of overall assistance to farming.

CNG (Compressed natural gas) and LPG conversions

Previously, depreciation could be claimed on the expenditure of CNG or LPG conversions carried out subsequent to the assembly of a motor car acquired by a business but not if such expenditure was incurred in respect of a car converted during assembly or if the cost of the car itself was more than $11,000. With effect from 1 April 1982, depreciation may be claimed on the cost of the assembly-line conversion of a business motor car. The depreciable cost will, however, be limited to the following:

- $1,200 for a one-cylinder CNG conversion;
- $1,600 for a two-cylinder CNG conversion;
- $1,400 for an LPG conversion.

Tax-free dividends

With effect from 1 April 1982, dividends from capital gains will qualify as tax free in the hands of the shareholders only if such gains have been realised through arm's length transactions outside any particular group of companies. "The aim of this measure is to prevent revenue losses arising from artificial arrangements to establish capital profits but which do not generate the cash to fund the resulting tax-free distributions to shareholders."

Charitable companies

From 1 April 1983, business income of charities will be exempt only if the business is directly related to the principal function of the charity concerned, or where the business employs that category of people for whose benefit the charity was originally established.

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Life assurance and superannuation funds

From 1 April 1983, the following changes will be made in the tax treatment of life assurance companies and superannuation funds:

- life assurance companies will be taxed on net investment income at a rate of 31% instead of the present 30% of allotted bonuses and dividends;
- lump-sum superannuation funds, which are tax exempt at present, will also be taxed at 31% on net investment income;
- superannuation funds which provide at least 75% of benefits in pension form will remain tax exempt;
- the personal tax exemption limits for life assurance premiums and contributions to superannuation schemes will be increased from $800 to $1,200 for members of employer-subsidised superannuation schemes, and from $1,000 to $1,400 for persons who are not members of subsidised schemes.

Building societies

Commencing with the 1983-84 income year, income of building societies will be taxed at the company rate of 45%. Dividends paid on withdrawable shares will be deductible in arriving at a society's assessable income.

Estate duty

For estates of persons dying on or after 1 April 1983, the exemption will be increased to $350,000.

Bonus issue tax

The bonus issue tax will be abolished. But, with effect from 1 April 1982, where there is a return or reduction of capital within 10 years of bonus issue, that part of the return or reduction which is applicable to the bonus issue will be taxed in the hands of the shareholder. Any return or reduction of capital will be deemed first to be attributed to bonus issues during the preceding 10 years.

Other taxes

Changes have also been announced in respect of stamp duty, taxes on alcoholic beverages and tobacco products, petroleum fuel taxation, international departure tax, and sales tax.

NEW ZEALAND:

Budget 1982

Extracts from the Financial Statement submitted by Mr. R.D. Muldoon, C.H., Prime Minister, to the House of Representatives on 5 August 1982.

See for a detailed discussion of the New Zealand tax system the Bureau's publication: TAXES AND INVESTMENT IN ASIA AND THE PACIFIC.

TAX REFORM

Following last year's Budget, I announced the establishment of a task force to examine the system of central government taxation, both direct and indirect, currently operating in New Zealand. In the time available, the Task Force on Tax Reform were not able to make firm recommendations on all aspects of taxation. Rather, they identified the areas of most immediate concern and suggested options for reform. These areas included personal income tax and indirect consumption taxes. In other areas they recommended further work.

As I said in last year's Budget, it is not possible to achieve overnight major changes in a tax system which has evolved over more than 100 years. Tax reform is a matter of identifying priorities and moving as circumstances and resources permit. The scope this year is limited by the overriding priority of reducing inflation. In this Budget, the Government is introducing major reforms in the area which it believes is of most widespread concern, namely personal income tax, and moving to eliminate some of the principal avenues for tax avoidance. Changes in the tax treatment of life assurance, superannuation, and building societies will also be announced. Other complex areas, such as the inflation adjustment of business income and the taxation of cooperatives, will require further study as the Task Force recommended.

PERSONAL INCOME TAX

In considering the options for changes to the income tax scale, the Government has placed major emphasis on five objectives. These are:

- first, to lessen substantially the fiscal drag in the present scale. Fiscal drag is the phenomenon by which, under a progressive tax scale and rising nominal incomes, tax paid rises faster than the growth in those incomes. Its effect is to erode disposable incomes and destabilise the economy;
- the second objective is to minimise the disincentive impact of high marginal tax rates on work, savings, and investment decisions;
- the third objective is to minimise the incentive for tax evasion and avoidance caused by high marginal tax rates;
- the fourth objective is to reduce the imbalance between the tax paid by single-income families and two-income families with the same total income;
- the fifth objective is to reduce the difference in tax burden between taxpayers with steady incomes and those with fluctuating incomes.

Clearly, the best way to achieve these objectives is to have a flatter tax scale, including a standard marginal rate covering the bulk of taxpayers and taxable income. At the same time, the Government wishes to reduce the average tax rate of most taxpayers, and to ensure that the degree of support provided to families with relatively low incomes is at least maintained. Naturally, compromises have had to be made. Nevertheless, I believe that the following decisions represent very substantial progress towards achieving all of these objectives.

The tax scale

From 1 October this year a new personal income tax scale will apply. Its main features will be:

- all taxable income up to $ 6,000 a year will be taxed at 20 cents in the dollar;
- taxable income between $ 6,000 and $ 24,000 a year will be taxed at the standard rate of 31 cents in the dollar;
- taxable income between $ 24,000 and $ 30,000 a year will be taxed at 41 cents in the dollar, and that between $ 30,000 and $ 38,000 a year at 51 cents in the dollar;
- the maximum tax rate of 60 cents in the dollar will apply to taxable income exceeding $ 38,000 a year.

One major benefit of the new tax scale is that, for approximately 90 percent of all taxpayers, the marginal tax rate will be 31 cents or less.

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The 31 cent marginal tax rate itself will apply to over 60 percent of all taxpayers, a group which faces marginal tax rates ranging up to 60 cents under the present scale. The new scale will ensure that, as incomes rise, the vast bulk of taxpayers will not face higher marginal tax rates or sharply rising average tax rates as they do now. As a result, after-tax margins for skill and responsibility will be increased.

Family assistance

A major feature of personal income tax over the last 6 years has been the development of a system of rebates related to family circumstances and income. This approach is both taken further and simplified in the new system. In particular, the Government is continuing its policy of targeting family assistance rebates to those families with children where household income is relatively low. Accordingly, a family rebate of $ 1,404 a year will be introduced from 1 October to replace the present low-income family, young family, and spouse rebates. This new rebate will be available in full to all families with a dependent child and an annual household income of up to $ 9,800. It will then abate at the rate of 15 cents in the dollar over the household income range $ 9,800 to $ 19,160 a year. New tax codes to be introduced from 1 October will enable most eligible taxpayers to have the benefit of the family rebate in their pay packets.

Transitional measures

There will be some transitional problems with the introduction of the new tax scale, both at the lower and upper ends of the income range. At the lower end, some people who do not qualify for the family rebate would pay more tax as a result of the change in the scale. At the upper end, a small number of taxpayers would receive very large tax cuts. This latter effect is justified to a large extent, given that in recent years this higher tax rate thresholds have been less effectively adjusted for inflation than the lower thresholds. Nevertheless, to ease the transition to the new scale and to ensure that virtually all principal income earners receive a tax cut from 1 October this year, two transitional measures have been adopted:

- a rebate for principal income earners of 5.5% of taxable income, up to a maximum rebate of $ 312 a year, will be introduced. This rebate will be available to all taxpayers except children, spouses of principal income earners, national superannuitants, and principal income earners eligible for the new family rebate. Eligible taxpayers earning between $5,673 and $ 12,000 a year will receive the full $ 312 rebate. The rebate will abate against principal income at 12 cents in the dollar over the income range $ 12,000 to $ 14,600 a year;
- a temporary surtax of 10% of the marginal tax rates applying to all income above $ 24,000 a year will be levied.

The new income tax scale, rebates and surtax will be incorporated in the PAYE tables applying from 1 October this year. Because a totally new set of PAYE tax codes has been developed to accommodate the new rebate structure, most taxpayers will need to complete a new tax code declaration by 1 October.

The effect of the new income tax scale will also be incorporated in the calculation of the net national superannuation rates applicable from September 1982. Because national superannuation in calculated on an after-tax basis, national superannuitants will effectively gain the benefit of the new tax scale from that date.

The benefits of the new tax regime

To illustrate the effects of the tax changes on a full-year basis, a single taxpayer on $ 300 a week, which is about the average weekly earnings, will gain $ 10.34 a week, or $ 537 a year. This amounts to a cut in income tax of 11.4%.

For the single-income family on the same income, the gain will be $ 13.02 a week, or $ 677 per annum, where there is a child under 5. This is equivalent to a 15.8% tax cut. If the children are all over 5, the gain will amount to $ 17.76 a week, or $ 923 a year. This represents a tax cut of 20.3%.

Further examples of the effects of the tax changes for individuals at various income levels and in different family situations are set out in the Appendices to the Budget.

The estimated net full-year cost of this package of measures is $ 915 million. The cost in 1982–83 will be around $ 400 million.

Housekeeper rebate

One of the major advantages of the new income tax regime will be to reduce substantially the difference between the income tax payable by a single-income family and that paid by a two-income family on the same level of total income. On the other hand, to recognise the additional costs of child care incurred by two-income families, especially those with pre-school children, the present housekeeper rebate will be retained and increased. The rebate will also continue to apply to solo parents who are employed, and disabled spouses. From 1 October this year, the maximum rebate will be increased from $ 156 to $ 310 a year, at a rate of 31 cents in the dollar on qualifying expenditure up to a maximum of $ 1,000 a year. This rebate will not be incorporated in the PAYE tables and will be available only on an end-of-years basis.

Child rebate

In 1978 a special rebate of $ 78 was introduced to avoid the need for pre-school and school children to pay tax on small amounts of income. This rebate will be increased from $ 78 to $ 156 a year with effect from 1 October this year. At a marginal tax rate of 20 cents in the dollar, the new maximum rebate will be equivalent to tax-free earnings of $780 in a full year, compared with $ 538 at present. In the year in which a child leaves school and commences work, he or she may claim either the child rebate or the new principal income earner rebate, whichever provides the greater benefit.

Consequential changes

A number of changes and simplifications to the income tax system have been made possible by the introduction of the new income tax scale and rebate structure.

The overtime, shift work, and back-pays rebates were originally introduced to offset some of the effects of a steeply progressive tax scale. This reason no longer applies, and the rebates will be abolished from 1 October 1982.

The following rebates will be altered as from 1 October this year to reflect the new standard marginal tax rate of 31 cents for most taxpayers:

- first-home mortgage interest rebate: the maximum level of this rebate will remain at $ 1,000 a year, and the rate of rebate will be reduced from 50% to 31% of qualifying interest. This means that the maximum amount of qualifying interest will be raised from $ 2,000 to $ 3,225 in a full year;
- dependent relative rebate: the maximum level of this rebate will remain at $ 60 a year, and the rate of rebate will be 31% rather than 40%. The maximum amount of qualifying expenditure will rise from $ 150 to $ 194 a year. The number of dependent relatives in respect of whom a claim may be made will be limited to a maximum of two;
- charitable donations and school fees rebate: the maximum level of rebate will be increased to $ 200 a year, and the rate of rebate will be 31% rather than 50% of eligible donations and fees. The combined effects of these changes will be to raise the maximum amount of qualifying expenditure from $ 350 to $ 645 in a full year.

In order that the new family rebate can be administered effectively, it will be necessary for all salary and wage earners claiming it to furnish an annual tax return, even if their income is below $ 11,500. Their spouses will also be required to furnish returns if they derive income. This change will apply to returns in respect of the 1982–83 income year.

The rate of tax to be deducted by employers from secondary employment income and extra emoluments will be reduced from 35 cents to 31 cents as from 1 October 1982.

Home vendor mortgage rebate

Because of the small number of taxpayers who have claimed the home vendor mortgage rebate since its introduction in 1977, this rebate will be abolished. Only taxpayers hold-

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ing approvals issued before tonight will continue to be able to claim the rebate.

TAX AVOIDANCE

The Task Force on Tax Reform highlighted the increasingly widespread avoidance and evasion of income tax. They believed that the reasons for this lay mainly in the high tax rates faced by many taxpayers and the availability of a variety of ways to divert income from taxed to untaxed sources. The Government accepts this view.

The new income tax scale announced tonight will reduce substantially the incentive to avoid and evade income tax. In addition, action is being taken on certain practices which are largely aimed at tax avoidance.

Leasing

The legislation regarding the tax treatment of lease payments in the hands of both the lessor and the lessee is to be amended. In respect of all financial leases entered into after tonight, the following tax provisions will apply:

- financial institutions will no longer be able to treat financial leases in the same manner as short-term hire contracts for income tax purposes. Instead, they will be required to follow generally accepted accounting practice and record their leasing transactions on the same basis as if they were loans;
- the lessor will be excluded from claiming depreciation allowances on assets subject to financial leases;
- the lessee will be permitted to deduct an amount equivalent to tax depreciation allowances for the particular leased asset, including first-year depreciation allowances if applicable, together with an amount equal to the interest content of lease payments.

These measures will place financial leasing on the same footing for tax purposes as other forms of financing the acquisition of assets, and will remove a significant avenue for tax avoidance. The existing tax treatment of leases of land and buildings and short-term hire contracts will not be changed.

Tax-free dividends

As from 1 April 1982 distributions of capital profits will qualify as tax free in shareholders' hands only when those profits have been realised outside any particular group of companies by way of armslength transactions. The aim of this measure is to prevent revenue losses arising from artificial arrangements to establish capital profits but which do not generate the cash to fund the resulting tax-free distributions to shareholders.

Farming and property investment

Under the existing income tax legislation, it is possible to deduct certain types of expenditure which are essentially of a capital nature. In the case of enterprises involving substantial interests in land, one of the few assets whose value is at least maintained in real terms, these provisions provide major avenues for tax avoidance. The concessions under which farming and fish farming development expenditure may be deducted, and livestock written down to standard or nil values, are the most obvious sources of this problem. Under inflationary conditions, however, it also has to be recognised that interest largely represents a repayment of capital. The fact that interest is deductible for income tax thus adds to both the incentives and the opportunities for avoiding income tax through the conversion of taxable income into non-taxable capital gain. Accordingly, a numer of measures are being taken to restrict these avenues for tax avoidance:

- under the present provisions, where a farm or fish farm is sold at a profit within 5 years of purchase and deductions have been allowed for development expenditure on the farm, that profit is treated as assessable income up to the extent of the deductions allowed. In order to deter the purchase and development of farms for capital gain rather than for productive use, the period of farm or fish farm ownership necessary to avoid recovery of the development expenditure deductions will be extended from 5 years to 10 years;
- interest deducted in respect of any land used in the production of income will become asssessable for income tax to the extent of profits made on the sale of that land within 10 years of its acquisition;
- new farmers and those purchasing additional land will be required to write down the value of livestock purchased from cost to standard or nil values progressively over a period of 3 years;
- losses created by the writing down of livestock to standard or nil values may in future be written off against farming income, but not against income from other sources;
- the period for determining basic livestock numbers under the nil standard value scheme will be extended from 2 to 4 years, or such shorter period as the Commissioner of Inland Revenue may determine;
- partnerships and syndicates of more than 6 persons engaged in farming, fish farming, horticultural and property owning ventures will be treated as companies for income tax purposes;

All of these measures will be implemented in respect of the income year beginning 1 April 1982, or equivalent accounting year. The provisions for the recovery of prior year expenditure will apply to property sold after tonight.

Film industry

The New Zealand film industry has grown rapidly in recent years. Part of this growth has been due to some tax shelter aspects arising from the use of so-called non-resource loans and other leveraging arrangements. In line with other moves to reduce tax avoidance practices, the Government is introducing a new tax regime which incorporates the main features of the tax treatment which applied to films in the past, but removes these tax shelter aspects.

The removal of the tax shelter will still leave the industry with substantial assistance from the Lottery Board, export incentives, and exemption from the film hire tax, which represents an appropriate level of support in the longer run. However, in line with its normal industry assistance approach of providing adequate time for adjustment, the Government has decided to give the Film Commission a grant of $ 1.75 million in 1982–83 in recognition of the effect that the change in tax treatment will have on the industry. This grant will be reduced progressively to zero over a period of 5 years.

Superannuation schemes for individuals

The last few years have seen rapid growth in the use of superannuation schemes for individuals to provide tax-free accumulation of income. Individuals are able to transfer large amounts of cash and capital assets, often the business assets of the contributor, to these schemes but at the same time maintain effective control of those assets. Such schemes are not superannuation schemes in the true sense.

I shall shortly be announcing changes in the taxation of all lumpsum superannuation schemes which will reduce these tax advantages, but additional measures are necessary. Accordingly, the rules under which superannuation schemes for individuals are approved will be tightened to stop their abuse.

In future, the Government Actuary will approve superannuation schemes for individuals under Part II of the Superannuation Schemes Act only if they meet at least one of the following criteria:

- they provide at last 75% of their benefits in pension form;
- the trustees and contributors are armslength parties.

Existing schemes which do not meet the new conditions will be given the option of converting to a pension scheme or winding up without additional tax liability. Alternatively, they may continue without the present tax advantages.

The necessary legislation will be introduced tonight.

Charitable companies

Some businesses carried on by charities enjoy an artificially advantageous position in the market through their exemption from income tax. Moreover, there has been a recent trend for individual business taxpayers to embark on schemes to secure the tax exemption for charities. A typical scheme involves the creation of a company, whose ostensible object is

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charitable, to conduct the business of a self-employed person. The company's net income, after payment of substantial remuneration to that person, is then tax exempt.

It is proposed to introduce legislation, which will be effective from 1 April 1983, to ensure that the business activities of charities will continue to be tax exempt only where the activity is directly related to the principal function of the charity concerned, or where the business employs that category of people for whose benefit the charity was originally established.

Personal tax

The legislation regarding personal tax concessions and rebates will be tightened with effect in the current income year:

- the Fourth Schedule to the Income Tax Act provides for the deduction of expenditure or losses incurred in the use of a private dwelling in connection with the employment of a taxpayer. Because of abuse of this provision, claims will be restricted to the additional expenditure incurred in the use of the specified room or defined area for purposes relating to the taxpayer's employment;
- the family rebate and the principal income earner rebate are designed to provide assistance to taxpayers whose annual income is below certain specified levels. Where a person enters or leaves New Zealand, the income derived during that part of the year he or she is resident in New Zealand is not an appropriate basis on which to calculate these rebates. Consequently, the income of a person in this situation will be grossed up to its full-year equivalent in order to determine the appropriate level of rebate. This will ensure that claims by such taxpayers are fully consistent with objectives of the rebates concerned.

Stamp duty

To prevent avoidance of stamp duty by transferring a property by way of a number of partial interests, the Stamp and Cheque Duties Act 1971 will be amended to ensure that such transfers are treated as one for the purposes of computing conveyance duty. This change will apply from tonight.

Administrative measures

The use of Inland Revenue code numbers in the tax system will be made compulsory. A tax intelligence unit has also been established to detect and police cases of tax avoidance and evasion.

The general tax avoidance provisions in section 99 of the Income Tax Act have not yet been tested before the courts, although some cases are in train. The Government will be watching the outcome very closely. If necessary, steps will be taken to give the legislation the force required to counter undesirable tax avoidance arrangements.

OTHER DIRECT TAX MEASURES

Bonus issue tax

The Task Force on Tax Reform concluded that the present bonus issue tax, while serving as an anti-avoidance measure, operates to inhibit the capital market. The Government broadly accepts the Task Force's view. Accordingly, bonus issue tax will be abolished.

To avert the potential tax avoidance problem identified by the Task Force, a new provision will be introduced. The objective will be to ensure that, when there is a return or reduction of capital within 10 years of a bonus issue being made from the capitalisation of revenue reserves, that part of the return or reduction which is applicable to the bonus issue will be taxable in the hands of the shareholder. Any reduction of capital will be deemed firstly to apply to such bonus issues made during the preceding 10 years.

The new legislation will apply to bonus issues made on or after 1 April this year. Any bonus issue tax paid in respect of bonus issues made subsequent to that date will be refunded.

Life assurance and superannuation

Following recommmendations of the Task Force on Tax Reform, the Government has reviewed the taxation of life assurance and superannuation.

The Government has decided that the overall tax relief given to these forms of long-term contractual saving and protection should continue. The balance is to be shifted, however, to reduce some of the present undue advantages of lump-sum superannuation, and to a lesser extent of life assurance, relative to pension arrangements. In addition, greater relief will be given at the point of initial saving or contribution rather than at the point where benefits are ultimately received.

As from the income year commencing 1 April 1982, the following specific changes are to be effective:

- life assurance companies will be taxed on net investment income at a rate of 31% instead of the present 30% of allotted bonuses and dividends;
- lump-sum superannuation funds, which are tax exempt at present, will also be taxed at 31% on net investment income;
- superannuation funds which provide at least 75% of benefits in pension form will remain tax exempt;
- the personal tax exemption limits for life assurance premiums and contributions to superannuation schemes will be increased from $ 800 to $ 1,200 for members of employer-subsidised superannuation schemes, and from $ 1,000 to $ 1,400 for persons who are not members of subsidised schemes.

Building societies

The Government has decided to implement the Task Force's proposal to tax the income of building societies at the company rate of 45%, commencing with the 1982–84 income year. Dividends paid on withdrawable shares will be deductible in arriving at a society's assessable income. Terminating group ballots will remain tax free in the hands of the recipient.

Investment allowances

A number of investment allowances for new plant and machinery are due to expire on 31 March 1983. Experience with these schemes indicates that they are not effective in achieving their original goals, and waste money in subsiding activities that are not the intended targets. Frequently their purpose has been fulfilled by broader policy moves or other events. Research, both in New Zealand and overseas, indicates that these incentives have had little impact on firms' investment decisions. Following a comprehensive review of investment allowance, the Government has decided not to extend the following schemes beyond their current expiry date of 31 March next year:

- the regional investment allowance;
- the export investment allowance;
- the fishing investment allowance.

The high priority activity investment allowance is to be terminated by allowing the high priority activity scheme, which was introduced with a specific lifespan of 5 years, to expire on 28 October this year. No applications for new approvals or extensions of high priority status will be accepted after tonight, but existing approvals will be allowed to run their course. The terminating date of the related investment allowance will be extended accordingly.

The terminating date of the industrial development plan investment allowance will be extended to 31 March 1986 in order to allow existing commitments to the wine and plastic industries and the New Zealand Steel expansion to be met.

As announced earlier, the farming and agricultural investment allowance is to be extended for a further year to 31 March 1984. This will allow time to consider its future in the context of overall assistance to farming in next year's Budget.

CNG and LPG conversions

At present, depreciation may be claimed for income tax purposes on the cost of CNG or LPG conversions carried out subsequent to the assembly of a motorcar purchased by a business. Depreciation on the cost of a conversion cannot, however, be claimed in respect of a car which has been converted during assembly and where the cost of the car itself is more than $ 11,000. To correct this anomaly, the Income Tax Act will be amended to permit depreciation to be claimed on the cost of the assembly-line conversion of a business motor car to CNG or LPG. The depreciable cost for this purpose will be limited to the following:

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- $ 1,200 for a one-cylinder CNG conversion;
- $ 1,600 for a two-cylinder CNG conversion;
- $ 1,400 for an LPG conversion.

This new provision will take effect from the income year which commenced on 1 April 1982.

Estate and stamp duties

In recognition of the effect of rising property prices:

- the exemption from estate duty will be increased to $ 350,000 in respect of the estates of people dying on or after 1 April 1983;
- the monetary limit in the definition of a "substantial interest" in a first farm will be increased from $ 100,000 to $ 150,000 as from tonight for the purposes of the stamp duty exemption.

The Minister in Charge of the Inland Revenue Department will, where necessary, announce further details of these tax measures.

INDIRECT TAXATION

Taxes on alcoholic beverages and tobacco products

The Government has reviewed the form and level of indirect taxes on alcoholic beverages and tobacco products. Because most of the taxes imposed in this area are levied at specific rates, regular updating is required to maintain both the real value of the revenue collected and the proportion of taxation in the price. It has been decided to increase the taxes on these goods by an average of over 30%.

Alcoholic beverages

The present ad valorem rates of sales tax on beer and spirits will be converted to specific rates. This measure has been undertaken at the request of the industry and so that the tax on each product can be more closely related to its alcoholic strength. One effect will be to alter the price relationships between higher- and lower-priced products.

Beer duty will be increased and amalgamated with the previous 30% sales tax on beer. As from midnight tonight, the rates of beer duty, which now incorporate sales tax, will be increased as follows:

- on beer with an alcoholic content of between 1.7 and 3 percent by volume, the rate of duty will be increased from 16 cent per litre to 21.5 cents per litre. On draught beer (in containers of not less than 8 litres capacity) the incorporation of the former sales tax will add 18 cents per litre to make the combined duty 39.5 cents per litre. On packaged beer the duty equivalent of sales tax will be 22 cents per litre, making a total beer duty of 43.5 cents per litre;
- on standard-strength beer (between 3 and 4.35% alcohol by volume), the rate of duty will rise from 20.5 cents per litre to 27.5 cents per litre. The incorporation of the former sales tax will bring the new combined rate of duty to 45.5 cents per litre on draught beer and 53.5 cents per litre on packaged beer;
- on beer with an alcoholic content of between 4.35 and 5% by volume, the rate of duty will increase from 31 cents per litre to 41.4 cents per litre, with sales tax adding a further 35 cents per litre to bring to combined beer duty rate to 76.5 cents per litre;
- on high-strength beer (in excess of 5% alcohol by volume), the rate of duty will increase from 41 cents per litre to 55 cents per litre. Adding in the former sales tax will bring the new beer duty to 99 cents per litre.

Corresponding adjustments will also be made to the customs duties on imported beer.

These changes will add 9 cents to the public bar price of a l-litre jug of standard-strength beer.

The existing sales tax of 50 cent per litre on table wines will be increased to 67 cents per litre. The tax on fortified wine will be increased from 60 cents to $ 1.06 per litre in order to bring the rate more closely into line with the taxes on other beverages on the basis of alcoholic strength. These changes will take effect from midnight tonight and will increase the price of a 750-ml bottle of table wine by around 13 cents and a similarly sized bottle of fortified wine by around 35 cents.

The domestic excise duty on spirits other than whisky will be increased from $ 9.07 to $ 12.10 per litre of alcohol, with commensurate increase in the customs duties on imported spirits. The excise duty on New Zealand whisky will remain at $ 8.77 per litre of alcohol. In addition, the present 40% ad valorem sales tax on spirits will be converted to three specific rates of sales tax as follows:

- on bitters and spirits containing not more than 23% alcohol by volume, the rate will be $ 2.15 per litre;
- on white spirits (gin, geneva, schnapps, and vodka), the rate will be $ 3.90 per litre;
- on all other spirits the rate will be $ 5.55 per litre

The new sales tax rate of $ 5.55 will raise substantially the tax on New Zealand whisky relative to that on higher-priced imported products. Because the rate of excise duty has not been raised, however, the net effect will be to preserve the competitive position of New Zealand whisky.

These changes to the taxation of spirits will take effect from midnight tonight and should add between 2 and 4 cents to the price of a nip in a public bar.

Tobacco products

The customs and excise duties on tobacco products will increase by 16% and the ad valorem sales tax will be raised from 25% to 40%, both with effect from midnight tonight. These changes will add approximately 20 cents to the price of 20 cigarettes and 35 cents to a 50-gramme packet of tobacco.

The 40% sales tax will also apply to cigarette papers (previously taxed at 20%) and to filter tips (previously exempt from sales tax).

The changes in the taxation of alcoholic beverages and tobacco products which I have announced tonight are expected to yield $ 115 million in a full year. While they will all take effect from midnight tonight, the operation of the Price Freeze Regulations will ensure that retail prices are not affected until existing stocks have been cleared.

The conversion of the present ad valorem sales taxes on alcoholic beverages to specific rates means that the industry will have to face up to regular adjustments of these taxes to ensure that their real value is at least maintained.

Petroleum fuels taxation

The Government has decided to adopt a more uniform taxation policy with respect to liquid fuels. This policy is designed to encourage greater efficiency in the use of imported fuels, and to encourage the development and use of indigenous substitutes.

In brief, the policy is that the relative prices of liquid fuels should reflect the relative costs of supply. Within this framework, taxes should not discriminate between fuels for similar uses. The taxes applying to oil products in the future will comprise three elements:

- first, an element of tax for the use of roads by those vehicles not levied under the road user charges system. This is made up of the existing sales tax on CNG and the National Roads Fund portion of motor spirits duty;
- secondly, an element of tax to encourage the development and use of indigenous alternatives to imported fuels. It has been decided to set this element, in the interim, at a specific rate equivalent to a 15% ad valorem tax at the wholesale level;
- thirdly, an element of general revenue or sales tax equivalent to a 5% ad valorem rate.

National roads fund contribution

To meet the light vehicles' share of the National Roads Board budget for the 1982–83 financial year, this element of motor spirits duty on petrol will be raised by 0.4 cents per litre to 6.4 cents per litre, and the sales tax on CNG will increase by 12 cents per gigajoule to $ 1.86 per gigajoule, both with effect from 1 October 1982.

From the same date, a sales tax at the equivalent rate of 4.93 cents per litre will be applied to LPG used in vehicles of 3.5 tonnes and under. This will replace the road user charges at present applied to such vehicles.

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Consolidated account taxes

The existing specific Consolidated Account taxes and duties on petroleum fuels will be adjusted to the equivalent of a general 15% wholesale level tax. In addition, the specific equivalent of a 5% ad valorem wholesale sales tax will be levied on petrol. As from midnight tonight the new rates of Consolidated Account tax will be as follows:

- motor spirits duty on petrol will rise from 6.7 cents per litre to 9.8 cents per litre premium grade and 9.3 cents per litre on regular grade. This means that from 1 October 1982 the total duty on petrol, including the National Roads Fund contribution, will rise to 16.2 cents per litre on premium grade and 15.7 cents per litre for standard grade;
- aviation gasoline, currently taxed at 9.36 cents per litre, will be taxed at 11.2 cents per litre;
- the present 0.5. cents per liter sales tax on diesel fuel other than marine diesel will be increased to 7.2 cents per liter;
- the sales tax of 1.5 cents per litre on marine diesel will be raised to 5.8 cents per litre;
- home heating oil and kerosene, both at present subject to sales tax at 4 cents per litre, will be taxed at 8 cents per litre;
- the sales tax of 5 cents per litre on jet fuel will increase to 7.2 cents per litre;
- the rate of tax on fuel oils will rise from 1.5 cents per litre to 5 cents per litre.

Rebates

The present policy of rebating the National Roads Fund portion of motor spirits duty for off-road use of petrol or where vehicles are levied under the road user charges system will continue. Consolidated Account rebates will continue to apply to the currently approved categories but will be restricted to 2.5 cents per litre for both grades of petrol. This is the specific equivalent of the 5 percent general revenue tax.

As most use of other petroleum products is in commercial applications, which would qualify for rebates of a general revenue tax, it has been decided not to impose the additional 5 percent tax on these products. Similarly, the additional 5% tax is not levied on aviation gasoline and refunds of motor spirits duty on this fuel will be eliminated. The tax to encourage the development of indigenous fuel substitutes will not be eligible for rebates, since this would effectively negate the desired effect of the tax.

The changes to fuels taxation which I have announced tonight are estimated to raise $ 140 million in a full year. They represent a major step towards a comprehensive taxation and pricing policy that will provide a sound and economic basis for future energy development, and help lessen New Zealand's dependence on imported fuels.

International departure tax

The rates of international departure tax are to be increased from $ 35 to $ 40 for each adult and from $ 7 to $ 8 for each child under 12. These new rates will apply to al tickets supplied after midnight tonight.

Sales tax

A number of changes are to be made to the sales tax legislation to reduce the scope for avoidance and simplify administration.

Sale value

Legislation will be introduced tonight to amend the sale value provisions of the Sales Tax Act. The proposed reforms principally include:

- clarification of the provisions for determining the fair market value of taxable goods;
- clarification of the treatment of advertising, warranty, and other service charges;
- the inclusion of the freight and insurance costs incurred in bringing goods to New Zealand in the sale value of goods on which tax is paid on importation;
- the provision of an uplift of 15% of the sale value of goods sold directly by a manufacturer to a retailer. The intention of this uplift is to place such direct sales on a more equitable basis with sales made by traditional wholesalers.

These measures are aimed at combating a rising trend in tax avoidance and are intended to reduce variations in the impact on prices of an ad valorem sales tax on goods distributed by different methods. They are expected to raise an additional $ 60 million of revenue in a full year.

Farm motorcycles

The concession under which sales tax may be refunded on motorcycles for farm use is to be abolished from midnight tonight. Given that the use of farm motorcycles is now firmly established in the farming community, and in the light of continuing policing difficulties, this concession is no longer serving a useful purpose.

Administrative changes

The following changes are being made to streamline the administration of the present wholesale sales tax:

- refunds of sales tax will no longer be allowed on taxable goods used in the repair of exempt goods;
- the turnover limit for exemption of traders from licensing is to be increased from $ 1,000 to $ 5,000. The exemption for contractors will be increased from $ 500 to $ 2,500;
- provision will be made in the Sales Tax Act 1974 to license and tax Government agencies which perform manufacturing or wholesaling functions within the meaning of the Act;
- with effect from 1 January 1983, the present flat 10% penal tax on default of payment of sales tax will be replaced by a new penalty of 10%, increasing cumulatively by 2% each succesive month that the tax remains unpaid. The new penalty will operate on the day following the date on which the sales tax return is due and will also be applied to the collection of domestic air travel tax, international departure tax, and motor spirits duty.

With the exception of the new cumulative penalty provision, these measures will take effect from midnight tonight. Introduction of the new cumulative penalty provision will be delayed until 1 January 1983 to allow taxpayers in default, and those who normally pay after the expiry of the discount period, an transitional period in which either to wipe off their debts or to arrange finance for the faster payment of tax without penalty. The shortening of the period for payment without penalty will increase sales tax collections by about $ 45 million for this year only.

The Minister of Customs will announce details of these changes to indirect taxes later tonight.

PUBLIC ACCOUNTS

The Public Accounts for 1981–82 were tabled in the House recently. The main features of the Consolidated Account, the major operating account, were:

- ordinary payments, which comprise annual and permanent appropriations, totalled $ 10,899 million, an increase of $ 1,913 million or 21% over 1980–81;
- ordinary receipts, comprising taxation, interest, dividends, profits, and departmental receipts, totalled $ 9,843 million, an increase of $ 1,891 million or 24% over 1980–81.

After transferring $ 100 million from the Consolidated Account to the Reserve Account to cover the balance of the commitment due at 31 March 1982 in respect of supplementary minimum prices, a transfer of $ 1,281 million was made from the Loans Account to the Consolidated Account. This latter transfer was well within the $ 1,950 million allowed for this purpose in the 1981 Appropriation Acts.

CONCLUSION

Tonight's Budget has implemented the income tax reductions which I said would be the counterpart to the prices and incomes freeze. For most wage and salary earners, the reductions will be substantial.

Within the constraints imposed by the need to reduce inflation, the first stage of the Government's strategy for tax reform has been introduced tonight. The new income tax scale will substantially lessen both fiscal drag and the imbalance in the tax treatment of single- and two-income families. It will also reduce the incentive to evade and avoid income tax. The

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scope for tax avoidance has been further reduced by a range of specific measures.

These changes will be achieved within firm and consistent fiscal and monetary policies. The Government is determined that the freeze will work, and that inflation and inflationary expectations will be reduced substantially.

In the medium term, the Government will continue to pursue its goal of making the economy more flexible. A substantial reduction in inflation will greatly assist the realisation of the growth strategy, just as a more flexible economy will support the counter-inflationary measures.

The success of these policies will depend upon the support of the people. I am convinced that our people will respond to the challenge.

APPENDIX I
New income tax rate scale for individuals

	The rate of tax for every dollar is (%)
On so much of the taxable income as:	
Does not exceed $ 6,000	20.0
Exceeds $ 6,000 but does not exceed $ 24,000	31.0
Exceeds $ 24,000 but does not exceed $ 30,000	41.0
Exceeds $ 30,000 but does not exceed $ 38,000	51.0
Exceeds $ 38,000	60.0

A 10% temporary surtax on the marginal tax rates applying to taxable income in excess of $ 24,000 will also apply in conjunction with the above scale. The marginal tax rates that will then apply are:

	The rate of tax for every dollar is (%)
On so much of the taxable income as:	
Does not exceed $ 6,000	20.0
Exceeds $ 6,000 but does not exceed $ 24,000	31.0
Exceeds $ 24,000 but does not exceed $ 30,000	45.1
Exceeds $ 30,000 but does not exceed $ 38,000	56.1
Exceeds $ 38,000	66.0

Note: These rates will be reflected in new PAYE tax tables applying to pay periods ending on or after 1 October 1982, and become the annual rates in respect of income from 1 April 1983. The annual tax rate scale for the year ending 31 March 1983 will take into account the combined effect of the present and new scales on income earned during the year.

APPENDIX II
Examples of changes in tax paid

	Single taxpayer		*Taxpayer with dependants**	
Weekly income	*Weekly tax payable under new scale (including principal income earner rebate)*	*Change in tax*	*Weekly tax payable under new scale (including family rebate)*	*Change in tax*
$	$	$	$	$
40	5.68	0	0	0
80	11.46	0	0	0
120	18.20	– 1.77	0	0
160	30.60	– 3.37	9.60	– 3.37
200	43.00	– 4.97	23.58	– 4.65
240	56.39	– 5.58	41.98	– 5.05
280	73.59	– 7.15	60.38	–10.22
320	86.20	–13.74	78.78	–15.82
360	98.60	–21.98	97.18	–20.40
400	111.00	–31.58	111.00	–28.58
480	138.26	–51.11	138.26	–48.11
560	174.34	–63.03	174.34	–60.03
640	217.25	–68.12	217.25	–65.12
800	313.76	–67.61	313.76	–64.61
1,000	445.76	–55.61	445.76	–52.61
1,200	577.76	–43.61	577.76	–40.61

* A taxpayer with dependants is a taxpayer who claims the spouse, young family, and low-income family rebates currently and who will be eligible for the new family rebate.

APPENDIX III[1]

Change in tax paid by a single person

Income		*Present annual tax paid*	*New annual tax paid*	*Change in tax*		*Percentage tax change*
Annual	*Weekly*			*Annual*	*Weekly*	
$	$	$	$	$	$	
10,400	200	2,494.3	2,235.9	– 258.4	– 4.97	–10.4
13,000	250	3,449.5	3,155.6	– 293.9	– 5.65	– 8.5
15,600	300	4,697.5	4,159.9	– 537.6	–10.34	–11.4
18,200	350	5,983.9	4,965.9	–1,018.0	–19.58	–17.0
20,800	400	7,413.9	5,771.9	–1,642.0	–31.58	–22.1
23,400	450	8,911.3	6,577.9	–2,333.4	–44.87	–26.2
30,000	577	12,871.3	9,462.5	–3,408.8	–65.55	–26.5
35,000	673	15,871.3	12,261.8	–3,609.5	–69.41	–22.7
40,000	769	18,871.3	15,259.7	–3,611.6	–69.45	–19.1

Change in tax paid by a single-income family with a child under 5[2]

Income		*Present annual tax paid*	*New annual tax paid*	*Change in tax*		*Percentage tax change*
Annual	*Weekly*			*Annual*	*Weekly*	
$	$	$	$	$	$	
10,400	200	1,468.1	1,226.1	– 242.0	– 4.65	–16.5
13,000	250	2,735.3	2,442.1	– 313.2	– 6.02	–11.5
15,600	300	4,295.3	3,618.1	– 677.2	–13.02	–15.8
18,200	350	5,827.9	4,814.1	–1,013.8	–19.50	–17.4
20,800	400	7,257.9	5,771.9	–1,486.0	–28.58	–20.5
23,400	450	8,755.3	6,577.9	–2,177.4	–41.87	–24.9
30,000	577	12,715.3	9,462.5	–3,252.8	–62.55	–25.6
35,000	673	15,715.3	12,261.8	–3,453.5	–66.41	–22.0
40,000	769	18,715.3	15,259.7	–3,455.6	–66.45	–18.5

Change in tax paid by a single-income family with a child over 5[3]

Income		*Present annual tax paid*	*New annual tax paid*	*Change in tax*		*Percentage tax change*
Annual	*Weekly*			*Annual*	*Weekly*	
$	$	$	$	$	$	
10,400	200	1,936.1	1,226.1	– 710.0	–13.65	–36.7
13,000	250	3,203.3	2,442.1	– 781.2	–15.02	–24.4
15,600	300	4,541.5	3,618.1	– 923.4	–17.76	–20.3
18,200	350	5,827.9	4,814.1	–1,013.8	–19.50	–17.4
20,800	400	7,257.9	5,771.9	–1,486.0	–28.58	–20.5
23,400	450	8,755.3	6,577.9	–2,177.4	–41.87	–24.9
30,000	577	12,715.3	9,462.5	–3,252.8	–62.55	–25.6
35,000	673	15,715.3	12,261.8	–3,453.5	–66.41	–22.0
40,000	769	18,715.3	15,259.7	–3,455.6	–66.45	–18.5

Notes:
(1) These taxables reflect the weekly tax changes on a full-year basis.
(2) These families may currently be eligible for the spouse, young family and low income family rebates.
(3) These families may currently be eligible for the spouse and low-income family rebates.

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APPENDIX IV[1]

Change in tax paid by a married couple without dependants

Principal income earner's weekly income	*Spouse's weekly income*				
	$0[2]	*$50*	*$100*	*$150*	*$200*
$	$	$	$	$	$
200	− 1.97	− 2.27	+ 0.48	− 1.94	− 3.94
250	− 2.65	− 2.96	− 0.21	− 2.62	− 4.62
300	− 7.34	− 7.64	− 4.89	− 7.31	− 9.31
350	−16.58	−16.88	−14.13	−16.55	−18.55
400	−28.58	−28.88	−26.13	−28.55	−30.55
450	−41.87	−42.18	−39.43	−41.84	−43.84

Change in tax paid by a two-income family with a child under 5[3]

Principal income earner's weekly income	*Spouse's weekly income*				
	$0[2]	*$50*	*$100*	*$150*	*$200*
$	$	$	$	$	$
200	− 4.65	− 3.49	+ 4.91	+ 9.99	+11.06
250	− 6.02	− 0.71	+ 9.54	+10.19	+ 8.19
300	−13.02	− 5.98	− 0.16	− 2.57	− 4.57
350	−19.50	−16.88	−14.13	−16.55	−18.55
400	−28.58	−28.88	−26.13	−28.55	−30.55
450	−41.87	−42.18	−39.43	−41.84	−43.84

Change in tax paid by a two-income family with a child over 5[4]

Principal income earner's weekly income	*Spouse's weekly income*				
	$0[2]	*$50*	*$100*	*$150*	*$200*
$	$	$	$	$	$
200	−13.65	−12.49	− 4.09	+ 0.99	+ 2.06
250	−15.02	− 9.71	− 0.54	+ 1.19	− 0.81
300	−17.76	−10.71	− 4.89	− 7.31	− 9.31
350	−19.50	−16.88	−14.13	−16.55	−18.55
400	−28.58	−28.88	−26.13	−28.55	−30.55
450	−41.87	−42.18	−39.43	−41.84	−43.84

Notes:
(1) These taxables reflect the weekly tax changes on a full-year basis.
(2) These families are eligible for the present spouse rebate.
(3) These families may be eligible for the present young family and low-income family rebates.
(4) These families may be eligible for the present low-income family rebate.

Conference Diary

JANUARY 1983

British Branch of I.F.A.: Recent tax cases. London (United Kingdom), January 18 (English).

FEBRUARY 1983

British Branch of I.F.A.: Tax treatment of non-residents (Tax workshop). London (United Kingdom), February 8 (English).

Steuer-Telex-Seminar: Tax beneficial investment IX. Cologne, Frankfurt, Munich (Federal Republic of Germany), February 23-25 (German).

Management Centre Europe: International tax management (Seminar). Brussels (Belgium), February 28-March 1 (English).

MARCH 1983

British Branch of I.F.A.: Tax aspects of interest (Tax workshop). London (United Kingdom), March 2 (English).

Management Centre Europe: Managing and developing foreign subsidiaries (including: tax in international operations). Brussels (Belgium), March 28-30 (English).

APRIL 1983

The Taxation Institute of Australia: Sixth National Convention (including: the role of the High Court in interpreting tax statutes; taxation of technology; tax shelters and planning for the '80s). Melbourne (Australia), April 10-15 (English).

Management Centre Europe: International tax conference (including: intra-group services; relationships with the national Fisc in country of operation; changes in the tax climate). Brussels (Belgium), April 13-15 (English)

OCTOBER 1983

37th Annual Congress of I.F.A.: I. Tax avoidance/tax evasion. II. International problems in the field of turnover taxation. Venice (Italy), October 10-15 (English, French, German, Spanish).

FOR FURTHER INFORMATION PLEASE WRITE TO:

British Branch of I.F.A.: P.O. Box 68, Unilever House, Blackfriars, London EC4P 4BQ (United Kingdom).

International Fiscal Association (I.F.A.): General Secretariat, Woudenstein, Burgemeester Oudlaan 50, P.O. Box 1738, 3000 DR Rotterdam (the Netherlands).

Management Centre Europe: Avenue des Arts 4, B-1040 Brussels (Belgium).

Steuer-Telex-Seminar: Dr. Peter Deubner Verlag GmbH, Abteilung Seminare, Postfach 410268, 5000 Köln 41 (Federal Republic of Germany).

The Taxation Institute of Australia: 113 Swanson Street, Melbourne VIC. 3000 (Australia).

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BANGLADESH:

The Finance Ordinance, 1982

By K.A. Gofran*

Some important amendments have been made this year in the different fiscal statutes by the Finance Ordinance, 1982. This article summarizes a number of changes which are of particular interest.[1]

INCOME-TAX ACT, 1922

1. Exemption of income from property [Section 4(3)(xii)(ff)]

The income from newly constructed buildings having a plinth area of not more than 1,000 square feet was exempt from income tax for a period of 5 years from the date of completion, provided erection of the building was begun and completed at any time between 1 July 1980 and 30 June 1985 (both days inclusive). This restriction on the date of commencement of construction during the above period has been withdrawn with retrospective effect from 1 July 1980. The income of such a property is now eligible for exemption even if construction of the building commenced before July 1980 and was completed at any time between 1 July 1980 and 30 June 1985.

2. Exemption on account of conveyance [Section 7(1)]

Previously a salaried person enjoyed exemption for 4,200 Tk. if he owned and maintained at his own expense a car registered in his own name and did not receive any conveyance allowance or any other benefit or perquisite in lieu of such allowance from the employer. Similarly the exemption was for 2,400 Tk. if the conveyance was any other power-driven vehicle and 1,800 Tk. if he maintained no vehicle. The limits of the above exemptions have been raised to 6,000 Tk., 3,200 Tk. and 2,400 Tk. respectively.

3. Determination of notional income from self-occupied house [Section 9(2)(b)]

In order to simplify the calculation of the annual value of a self-occupied building of an assessee, an amendment has been made in clause (b) of sub-section (2) of Section 9. No tax is payable if the annual value of such property does not exceed 6,000 Tk. Under the previous wording, if it exceeded 6,000 Tk., a deduction of 6,000 Tk. was made and the balance so arrived at or a sum equal to 10% of the total income of the owner, whichever was less, was taken as the annual value. The position after amendment is that either the balance after deduction of 6,000 Tk or a sum equal to *10% of all other income excluding the notional income* from the residential house, whichever is less, is the annual value of the self-occupied house for the purpose of assessment.

4. Availability of accelerated depreciation [Section 10(2)(vi)(b)]

The date up to which accelerated depreciation was available in respect of any machinery or plant (other than office appliances and road transport vehicles) expired on 30 June 1982. The time limit has been extended to 30 June 1987.

5. Admissibility of festival bonus as business expenditure [Section 10(2)(x)]

A bonus paid to an employe is an admissible expenditure if it is a reasonable amount with reference to the pay of the employee, profit of the business and general practice in similar businesses. In other words, it is an admissible expenditure under certain conditions. These conditions have been waived in the case of admissibility of festival bonus as a business expenditure.

6. Exemption of capital gains invested in new industrial undertaking [Section 12B (7)]

Capital gains arising from the sale, exchange or transfer of lands or buildings have been made exempt from tax if they are invested for setting up a new industrial undertaking within the 2-year period immediately following the date on which the sale, exchange or transfer took place.

7. Furnishing of certificate by private limited company [Section 13A(1)]

Previously every private company whose paid-up capital on the last day of any previous year was 2,000,000 Tk. or more was required to furnish to the Deputy Commissioner of Taxes a copy of the balance sheet and profit and loss account duly certified by a chartered accountant. This limit of the paid-up capital has been reduced to 1,000,000 Tk.

8. Enhancement of exemption limit for investment by cottage industries [Section 14(3)(b)(ii)]

For the purpose of exemption of cottage industries the maximum investment limit has been raised from 10,000 Tk. to 50,000 Tk.

9. Withdrawal of earned income relief [Section 2(6AA) and (15A)]

The distinction between earned income and unearned income has been done away with this year by omitting the definition of "earned income" in Section 2(6AA). Consequently the earned income relief previously granted to an assessee other than a company has been withdrawn by omitting Section 15A. However, the National Board of Revenue has issued instructions to tax officials to allow the earned income allowance to salaried persons whose salary is liable to be charged to tax according to the rates as per the Finance Act, 1981 for the assessment year 1982-83 (see N.B.R. Circular No. 10 (I.T.) of 1982).

* Editor of *Bangladesh Tax Decisions*.

1. *Editor's note:* The November 1982 issue of the *Bulletin* contains extracts from the Budget Speech for 1982-83.

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10. Withdrawal of restriction on investment allowance [Section 15(3A)]

The restriction imposed by the Finance Act, 1980 on the availability of the full benefit for investment in the purchase of Savings Certificates, etc. has been withdrawn. Henceforth the investment allowance will be available to an assessee for his full investment subject to the maximum of 30% of his total income or 35,000 Tk., whichever is less.

11. Exemption of contribution to Zakat Fund, etc. [Section 15DD]

A new Section 15DD has been inserted which provides an exemption in respect of any sums paid by an assessee as Zakat to the Zakat Fund or as a donation or contribution to a charitable fund established by or under the Zakat Fund Ordinance, 1982.

12. Withdrawal of exemption for educational expenses of children [Section 15E]

An assessee whose total income was not more than 50,000 Tk. previously enjoyed exemption of a portion of his income on account of the educational expenses of his children or children wholly dependent on him. This exemption has been withdrawn by omitting Section 15E. However, the National Board of Revenue has issued instructions to allow the exemption to salaried persons (if eligible) for the assessment year 1982-83 as in the case of the earned income allowance (see N.B.R. circular No. 10 (I.T.) of 1982 dated 31 July 1982).

13. Tax credit on investment of shares by a company [Section 15G(3)]

A company is entitled to a credit equal to 50% of the amount it invests in the purchase of shares or debentures issued by the Equity Participation Fund against the tax payable by it. Sub-section (3) of Section 15, which replaces the old sub-section (3), provides that where no tax is payable by a company in respect of the year in which the company makes such investment or where the amount of tax payable is less than the amount of credit, the amount of the credit or so much of it as has not been deducted, as the case may be, shall be carried forward and deducted from the tax payable by the company in the following year and so on.

14. Withdrawal of personal allowance [Section 15H]

Previously an assessee, whether an individual, Hindu undivided family, unregistered firm or association of persons, enjoyed exemption for 3,000 Tk. on account of personal allowance. This exemption has been withdrawn by omitting Section 15H. However, the National Board of Revenue has issued instructions to allow this allowance to a salaried person for the assessment year 1982-83 as in the case of earned income allowance (see N.B.R. Circular No. 10 (I.T.) of 1982 dated 31 July 1982).

15. Tax on non-residents [Section 17(1)(a)]

Provision has been made this year to charge income tax only at the maximum rate on the total income of a non-resident assessee other than a company. The other alternative – to charge tax at the rate applicable to a resident in such a case – has been abolished. The maximum rate of income tax has been fixed at 30% of the total income of a non-resident assessee according to the Finance Ordinance, 1982.

16. Reduction in the rates of tax on capital gains [Section 17(5)(b)(ii)]

The rates of tax on capital gains in the case of an assessee other than a company or a registered firm have been reduced and fixed as follows:

(i) Where the capital gains arise as a result of disposal by an assessee of his capital assets after 2 years but within 5 years from the date of their acquisition, the income tax is payable on the said gains at the rate applicable to total income including the said capital gains, or income tax at the rate of 25% on the amount of capital gains, whichever is lower.

(ii) Where the capital gains arise after 5 years but within 15 years from the date of acquisition of the capital assets, income tax payable on such gains is at the rate applicable to total income including the said capital gains, or income tax at the rate of 20% on the amount of capital gains, whichever is lower.

(iii) Where the capital gains arise after 15 years from the date of acquisition of the capital assets, the income tax payable on the capital gains is at the rate applicable to total income including the said capital gains, or income tax at 15% on the amount of capital gains, whichever is lower.

17. Withdrawal of exemption of capital gains [Proviso to Section 17(5)]

The provision of exemption of capital gains arising as a result of disposal of assets acquired before 14 August 1947 has been withdrawn by omitting the proviso to Section 17(5).

18. Enhancement of limit of income for liability to pay advance tax [Section 18A(1)]

The limit of total income for liability to payment of advance tax under Section 18A has been raised from 25,000 Tk. to 50,000 Tk.

19. Enhancement of the rate of interest on delayed refund of excess advance tax [Section 18A (5)]

The rate of interest for delayed refund of advance tax paid in excess under Section 18A has been raised from 10% to 13.5%.

20. Raising of limit of income for liability to furnish statement of assets and liabilities [Section 22(4A)]

Previously, an individual whose total income exceeded 25,000 Tk. was required to furnish along with the return a statement of assets and liabilities of himself, his wife or wives and his minor children. This limit of income has been raised to 50,000 Tk.

21. Abolition of provision for presumptive assessment [Section 23(3A)]

The provision of presumptive assessment introduced by

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the Finance Act, 1980 has been abolished by omitting sub-section (3A) of Section 23.

22. Requirement of obtaining clearance certificate for registration of documents [Section 47A(1)]

Clearance certificates previously had to be obtained from the Deputy Commissioner of Taxes in connection with the registration of any document purporting to transfer, assign, limit or extinguish the right, title or interest of any person in any property valued at more than 50,000 Tk. This limit has now been raised to 100,000 Tk. A clearance certificate is, therefore, not necessary for registering a document of a property valued at up to 100,000 Tk.

23. Taxable limit

The maximum taxable limit has been raised from 15,000 Tk. to 20,000 Tk.

24. Self-assessment

The scope of the scheme of self-assessment has been widened this year by raising the maximum limit from 25,000 Tk. to 50,000 Tk. Moreover, the salaried directors of limited companies have also been made eligible for self-assessment. The National Board of Revenue has issued Notification No. S.R.O. 276-L/82 dated 30 July 1982 in this regard.

25. Exemption of gratuity

Gratuity paid to a retired employee has now been totally exempted from the payment of tax (see N.B.R. Notification No. S.R.O. 226-L/82 dated 30 June 1982).

26. Exemption of royalty and technical know-how fees

Royalty and technical know-how fees have been exempted from payment of tax (see N.B.R. Notification No. S.R.O. 227-L/82 dated 30 June 1982).

27. The Sales-tax Act, 1951 (III of 1951)

The Sales-tax Act, 1951 (III of 1951) has been repealed and the sales tax law has been completely recast. A new Ordinance called the "Sales-tax Ordinance 1982" has been promulgated.

This Ordinance came into force on 1 July 1982. Sales tax will henceforth be levied at the import and export stages. Therefore, there will no longer be any sales tax on locally manufactured or produced goods. However, according to the provisions of the new Ordinance all pending sales tax assessments for the period up to 30 June 1982 will be made as before. The provisions of the Sales-tax Act, 1951, rules made and Notifications issued thereunder will remain in force for the purpose of pending sales tax assessments.

The administration of the Sales-tax Ordinance, 1982 will be the responsibility of the Customs Authorities.

28. The Urban Immovable Property Tax Act, 1957 (E.P. Act XI of 1957)

The rates of urban immovable property tax have been rationalised and reduced this year. The rates of this tax are as below after the amendment:

	Rates of tax
(a) in all cases of holdings within the limits of the Dacca Metropolitan Area the annual value of which does not exceed 18,000 Tk.	Nil
(b) in all cases of holdings other than holdings within the limits of the Dacca Metropolitan area the annual value of which does not exceed 12,000 Tk.	Nil
In other cases –	
(a) Not being self-occupied holdings	3% of the annual value
(b) Self-occupied holdings	1.5% of the annual value

In case the holding (not being a self-occupied holding) remains vacant for at least 60 days, the assessee is entitled to a remission to the extent of ¾ of the amount of such period. The above rates are effective from 1 July 1982.

29. The Gift Tax Act, 1963 (XIV of 1963)

(a) *Exemption from gift tax* [Section 5(1)]

Gifts to father, mother, real sons and daughters up to 300,000 Tk. and to spouse up to 100,000 Tk. were previously exempt from tax. These two exemptions have been merged into one and the maximum limit of a tax-free gift has been fixed at 400,000 Tk. This means that gift tax is not payable on gifts made by an assessee to his real sons, daughters, father and mother or to his or her spouse for an amount up to a maximum of 400,000 Tk. in value in the aggregate in one or more previous years.

(b) *General exemption from gift tax* [Section 5(2)]

There was a general exemption from gift tax for an amount of 20,000 Tk. per year. This limit has been raised to 25,000 Tk.

(c) *Rates of gift tax*

Previously there were 6 slabs of rates of gift tax. The number of slabs has been reduced to 4 this year with a modification in the rates of tax in each slab. The rate of tax varies from 5% to 20% of the value of all taxable gifts.

30. The Wealth Tax Act, 1963 (XV of 1963)

(a) *Enhancement of exemption limit for self-occupied residential house* [Section 5(1)(xiii)]

The value of a house owned and occupied by an assessee for the purpose of his own residence was exempt up to 1,500,000 Tk. The exemption limit has been raised to 2,500,000 Tk.

(b) *Withdrawal of restriction on the aggregate amount of income tax and wealth tax*

Previously the aggregate of income tax and wealth tax could not exceed 60% of the total income of an assessee if his taxable income exceeded 150,000 Tk. This restrictive provision has been withdrawn.

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UNITED STATES:

The International Banking Facility

by David A. Taran*

On 3 December 1981, U.S. Federal Reserve Board amendments authorizing U.S. depository institutions, Edge Act Corporations, Agreement Corporations and U.S. branches and agencies of foreign banks to establish international banking facilities in the United States became effective.[1] The amendments were necessary to permit banks within the United States to enjoy some of the competitive advantages available to offshore shell branches. Many states have already adopted enabling legislation and have favorably amended their state income tax laws.

Generally, an international banking facility, while based in the United States, enjoys the advantage of having its business activities treated as if conducted outside the United States.

An international banking facility is not a separately licensed bank or office of a bank, but, rather, a segregated portion, or division, of the business of such bank or office in the United States. This segregated portion is to be reflected in separate accounts segregated on the books and records of that bank or office, to be treated for regulatory and, generally, for state income tax purposes as being conducted outside of the United States.[2]

This article will first provide some vital background discussion on the international banking facility. Focus will then be directed to the state and local income tax relief afforded international banking facilities by the states of New York and California.[3] International banking facilities do not enjoy federal income tax relief.

1. BACKGROUND

International banking facilities may be maintained at any one or more of the U.S. agencies or branches of a foreign bank. Transfers of assets and liabilities between the international banking facility and the branch or agency of which it is a division or other domestic offices of the foreign bank would be subject to Eurocurrency reserve requirements as if the international banking facility were an offshore office of that bank.[4] Operations of the international banking facility can be conducted side by side with, and under the same management as, the domestic operations of the branch or agency, in the same manner as operations of offshore shell branches are conducted in tandem with domestic operations of U.S. banking offices.

International banking facilities are permitted to accept time deposits only from foreign offices of other U.S. depository institutions, or foreign banks, foreign residents, other international banking facilities and the foreign or domestic operations of the foreign bank in question.[5] This includes foreign affiliates of U.S. corporations, provided that funds received on deposit are not derived from the U.S. operations of the depositor and the size of such deposit is $ 100,000 or more.[6]

Time deposits may be held by the division in the form of deposits, borrowing, placements or equivalent instruments. To prevent purchase of such deposits by U.S. residents, no negotiable certificates of deposit, banker's acceptances, or other such negotiable instruments can be issued by an international banking facility.[7] Furthermore, international banking facilities do not have the authority to accept demand deposits.[8] Funds may be borrowed from foreign offices of other depository institutions, from other international banking facilities, and from foreign or domestic offices of the bank establishing the international banking facility.[9] Time deposits of qualified depository banks will not be subject to any minimum transaction amount. Any funds raised by an international banking facility, whether through deposits or borrowings, are exempt not only from federal reserve requirements but also from interest rate restrictions.[10]

On the loan side, international banking facilities can extend credit to foreign residents, other international banking facilities and, subject to Eurocurrency reserve requirements, to the U.S. offices of their parent banking institutions. However, loans made to a foreign resident cannot be repatriated to finance the U.S. operations of the borrower.[11] The effect of this is to permit the repatriation of Eurodollars, which can be held and exchanged in the United States through a network of international banking facilities. However, because of the limitations of lending and borrowing imposed on international banking facilities, Eurodollars held by international banking facilities cannot be integrated into the U.S. banking system, except through the "screen" of reserve requirements imposed on domestic borrowings of Eurodollars.

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* © 1982 David A. Taran. David A. Taran received his D.C.S. from McGill University, LL.L. from University of Ottawa, and J.D. from Columbia University. Mr. Taran is an attorney with the law firm of Graham & James in Los Angeles, and a member of the Editorial Advisory Board of the *International Tax Journal*. He is currently enrolled in the LL.M. (Taxation) program at New York University.

1. These amendments were made to Regulation D, 12 C.F.R. § 204.8 and Regulation Q, 12 C.F.R. 217.3(g).
2. See Regulation D. 12 C.F.R. § 204.8(a)(1).
3. As a result of the U.S. federal system of government, foreign banks are generally subject to U.S. income taxation on their U.S. operations at two levels, both the federal level and the state level. Federal income tax laws are normally of greater concern to a foreign bank operating in the United States. However, state income taxes can be substantial in amount and are not subject to the many tax treaties which the United States has negotiated with various foreign governments to mitigate the effect of double taxation.
4. See Regulation D, 12 C.F.R. § 204.8(a)(1).
5. See Regulation D, 12 C.F.R. § 204.8(a)(2).
6. See Regulation D, 12 C.F.R. § 204.8(a)(2).
7. See Regulation D, 12 C.F.R. § 204.8(a)(2).
8. See Regulation D, 12 C.F.R. § 204.8(a)(2).
9. See Regulation D, 12 C.F.R. § 204.8(a)(2).
10. See Regulation Q, 12 C.F.R. § 217.3(g).
11. See Regulation D, 12 C.F.R. § 204.8(a)(3).

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2. STATE TAXATION

Since the purpose behind the international banking facility concept is to provide United States-based banking operations of foreign and domestic banks with many of the advantages of operating an offshore shell branch, a crucial element in this scheme is the availability of state and local tax relief. Many states have, therefore, enacted legislation granting an exemption, from state and local taxation, of the income of banking institutions which is derived from an international banking facility. This article will focus solely on the states of New York and California, both of which play a major role in international banking.

A. New York

Both New York and New York City enacted tax legislation on 19 June 1978, the effective date of which was deferred until 3 December 1981, which generally exempts net income derived by international banking facilities from state and local income tax by the mechanism of allowing the deduction of adjusted eligible net income (eligible gross income less attributable expenses, the ineligible funding amount, and the floor amount) from income subject to state and city tax.[12]

Gross income which is eligible for this relief includes income earned, by an international banking facility, from making, arranging for, placing, or servicing loans to foreign persons, making or placing deposits with foreign banks or foreign branches of banks (including foreign subsidiaries or foreign branches of the bank that has organized the international banking facility) or with other international banking facilities, and entering into foreign exchange trading or hedging transactions related to any of the above transactions.[13] In addition, where an international banking facility makes a loan to an individual who is a non-resident of the United States, to a foreign branch of a U.S. corporation, or to a foreign corporation or foreign partnership which is owned or controlled, directly or indirectly, 80% or more, by one or more non-bank U.S. corporations, U.S. partnerships or resident aliens, substantially all of the proceeds of the loan must be for use outside the United States if the gross income derived from that loan is to be eligible for the deduction.[14]

Although an international banking facility is limited to transacting business with foreign persons, the term foreign person has been given an expansive definition under the New York tax law. In determining whether an individual is a foreign person, citizenship is not the determining factor. Any individual who is not a resident of the United States should qualify as a foreign person, as should a foreign corporation, foreign partnership, or foreign trust, subject to the qualification that a U.S. branch of any of those entities will be a U.S. person.[15] Conversely, a foreign branch of a U.S. corporation, including the bank which organized the international banking facility, will constitute a foreign person.[16] An international banking facility, a foreign government, and international organization or any agency of either, will also qualify as foreign persons.[17]

Expenses and deductions attributable, directly or indirectly, to gross income which is eligible for the special international banking facility deduction must then be subtracted from eligible gross income to get a net income figure eligible for the special international banking facility deduction.[18] This net income figure is then subject to further downward adjustment where the international banking facility is partly or wholly funded from U.S. sources, as opposed to funded wholly from foreign sources.[19] This specific downward adjustment, by the ineligible funding amount, is computed separately each year and is equal to a fractional share – equal to the amount of liabilities of the international banking facility from domestic sources over the world-wide liability of the international banking facility – of the eligible net income.[20]

In addition to the downward adjustment to eligible net income for funding from U.S. sources (the ineligible funding amount), a further reduction of eligible net income by the floor amount may be required. Since the intent of the New York legislation is to grant the international banking facility tax benefit only to the extent that banks have increased their permissible activities in New York over the same activity conducted in New York during a base period, where a bank engaged in permissible activities during those base years, a downward adjustment is made based on the average of the annual aggregate amounts for the three base years, subject to a phase-out percentage based on a 10-year phase-out period.[21] This specific downward adjustment is computed separately each year and is equal to a fractional share – equal to the quotient of the product of the bank's loans and deposits during the base period, recorded in the financial books of its New York branch, agency, or office, which would have qualified as international banking facility qualified loans and deposits ("qualified loans and deposits") multiplied by the applicable phase-out percentage, all less the qualified loans and deposits for the current taxable year, other than those recorded in the financial books of the international banking facility divided by the qualified loans and deposits for the current taxable year, recorded in the financial books of the international banking facility – of the eligible net income less the ineligible funding amount.[22]

The base period selected for comparison, in determining this last downward adjustment to eligible net income, is 1975 through 1977. The phase-out percentage based on a 10-year phase-out period is:[23]

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12. See sections 1450(c), 1453(f), Tax Law; sections R46-37.0(c), -37.3(f), N.Y.C. Adm. Code. The effective date of these sections was deferred until 3 December 1981, the effective date of the Federal Reserve Board admendments to Regulations D and Q, see note 1.
13. See sections 1453(f)(2)(A), (B), (C).
14. See section 1453 (f)(8)(A).
15. See sections 1453(f)(8)(A), (B).
16. See section 1453(f)(8)(C).
17. See sections 1453(f)(8)(D),(E).
18. See section 1453(f)(3).
19 See sections 1453(f)(4), (5).
20. See sections 1453(f)(4), (5).
21. See sections 1453(f)(4), (6).
22. See section 1453(f)(6).
23. See section 1453(f)(6)(C).

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Years	Phase-out percentage
1981 to 1985	100%
1986	80%
1987	60%
1988	40%
1989	20%
1990	nil

B. California

California tax law employs the unitary method of taxation based on world-wide combined reporting. Under the California unitary method of taxation, a three factor formula – based on real and tangible property, payroll, and sales –[24] is used in apportioning the income of a unitary[25] multi-state or multi-national business.

By comparing the size of a foreign bank's operations in California to the size of its world-wide operations, a fractional share – equal to the average of its California payroll over world-wide payroll, California sales over world-wide sales, and California property over world-wide property – is applied against its world-wide income to determine the amount of the bank's income subject to California state income tax.

The unitary method of taxation based on world-wide combined reporting can have an adverse effect on the taxation of foreign banks and, in general, has been vehemently opposed, because, it is claimed, it can inequitably and improperly allocate the tax burden of foreign banks and result in double taxation. Among some of the inequities and problems cited are the difficulties involved in the translation of foreign currency base financial statements into dollar base financial statements. Identical transactions, and loans by the foreign bank and its agency, branch, or domestic subsidiary or affiliate, will earn different amounts of income dependent on fluctuations in foreign currency exchange rates.

The unitary method of taxation, it is claimed, can be seen as a fee for doing business in California, and not an income tax. Since the amount of the tax imposed depends on a comparison of the size of the bank's operations in California to the size of its world-wide operations and not on the basis of its profitability in California, tax liability determined under the world-wide combined reporting method has taken on the appearance of a fee for engaging in business in California, a fee which is substantially out of proportion to the income earned in California.

The situation may be exacerbated by the existence of minority shareholders holding stock in a domestic bank which is combined with its foreign parent bank. Here the fair market value of the minority shareholder's stock will be decreased by the California tax liability.

While there have been continuing efforts to abandon the method of unitary taxation based on world-wide combined reporting, both in the California state legislature and the United States Congress, and continuing attacks on the constitutionality of the world-wide combined reporting method in the courts,[26] to date, all these efforts have failed. Limited relief, however, is available under the California tax law for international banking facilities.

Legislation was passed by the California legislature and signed into law on 25 September 1981 which provides that, in determining the income of an international banking facility subject to California taxation, an international banking facility maintained by a bank in California shall be considered located without the state, and the property, payroll, and sales recognized as attributable to the international banking facility shall be attributed to the international banking facility in determining the proporty, payroll, and sales factors of the bank.[27] In effect, this will exempt income attributable to an international banking facility maintained in California from California taxation. The income attributable to an international banking facility will be determined in accordance with the usual California apportionment rules, including world-wide combined reporting for a unitary business; however, it may not be the same as the income shown on the books of the international banking facility as having been earned by the international banking facility.

3. FEDERAL INCOME TAXATION

The international banking facility is not a separately licensed bank or office, but simply a division of a bank, branch or agency. For federal income tax purposes, the international banking facility is taxed as a part of the bank, branch, or agency of which it is a division and not as a separate entity. It will be taxed under the normal federal income tax rules which, unless subject to a favorable treaty, will generally subject its income to taxation under the code rules regarding taxation of foreign and U.S.-source income effectively connected with a U.S. trade or business.[28]

Conclusion

The international banking facility is the newest of the banking vehicles available to a foreign bank operating or choosing to operate in the United States. It enjoys the advantage of having its business activities treated as if conducted outside the United States for both regulatory and state income tax purposes. However, because the international banking facility is not a separately licensed bank or office, but simply a division of a bank, branch, or agency, the international banking facility is taxed for federal income tax purposes as part of the bank, branch, or agency of which it is a division and not as a separate entity.

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24. See sections 25101, 25121, Revenue and Taxation Code.
25. See Buthler Brothers v. McColgen, 17 Cal. 2d 664 (1941); Edison California Store v. McClogan, 30 Cal. 2d. 472 (1947).
26. The United States Supreme Court has granted certiorari to two cases dealing with the constitutionality of the state method of unitary income taxation based on world-wide reporting, and will continue hearing these cases in the next term. Chicago Bridge & Iron Co. v. Caterpillar Tractor et al., No. 81-349 and Container Corp. of America v. Franchise Tax Board, No. 81-523; see Chicago Bridge Unitary Case Deferred, Tax Notes, May 10, 1982, p. 513.
27. See sections 1, 2, 3 Ch. 825, 1981-1982, Regular Session, adding sections 23044, 25107, Revenue and Taxation Code.
28. See sections 894(b), (c), 881, 882, 894 IRC.

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Fiscal Policies of the Middle East States with respect to Foreign Investment

Ahmed Abdullah Al-kadi *



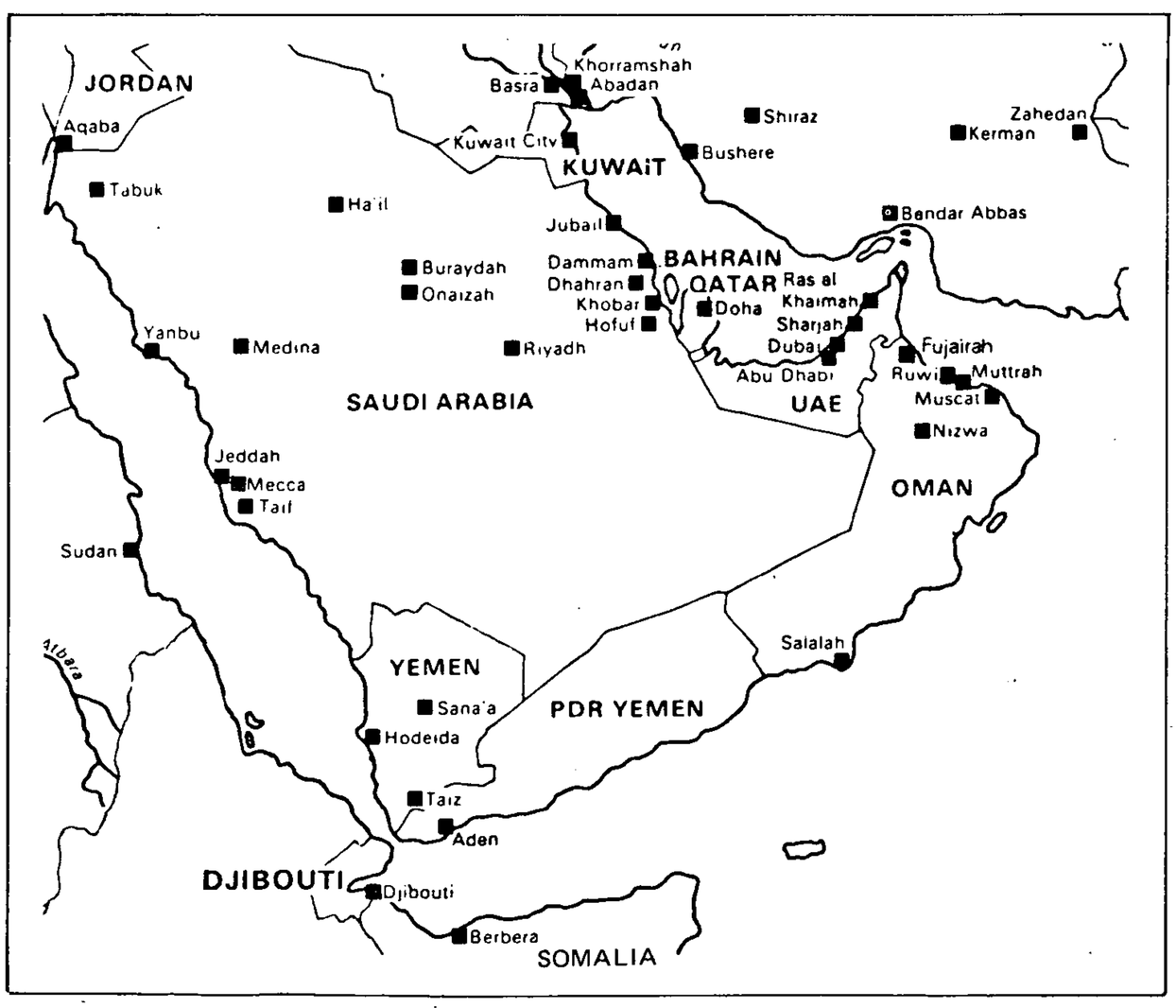
In trying to attract foreign investments, the Middle East States have created a good fiscal climate by enacting a number of investment laws which provide for numerous tax incentives and tax holidays. This article examines in particular the policies on inward investment of 3 States: the People's Democratic Republic of Yemen, the Yemen Arab Republic and Saudi Arabia.[1] The most favorable tax concessions are given to foreign investments in industrial and agricultural development schemes.

Examples are:

(1) The Law on the "Encouragement of Investment", No. 25 of 1981,[2] of the People's Democratic Repubic of Yemen provides for the following incentives: (a) exemption from customs duties on importation of machinery and construction materials necessary for the establishment or expansion of the project, on condition that such machinery and construction materials are not available in local production; (b) exemption from customs duties on the importation of spare parts for 2 years as of the date of the beginning of actual production for the market on condition that such spare parts are not available in the local market; (c) exemption or reduction of customs duties on importation of basic and raw material necessary for local production for 3 years as of the date of commencement of actual production for the market; (d) licensed projects are exempted from income tax for a period not exceeding 5 years as of the date of commencement of actual production for the market; (e) the project is allowed to carry over its losses according to Income Tax Ordinance 8 of 1961; (f) the investor and the participant are exempt from income tax on 30% of their profits derived from investing and participating in the project.[3]

(2) In the Yemen Arab Republic (North Yemen) under Law 18 of 1975, in connection with Promotion and Organization of Investment, a development project in which foreign capital may be invested is one which operates mainly in the fields of industry, agriculture, and tourism. Tax incentives are: (a) exemption from commercial, industrial and business taxes for 5 years as of the date of production. If the turnover of profits in the fifth year exceeds 2,000,000 Yemeni Rials, then for an additional 5 years tax will be charged at only half the normal rates; (b) exemption from the payment of all kinds of import and customs duties on equipment, spare parts, and building materials for 5 years, which may be extended for an additional 3 years.

(3) The most illustrative law is that of Saudi Arabia. The Foreign Capital Investment Code of 1964 (Royal Decree 35 of February 1964) provides



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1. Examples of policies of other States of the region, for the sake of comparison, are also indicated.
2. Law 25 of 1981 entered into force on 22 October 1981. It repealed the previous Law for Regulation and Promotion of Investment of 1969, No. 23 of 1971.
3. In addition to tax incentives, the Law provides for a number of financial facilities. For instance, projects with special importance to the domestic economy and whose products are not destined for export are allowed to transfer the entire amount of annual profits abroad. Foreign employees of the project are allowed to transfer abroad up to 75% of their income, after paying the income tax due.

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for tax exemptions for licensed industrial and agricultural projects on net profits for 10 years, and 5 years for other projects.

Requirements for doing business

As a rule, participation of national capital in development projects is required. In the People's Democratic Republic of Yemen, under the above-mentioned investment law, the share of national capital, whether private or public, in an approved project is not defined. However, the Law establishes a Standing Committee which advises the Council of Ministers on almost all aspects of investment, including the proportion of foreign participation in an approved project. Under the Investment Law of the Yemen Arab Republic, there are three categories of enterprises: national, where the Yemeni capital is at least 90%; mixed, where the foreign capital is more than 10%; and finally foreign enterprises, where the foreign capital is at least 90%.[4] In Saudi Arabia, foreign capital may be invested without Saudi participation, but in this case it will not benefit from the provisions of the above-mentioned Foreign Investment Code. In Kuwait, under Section 26 of the Commercial Law of 1961, Kuwaiti participation in a joint business must not be less than 51%. The State of Qatar follows the example of Kuwait, except that non-Qataris wishing to invest in industry, agriculture, mining, and the tourism business may be exempted from the above rule by the Minister of Finance. In addition to this requirement, there are a number of other requirements which a foreign investor should fulfill before commencing business, including the license and registration requirements. In Democratic Yemen licenses are granted by a Standing Committee after the approval of the Council of Ministers.

When a license is granted, the enterprise is registered at the Civil Registrar. In the Yemen Arab Republic, the license is given by the Ministry of Economy. The project is registered in the Commercial Register within 30 days after granting the license. In Saudi Arabia, application must be made to the Foreign Capital Investment Bureau of the Ministry of Industry and Electricity to obtain a license to invest. Once the license is granted,[5] the project must be implemented within 6 months, otherwise the Minister may cancel it.[6] The project is registered in the Commercial Register at the Ministry of Commerce.[7] The date of granting the license is important for the foreign investor from the viewpoint of Saudi taxation. If the company signs a business contract before the license was granted to it, then it does not enjoy the tax holiday provided for in the Investment Code. In this case, the company is liable to Saudi income tax on all its income from the project including that part which accrued after the license was granted.

Forms of business and company taxation

Several forms of business where foreign capital may participate are known in the Middle East countries. In Democratic Yemen, no distinct legislation applies to corporate bodies, with the exception of State corporations. Private business is carried out by sole proprietorships, general and limited partnerships, and by private mixed or foreign companies. Private companies are taxed on the same basis as partnerships, at the rate of 37.5% of their annual net profits. The taxable income of a company is the gross income less deductible expenses which should be exclusively incurred by the taxpayer in the production of the chargeable income.[8] In the Yemen Arab Republic, the law regulating companies is Presidential Act 106 of 1976. Beside general and limited partnerships, joint stock and limited liability companies are known. The tax is levied on the net profits of a foreign company derived from industrial or commercial activities regularly carried on in the Republic. The annual taxable profits are charged at rates ranging from 7% on the first 7,500 Yemeni Rials (approximately 5 to 6 Rials equal US$ 1) rising to 25% on any profits in excess of 30,000 YR.[9] In Saudi Arabia, the most acceptable form of business for foreigners is the joint stock[10] or limited liability company. Companies are taxed on their net profits at rates ranging from 25% on the first 100,000 Saudi Rials, rising to 45% on any amount in excess of 1,000,000 SR[11] (parity for the Saudi Rial is maintained with the International Monetary Fund, so that 4.28 SR equal 1 Special Drawing Right – SDR). The Saudi tax system consists primarily of income tax and Zakat (an Islamic wealth tax on income and property). The Saudi portion of taxable income in a joint business is subject to the Zakat. Zakat rates are 2.5% on profits of a joint stock company, and 1.25% on profits of other legal entities. Zakat is levied on the total of the taxpayer's capital resources. Zakat and income taxes are collected by the Zakat and Income Tax Department. Generally, foreigners are subject to income tax,[12] while Saudis are subject to Zakat. Nationals of Kuwait, Bahrain and Qatar are con-

4. Basically, non-residents may participate without limit in the capital of any kind of company incorporated in the Yemen Arab Republic.
5. A license is not required in connection with work done for the Government; the contract with the Government is enough. Licenses must be granted to those operating in the private sector.
6. When the project is incorporated, the corporation acquires Saudi nationality, and its headquarters should be in the Kingdom.
7. All persons carrying on business in Saudi Arabia must record certain information in the Commercial Register. An enterprise located in several Saudi provinces must register in each province.
8. The law regulating company taxation is Income Tax Ordinance 8 of 1961, which regulates taxes imposed on individuals. This Ordinance, enacted before independence, remains in its amended form the governing legislation for income tax purposes. State corporations, which are regulated by Law 13 of 1979, are also obliged to pay tax under the Income tax Ordinance (as amended).
9. The law regulating taxes on commercial and industrial profits is Law 11 of 1972. Individual taxpayers falling under this category of taxpayer have an exempt minimum amount of 7,500 YR.
10. Members of a joint stock company should number not less than 5, and are liable for company debts only to the extent of the value of their shares. The share capital of this form of company may not be less than 200,000 SR, but if such a company offers its shares to the public for subscription then the share capital may not be less than 1,000,000 SR.
11. Company tax rates apply to the following:
(a) net profits of a foreign company operating inside the Kingdom, or inside and outside the Kingdom simultaneously;
(b) the total share of the net profits of a Saudi company attributed to non-Saudi shareholders;
(c) the total share of the net profits of a partnership attributed to non-Saudi sleeping partners.

The tax is imposed on both companies on those non-Saudi individuals investing in a Saudi company (sleeping partners) at the company level rate.
12. An income tax law was introduced in 1950 (Royal Decree 17/2/28/3321). Since then it has undergone several amendments by Royal Decrees and Circulars. The income charged is the income derived within the Kingdom.

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sidered Saudis for tax purposes. Joint stock and limited liability companies are also the most favorable forms of business for foreigners in the Gulf States.

In each of the United Arab Emirates,[13] different laws prevail with respect to the establishment of a business. In an attempt to harmonize these laws, particularly in establishing industrial projects, the Organization of Industrial Affairs Act (Federal Act 1 of 1979) was enacted which applies to all industrial projects in the Federation. The Act requires registration and licensing of all industrial projects by the Industrial Advisory Committee in the Ministry of Finance and Industry. Under Section 8 of the Act, no license will be granted to any project unless it is established by U.A.E. citizens or by a company 51% of which is owned by U.A.E. citizens. Foreign companies must comply with this requirement or wind up their business within 2 years as of the date of the Act. Projects meeting the requirements of the Act are granted several privileges, e.g. supply of land, electricity and water at nominal prices, an unlimited period of exemption from customs duties on import of machinery, equipment, raw materials, and an exemption of the profits from all taxes for a period of 5 years. Tax Decrees in the Emirates are almost the same. Taxes are generally very low. The first 1,000,000 Dirhams of taxable profits are practically not chargeable, 10% is charged on the next 1,000,000 Dirhams, rising to 50% on the amount in excess of 5,000,000 Dirhams. The Ruler has wide tax authority. He may exempt any enterprise, for any period of time, from taxes due and may even exempt any foreign project from the local participation requirement set by law.

Conclusion

Middle East countries fall under the category of developing states. However, unlike other developing countries, many possess huge monetary resources from which they are able to finance their development projects and schemes. For this reason, the interest of foreign businessmen and investors is more and more focused on this region.

The general attitude towards foreign investment is positive. Nevertheless, it is guided by two basic trends: the first is restrictive towards foreign individuals wishing to do business, particularly engaging in trade; the second is the waiving of restrictions and the offering of incentives for foreign investors desiring to do business in the form of companies where local capital is a partner. Therefore, it is more suitable for foreigners to invest their capital in joint stock and limited liability companies. In this case, the most preferential treatment is obtained by those foreigners who engage in projects defined by the local authorities as development projects. Such projects are in the first place industrial projects, promoting the production of local goods. Another notable trend now prevailing is that the governments of the Middle East countries are more and more engaged in mixed projects with foreign participation. Foreign partners in mixed governmental enterprises are exempt from fulfilling a series of requirements demanded by domestic laws, for instance, the license and registration requirements. The contract with the Government is enough to commence business, and in many cases will not render the foreign company liable to taxes.

13. The United Arab Emirates is a Federation of 7 Emirates, formerly known as the Trucial States. They are: Abu Dhabi, Ajman, Dubai, Fujairah, Ras al Khaimah, Sharjah and Umm al Quwain. Every Emirate has its own ruler. The President of the Federation is the Ruler of Abu Dhabi.

IFA NEWS

continued from page 539

USA BRANCH

The USA Branch of IFA will hold its annual meeting on 10–11 February 1983 in the Beverly Wilshire Hotel, Beverly Hills, California. The program features a number of "updates" during which speakers will discuss developments in specific fields. The subjects are:

Subject	*Speaker*
Technical update	D. Brockway
Treaty update	P. Lerner
Singapore update	D. Hong
Australia update	J. Kirkwood
Hong Kong and People's Republic of China update	P. Paul
Japan update	H. Olsen
FIRPTA	J. Forry

A panel consisting of Messrs. Hong, Kirkwood, Paul, Olsen, Tillinghast and Abrutyn will discuss Pacific Basin problems.

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MALAYSIA:

The 1983 Budget

Extracts from the speech pronounced by the Minister of Finance, Y.B.M. Tengku Razaleigh Hamzah, introducing the Supply (1983) Bill in the House of Representatives on 22 October 1982.

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Sales tax

As a revenue measure, I propose to increase the rate of sales tax from 5% to 10%. This tax presently affects only about 25% of the goods imported and produced in the country. Thus, about 75% of all these goods are exempted and these include food items, pharmaceuticals, raw materials and machinery, construction equipment and building materials. I want to make it clear that these items will continue to be exempted.

Service tax

I also propose to increase the scope and rate of the service tax as follows:

(a) the current rate of 5% will be increased to 10%; and
(b) the service tax will now be extended to include all restaurants, bars and coffee houses located outside hotels and also private clubs. However, this change will only apply to these establishments if their annual sales turnover is $ 500,000 and above, and this will be made effective from 1st January, 1983.

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Export incentives

In order to strengthen the Balance of Payments I propose to improve certain export incentives. Currently, the export allowance and the double deduction on expenses for export promotion are only limited to manufacturers who export. These incentives will now be extended to traders who export locally manufactured goods. Further, it is proposed that:

(a) the present export allowance of 2% on ex-factory value of exports and 10% on the increase in value of exports, will be replaced by a new flat rate of 5%;
(b) the export allowance will now be calculated on the basis of f.o.b. value of exports; and
(c) the maximum allowable double deduction for overseas accommodation and subsistence expenses will be increased from the present $ 100/- per day to $ 200/- per day.

Liberalisation of exports

The Government will also liberalise the export of a number of products by removing the present export licensing and export duty of 5%. Thus, export licensing will no longer be required for the export of various products such as sugar confectionery, chocolate, meehoon, mee and similar products, fruit juices, aerated waters, PVC resin and compounds, glass bottles and wire ropes.

The export duty on cement and clinker, round and flat bars of iron and steel as well as mosaic, wall and roofing tiles will be abolished. However, since these items are classified as essential materials that are required by the housing and construction industry, they will continue to remain under export licensing.

In line with the proposals to liberalise exports, I also propose to abolish the 15% export duty on coconuts and copra. Coconut prices in the country have declined sharply in recent months and are much lower than the prices obtained in the export market. With the lifting of the export duty on coconuts and copra, this will help to facilitate export and improve the incomes of coconut producers and smallholders in the rural areas.

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Liberalisation of import procedures

Hon'ble Members will recall that one of the measures introduced last year concerned the liberalisation of import duty procedures on a wide range of raw materials. As a continuation of this effort to improve the system of duty exemptions, I propose to expand further on the list of raw materials which are eligible for consideration under this new procedure. The procedure will be simplified by integrating the reduced surtax into the import duty, to enable manufacturers to obtain the reduced surtax on the raw materials automatically, without having to apply for it.

The Reinvestment Allowance amounting to 25% of the expenditure on plant, machinery and industrial buildings was first introduced in the 1979 Budget and will end in the year of assessment 1983. This incentive is aimed at encouraging manufacturing industries to undertake expansion of their plants. As this incentive has been found to be attractive to the private sector, I propose to extend the Reinvestment Allowance up to the year of assessment 1986.

Hon'ble Members will recall that in last year's Budget Speech, I also extended the Accelerated Depreciation Allowance to assessment year 1986 and at the same time, made this incentive available to all industries.

Import duty on motor vehicles for private use

Hon'ble Members will agree that we import a large quantity of conspicuous consumption and luxury items, which do not contribute to the productive capacity of the economy. For instance, in 1981 the import value of motor vehicles for private use amounted to $ 800 million, an increase of 12% over that of 1980.

I therefore propose to increase the import duty on completely-built-up (CBU) passenger cars for private use and to introduce for the first time, an import duty on completely-knocked-down (CKD) motor vehicles.

Thus, the import duty on CBU passsenger cars for private use will be increased:

For cars valued less than $ 20,000, from 60% to 90%;
For every Ringgit of the next $ 5,000, 110%;
For every Ringgit of the next $ 5,000, 135%;
For every Ringgit of the next $ 5,000, 160%; and
For every Ringgit of the balance, 200%.

For CKD passenger cars, I propose to introduce an import duty of 15%. This measure is designed to encourage a higher level of local content and import substitution in the motor vehicle industry. Commercial vehicles will not be affected by this new duty.

In addition, I propose that locally assembled passenger cars intended for use as taxis be given full exemption from excise duty.

Import and excise duties on liquor

From cars I move to liquor. I propose that the current import duty on beer and liquor be increased between a range of 10% to 40% and that the excise duty for locally produced beer and stout, be also increased by 60% from $ 1.25 per litre to $ 2.00 per litre.

Import and excise duties on tobacco

Similarly, I propose to increase the import duty on unmanufactured tobacco by 54% from $ 32.54 per kg. to $ 50 per kg. The import duty for cigarettes and other items will be raised within a range of 3% to 137%. Besides providing additional revenue to the Government for development purposes, these tax measures will also encourage the greater use of locally grown tobacco, and help increase the incomes of about 53,000 farm families. Consequent to the increase in import duty on tobacco, I also propose to increase the excise duty on locally manufactured cigarettes from $ 4.37 per kg. to $ 9.00 per kg.

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Computers

I would add that consistent with Government's wide ranging policies to encourage the private sector to modernise more rapidly and become more competitive internationally, I also propose to abolish the 25% import duty on computers.

Research and development

At present companies undertaking research are allowed single deductions for tax purposes in respect of expenditure incurred on research provided that the research is scientific in nature and is related to their business. It is now proposed to improve this incentive by removing these conditions so as to encourage more companies to undertake research. The improved incentives will be made available only if the companies undertake research that has been approved. The improved incentive is as follows:

(a) 1⅓ deduction for revenue expenditure for R and D;

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(b) such research may be carried out by the taxpayer himself or on his behalf by any scientific association, university or college or research institution;
(c) buildings for R and D be deemed to be industrial buildings and be entitled for industrial building allowance.

As Hon'ble Members will agree, there is already a wide range of incentives for the private sector. These investment incentives are very liberal and include exemptions and allowances on income tax, import duties and sales tax. Further, the incentives cover not only the manufacturing sector but also other industries such as the hotel and shipping industries.

The main concern of the Government now is to allow time for these incentives to be fully absorbed into the economic system and to ensure that the various incentives are implemented effectively rather than offering new incentives. We want to be sure that the private sector is able to realise the full benefits of these extensive tax concessions and incentives before new incentives are provided. To this end, the Government will continue to improve the present system of incentives.

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Rubber smallholders

The rubber smallholders, rubber estates and tin producers have continued to be hit by both rising costs and lower income and profits at the same time.

I therefore propose to help alleviate the problems of our rubber and tin producers by taking the following actions:

(a) in the case of rubber, the export duty will now apply only when prices exceed 170 cents per kg. whereas before this, it was imposed when prices exceeded 154 cents per kg.;
(b) in the case of tin, the export duty will now apply only when prices exceed $ 26.40 per kg., whereas before this, it was imposed when prices exceeded $ 23.15 per kg.

Road tax

The Government has spent large sums of money to build new roads and bridges and to improve the existing network of roads. It is only fair that road users should pay more to assist in their maintenance. Furthermore, the rate structure should be made more progressive by injecting greater equity in the sharing of the burden in road taxes. I therefore propose to revise the road tax rates for cars for private use.

The proposal will not, however, affect owners of passenger cars with engine capacities of 1,200 cc. and below. Cars with engine capacities of more than 1,200 cc. will now be subject to higher road tax ranging from 20 cents per cc. to $ 3.60 per cc. for cars above 3,000 cc. Thus, owners of expensive cars, especially those in the 3,000 cc. category will pay more road tax. And owners of private diesel vehicles will pay five times more but at these new rates.

I must stress, however, that these revisions will not affect buses, taxis, hired cars and commercial vehicles.

Motor vehicles owned by companies

Company owned passenger cars however are in a different category. Since they are used for business purposes, they should be charged different rates. Consequently, I propose that the road tax on cars owned by companies, should be four times the road tax on cars for private use. However, taxis, hired cars and commercial vehicles owned by companies will not be affected by this proposal.

Appendices Concerning Taxation

APPENDIX I

Proposal to review the rate of sales tax

Presently, all essential items are exempted from sales tax. However all other items attract a sales tax of 5% except for a few luxury items which attract a sales tax of 10%. The 5% general rate of sales tax has been effective since 1972 when the sales tax was first introduced. There is therefore justification to raise this rate of tax to a higher level in order to increase the contribution of the sales tax to government revenue. It is proposed that the sales tax be increased to 10%. This increase will not affect essential items which will continue to be exempted from sales tax.

APPENDIX II

Proposal to introduce the "credit system" in the sales tax administration

Sales tax is a single stage tax which is imposed either at the importer's level or at the manufacturer's level. To avoid the multiple imposition of the sales tax, manufacturers are allowed to import or buy raw materials free from sales tax by using sales tax form No. 5. Some manufactures, however, are not able to utilise this facility to obtain tax exempt raw materials because of the size of their operations. They are therefore subject to sales tax on both the imports (raw materials) as well as the final products. To overcome this problem, it is proposed that the small manufacturers who for some reason or other are unable to utilise the facility under the present system be given "credit" for the sales tax paid by them on the purchase of the raw materials and this credit be utilised to offset the sales tax that is payable on their final products.
This proposal will take effect from 1st January, 1983.

APPENDIX III

Proposal to increase the rate of service tax

The current rate of service tax is 5% on taxable goods and services provided or sold in prescribed establishments. This rate of 5% was first imposed in March 1975 and has not been revised since then. It is proposed that the rate of service tax be increased from 5% to 10% in order to enhance the contribution of service tax to revenue.

APPENDIX IV

Service tax

Presently, the establishments covered by service tax are hotels, night-clubs, dance-halls, cabarets, health centres and massage parlours. The present coverage of the service tax is very narrow. It is therefore proposed that this base be widened and that the service tax be extended to the following:
(i) all restaurants, bars, snack-bars and coffee houses located outside hotels and having an annual sales turnover of $ 500,000 and above of prescribed goods and services;
(ii) all private clubs having an annual sales turnover of $ 500,000 and above of prescribed goods and services.
This proposal will take effect from 1st January 1983.

APPENDIX V

Proposal to abolish all duties from cine-cameras, sound recorders etc. for film of less than 16mm width, perfurmes, cosmetics, transistor radios and ball point pens (other than plastic)

In the last Budget all duties from cameras, watches, fountain pens and lighters were abolished with the aim of promoting tourism and the growth of related industries. It is now proposed that all duties on perfumes, certain types of cosmetics, cine-cameras, projectors, sound recorders, transistor radios and transistor radios with sound recorders and ball point pens (other than plastic) be abolished. These items are not produced locally and with the abolition of these duties it is envisaged that the retail trade in these items will further expand throughout the country. The full list of these items is in Attachment I.[1]

APPENDIX VI

Proposal to remove certain selected items from export licensing

To further encourage the export of certain selected products, it is necessary that these products be allowed to be exported freely. It is therefore proposed that the following products be no longer subject to export licensing:
(i) Sugar confectionery not containing cocoa
(ii) Chocolate, chocolate candies and other chocolate confectionery
(iii) Macaroni, spaghetti similar products like meehoon, kowy teow, mee and noodles
(iv) Fruit juices requiring dilution before use and packed for retail sale, including fruit cordials, fruit syrup, rose syrup etc.
(v) Aerated waters
(vi) PVC resin and compounds
(vii) Glass bottles
(viii) Rubber drying plant
(ix) Diamonds and precious stone set or unset
(x) Carbon black
(xi) Explosives
(xii) Wire ropes.

1. The Attachments are not reproduced here.

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APPENDIX VII

Proposal to abolish the export duty on certain selected items

In order to encourage exports it is essential that they should be competitive in the world markets. Export-duty is a factor which inhibits the penetration of these markets because it increases the price of the product exported. It is proposed that the export duty of 5% on the following items be abolished.

(a) Cement & clinker under Tariff Code		(b) Round bars of iron and steel under Tariff Code	
25.23	100	73.10	210
	200		290
	300		299
	900		

(c) Flat bars of iron and steel under Tariff Code		(d) Mosaic tiles under Tariff Code	
73.10	910	69.07	900
	930	69.08	900
	990		

(e) Roofing tiles under Tariff Code		(f) Frozen prawns under Tariff Code	
69.05	100	03.03	111 to 299
	900		

However to ensure adequate local supply, the export of these items wil continue to be subject to export licensing.

APPENDIX VIII

Proposal to abolish the export duty on copra and fresh coconuts

In the 1979 Budget the export duty on copra and fresh coconut was increased to 15% in order to discourage exports and ensure sufficient supply to domestic oil mills. This situation has however since changed. There has been a reduction of local demand for these products. The reduction in the demand for coconut and copra is due to an increase in the processing of palm oil and the production of edible oils from it on a larger scale. The depressed prices of coconut and copra have been further aggravated by the export duty and this has in turn affected the livelihood of coconut growers. In view of the above it is proposed that the export duty on fresh coconut and copra be abolished so that coconut growers will be able to get more competitive prices for their produce.

APPENDIX IX

Proposal to include raw materials in the Second Schedule of the Customs Duties Order, 1976

In the 1982 Budget the surtax on the imports of a wide range of raw materials which were not available locally was abolished. Instead, the reduced rate of surtax at 2% or 3% as the case may be, which was payable under the existing exemption was integrated into the import duty. The advantage of this proposal to manufacturers is that they can obtain the reduced duty of 2% or 3% for importing their raw materials without having to apply for it. As a continuation of this exercise additional items of raw materials have been identified and it is proposed that the surtax on these items likewise be integrated into the import duty structure. (A list of the raw materials is in Attachment II).

APPENDIX X

Reinvestment allowance

The reinvestment allowance amounting to 25% of the expenditure on plant, machinery and industrial buildings and first introduced in the 1979 Budget ends in the year of assessment 1983. This incentive is aimed at encouraging manufacturing industries to undertake expansion of their plants. This incentive has been found to be attractive to the private sector and is open to all industries which are not enjoying incentives under the Investment Incentives Act 1968. It is therefore proposed that the reinvestment allowance be extended up to the year of assessment 1986.

APPENDIX XI

Proposal to increase the import duty on passenger motor vehicles

In view of the large increase in imports of motor vehicles (CBU and CKD) it is proposed that as a revenue raising measure the import duty on the completely-built-up (CBU) motor vehicles be increased and that an import duty on completely-knocked-down (CKD) motor vehicles be imposed for the first time. This high duty will also encourage greater use of locally made parts. The new rates are as follows:

	Present rate	Proposed rate
(i) Import duty on CBU motor vehicles		
On value of less than $ 20,000	60%	90%
Next $ 5,000	70%	110%
Next $ 5,000	80%	135%
Next $ 5,000	90%	160%
On the balance	100%	200%
(ii) Import duty on CKD motor vehicles	Nil	15%

With a view to offset the increased cost of passenger cars to taxi operators due to the higher import duty, it is proposed that locally assembled cars intended for use as taxis be wholly exempted from excise duty.

APPENDIX XII

Proposal to increase the import duty and excise duty on liquor

The current rates of import duty and excise duty on liquor were imposed in 1980. From the health point of view, liquor is an item whose consumption should be discouraged. In view of this, it is proposed that the import duty on liquor be increased within a range of 10% to 40%. Further since some types of liquor are produced locally, it is proposed that the excise duty on beer and stout be accordingly increased by 60% from $ 1.25 per litre to $ 2.00 per litre. Details of the proposed changes are in the Attachment III.

APPENDIX XIII

Proposal to increase the import duty and excise duty on tobacco

Tobacco is another item whose consumption should be discouraged. The current rates of import duty and excise duty were imposed in 1980. In view of this, it is proposed that the import duty on unmanufactured tobacco be increased by 54% from $ 32.54 per kg. to $ 50 per kg. Similarly, it is proposed that the import duty on cigarettes and other items of manufactured tobacco be increased within a range of 3% to 137%. In keeping with the above increases it is proposed that the excise duty on locally manufactured cigarettes be increased by 105% from $ 4.37 per kg. to $ 9.00 per kg. Details of the proposed changes are in Attachment IV.

APPENDIX XIV

Revision of export incentive

In view of the strategy to stimulate exports of manufactured goods, the tax incentives for exports have to be reviewed in order to encourage the manufacturing industries to sustain and improve that export performance. It is therefore proposed that:

(a) the maximum allowable double deduction for overseas accommodation and subsistence expenses be increased from the present $ 100 to $ 200;
(b) the existing export allowance:
  (i) be made available to all exporters, including traders;
  (ii) the basis of calculating the allowance be based on f.o.b. value of export instead of the ex-factory value; and
  (iii) the existing rate of 2% for value of export and 10% for increase in performance be replaced by a flat rate of 5%.

It is also proposed that Masterbatch be included in the list of products not eligible for export allowance.
This proposal will be effective from the basis year 1983.

APPENDIX XV

Proposal to abolish the import duty on computers

The current import duty on computers is 25%. It is felt that the private sector should be encouraged to make greater use of computers in order to increase its efficiency and performance. In view of this, it is proposed that the import duty on computers be abolished. However such imports will continue to be subjected to sales tax and surtax.

APPENDIX XVI

Promotion of local research and development (R&D)

At present companies undertaking research are allowed single deductions for tax purposes in respect of expenditure incurred on research provided that the research is scientific in nature and is related to their business. It is now proposed to improve these incentives by removing these conditions so as to encourage more companies to undertake research. These improved incentives will be made available only if the companies undertake research that has been approved. The improved incentives are as follows:

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(a) 1⅓ deduction for revenue expenditure for R and D;
(b) such research may be carried out by the taxpayer himself or on his behalf by any scientific association, university or college or research institution;
(c) buildings for R and D be deemed to be industrial buildings and be entitled for industrial building allowance.

The proposal will be effective from the year of assessment 1984.

APPENDIX XVII

Proposal to review the present method of calculating the export duty of rubber based on the gazetted value of rubber

Since August 1981 the Government has been collecting export duty on rubber based on the gazetted value of RSS1, RSS3 and SMR20. Though this system is a simplification over the previous system whereby 9 different grades of rubber (3 RSS and 6 SMR) were used in determining the gazetted value of rubber, however it has been found that the present system is still not satisfactory in that it causes disputes on the grades of rubber to be exported especially those in the RSS1 and RSS2 categories because under the existing system though RSS2 is a lower grade of rubber as compared to RSS1 yet exports of RSS2 attract the same amount of duty as that of RSS1. This has resulted in much inconvenience and dissatisfaction amongst exporters. In view of this, it is proposed that the export duty on rubber be collected on the gazetted value of RSS2, RSS3 and SMR20 so as to minimise disputes pertaining to the grades of rubber that are exported and facilitate the clearance of shipments of rubber at the various points of export.

APPENDIX XVIII

Proposed changes to the threshold price of rubber and tin

The cost of production of rubber and tin has increased since the threshold price was last revised in December 1981. In view of the above, it is proposed that the threshold price of rubber be revised from 154 cents per kg. to 170 cents per kg. and that for tin be revised from $ 23.15 per kg. to $ 26.40 per kg.

APPENDIX XIX

Feedmill

Presently the import duty on wheat pollard and wheat bran attract an import duty of 13%. These are ingredients for the animal feed industry. As the present local supply of these products is insufficient to meet the needs of the feedmill industry, it is felt that a reduction in the import duty of these products will assist the feedmill industry and the poultry farmers in reducing cost of producing food. It is therefore proposed that the import duty on wheat pollard and wheat bran be reduced from 13% to 5%.

APPENDIX XX

Proposal to increase the road tax on private passenger cars

The road tax on motor vehicles for private use was last revised in 1980. In view of the current recession, it is proposed that the road tax be increased and that the existing road tax structure be made more progressive. The higher road tax will apply to both petrol and diesel powered cars.
The proposed road tax structure for petrol powered cars is as follows:

	Rate (cts. per cc.)		Road tax payable ($)		% increase in rate of
Engine capacity	Present	Proposed	Present	Proposed	road tax
First 1000 cc.	13	13	130	130	(Nil)
Next 200 cc.	15	15	160	160	(Nil)
Next 300 cc.	15	20	205	220 (60)	(33.3)
Next 500 cc.	30	35	335	395 (175)	(16.7)
Next 500 cc.	50	80	605	795 (400)	(60.7)
Next 500 cc.	80	200	1005	1,795 (1000)	(150.0)
On the balance	120	360	1605	3,595 (1800)	(200)

With regard to diesel powered cars, the road tax payable will remain at 5 times that of the road tax payable on petrol powered cars.

APPENDIX XXI

Proposal to increase the road tax on private passenger motor vehicles owned by companies

Presently there is no difference in the rate of road tax that is payable on a company owned car and that owned by an individual. As the maintance of cars owned by companies (inclusive of road tax) is treated as an expense item for purposes of income tax whereas no such allowance is given to cars owned by individuals, it is proposed that the road tax on motor vehicles owned by companies be payable at four times the road tax payable on motor vehicles owned by individuals.

APPENDIX XXII

Withholding tax on non-resident contractors and professionals

In order to resolve problems of taxing non-residents and at the same time to protect government's revenue, it is proposed that:
(i) All persons making payments to a non-resident person who is a contractor, consultant or professional shall upon paying or crediting such payments, deduct therefrom tax at the rate of 15% of the contract payment pertaining to the service portion of the contract.
(ii) All persons making payments to a non-resident person who is a contractor shall upon paying or crediting such payments, deduct therefrom a further 5% of the contract payment pertaining to the service portion of the contract to cover the tax obligation of the employees.

The taxes se deducted in (i) and (ii) above are to be accounted to the Revenue Department within 30 days of such payments. These deductions, however, are not a final tax. The final liability of tax will be computed when the taxpayer files in his income tax returns.

APPENDIX XXIII

Review of stamp duty

The last review made on stamp duties was in 1967. Therefore some of the duties are outdated and rates are low, having been eroded over the years by inflation.

Proposals

With a view to rationalising the existing rates and to deleting duties on instruments which are outdated, it is proposed that the First Schedule to the Stamp Duty Ordinance be reviewed:
(i) Duties which originally were at $ 1, $ 3 and $ 5 are recommended to be increased to $ 3, $ 5 and $ 10 respectively to suit current needs. Nevertheless, where appropriate, to lessen the tax burden on the lower income groups the current level of exemption for some instruments is increased or otherwise new exemption provisions are introduced e.g. for affidavits, although duty is increased from $ 2 to $ 5, an exemption provision is introduced for situations where the statutory declaration is required to conform with government regulations.
(ii) Duties on cheque to be increased from 10 cents to 15 cents and the existing $ 10/- duty each of article and memorandum of association for companies is to be increased to $ 100 each. The new rates do not apply to sole proprietorships and partnerships.
(iii) Duty on the transfer of shares, stocks or marketable securities which at present attract 2 separate duties of 15 cents ad valorem (i.e. where the name of transferee was filled prior to execution of transfer) and 30 cents ad valorem (i.e. for any other case) is recommended to be standardised to 30 cents ad valorem.
(iv) Duties imposed on instruments which are considered archaic such as charter party and notarial act are to be deleted.

APPENDIX XXIV

Tax exemption of pension and gratuity

With a view to retaining the benefits to the pensioners prior to the introduction of Cabinet Committee Report and to alleviate hardship for those who are retired due to ill-health it is proposed that:
(i) All gratuity received by Government employers, whose retirement is approved on or after the 22nd October 1982, be exempted from income tax.
(ii) Pensions received by persons retiring after reaching 55 or upon reaching any compulsory age of retirement under any written law, who are retired on grounds of ill-health also be exempted from tax. This proposal will take effect from year of assessment 1983.

APPENDIX XXV

Tax exemption for house owners on transfer

In the 1981 Budget, tax exemption on rental income from houses has been granted to persons who are being transferred beyond 20 miles of the original place of residence. This exemption however is limited to transfers within Malaysia. Persons on overseas transfers are not eligible.
With a view to giving equal treatment to such persons, it is proposed that this exemption be amended to include persons who are transferred overseas. The condition that such persons must first be in occupation of their houses before their transfers is retained.

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SOLOMON ISLANDS:

New Income Tax Incentives for Investors

New incentives to encourage investment in Solomon Islands were introduced by the Minister of Finance, the Hon. B Ulufa'alu, in two orders signed on 6 August. The orders, which amend the Second Schedule to the Income Tax Act, are the Income Tax (Deduction of Capital Expenditure on Re-afforestation) Order 1982 and the Income Tax (Deduction of Capital Expenditure on Special Development Assets) Order 1982.

The purpose of the re-afforestation order is to encourage the timber industry to invest in re-afforestation by providing immediate tax relief for the cost of clearing and preparing land, purchasing, planting and maintaining trees and the costs of rents, rates, insurance and interest related to re-afforestation. Under the new law investors will be able to offset these costs against taxable profits in the year the re-afforestation expenses are incurred. There is also the option to spread the relief over 15 years.

The special development asset order provides a similar tax concession. The order permits the Minister in the national interest to declare the activity of any investor to be a special development activity for a period of up to 5 years. During this period the investor will be able to offset the cost of development activity assets against taxable profits in the year the asset is purchased or to spread the relief forward by claiming standard depreciation.

This concession is aimed at encouraging and promoting new forms of investment activity which will help to develop the Solomon Islands economy. Factors which the Minister will take into account in considering applications for special development activity status include the contribution the new investment activity will make towards increased exports, import substitution, employment opportunities and the development of rural areas.

A comprehensive description of the tax system of Solomon Islands is contained in our publication: *Taxes and Investment in Asia and the Pacific.*

SOME HIGHLIGHTS OF BUSINESS TAXATION

COMPANY TAX RATE – 35% for companies incorporated in Solomon Islands and 50% for other companies.

DIVIDEND WITHHOLDING TAX – Resident companies are required to deduct withholding tax from dividends at the rate of 35% from dividends paid to non-residents and at the rate of 20% in the case of dividends paid to residents. The gross dividends are a deductible expense of the paying company.

NON-RESIDENT WITHHOLDING TAX – Certain gross income payments to non-residents are liable to withholding tax in lieu of individual and company taxes. The rates of deduction are:

Interest	15 %
Know-how payments	15 %
Royalties	15 %
Income from contracting	6 %
Outward income from ships and aircraft	2.5%
Insurance premiums	15 %
Film rental	5 %

BONUS ISSUE TAX – Bonus issues are not subject to tax until the amount capitalised is distributed. The rate of tax on such a distribution is 20%.

BUSINESS LOSSES – A deficit for any year may be set off against the profits of a future year if the shareholders are substantially the same (51%). There are no time restrictions.

CAPITAL ALLOWANCES IN LIEU OF DEPRECIATION

Buildings, building fixtures and fittings, bridges, wharves, slipways, boilers and oil storage tanks	5% d.v.
Plant, machinery, ships, vehicles and aircraft	25% d.v.
Assets used by a timber concessionnaire for cutting, extracting and processing timber from a timber concession and low cost housing for employees	35% d.v.
Cost of purchasing and planting coconuts, oil palms and cocoa; provision of yards, fences and water supplies for livestock; prevention of soil erosion; experimentation, scientific or other research expenditure	100%
Capital expenditure on mining	20% p.a.

TAX HOLIDAYS – There is provision for the granting of tax holidays to pioneer companies where the investment is likely to provide significant benefits to the economy such as export contribution, net import substitution, increased employment and development of rural areas.

FOREIGN INVESTMENT – Foreign investment is governed by the Foreign Investment Act which can be obtained from the Government Printer, P.O. Box G. 14, Honiara.

PROVINCIAL TAXATION

Provinces have a wide range of rating powers including basic rates and rates on possessions and property. Basic rates vary between $1 and $90 a year and are generally at a uniform amount per capita, although some provinces have introduced graduated rates according to the occupation or assessed income of the ratepayer. Basic rates are payable by all persons of or above the age of 18 and resident within the area of a province's authority unless generally or specifically exempted. Only the Honiara Municipal Authority has introduced general property rates based on the unimproved value of rateable land in the town. The current property rate is 3.25%.

Business licence fees paid to provinces are treated as prepayments of income tax.

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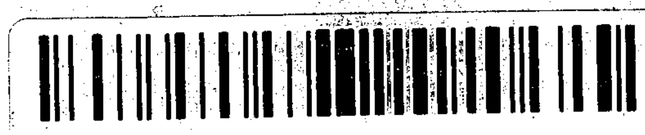
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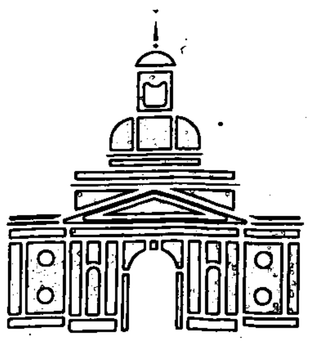
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REVUE RAPIDE DU SYSTEME DE L'IMPOT SUR LE REVENU ETHIOPIEN

L'auteur rappelle les bouleversements récents en matière économique et sociale en Ethiopie et les modifications qu'ils ont entraînées dans la législation. Cet article cherche à déterminer l'état actuel de la loi sur l'impôt sur le revenu en pleine modification.

EIN KURZER ÜBERBLICK ÜBER DAS EINKOMMENSTEUERSYSTEM ÄTHIOPIENS

Der Verfasser untersucht die jüngsten Umwälzungen im Wirtschafts- und Sozialsystem Äthiopiens und die daraus resultierenden Veränderungen in der Gesetzgebung. Dieser Artikel stellt den Versuch dar, den augenblicklichen Stand der sich rasch änderenden Einkommensteuer-Gesetzgebung festzuhalten.

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In diesem Artikel werden die schwierigsten Punkte einer eingehenden Untersuchung unterzogen.

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tax. The proposed text of the new VAT legislation and the explanation thereto have been reproduced in this issue.

ETATS UNIS: LA TVA DEVANT LE CONGRES

Le 22 octobre 1979 M. Ullman, Président du Comité "Ways and Means" introduit la "Tax Restructuring Act 1979", prévoyant une réduction massive des impôts sur le revenu et de sécurité sociale. Cette réduction sera compensée par l'introduction simultanée d'une taxe sur la valeur ajoutée de type européen. Le texte proposé de la nouvelle législation sur la TVA et les explications s'y rapportant sont réproduits dans ce numéro.

U.S.A.: DIE MEHRWERTSTEUER IM KONGRESS

Am 22. Oktober 1979 hat Herr Ullman, der Vorsitzende des "Ways and Means" - Ausschusses, das Steueränderungsgesetz 1979 (Tax Restructuring Act of 1979) eingebracht, das, würde es angenommen, zu einer erheblichen Ermässigung bei der Einkommensteuer und bei den Sozialversicherungsbeiträgen führte.
Die Steuerausfälle würden durch die gleichzeitige Einführung einer Mehrwertsteuer nach europäischem Vorbild aufgefangen. Der Text des Gesetzesverschlages sowie die entsprechenden Erläuterungen sind in dieser Ausgabe abgedruckt.

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A Short Review of the Ethiopian Income Tax System

by M. Fisseha-Tsion *

INTRODUCTION

Ethiopia is currently undergoing tremendous changes in the very fabric of its existence. Political, economic and legal changes have taken place at such a swift pace that a major transformation has occurred in daily life. Numerous laws have been enacted legitimizing the restructuring of the socio-economical and political organizations which administer the new reforms. A metamorphosis too has taken place in the fiscal laws resulting in the entire restructuring of the tax system bringing about confusion and incomprehension.

Readers therefore interested in the Ethiopian legal system in general and the economic and fiscal laws in particular are advised to update their information in this area. However, as a practical matter this process might prove to be difficult as information on the new developments is hard if not impossible to obtain.

Because of this situation the author would like to emphasize that any errors in information contained in this article are due to the rapidly changing situation in Ethiopia. However, he will take sole responsibility for any inaccuracy contained herein.

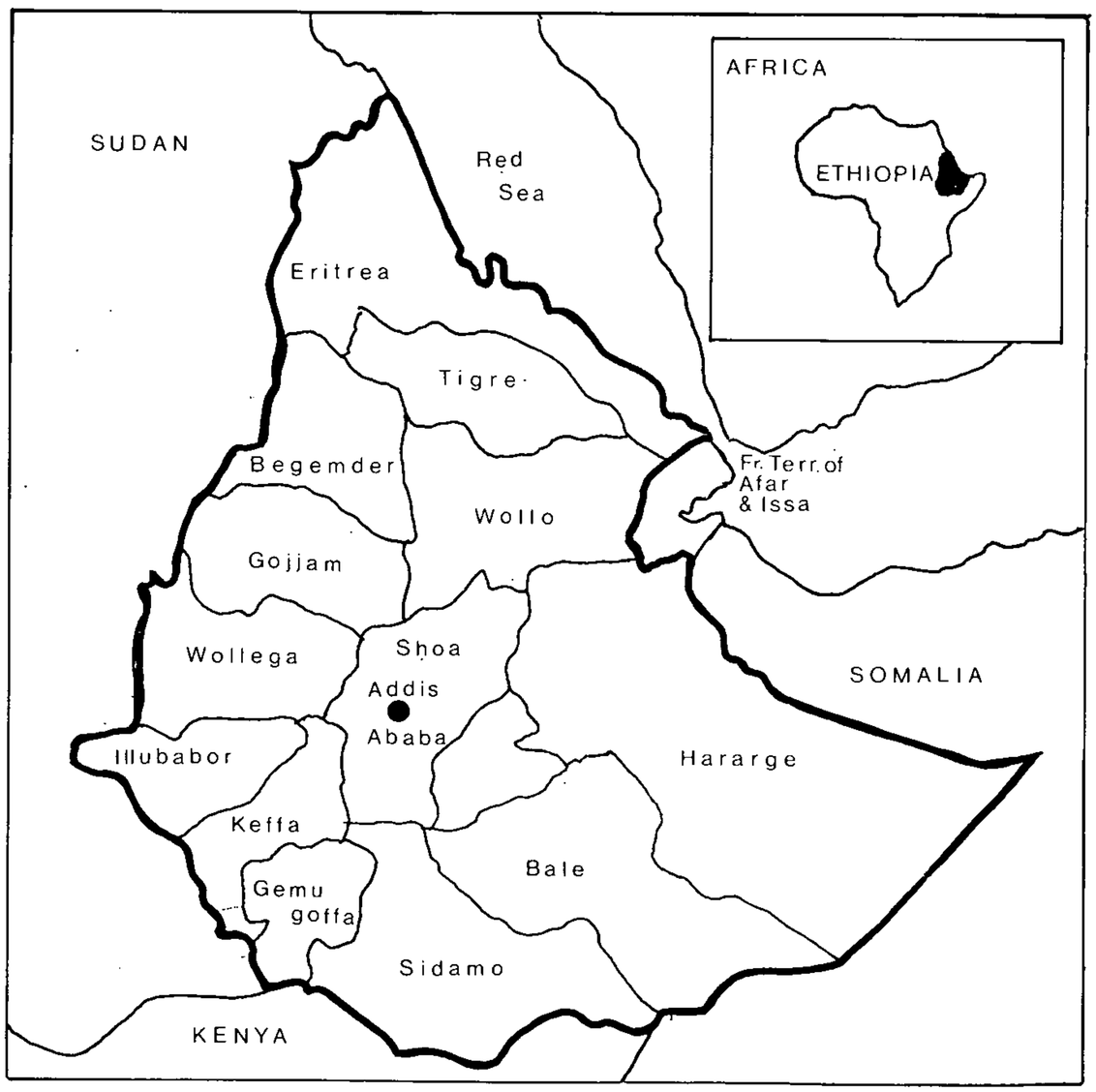


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* **LL.B, LL.M, formerly taxation adviser in the Ministry of Finance of Ethiopia. A recipient of a scholarship from the International Bureau of Fiscal Documentation, he is currently writing his doctoral dissertation on *The taxation aspects of payments arising from the transfer of technology to developing countries* at the University of Amsterdam.**

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I. A BIRD'S EYE VIEW OF SOME OF THE SOCIO-ECONOMIC CONDITIONS OF ETHIOPIA

A. Climatic conditions

Ethiopia has an ideal climate. It is partly temperate and partly tropical. Because of its altitude, the humidity is low and the average annual temperature is 13°C (55°F) except in certain places along the Rift valley areas.

It has abundant rainfall and large under-utilized rivers. In short, due to its size and variety of climatic conditions it is capable of growing all types of temperate and tropical agricultural products [1] and yet the country has not been able to feed itself. Its people still suffer from hunger, malnutrition and the lack of the basic necessities of life.

B. Government

1. Current situation

The country is now run by a Military Government which calls itself "Provisional" and the state a "Socialist State". It is officially called "The Provisional Military Government of Socialist Ethiopia". The Provisional Military Administrative Council (PMAC) is the executive as well as the legislative body of the State. Despite this appellation, there has been little or no political socialization of the State. The Military as an organized institution has assumed for itself the role of a democratic regime in absence of any other viable civilian alternative.

2. Political parties, organizations and national fronts

There are over a dozen political organizations and fronts organized legally and illegally under vaguely defined objectives and causes. They include right wing elements who aspire to restore the old order and national fronts seeking secession and full sovereign independence from Addis Ababa Government. There are also self-styled Marxist-Leninist organizations which in theory recognize, inter alia, the right of nations to self-determination but who nonetheless do not have the political will and desire to translate their slogans into deeds. However, there is no broadly based communist or socialist or capitalist oriented party at the regional and national levels which can command the respect and confidence of the overwhelming majority of the population. The on-going civil war between and among the bulk of the population is instigated by such political organizations and fronts. Whether the bulk of the population has a clear idea of why they are fighting among and between themselves is a perplexing question raised by all concerned about the anti-developmental perpetual state of war.

C. Components of the economy

Despite its agricultural, mineral, and oil potential and its capability of producing exportable livestock, Ethiopia is categorized as one of the world's half-dozen poorest and most backward countries which during Haile Selassie's reign was ravaged by famine, disease and malnutrition. Even today starvation and poverty are still prevalent. Ethiopia has a predominantly agricultural and pastoral economy that exists on a subsistence level.

1. Rural economy

The rural economy consists basically of small individual farms whose farmers account for 95 percent of the total agricultural production of the country but who have little or no say in the marketing of their produce. Although 80 to 90 percent of Ethiopia's exports consists of agricultural goods, because the state owned farms are more mechanized they produce most of the cash crops for exports. Coffee accounts for a substantial 70 percent of Ethiopia's export bill.

Land ownership is primarily vested in the government. At present all privately owned rural holdings of more than 20 hectares and urban lands and buildings in addition to most major industries, banks, insurance companies and other financial institutions have been nationalized.

Land is usually held by families (in a broad sense), village communities, private persons and the Government. Ethiopia had one of the most intricate land tenure systems in the world; however, after 1974 land was declared to be the "property of the whole people", and not to be used for speculation and profit.

The farming population is being organized into "Peasant Associations" [2] in order to increase production and improve farming methods. There are more than 27,000 peasant associations with about 8 million members, 500,000 of whom have joined peasants' defence squads. [3]

---

1. Some of the crops grown include coffee, wheat, barley, maize, oats, millet sorghum, sugar cane, potatoes as well as other roots and tubers, beans, peas, broad beans, chick peas, lentils and other pulses, ground nuts, castor beans, rapeseed, linseed, sesame seed, cotton seed, cotton (lint), sunflower seed, vegetables and fruits of various kinds and descriptions.

2. "Peasant Associations" are legal associations composed of individuals who at the time of the Rural Lands Proclamation of March 4, 1975 and thereafter were tenants, landless persons, agricultural labourers or landowners with less than ten hectares of land. Such associations are empowered to establish judicial tribunals to hear land disputes arising within each locality and control travelling of persons from one locality to another.
Organizations of the peasantry (constituting no less than 85 percent of the population) include:
(a) Peasant Associations at local levels;
(b) All Ethiopian Peasant Associations at the national level.
Sources: — Public ownership of Rural Lands Proclamation No. 31, 1975.
— Peasant Associations Organization and Consolidation Proclamation No. 71, 1975.
— All Ethiopia Peasant Association Proclamation No. 130, 1977.

3. "Peasants' defence squads" are sub-divisions of peasant associations designed to recruit militiamen and women to form the People's Militia to safeguard and protect the programme of the Government and to defend the country's territorial integrity.

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Moreover, Revolutionary Administrative and Development Committees [4] have also been set up.

2. Urban economy

Urban areas are centers of Ethiopia's industrial, commercial, diplomatic, administrative and business communities. One third of all the health facilities are located in Addis Ababa, Asmara and Harar. The entire urban population has been organized, irrespective of their profession but based on the locality in which they live, into Urban Dwellers Associations. [5] These associations (almost 1200) have substantial control and power within their respective neighborhoods, [6] with a membership of about 3 million.

D. Industry

The principal industrial activities in Ethiopia include the manufacturing and processing of tinned meat, vegetable oils, wheat flour, macaroni, refined sugar, liqueurs, wine, beer, lemonade, mineral waters, cigarettes, cotton yarn, woven cotton fabrics, woollen blankets, woollen carpets, nylon fabrics, leather footwear, canvas and rubber footwear, plastic footwear, plywood, particle board, soap, ethyl alcohol, refining of some petroleum products, clay building bricks, quicklime, cement, nails.

E. Mining

There is substantial evidence to suggest that Ethiopia may have oil and gas around the Dahlak islands in the area 75 miles north of Massawa and the southern part of the Red Sea as well as in the south eastern part of the country. There are also vast potential resources of geothermal power along the Rift valley.

Other considerable mineral deposits include agate, asbestos, bentontic clay, barite, copper, diatomite, feldspar, gold, gypsum, iron, kaolin, lignite, limestone, magesium, marble, mica, nickel, platinum, potash, pumice, salt, silica, sulphur, talc and zinc. [7]

To date Tenneco, General American Oil company and Shell have concessions to exploit the oil and gas, [8] with the terms of the concessions granted during the Haile Selassie Government still in force.

F. Labour

The number of industrial workers is approximately 500,000. The minimum salary for unskilled persons is 2 birr per day. Labour legislation was enacted which claimed to advance the interests of the Ethiopian workers and to improve the working conditions over the pre-1974 period. [9]

G. Imports

The main imported products include mineral fuels, lubricants, etc., including crude petroleum and petroleum products, chemicals, medical and pharmaceutical products, manufactured rubber products including tyres and tubes, textile yarn and thread, textile fibres, iron and steel, machinery in general including agricultural machinery and implements, textile and leather machinery, electrical machinery applicances, telecommunications apparatus and transport equipment including motor vehicles and parts, aircraft and clothing.

H. Exports

Exported products include food and live animals, meat and meat preparations, fruit and vegetables, coffee (green or roasted), hides and skins (undressed), oilseeds, oil nuts and oil kernels, sesame seeds.

I. Foreign investment

The nationalization of financial institutions, insurance companies, large industries, rural and urban private land and buildings and schools on one hand and the formation of peasant and urban dwellers' associations to control rural and urban activities as well as the encouragement of the formation of cooperatives and industrial workers' councils, inter alia, imply that in post-1974 Ethiopia, there is little room for companies to do business in real estate. This means that a foreign company is not allowed to engage in the trading of land and buildings, except as an integral part of its factory. Foreign companies are, however, entitled to have a right of possession in the land for which they have to pay a rent or use fee as the case may be. It is therefore not possible to acquire land for resale or trade.

Large scale development of land either for agriculture, dairy or forestry or otherwise is mainly carried out at the initiative of the State through its own specialized bodies and State economic organizations. Foreign com-

---

4. "Revolutionary Administrative and Development Committees" are committees set up to consolidate and implement the National Democratic Revolution Programme issued by the Government.

5. "Co-operative Societies of Urban Dwellers" are neighbourhood societies having juridical personality of which any urban (i.e. within the boundaries of the municipality or a town) dweller may become a member subject to restrictions provided by law (see Government Ownership of Urban Lands and Extra Houses Proclamation No. 47/1975).

6. Organizations of neighbourhoods include:
(a) Co-operative societies of urban dwellers in each unit of urban areas.
(b) Higher co-operative societies of urban dwellers at intermediate level.
(c) Central co-operative societies of urban dwellers at the highest level depending on the size and population of the urban area.
Source: Government Ownership of Urban Lands and extra houses Proclamation No. 47, 1975)

7. See M. Fisseha-Tsion, *A survey of the taxation of mineral and oil resources; with particular reference to Ethiopia*, LL.M. thesis, the Faculty of Law, University of Leeds, U.K. (unpublished), August 1976.

8. Id., pp. 31-41.

9. *Organizations of labour* working in ex-privately owned as well as State-owned enterprises:
(a) Individual Trade Unions at enterprise level.
(b) All Ethiopia Trade Unions at the centralized and national levels.
Source: Labour Proclamation No. 64, 1975.

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panies have little or no opportunity to own land but may be allowed to get long term leases from the State to perform some of the approved activities.

Foreign investors do not have the freedom to invest in all activities. The areas in which foreign investors are allowed to do business are provided in the Government's economic policy declaration and in the Government ownership and control of the Means of Production Proclamation No. 26 of 1975. [10]

In order to systematically organize and implement the economic and development policy of the Government, a Central Planning Supreme Council has been established by virtue of Proclamation No. 156/1978. This implies that individual private industrial enterprises, privately owned banks etc., have little scope to invest in any activity they think fit. The Haile Selassie Government's policy of "you are welcome to invest in what you like" has been replaced by a policy of "you are welcome to invest in accordance with our national plan".

1. Activities where foreign collaboration is needed

Areas in which there is co-operation with foreign investors include the following:

a) *Financing* of Government approved industrial and agricultural projects.
b) *Technological assistance* and foreign technical and managerial collaboration with or without foreign loans or credits to finance the capital expenditures and in some cases ordinary expenditures of such projects.
c) *Direct foreign investment* enabling the foreign investor to own 49 percent of the equity interest in Ethiopia's industrial enterprises.
d) *Joint ventures* in Government approved activities.

2. Exchange transactions

All transactions in foreign exchange must be carried out through an authorized bank under the control of the National Bank. [11]
Foreign investors are permitted to transfer their earnings abroad subject to the approval by the Government.
Foreign employees of the private sector may remit a maximum ranging between 40 and 50 percent of their net earnings during the period of service and upon final departure. Other expatriate employees may on final departure take out the same maximum amount but not more than 20,000 birr in any one year. [12]

J. Tax structure

The existing fiscal structure of Ethiopia is schedular, primarily designed to raise revenue for the Government, although there is no substantial proof that the fiscal system has achieved the objective for which it was intended. The low yield of revenue of the fiscal system is evidenced by the figures indicated below.

Total Revenue Yield (million birr)					
Year	1973/74	1974/75	1975/76	1976/77	1977/78
Total revenue	754.4	804.7	615.5	659.0	932.9

Source: Ministry of Finance (unpublished notes)

However, the external loans for accounting year 1978-1979 are as follows:

Donor	*Activity/project*	*Amount*
IDA (International Development Agency)	Agricultural development projects	52,973,000
IDA	Washed coffee project	2,569,600
IDA, PRC (People's Republic of China), UK	Water supply	4,129,800
IDA, PRC, EEC, FRG (Federal Republic of Germany), UK, ADA	Road construction	105,172,400
IDA	Fifth Telecommunication programme	20,000,000
IDA	General education and other community services	27,897,300
IDA	Higher education	5,260,000
USSR	Mining	513,400
ADB, PRC, FRG	Electricity supply	22,148,700
GDR (German Democratic Republic)	Port expansion	4,000,000
		244,664,500

Source: Provisional Military Government of Socialist Ethiopia; Budget for the Fiscal Year 1971 (1 Hanle 1970-30 Sene 1971) (1978-79).
Negarit Gazeta – No. 1, 7th October 1978, pp. 9-10.

II. THE TAXATION OF INCOME

A. Introduction

Income tax is imposed on taxable income, i.e. on gross income less allowable deductions. However, what is considered to be "income" itself is not clear. It is defined as "every sort of revenue from whatever source . . . which has its origin within Ethiopia". [13] There is no distinction made between "income" and "capital". To be subject to income tax the *origin* of the taxable income must be *within* Ethiopia, i.e. income originating outside Ethiopia is not subject to tax under Ethiopian law.

10. Note that the following foreign investment laws are also still in force:
— Notice No. 10 of 1950;
— Investment Decree 1963 which has been renumbered Investment Proclamation No. 242 of 1966.
11. For detailed information see, *Annual Report Exchange Arrangements and Exchange Restrictions 1979 International Monetary Fund*, pp. 150-152.
12. Id., p. 150.
13. Income Tax Proclamation 1961, Art. 4 cum Art. 3(3).

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1. Pre-1974 income tax structure

Before the political changes of September 12, 1974 there were four schedules under which income tax was payable:

- *Schedule A.* Employment income; income tax at progressive rates is due within the month following the period of payment of the income; [14]
- *Schedule B.* Income from rent of land and buildings (irrespective of the purposes for which the land and buildings were to be used), including income from crop-sharing arrangements made between owners of the lands and tenants. The tax is paid annually on a *preceding year basis*; [15]
- *Schedule C.* Income from any trade, business, profession or vocation [16] and from:
  - (i) the exploitation of woods and forests for lumbering purposes; [17]
  - (ii) the processing or transforming of agricultural products; [18]
  - (iii) other activities relating to agriculture, forestry, breeding cattle or maintaining pasture land, provided the said activities are considered as being pursued by traders or by business organizations of a commercial nature according to the commercial code of Ethiopia; [19]
  - (iv) cattle breeding activities for trade. [20]
- *Schedule D.* Income from agricultural activities, i.e. the cultivation and/or development of land and/or the harvesting of any crop from land including the raising and breeding of livestock on such land (but excluding items (i), (ii) and (iv) above). [21]

Taxes were calculated on the amount of income within each category subject to income tax. There was no aggregation of the income of the Schedules and each Schedule had its own tax rates. This situation has remained unchanged. [22]

2. The post 1974 tax reform and the effects of land reform on Schedule B

The income disparity between the lowest income earning groups and the highest was wide. [23] However, it is the issue of land ownership where everything which is connected with the underdevelopment of the country culminates. As Robert S. McNamara, President of the World Bank, stated at the IMF-World Bank Meeting in 1972:

"When the highly privileged are few and the desperately poor are many . . . and when the gap between them is worsening rather than improving . . . it is only a question of time before decisive choice must be made between the political costs of reform and the political costs of rebellion." [24]

The above statement was true in Ethiopia prior to 1974. There were millions without land but there were individual landlords whose aggregate land holding was half of, for instance, the Netherlands. Land was concentrated in the hands of the royal family, the church, the nobility and their associates, i.e. the same group which exercised the political power. Thus the owners of real estate were also the most important rental recipients. However, either because of the lack of political will or of the lack of compliance of tax laws, the amount of revenue derived by the State from Schedule B was insignificant. If the Haile Selassie Government had enforced its tax legislation, this would have increased the total tax revenue considerably. About 40 percent of the income of the landlords would have been transferred to the Treasury by virtue of Schedule B alone. [25]

The land reform that took place in Ethiopia was something quite different in its depth and magnitude from any other that has so far occurred in Africa. It is believed to be comparable to the agrarian program of the Russian Bolshevik Party of 1917, [26] although the issue of implementation is, however, the crucial test. The land reform law did not merely limit the size of landholdings to 20 hectares, but it did away with the private ownership of land by absentee landlords and to a great extent with the system of tenancy in areas where absentee landlordism was chronic, especially in the southern part of Ethiopia. In addition, no private farmer is now allowed to hire a laborer and the Government has recently issued a collectivization program which in principle abolishes private ownership of land. There is, however, great skepticism and caution about the implementation thereof.

Due to the land reform and nationalization of urban land and buildings, the government has become the most important landowner. As a result, the tax structure related to Schedules B and D has been drastically changed. The principal tax proclamations which amended the tax law are the following:

a) Rural Land Use Fee and Agricultural Activities Income Tax Proclamation No. 77/1976;
b) Rural Land Use Fee and Agricultural Activities Income Tax Amendment Proclamation No. 152/1978, and

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14. Income Tax Proclamation 1961, Art. 7(a) cum Art. 4(a).
15. Id., Art. 4(b) and Art. 10(a) as amended by Proclamation 255/1967, Art. 2(B)(b).
16. Id., Art. 4(c) and Art. 12(a) Income Tax (Amendment).
17. Id., Art. 3(d) as amended by Income Tax Amendment Proclamation 1967, Art. 2(i).
18. Id., Art. 2(a)(ii).
19. Id., Art. 2(a)(iii).
20. Id., Art. 2(a)(iv).
21. Income Tax Proclamation 1963, Art. 3(d) as amended by Proclamation No. 255/1967, Art. 2A.
22. Income Tax Proclamation 1963, Art. 5.
23. This disparity can best be illustrated from the following facts. While the lowest wage was about 18.2 birr per month, the range of basic salaries within the senior management ranged between 4,000 birr to 7,000 birr (exclusive of other allowances) for Ethiopians and about 10,000 birr for skilled expatriates. One way of distributing income often suggested by many persons is to use the fiscal instrument for imposing higher taxes at progressive rates against the high income groups. See Y. Mekbib, *The Impact of Volitional and Institutional Factors on Income Taxation in Ethiopia*, M. Phil. thesis (unpublished), University of East Anglia, June 1979.
24. See R.M. Bird, "Public Finance and Inequality", *Finance and Development*, 11 (7) (March 1974), p. 2.
25. Mekbib at 301-302.
26. Raul Valdes Vivo, *Ethiopia the Unknown Revolution* (Crudad de la Habana: Editorial de Ciencias Sociales, 1977), p. 94; Navina and David Ottaway, *Ethiopia, Empire in Revolution* (London: African Publishing Company, 1974), p. 8.

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ORGANIZATION OF THE ECONOMY

Economic organizations operating in rural areas (i.e. outside the boundaries of a municipality or a town)

Agriculture:	Agricultural cooperatives in peasant state enterprises to farm state-owned farms.
Industry:	Handicraft cooperatives engaged in small scale cottage crafts and industrial activities.
Mining:	State and foreign cooperation enterprises to develop the mineral and oil potential of the country.

Urban based or resident economic organizations engaged in predominantly economic activities in rural and urban areas.

Private:	Co-operatives. Partnerships. Joint ventures. Private limited organizations.
Mixed:	Joint venture enterprises to facilitate international industrial cooperation between state and foreign private or state investors.
Wholly state owned enterprises:	State enterprises to engage in key industrial, mining, agricultural, commercial, trading and other economic activities.

c) Income Tax Amendment Proclamation No. 155/1978.

The new laws do not, however, expressly state that Schedule B is to be omitted and that Schedule D is to be replaced by a new Schedule D. Under the new laws, income derived from the following sources is subject to tax:

a) Income or benefits in kind from employment, [27] (Schedule A);
b) Income from any trade, business, profession or vocation and from all other sources not specifically mentioned [28] (Schedule C);
c) Income from dividends distributed to shareholders; [29]
d) Income from chance winnings; [30]
e) Income from royalties; [31]
f) Income from services rendered to persons or organizations in Ethiopia by persons or organizations from abroad. [32]

3. Taxable persons

Prior to 1978, income tax was paid by all persons, i.e. individuals and all forms of associations, [33] including partnerships but excluding entities with limited liability like joint stock companies. [34]

Now, in the post-1978 legislation, the taxable entity is the "*organization*". The "*organization*" is defined as "any government or privately owned juridical person or association that carries out business activities excluding a cooperative society". [35] However, the types and legal aspects of such organizations are not spelled out in any law, but it may be assumed that joint venture and state enterprises (companies) are now included.

The following provides a brief description of the Ethiopian tax structure on income from various taxable sources.

B. Income from employment (Schedule A)

1. Taxable source

Tax under Schedule A is payable on income in cash or in kind from employment including salaries, wages, allowances, pensions, directors' fees and other personal emoluments etc., [36] unless exempted by the Minister of Finance. The tax is therefore imposed on payments in cash and benefits in kind arising from a contract of employment.

Wages and other employment income received by a person *not* working in Ethiopia are considered to have their origin *outside* Ethiopia and are thus not subject to tax. [37] Persons who remain in Ethiopia for more than an aggregate of 183 days in any twelve-month period are liable for taxes due under Schedule A from the beginning of their stay. [38]

Pensions and other personal emoluments are without exception subject to tax under Schedule A. [39]

Benefits in kind are included in taxable income. There is no guideline for computing the value of benefits in kind, so that valuation of such benefits has to be approved by the Income Tax Authority.

2. Tax rates

The tax on income from employment over 50 birr shall be levied and collected monthly according to Schedule A at the following rates:

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27. Income Tax Amendment Proclamation No. 155/1978, Art. 2 (a) cum Income Tax Proclamation 1963, Art. 4(a).
28. Id., Art. 2(b) cum Income Tax Proclamation 1963, Art. 4(c).
29. Id., Art. 2(c).
30. Id., Art. 2(d).
31. Id., Art. 2(e).
32. Id., Art. 2(f).
33. Which according to Art. 404 of the Ethiopian Civil Code is defined as a group formed between two or more persons with a view to obtaining a result other than the securing of profit sharing.
34. Income Tax Proclamation 1961, Art. 3(b).
35. Income Tax Amendment Proclamation No. 155/1978, Art. 2(1) cum Income Tax Proclamation 1961, Art 3(a) as amended.
36. Id., Art. 4(a) cum Arts. 6 and 8.
37. See also R.C. Means, Materials for Public Law (Faculty of Law, H.S.I.U., Addis Ababa, 1966), p. 24.
38. Income Tax Regulations 1962, op. cit., Art. 11.
39. Income Tax Proclamation No. 173 of 1961, op. cit., Art. 4(a).

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Taxable income per month (in birr)	*Tax rate on every additional slice of income (%)*
50 - 250	10
250 - 500	13
500 - 750	19
750 - 1,000	24
1,000 - 1,250	29
1,250 - 1,500	34
1,500 - 1,750	39
1,750 - 2,000	44
2,000 - 2,250	49
2,250 - 2,500	54
2,500 - 2,750	59
2,750 - 3,000	64
3,000 - 3,250	69
3,250 - 3,500	74
3,500 - 3,750	79
3,750 and over	85

Compared to the pre-1974 situation the tax rate has almost doubled for persons deriving income of about 1,000 birr a month and it is more than three times that of the previous rate at the highest income bracket. It is not, however, clear why the Government has preferred the progressive rate method of taxing higher income groups when it has in fact put a ceiling on wages by administrative decision. Whether this policy of imposing high tax rates is desirable when there are neither employees earning the taxable amount nor even the possibility of earning such an amount is an arguable point. [40]

3. Deductions

The family circumstances of the taxpayer are not given any consideration under Schedule A. Contributions to provident, savings or pension funds as well as payments made at the termination of a contract of employment are deductible.

The following categories of payments are excluded from computation of income taxable under Schedule A:

(i) actual cost of medical treatment of employees provided by the employer; [41]
(ii) allowances in lieu of means of transportation granted to employees in accordance with Government regulations or under the contract of employment; [42]
(iii) travelling expenses incurred while on duty paid to employees by the employer; [43]
(iv) compensation for reasonable amounts of travelling expenses incurred by employees recruited from other than the place of employment on joining or terminating employment or in connection with their leave. [44]

4. Exemptions

The following are exempt from Schedule A tax:

(a) the first 50 birr of income from employment; [45]
(b) employment income received from abroad by persons present in Ethiopia representing foreign business or other persons not doing business in Ethiopia, who are not employed or retained by any employer in Ethiopia, remaining in Ethiopia less than an aggregate of 183 days in any one year. [46]

C. Rural land use fee (formerly Schedule B)

1. Rural land use fee rates

Rural land, i.e. land outside the boundaries of municipalities and towns [47] which has been declared to be under public ownership, is subject to a land use fee payable at the following rates:

(a) Every farmer [48] who is a member of an agricultural producers' cooperative is obliged to pay 5 birr; [49]
(b) A farmer who is not a member of an agricultural producers' cooperative is charged 10 birr; [50]
(c) Every Government agricultural organization pays 2 birr per hectare on the total of its holdings. [51]

The above implies that the effective ownership of rural land is with the Government and a use fee or rent, as the case may be, is paid for the right to possess or use the land. The land use fee payable by individual farmers whose annual agricultural income is below 1,200 birr and who are members of an agricultural producers' cooperative is collected by the local tax collector [52] (i.e. by a farmers' association or any person authorized by the Inland Revenue Agency (IRA) [53]) every year between the first of Tahsas (December) and 30th of Miazia (April). [54] Farmers' associations or any persons authorized by the Inland Revenue Agency are paid two percent of the amount of the collection they make. [55]

However, rural land use fees from Government agricultural organizations and farmers whose annual agricultural income exceeds 1,200 birr are collected by the tax office, [56] i.e. the Inland Revenue Agency of the Ministry of Finance, and any Provincial, "Awraja" or "Woreda" income tax office, as well as any other office which the IRA may authorize in writing to implement the Proclamation. [57]

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40. The same argument can be made for the taxing of agricultural land or income in a predominantly peasant society.
41. Income Tax Regulations 1962, Art. 4(a).
42. Id., Art. 4(b).
43. Id., Art. 4(c).
44. Id., Art. 4(d).
45. Income Tax Proclamation No. 173/1961, Art. 7 (b) as amended by Income Tax Amendment Proclamation No. 155/1978, Art. 3(b)(1).
46. Income Tax Proclamation No. 173/1961, Art. 18(d).
47. Rural Land Use Fee and Agricultural Activities Income Tax Proclamation No. 77/76, Art. 2(2).
48. A farmer shall mean any individual farmer or one who farms land in common with others, any private organization or association or any government agricultural organization other than agricultural research station having legal personality.
49. Rural Land Use Fee and Agricultural Activities Income Tax Proclamation No. 77/1976, Art. 8(1) as amended by Proclamation No. 152/1978, Art. 2(1)(1).
50. Proclamation No. 77/1976, Art. 8(2) as amended by Proclamation No. 152/1978, Art. 2(1)(2).
51. Proclamation No. 77/1976, Art. 8(3).
52. Id., Art. 10(2)(b).
53. Id., Art. 2(8).
54. Id., Art. 10(1).
55. Id., Art. 44.
56. Id., Art. 10(2).
57. Id., Art. 2(7).

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2. Rural land use fee and rural development

The overall concepts of rural development, regional autonomy, etc. cannot be separated from the financial, political, economic, legal and administrative relationships between the central authority and institutions of local government and rural development.

The municipalities and local authorities or the rural organizations do not have substantial financial autonomy to perform the duties which they have been delegated to undertake. The central government collects income earned from land and other sources located in rural areas. However, the country's funds are not fairly distributed.

If ownership of land is primarily in the hands of the State, it has the special responsibility of redistributing the national wealth more equitably. [58]

D. Income from business profits (Schedule C)

1. Taxable source and taxable subjects

Income from business profits is subject to a tax if derived by individuals, associations or incorporated bodies. The tax is imposed on gains accrued from economic activities except [59] those derived from humanitarian, cultural, religious and social activities.

Schedule C is also intended to apply to all sources of income not covered by the other Schedules including income from occasional rental of property. [60]

It is worth emphasizing that for tax purposes no distinction is made between a branch and subsidiary. However, non-residents trading in Ethiopia through an agent are jointly responsible with the local agent for the filing of returns and for the payment of income tax which may be due by such non-resident. [61] Moreover, no payment of any kind made by an Ethiopian branch to its foreign head office or by an Ethiopian company to its foreign parent or to another affiliated foreign company is accepted as a deduction from gross income unless it is a payment for services actually rendered [62] and this service was necessary for the business and could not be performed by other persons or bodies or by the business itself at a lower cost. [63]

BASIC INFORMATION

Area: 1,211,900 square kilometers
Population: 30 million (approximately) with more than 82 different nationalities
Religion: predominantly Christian and Muslim
Population growth rate: 2.5% per annum
Average rate of agricultural production: 2%
Population distribution: 11.8% urban, 88.2% rural
Annual growth rate of urban population: 6.6%
Per capita income: U.S.$ 80
Illiteracy rate: about 85%
Currency: 1 Eth. birr. = U.S.$ 2.071 (August 1979)
Communication and transport system: About 80 percent of the people live about a day's walk from an all-weather road.

2. Individual income tax rates

Individuals who derive income under Schedule C are subject to the following rates of tax:

Annual amount of income (in birr)		*Rate*
Under	300	10 birr
300 -	500	18 birr
500 -	700	24 birr
700 -	900	40 birr
900 -	1,200	70 birr
		plus a percentage of each additional slice [64]
1,200 -	3,000	11
3,000 -	6,000	14
6,000 -	9,000	20
9,000 -	12,000	26
12,000 -	15,000	33
15,000 -	18,000	40
18,000 -	21,000	47
21,000 -	24,000	54
24,000 -	27,000	61
27,000 -	30,000	68
30,000 -	33,000	75
33,000 -	36,000	82
Over	36,000	89

One of the main reasons for doubling and tripling the tax rate payable by persons in high income brackets might have been to narrow the gap of income inequality. But this objective has theoretically been achieved by the nationalization of land, buildings and industries and by putting a maximum ceiling on wages and property holdings.

3. Taxable legal entities: "organizations"

As was explained in the Introduction to this section, "organizations" are subject to income tax.

Art. 4(c) of the 1961 Proclamation provides:
"... [E]very ... body [65] having an income as defined herein [i.e. in Art. 3(c)] is liable to pay income tax thereon ... on income from any trade, business, profession or vocation and from any activity mentioned in subparagraphs (i), (ii) and (iii) of Art. 3 (d) hereof and from any interest and from *all other sources not specifically mentioned* in paragraphs (a), (b) and (d) of this Article 4."

58. The writer is of the opinion that the Ethiopian fiscal system is not designed to promote rural development. It encourages centralization rather than decentralization. Moreover, it is an impediment to the basic principles of regional autonomy or self-rule. There can be no autonomy without a granting of power to the administrative agencies of the region to raise revenues from regional sources.
59. Income Tax Proclamation No. 173/1961, Art. 4(c).
60. Income Tax Amendment Proclamation No. 155/1978, Art. 5(b) cum Income Tax Proclamation No. 173/1961, Art. 12(d).
61. Income Tax Proclamation 1961, Art. 36(b).
62. Id., Art. 18(a).
63. Id., Art. 18(b).
64. Income Tax Amendment Proclamation No. 155/1978, Art. 5(a)(b)(ii) cum Income Tax Proclamation 1961, Art. 12(b).
65. "Body" means any incorporated body with limited liability. This generally refers to public and private companies with limited liabilities. See Income Tax Proclamation No. 173/1961, Art. 3(a).

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However, Art. 3(a) of Proclamation 173/1961 is deleted and replaced by Art. 2(i) of Tax Proclamation No. 155/1978 which provides:

"Organization shall mean any government or privately owned juridical person or association that carries out business activities excluding a cooperative society."

Any corporate body which carries out business activities therefore is considered to be an organization. It is not clear, however, whether such organizations are legally different from the business organizations formed under the 1960 Commercial Code or whether this change is merely a cosmetic one, replacing "company" by "organization". It appears that this change may be intended to pave the way for the imposition of tax on state enterprises, joint ventures, or farmers' organizations that are separate legal entities.

a. Tax rates

The tax rate payable by organizations as defined above is fifty percent. [66]

b. Deductions

(i) Ordinary expenses

The general rule is that all expenses paid or incurred wholly, necessarily and exclusively for the purposes of creating income are deductible. No expenditure not wholly and exclusively incurred for the purpose of producing the income is allowed as a deduction. [67]

The following expenses are deductible from gross income in calculating taxable income under Schedule C:

- the direct cost of producing the income, such as the direct cost of manufacturing and trading operations, of professional and vocational occupations, of exploitation of woods and forestry and so on; [68]
- general and administrative expenses connected therewith; [69]
- depreciation, allowed under Articles 22 through 24 of the Income Tax Regulation; [70]
- premiums payable on insurance directly connected with the activity chargeable under Schedule C; [71]
- commissions paid for services rendered to businesses or to persons or bodies engaged in a professional or vocational occupation, provided that:
  (a) said services were in fact rendered; [72] and
  (b) the amount paid as commission for said services correspond to the normal rates paid by other businesses or persons or bodies similarly situated for similar services rendered in similar circumstances; [73]
- bad debts, [74] but not losses unconnected with or not arising out of the activity of the enterprise [75] or losses recoverable by insurance or contract of indemnity. [76]

(ii) Depreciation allowance for "capital" expenses

The annual rates of depreciation for capital expenditure are as follows:

- buildings: five percent;
- machinery: sixteen percent for the first year and twelve percent thereafter;
- furniture: ten percent;
- motor vehicles: twenty percent.

In certain cases higher allowances may be approved by the Income Tax Authorities if they are justified in respect to the probable life of the asset. [77]

Unless otherwise specifically prohibited by law or otherwise rejected by the Internal Revenue Agency, the deduction and depreciation method which applies to legal entities also applies to individual and small businesses.

4. Investment exemptions

In order to encourage foreign investment in Ethiopia the Haile Selassie Government issued various laws. These were the following:

(i) Notice No. 10 of 1950;
(ii) Investment Decree, 1963; and
(iii) Investment Proclamation 1966.

The above laws are still in force.

a. Exemptions from profits tax

The foreign investment laws of Ethiopia currently in force, inter alia, provide a five year tax exemption period for newly established agricultural, industrial, mining, transport and tourist enterprises which invest about two hundred thousand birr in Ethiopia prior to the commencement of their operation.

An enterprise which invests an additional 200,000 birr in an extension or expansion of an existing enterprise may be exempted by the Minister of Finance from the tax on income derived from the additional investment for an additional period of five years from the date of the commencement of such operations, provided, however, that the new extended or the expanded facility is operated as a separate technical unit with separate accounts and is earning a separate income. [78]

b. Exemption from customs and import duties of raw materials and machinery

Moreover, agricultural and industrial machines, implements appliances, or parts thereof, which are imported by a person or enterprise having juridical personality for exclusive use in agricultural and industrial enterprises, are exempt from the payment of customs import duties, transaction taxes on imports, municipal taxes and all

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66. Income Tax Proclamation No. 173/1961, Art. 12(c) as amended by Income Tax Amendment Proclamation No. 155/1978, Art. 5(b). Note that the maximum tax rate for individuals or non-organizations under Schedule C is higher than for organizations.
67. Income Tax Proclamation 1961, Art. 16 cum Income Tax Regulation 1962, Art. 17(a).
68. Income Tax Regulations 1962, id., Art. 16(a).
69. Id., Art. 16(b).
70. Id., Art. 16(c).
71. Id., Art. 16(d).
72. Id., Art. 16(c)(i).
73. Id., Art. 16(e)(ii).
74. Id., Art. 16(f).
75. Id., Art. 17(b)(vii).
76. Id., Art. 17(b)(viii).
77. Id., Art. 24(b).
78. Id., Art 19(a) see also Investment Decree 1963, Art. 5(2) as amended by Investment Proclamation 1966, Art. 9. cum Income Tax Proclamation 1961, Art. 19(b).

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other taxes and duties levied on imports: *provided, however that similar goods are not being produced within* Ethiopia. The Minister of Finance is authorized to issue regulations designating, by reference to items of the Customs Tariff, all goods which are subject to exemption and specifying declaration forms which shall be submitted to the Customs Administration by persons claiming the exemption. [79]

c. Exemption for construction material for industrial enterprise

Furthermore, upon the proposal of the Investment Committee, the Minister of Finance is authorized to grant exemption from payment of customs import duties, transaction taxes on imports, municipal taxes and all other taxes and duties levied on imports, with *respect to buildings, structural and other construction material* provided that such building, structural and other construction material is being imported for direct and exclusive use in construction *destined to house industrial enterprises* but not for office or living quarters; and provided, further, that similar materials are not being produced within Ethiopia. [80]

d. Exemption for packaging materials

Packaging materials and containers imported and used for the export of any goods manufactured locally are also exempt. [81]

e. Export duty relief

Goods manufactured locally destined for export are exempt from export duties and transaction taxes on exports for a reasonable period of time if such exemption is found necessary to assure the competitive position of these goods in export markets. [82]

The investment laws authorize the National Bank of Ethiopia to make available foreign exchange necessary to assure:

(i) The remittance of the profits of foreign investors to their countries of origin; [83]
(ii) The repatriation of the net proceeds belonging to a foreign investor upon partial or total sale or liquidation of his investment; [84]
(iii) The payment of the interest and the repayment of approved foreign loans contracted by enterprises; [85]
(iv) The remittance of the savings of foreign personnel employed in Ethiopia by investors; [86]
(v) The purchase of replacement, spare parts and other materials and goods required in connection with their investment operations. [87]

f. Other exemptions

The following categories of income are, inter alia, exempt from income tax:

(i) income from interest received by persons on bank accounts; [88]
(ii) income paid to foreign re-insurers. [89]

E. Income from agricultural activities (Schedule D)

1. Taxable source

Under the new laws, "agricultural activities" mean: the cultivation or development of rural land by any means and with the aid of any implement, regardless of whether or not the farmer processes it further by industrial means, the harvesting of crops as well as the breeding of livestock on such land, but excluding the following:

(i) the exploitation of woods and forests for wood lumbering purposes; [90]
(ii) the processing of agricultural crops by a natural or juridical person other than the farmer who produces such crops; [91]
(iii) other activities relating to agricultural forestry, breeding of cattle or maintaining pasture land in cases where said activities shall be deemed to be registered as commercial activities and pursued or conducted by a trader or a business organization, in accordance with the provisions of the Commercial Code of Ethiopia, and where the same is the principal activity; [92] and
(iv) notwithstanding the Cattle Tax Proclamation No. 142 of 1954, breeding animals for domestic use. [93]

2. Taxable subjects

a. Individuals: farmers

(i) Declaration of income

Each farmer has the duty to declare on the form issued by the Internal Revenue Agency, the amount of gross annual income he realized. The tax due thereon is payable to the nearest tax collector or tax office between the 1st of Tahsas (December) and the 30th of Miazia (April) or 30 days from the date of the realization of the income. [94]

Taxpayers are registered according to their annual declaration. Every tax collector has the duty to register individual farmers as well as those members of agricultural producers' cooperatives in the following categories:

— annual gross income up to 600 birr; [95]
— over 600 but not exceeding 900 birr; [96]
— over 900 but not exceeding 1,200 birr; [97]
— over 1,200 [98] but not exceeding 6,000 birr.

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79. Transaction Taxes Proclamation 1963, Art. 6(a)(1).
80. Id., Art. 6(a)(2).
81. Id., Art. 6(f).
82. Id., Art. 12(a) cum Investment Proclamation No. 242/1966, Art. 7.
83. Investment Proclamation No. 242/1966, Art. 8(1) cum Investment Decree 1963.
84. Id., Art. 8(2).
85. Id., Art. 8(3).
86. Id., Art. 8(4).
87. Id., Art. 8(5).
88. Id., Art. 18(c).
89. Id., Art. 18(f) cum Proclamation No. 155/1978, Art. 2(9).
90. Id., Proclamation No. 77/1976, Art. 9(a).
91. Id., Art. 9(b).
92. Id., Art. 9(c).
93. Id., Art. 9(d).
94. Proclamation No. 77/1976, Art. 13.
95. Id., Art. 14(1).
96. Id., Art. 14(2).
97. Id., Art. 14(3).
98. Id., Art. 14(4).

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(ii) Assessment

The above taxpayers are assessed by estimation of the potential crop yield which estimation is valid for a period of three consecutive years but such tax must be paid annually. [99] Loss of a harvest due to difficulties in connection with or damage to the agricultural activity therefore is subject to relief that may be granted by the Ministry of Finance. [100]

The tax office has the responsibility of assessing and collecting taxes on income over 600 birr but not exceeding 6,000 birr. [101]

A farmer who has an income of over 6,000 birr is required to keep books of account and supporting documents in accordance with the directives issued by the tax office. [102] In such cases taxes are assessed on the basis of the taxpayer's annual return unless they are either unacceptable for the tax office in which case they will be assessed by estimation which is often arbitrary. [103]

The tax is assessed on the aggregate of the income realized or deemed to be realized from two or more agricultural activities, subject to tax under the new tax. [104]

(iii) Tax rates

Any farmer whose annual income from agricultural activities does not exceed 600 birr pays 10 birr. [105]

Moreover, an additional tax on income exceeding 600 birr is levied at the following rates:

Annual taxable income in birr	*Tax rate on every additional slice of income (%)*
600 - 1,200	10
1,200 - 3,000	11
3,000 - 6,000	14
6,000 - 9,000	20
9,000 - 12,000	26
12,000 - 15,000	33
15,000 - 18,000	40
18,000 - 21,000	47
21,000 - 24,000	54
24,000 - 27,000	61
27,000 - 30,000	68
30,000 - 33,000	75
33,000 - 36,000	82
36,000 and over	89

(iv) Deductions

No deductions are allowed for taxpayers deriving income below 1,200 birr. However, taxpayers earning above this figure may on request deduct in whole or in part:

(a) any fee [106] which includes the rural land use fee;
(b) all expenses which are necessary and have been incurred especially and directly for the realization of the annual income; [107] and
(c) depreciation of movable and immovable fixed assets used in the agricultural activity to be deducted in accordance with the Income Tax Regulations 152/1962 or Regulations to be issued by the Minister. [108]

However, the tax office may refuse to accept the declaration as well as expenses demanded to be deducted from the gross income unless they are supported by satisfactory evidence. [109]

It is not clear why 1,200 birr is the figure chosen to serve as the line of demarcation. It would appear to be better to have either an estimated deduction system for those taxpayers whose tax liability is assessed by estimation or not to allow any deductions for those who are required by law to keep books but are assessed by estimation on the grounds stated under Art. 21(2) and Art. 22.

(v) Collection

Income tax arising from Schedule E is collected by (a) local tax collectors, or (b) the tax office. The former are mass organizations like peasant associations and presumably cooperatives. The tax office is a local branch of the Ministry of Finance and the government administration. The farmers' associations are allowed to collect only income tax accrued from agricultural activities from a category of farmers whose annual gross income is less than six hundred birr. Whether farmers in such a category should be taxed at all is debatable. The writer believes that it is anti-developmental, unjust and unequitable to tax farmers who are below the poverty line and exist at subsistence level. A better policy would be for the government to provide them with all that they need and impose tax thereon only after they manage to attain a sufficient level of income. Neither the former nor the present government have seriously attempted to use taxation of agricultural income for rural development. While the predominant sources of wealth of the country at present are the land and the rural population, the latter is still suffering from the lack of basic needs and a resulting unequal distribution of resources between the rural and the urban population.

b. Organizations

Every organization defined above having income is liable for the payment of income tax. The tax rate for Government agricultural farms or corporate body or organizations is fifty percent of their taxable income. [110]

For purposes of deductions, the tax office has the right to determine whether expenses submitted in accordance with Art. 24 of the Proclamation stated above are to be deducted. [111]

99. Id., Art. 19(1).
100. Id., Art. 19(2).
101. Id., Art. 21(1) as amended by Proclamation No. 152/1978, Art. 4(1).
102. Id., Art. 22.
103. Id., Art. 21(2).
104. Id., Art. 23.
105. Id., Art. 17 as amended by Proclamation No. 152/1978, Art. 2(2).
106. Id., Art. 24(1)(a).
107. Id., Art. 24(1)(b).
108. Id., Art. 24(1)(c).
109. Id., Art. 24(2).
110. Rural Land Use Fee and Agricultural Activities Income Tax Proclamation No. 77/1976, Art. 25(1).
111. Ibid.

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F. Withholding taxes on income from specific sources

In addition to the above, the following new income taxes are withheld at the rates specified below irrespective of whether it is paid to individuals or organizations:

Income from:	Withholding tax
(i) dividends	25% [112]
(ii) chance winnings and tote	10% [113]
(iii) royalties	40% [114]
(iv) service rendered to any person or organization or cooperative society in Ethiopia by any person or organization from abroad.	10% [115]

In addition to the payment of taxes on income payable under the relevant Schedules foreign investors are also subject to an additional withholding tax at above rates.

1. Dividends

Under prior law, dividends received by shareholders from bodies incorporated in Ethiopia were exempt provided that amounts paid as dividends were included in the taxable income of the bodies making such payments. [116]

However, as indicated above, dividends are taxed at the rate of 25 percent in the post-1974 tax reform.

2. Royalties

Royalties are taxed at the rate of 40 percent in the post-1974 tax reform. However, there is no definition of the term. This is perhaps one manifestation of the fiscal crisis of the state. The tax authorities seek to impose a tax on income derived from undefined activity. This is bound to encourage tax litigation. There is not even an indication of whether the tax is imposed on a gross or net basis. [117]

3. Tax on payments for services

Income derived from services rendered to any person or organization or cooperative society in Ethiopia by any person or organization from abroad is subject to a 10 percent income tax. [118]

Whether the introduction of the new law is an anti-avoidance measure for commissions paid for services rendered to business stipulated in Art. 16(e) of Income Tax Regulations, 1962 or whether it is a tax imposed on technical assistance services or other categories of services is not clear.

G. Tax treaties and the avoidance of double taxation

Ethiopia has not as yet concluded any tax treaty for avoidance of "double taxation" on income or capital with any country with the exception of income arising from shipping and air transport. From the viewpoint of foreign investors, therefore, the usual "double taxation" argument applies. It is worth emphasizing to note that in the Ethiopian tax system a tax is imposed on the income derived from activities where the Ethiopian State exercises sovereign territorial including offshore jurisdiction.

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113. Id., Art. 7(b) cum Art. 2(d).
114. Id., Art. 7(c) cum Art. 2(c).
115. Id., Art. 8(d) cum Art. 2(f).
116. Income Tax Proclamation 1963, Art. 18(f).
117. The post-1974 amendments are so incomprehensible and badly drafted that it would have been much easier both for tax administrators and taxpayers if new tax laws were promulgated altogether.
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BRAZIL: The Supplementary Income Tax (Imposto Suplementar de Renda) on Dividend Distributions

by Paulo Kantor*

1. The supplementary income tax (Imposto Suplementar de Renda) (ISR) was instituted by Law No. 4,131, of September 3, 1962, and amended by Law No. 4,390, of August 29, 1964, and is presently regulated by the supplementary provisions of Normative Ruling No. 2, of September 12, 1969 (IN 2/69), as amended by Normative Ruling No. 17, of April 30, 1971 (IN 17/71), both issued by the Secretariat of Federal Revenue, and article 348 of the Income Tax Regulations (RIR) approved by Decree No. 76,186, of September 2, 1975.

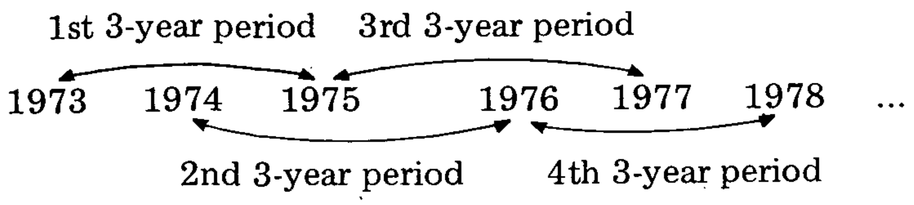
2. Generally speaking, the profits and dividends which Brazilian companies remit to individuals or entities resident or domiciled abroad are subject to the withholding of income tax at source at the rate of 25 percent, in accordance with articles 344-1 and 343(a) of the RIR.

3. Regardless of the above form of taxation, when the average of profits or dividends remitted during a three-year period exceeds 12 percent of the capital and reinvestments capitalized and registered by the Central Bank of Brazil (Central Bank), ISR will be levied *on the excess*, at the following rates:

- remittances over 12 percent and up to 15 percent of the capital and reinvestments: ISR — 40 percent on the excess;
- remittances over 15 percent and up to 25 percent of the capital and reinvestments: ISR — 50 percent on the excess; and
- remittances over 25 percent of the capital and reinvestments: ISR — 60 percent on the excess.

4. Thus, two factors must be considered in ascertaining the existence of excess remittances and of possible ISR to be paid: (i) the average capital of the foreign investor in the Brazilian investment recipient, and (ii) the remittances of profits or dividends abroad, both relating to a specific period of time, i.e. the three-year period.

5. It is worthy of mention that, in spite of the fact that the period of time determining the taxation of ISR is a three-year period, ascertainment of the excess remittances must be made annually, since each year will represent the end of a new three-year period, as shown below:



The Editors of the Bulletin for International Fiscal Documentation are proud to publish this article on the Brazilian Supplementary Income Tax by Mr. Paulo Kantor. However, this tax is only part of the Brazilian corporate income tax system which consists of the following taxes:

Corporate income tax on the income of legal entities: normal rate, 30 percent, but for corporations which have opted for consolidated returns, 32 percent.

Profit distributions tax at a rate of 5 percent on all profit distributions of legal entities including remittances by Brazilian branch offices to their foreign head offices.

Tax on excess reserves at a rate of 25 percent on any increase of a corporation's reserve funds above a sum equal to its paid-in capital (as adjusted for inflation). A number of reserve funds are not considered in computing the tax.

Supplementary income tax, which is the subject of this article. Note that this tax also applies to branch profits of foreign corporations.

See for more detailed information our loose-leaf publication, *Corporate Taxation in Latin America.*

When due, ISR must be paid within 30 days from the end of the three-year period in which the excess remittance abroad has been verified.

6. The average capital of the three-year period must be computed in accordance with the number of days in which the capital and capitalized reinvestments of the foreign investor have actually remained in the Brazilian company within the three-year period, in accordance with the registrations effected by the Central Bank.

The investments pending registration at the Central Bank may be included in the calculation of the average capital of the three-year period, from the accounting entry of the Brazilian company which received the

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investment. A later readjustment, if necessary, will have to be made after the respective registration by the Central Bank.

Example I

1st year

foreign capital registered at the Central Bank 75

2nd year

foreign capital registered at the Central Bank 75

3rd year

foreign capital registered at the Central Bank 150

(1st year) (2nd year) (3rd year)

$$\text{Average capital of the 3-year period} = \frac{(75 \times 365 \text{ days}) + (75 \times 365 \text{ days}) + (150 \times 365 \text{ days})}{3 \text{ years } (365 \text{ days} \times 3)}$$

$$= \frac{27{,}375 + 27{,}375 + 54{,}750}{1{,}095 \text{ days}} = \frac{109{,}500}{1{,}095} = 100$$

7. For effects of ISR taxation, the average amount of the profits or dividends remitted abroad in the three-year period may not exceed 12 percent of the average capital of the same period. Thus, in Example I, for an average capital of *100*, the average of the remittances may reach up to 12 (12 percent) at the end of the three-year period, without ISR being due *(the average of 12 percent* corresponds, of course, to amounts *that total 36 percent* of the average capital in the three years computed).

Example II

	Capital	Remittances permitted
1st year	75 x 12%	9
2nd year	75 x 12%	9
3rd year	150 x 12%	18
	300	36
Three-year period (average amounts)	100 (see Example I)	12 $\frac{(9+9+18)}{3 \text{ years}} = \frac{36}{3}$

As verification of whether or not there are excess remittances is made at the end of the three-year period, the 12 percent limit will not have to be observed for each year, since it is admissable to compensate the shortfall of one year with the excess of another, as follows:

Example III

	Capital	Remittances permitted	Remittances effected	Shortfall	Excess
1st year	75	9	0	9	0
2nd year	75	9	11	0	2
3rd year	150	18	25	0	7
		36	36	9	9
Three-year period (average amounts)	100	12	12	0	0

As may be seen, in the above example the annual excesses were absorbed by the shortfalls, without any excess of remittances being verified at the end of the period. A reservation must be made, however, for the fact that compensation is admitted only *between the years of one and the same three-year period.* Shortfalls verified in one three-year period may not be compensated (in case the remittances abroad corresponded to 34 percent of the average capital, for example), by remitting profits or dividends with an excess of 2 percent in the following three-year period, without ISR taxation.

8. The diagram appearing in paragraph 5 shows that the last two years of a three-year period will be the first two years of the following three-year period. Article 41 of IN 2/69, as amended by IN 17/71, specifies that *the remittances of the last two years of a three-year period* will be considered, *in the first two years of the following three-year period,* in the following manner: (i) *if there was no* excess in the previous three-year period, *in the amounts actually remitted,* and (ii) *if there was* an excess of remittances in the previous period, *in the amount corresponding to 12 percent of the average capital of each one of said years.*

9. The practical result of this rule is to make it recommendable, at times, to remit profits or dividends abroad with an excess, in order not to overburden the limit of the following three-year period.

Example IV, *without excess remittances:*

	1st 3-year period			2nd 3-year period		
	1975	*1976*	*1977*	*1976*	*1977*	1978
remittances effected	0	0	36%	0	36%	0*

* (any remittance in 1978 will be an excess and incur ISR taxation)

Example V, *with excess remittances:*

	1st 3-year period			2nd 3-year period		
	1975	*1976*	*1977*	*1976*	*1977*	1978
remittances effected	0	0 (1% excess)	37%	12%	12%	(12%)*

* (availability for remittance in the year 1978, without constituting an excess).

10. Even though it is not adopted by the federal tax authorities, which follow the criterion indicated in alternative (II) below (as per Normative Opinion No. 77/78, of the Coordination of the Taxation System), there is another interpretation of article 41 of IN 2/69, in the sense that only the remittances that exceed 12 percent of the average capital will be reduced to 12 percent in the three-year period following that in which an excess has occurred, the remittances below the same 12 percent being maintained in the amounts actually remitted.

Example VI

Alternative I							Alternative II		
1975	*1976*	*1977*		*1976*	*1977*	1978	or	*1976*	*1977*	1978
0	0 (excess)	37%		0 (without excess)	12%	(24%)		12% (without excess)	12%	(12%)

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Sri Lanka: Budget 1980

Reproduced below is an extract from the Budget Speech for 1980 presented in November 1979 by Mr. Ronnie de Mel, the Minister of Finance and Planning of the Democratic Socialist Republic of Sri Lanka. The extract only covers the proposed tax changes.

Mr. Speaker, I now come to my tax proposals. A favourable climate for savings, investment and growth has been established by the exchange, monetary and fiscal policies of this Government. A simplified and restructured tax system has been brought into existence with the passage of the Inland Revenue Act No. 28 of 1979. I hope in the near future to present a new and revamped Estate Duty Act and a new Stamp Act. However, there still remain certain areas, where further incentives and relief are required to trigger off productive investment which is the surest foundation for increasing employment and raising the living standards of the people. While we concentrate on investment and growth, the Government is equally conscious of the need to ensure that the fruits of this increased prosperity are shared by as large a number of people as possible. It is with these objectives in view that I now unfold my proposals relating to taxes.

(A) Taxation of companies

Mr. Speaker, in order to encourage company formation I reduced the non-refundable tax on companies from 60 percent to 50 percent last year. Even with this reduction, from the point of view of the local investor, the current rate of return on investment in equity capital of limited liability companies, is not attractive when compared to the alternative options available to him. The company form of business organisation should be actively encouraged to attract the small investor into its fold. To achieve this end, not only should investment in equity capital be made more attractive through the prospect of better yields, but the tax concessions to companies should be geared to induce corporate business to become more broad-based. Fiscal policy should be designed to reactivate the capital market which is a valuable adjunct of the financial system in ensuring the flow of funds for investment. There is also the need to attract foreign capital not merely into the Investment Promotion Zone where enterprises are geared to the export market, but outside the Zone as well. If joint investment outside Zone between local entrepreneurs and foreign investors is to be encouraged, then the relevant tax rates should be comparable with those in other developing countries in our region.

(i) Resident companies

Mr. Speaker, you will, therefore appreciate that there is a strong case for consideration being given to lowering of the rate of tax on companies, particularly companies which are truly broad-based where even the small investor gets a chance to participate in the investment. We already have a concessionary rate of tax of 40 percent in respect of People's Companies in contrast to the rate of 50 percent applicable to other resident companies. Unfortunately, however, the People's Company concept with its restrictive conditions, has not proved to be popular in this country. Mr. Speaker, with the primary objective of broad-basing limited liability companies. I wish to offer a package of incentives. Firstly, I propose to extend the concessionary rate of tax of 40 percent to cover all public limited liability companies, whose shares are quoted and who make available for purchase by the general public a stipulated minimum percentage of shares. I expect such companies to be public in true sense of the word. Secondly, I also propose to do away with the $33^1/3$ percent withholding tax on the dividends declared by such companies. Dividends will, however, be taxable in the hands of the shareholders. Thirdly, I propose to exempt completely from tax, the capital gains that arise from the transfer of ownership of shares in such companies. At present capital gains on the transfer of shares in GCEC enterprises enjoy this exemption. Finally, I also propose to exempt from tax, capital gains which arise on the conversion of a proprietary concern or a partnership to a public company that is broad-based. However, this concession will be available only where the assets are transferred to the new company at the valuation of 31st March, 1977, for Wealth Tax purposes. Such a restriction is necessary to prevent attempts at tax avoidance. With the prospect of higher dividends due to the reduction of the rate of tax and the removal of the withholding and capital gains tax. I expect the small saver to participate in the economic progress of the country. I also hope that these measures will help to reactivate the Colombo Share Market and lead to the creation of more broad-based public companies and a full fledged Stock Exchange in due course.

(ii) Withholding tax on dividends

Mr. Speaker, I have already announced that the withholding tax of $33^1/3$ percent deducted at source on dividends will not apply to broad-based companies whose shares are quoted. As regards the withholding tax on all other companies, I propose to reduce the rate to 20 percent.

(iii) Exemption of dividends

Mr. Speaker, there is also an anomaly that exists at present in regard to the exemption of dividends from tax. Dividends declared by a company carrying on an exempt undertaking are exempt in the hands of the shareholders in so far as the dividends are declared out of exempt profits during the period of the tax holiday or the year immediately succeeding. This exemption is presently available to every shareholder irrespective of whether such shareholder is an individual, a company or any other person. However, in the case of a company which receives exempt dividends, and pays it out in the form of dividends to its shareholders, such dividends become liable to tax in the hands of the shareholders. This is clearly an anomalous situation. Mr. Speaker, I, therefore, propose to amend the Inland Revenue Act to exempt from tax, dividends which are declared out of exempt dividends received by a company so long as they are paid out as dividends in the year in which the exempt dividends were received or in the year immediately succeeding.

(B) Taxation of individuals

Mr. Speaker, the present maximum marginal rate of tax for individuals is 70 percent. High marginal rates induce a greater degree of evasion and compel governments to have recourse to periodic tax amnesties. Amnesties by and large discriminate against the honest taxpayer. Greater compliance with tax laws and less evasion can be induced by reasonable rates of tax. Moreover, high marginal rates can also exert an adverse effect on incentives to work, save and invest. They hamper growth. Mr. Speaker, I, therefore, propose to reduce the maximum marginal rate of tax on individuals to 55 percent. A differential of 5 percent and 15 percent respectively between this rate and 50 percent on

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ordinary resident companies and 40 percent on broad-based companies, is intended to encourage company formation and growth. I do not expect any significant loss in revenue as a result of this measure, as loss evasion is likely to take place.

(C) Taxation of terminal benefits of private sector employees

Mr. Speaker, all public sector employees were exempted from income taxes both on their employment income as well as on their superannuation benefits, with effect from the year of assessment 1979/80. This was done particularly in view of the highly rigid salary structure in the public service, particularly in the management grades, where salaries are well below the level of their counterparts in the private sector. It is my intention now to provide some relief to private sector employees too. This relief will apply to terminal benefits of these employees especially those in the lower ranks who are nearing retirement. Terminal benefits often represent the only saving of their lifetime, the real value of which has unhappily been eroded with inflation over the years.

Mr. Speaker, the terminal benefits which private sector employees receive are now liable at a single rate of tax determined by the average rates for the last three years of assessment, subject to a maximum of 15 percent. I intend adopting a more straightforward and rational system while affording substantial relief to lower rank employees by exempting the first Rs. 50,000 of such benefits from tax altogether. The rates of tax on all terminal benefits, which I propose to levy will be as follows:

On the first	Rs. 50,000	. . . . Nil
On the next	Rs. 25,000	. . . . 5%
On the next	Rs. 25,000	. . . . 10%
On the balance	—	. . . . 15%

This concession will be made available only if the benefit paid by an employer is on the basis of a scheme under which payments are made to all employees of the enterprise under a common set of rules.

(D) Charitable institutions

Mr. Speaker, in the last Budget I reduced the tax rate on religious and charitable institutions from 23 percent to 20 percent. The present position is that a charitable institution is not liable to tax if its assessable income for a year does not exceed Rs. 12,000 whereas if it exceeds this figure the entirety of its income is liable. I propose to grant a measure of relief to these institutions by giving a tax free allowance up to Rs. 12,000 for all charitable institutions in future.

(E) Wealth tax

Mr. Speaker, representations have been made to me regarding the hardships caused by the general escalation of property values. Consequently taxpayers, if they are to declare the current true market values of property, will be confronted with substantially increased liability on capital taxes. This increased tax liability is not sufficiently compensated by the increase in incomes from such properties if true market values were to be declared by taxpayers. Wealth Tax has in these circumstances become a highly confiscatory tax, even if the asset were to be put to its optimum use. This is particularly true of immovable properties like houses. I, therefore, propose to provide for the freezing of values of immovable property at their values as on 31st March, 1977 for Wealth Tax purposes. A similar provision will also be made in respect of Estate Duty and Gifts.

(F) Capital allowances

Mr. Speaker, last year, I announced my intention to do away with the scheme of lump sum capital allowances for plant, machinery, fixtures and buildings and to replace it with effect from 1st April, 1980 with a new scheme of capital allowances based on a fixed percentage of the cost of acquisition or construction as the case may be, to be written off over a period of years. I allowed the scheme of capital allowances then in existence to continue for a year till 31st March, 1980. This was because I felt that industries starved of machinery and equipment during the last regime should be able to take advantage of the liberalisation policy and modernise and expand their production capacity without undue liquidity problems. Representations have been made to me that the grace period of one year that was granted was inadequate for investors to get down machinery and equipment. I am firmly convinced that in the long term interests of the economy, the lump sum capital allowances should be replaced as proposed last year. Nevertheless, I admit that the time given to take full advantage of the old scheme is insufficient. I, therefore, propose to continue the scheme of capital allowances which was to have ended on 31st March, 1980 for another 2 years only.

(G) Incentives to employers for the construction of houses

Mr. Speaker, I wish to provide incentives to employers who contribute towards the easing of the currently acute problem of housing. I propose to make them eligible to claim the monies expended on housing for their employees as "qualifying payments" and hence deductible from their assessable incomes. Employers who construct houses for occupation by employees with a floor area not exceeding 1500 sq. ft. could claim expenditure incurred on the construction of such residential houses as "qualifying payments". In the event of the houses being sold to employees however, such sale proceeds will be taxable as capital gains, since the cost of construction would have been allowed as a deduction.

(H) Penalties for non-payment of tax in default

Mr. Speaker, Section 125 (2) of the Inland Revenue Act stipulates the following penalties where any tax due whether under the self-assessment scheme or on an assessment issued by the Department, is not paid by the due date:

1. An automatic penalty of 5 percent of the amount of tax due, if the tax is not paid on or before the due date;
2. Where the tax is not paid before the expiry of 30 days after the tax has begun to be in default, an additional penalty of 5 percent in respect of each further period of 3 months or part thereof during which tax is in default.

The maximum amount leviable as a penalty on tax in arrears is 25 percent per annum of the tax outstanding.

I am of the view that the penalties levied should bear some relation to the prevalent rates of interest. Otherwise as it happens now, even taxpayers who can well afford to pay the tax due, will postpone tax payments and utilise such funds for further investment. Non-compliance has to be taken more seriously, once compliance has been made less burdensome, as I have done, by moderating its incidence. I, therefore, propose to increase the ceiling on the amount of the penalty payable from 25 percent to 50 percent, the penalties increasing by 5 percent for each quarter that tax is in default.

(I) Tax incentives

(1) Property development projects approved by the Urban Development Authority, contract work for Mahaweli Development, import substitution industries of a pioneering nature

Mr. Speaker, in order to enable high priority national projects such as the Mahaweli and Urban Development to be completed within the target dates, I propose to extend certain tax concessions to new companies as an incentive towards the quick implementation of these projects. Whilst we have already extended every possible concession to GCEC enterprises and export-oriented ventures outside the Free Trade Zone, there is still some need to also consider certain import substitution industries and industries of a pioneering nature for the grant of similar tax concessions. This is necessary if our industrial development is to be more widely and securely based. It is for these reasons that I propose to offer tax concessions to new companies engaged solely in

(a) contracts in respect of irrigation works, clearing of lands etc., with the Mahaweli Development Board;

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(b) import substitution industries and industries of a pioneering nature;

and approved by the Minister of Finance and Planning.

These companies will be granted a five year tax holiday. Dividends declared out of exempt profits will also be exempt and investment in shares of such companies will be treated as "qualifying payments" enabling the investor to claim relief from his assessable income. To qualify for these concessions, the companies should be broad-based public companies whose shares are quoted in the market.

Tax concessions will also be granted to new companies engaged solely in property development projects recommended by the Urban Development Authority and approved by me. They will be entitled to the same concessions except that the tax holiday on profits and dividends will be for 10 years in their case. Such companies will have to become public companies and get their shares quoted in the share market within two years of commencement of business.

(2) Foreign Currency Banking Units

The Central Bank has recently launched Foreign Currency Banking Unit Scheme, with the objective of establishing a full fledged off-shore banking centre in Sri Lanka and making available financial facilities at competitive rates of interest to GCEC enterprises. It is necessary to give every possible incentive to these banking units and I propose to offer the following concessions to them —

(a) Depositors of foreign currency with Foreign Currency Banking Units (FCBU) will be exempted from income tax on their interest income;

(b) Foreign Currency Banking Units will be granted tax exemption on their profits from off-shore transactions and on certain designated on-shore foreign currency transactions.

(3) A package deal for the gem industry

Mr. Speaker, smuggling of gems has always been a problem in this country and in every country where gems are found. Exporters of gems through legal channels are offten in a disadvantageous position vis-a-vis the smugglers who offer higher price for gems in the local market. It is also a trade where the primary producer, the miner, has been always forgotten. He is often at the mercy of exploitative middlemen. No scheme evolved for the gem industry up-to-date has given sufficient consideration to the small man — the actual miner and the gem worker. I propose to do what I can to help these categories who really produce the gem wealth of the country. I also feel that there is a great potential for jewellery exports if only the required incentives could be provided. This will provide an opportunity for our traditional craftmen to enjoy some part of the handsome benefits that acucre to the trade.

Mr. Speaker, I, therefore, intend offering the gem and jewellery industry a package deal which will benefit all those in the industry from the miner to the eventual exporter.

It will

(i) ensure a better price to the gem miner;

(ii) channel gem exports through official channels as far as possible; and

(iii) promote the export trade in jewellery.

The policy package will embody the following:

(a) Weekly gem auctions to be conducted by the Chamber of Commerce at chosen locations to encourage miners and dealers to sell their stones, rough as well as cut, in the open market. The Gem Corporation too will be a buyer at these auctions. These auctions will initially be held at Colombo, Ratnapura and Matale.

(b) As an encouragement to miners and dealers to sell through auctions, exemptions from income tax of profits from the sale of stones sold at the auction will be granted. These sales will also be exempt from Business Turnover Tax;

(c) Exemption from income tax will be granted on profits from all gem exports as well. At present, only profits from the sale of gems to the Gem Corporation and from exports made through the Corporation are exempt. Export sales will, however, be subject to Business Turnover Tax at 5 percent;

(d) Manufacturers and exporters of jewellery can avail themselves of the tax concession presently available up to 1983 for small and medium-scale industries and the five year tax holiday available for manufacture for export;

(e) Exports of jewellery will be liable to a Business Turnover Tax of 2 percent.

Mr. Speaker, these are considerable concessions to the gem and jewellery industry. I hope the industry will respond in a positive manner and establish itself as a leading foreign exchange earner for the country.

If despite these concessions, persons still indulge in smuggling, it would be a crime against the nation. I propose, therefore, to introduce severe penalties for infringement of any rules and also provide rewards to informants who bring to our notice such infringements. A fine of 300 percent of the value of the gems will be imposed on anyone detected attempting to smuggle gems or violating gem licence regulations. Informants will be paid a reward of 100 percent of the value of the gems detected on information given by them. The condition on which licences are presently issued by the State Gem Corporation will be strictly enforced both as regards miners as well as dealers in gems. I hope these measures will lead to a reduction in smuggling and the revitalisation to the gem industry.

(4) Incentives for entrepot trade

Mr. Speaker, Sri Lanka is located in an advantageous position in relation to both shipping and airline routes and can be, in my opinion, developed as a centre for a lucrative entrepot trade catering to other countries in our region. To attract activities of this nature, infra-structural support in the form of quick and efficient communication links with major cities, a well organised banking system and adequate bonded warehouse facilities are essential. At a time when we are developing these services to ensure the sucess of the Investment Promotion Zone and giving every encouragement to off-shore banking, we must also try to derive the maximum advantage from our investment in these services. I wish, therefore, to include a provision in the Inland Revenue Act, granting exemption from income tax on the profits from entrepot trade in respect of specified commodities. Some of the likely commodities that could be traded on this basis are precious metals and precious stones not mined in Sri Lanka, petroleum products and other primary produce not produced in Sri Lanka.

(5) Exemption of presidential awards and government awards to inventors

I also propose to amend the Inland Revenue Act to exempt from income tax cash prizes given together with presidential awards and cash prizes to be given to inventors by the Government with a view to encouraging new research and inventions.

Mr. Speaker, my tax proposals and the incentives I have offered are in line with our basic objectives of investment and quick economic growth. They cost very little in terms of loss of revenue. I expect my pre-budget income tax revenue to come down marginally by Rs. 12 million in respect of corporate taxes and Rs. 18 million in respect of non-corporate taxes. Considering their long-term, or even for that matter, their short-term effects, they should in fact be self-financing by inducing increased production and exports, and less tax evasion. Fiscal policy is not merely a question of taxing regardless of circumstances, incidence of the consequential effects of taxing. As Colbert, one of the greatest Finance Ministers of all time said, "The art of taxation consists in so plucking the goose as to obtain the largest amount of feathers with the least possible amount of hissing".

Mr. Speaker, let me now come to the next set of proposals which will assist me in the task of collecting revenue:

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(J) Withdrawal of tax exemptions from public corporations which are statutorily exempt

Mr. Speaker, I have already referred to the massive investment in public corporations which successive Governments have undertaken, mostly with loan funds, on which interest is payable by the Government. The returns received by Government in relation to the capital employed have been very disappointing, being less than 2 percent. The system of levies on corporations which has been tried out in the past by the Treasury, has led to lack of uniformity and has tended to penalise the relatively more successful corporations, just because they have proved to be more efficient. On the other hand, statutory provisions currently exempt from income tax the profits of certain corporations and statutory boards. Such exemptions may be justified, as in the case of new industrial undertakings, provided the concession is limited to a period of time sufficient to enable them to become viable enterprises. The continuation of these exemptions beyond this period is, however, indefensible. I, therefore, propose to withdraw the present statutory exemption conferred on the National Lotteries Board, Sri Lanka Broadcasting Corporation and on the Sri Lanka Insurance Corporation in respect of its profits from the business of life insurance. These enterprises have now been in existence for a long period of time and are certainly viable enough to meet any normal tax liabilities. The additional income tax revenue I hope to collect as a result would be in the region of Rs. 30 million.

(K) Non-citizens employed in Sri Lanka

The existing provisions in the Inland Revenue Act confer an exemption on the emoluments arising in Sri Lanka of a non-citizen who being a scientist, technician, expert or advisor is employed by Government or any public corporation or institution approved by me. There is also provision in the Act to exempt foreign personnel employed by the hotel industry.

Mr. Speaker, there is no reason whatsoever why non-citizens of any category should be granted full exemption. The loss to revenue could be considerable. I am of the view that they should be subject to income tax, though not on the basis of the existing rate schedules. I, therefore, propose in future to levy a flat rate of tax at 25 percent on all non-citizens employed in all undertakings. However, employees who have already been granted an exemption under the existing provisions will continue to enjoy the benefit. This scheme of preferential treatment will apply to any non-citizen for three years of employment either at one stretch or in broken periods which aggregate to three years in all. In addition to ensuring that local personnel are sufficiently trained to replace these expatriate personnel as quickly as possible, this will also enable us to save a considerable amount of tax revenue now lost.

(L) Airport levies

The Embarkation Tax that is levied at our International Airport at present of Rs. 25 per passenger is very low by international standards. I propose to increase the levy to Rs. 100 per passenger.

(M) Fees levied by the registrar of motor vehicles

(a) Registration fees for vehicles

The fees charged at present for the first registration of a motor car, motorcycle or scooter is only Rs. 10 per vehicle. On lorries, buses and tractors the fee levied is only Rs. 20. These fees have remained unchanged for many years. It is proposed to increase the fee for the first registration of vehicles as follows:

Rs. 50 for motor cycles, scooters and three wheelers;
Rs. 200 for motor cars, tractors and other land vehicles; and
Rs. 400 for buses and lorries.

(b) Annual licence fee on diesel driven passenger cars

Mr. Speaker, although the fuel prices were raised to partly offset the tremendous losses that were being incurred on its sale, we were compelled to keep the prices of certain fuels like diesel, low enough to soften the impact on the cost of living. However, there is no justification why this price advantage on diesel vis-a-vis petrol should accrue to the owners of diesel operated passenger cars. Hence, I propose to levy a 100 percent surcharge on the current annual licence fee payable on such vehicles.

(c) Tax on transfer of motor vehicles

The present transfer tax of Rs. 5,000 in respect of cars less than 17 cwt. and Rs. 10,000 in respect of cars of 17 cwts. or over, was introduced last year in place of the earlier prohibitive tax which discouraged the official transfer of cars. This reduction brought about the desired and intended effect of increasing revenue substantially from Rs. 2 million per year to Rs. 20 million in 1979. With the increase in the price of petrol and slump in the car market, the present rates of tax have once again become high enough to discourage compliance. In view of this, it is proposed to levy a uniform rate of transfer tax of Rs. 2,500 in respect of the first transfer in Sri Lanka of all vehicles other than three wheelers, motor cycles and scootors. These several measures will result in an additional revenue of Rs. 7 million.

(N) Fees on the issue of passports

The current fee levied by way of stamps for the issue of a passport is Rs. 20 and for the extension of a passport is Rs. 5 per year. These charges have remained unchanged for quite some time, and are totally unrelated to the administrative costs involved.

A fee of Rs. 5 per individual is now charged on persons granted admission to the airport departure lounge and/or viewing gallery. It is proposed to increase this levy to Rs. 10 per person. The additional funds to be collected from these measures are estimated at Rs. 21 million.

It is proposed to revise the fees levied as follows:

Issue of passport	Rs. 100
Issue of emergency certificate . .	Rs. 25
Extension of passport . .	Rs. 20 per year

The additional revenue expected is about Rs. 15 million.

(O) Revision of B.T.T. rates

Services and professions are today subject to BTT mostly at the 1 percent rate. A higher rate of 10 percent applies to tourist hotels. Some of these services cater to the affluent. In the case of certain others, such as the travel agency and Indenting Agency businesses, there has been a remarkable increase in the turnover consequent to liberalisation.

I propose to increase the present rates of BTT applicable to Services and Professions as follows:

	%
Professions	5
Tourist Hotels	15
Travel Agencies	5
Produce Brokers	5
Advertising	5
Indenting and Commission Agents	5

The additional revenue is estimated at Rs. 90 million.

(P) Cigarettes

Mr. Speaker, the yield from tobacco tax has been decreasing for some time, as a result of the increased production of filter as against plain cigarettes and the loose packing of cigarettes. While it is true that a turnover tax on the manufacture of cigarettes operates at the same time as the Tobacco Tax, and would probably recoup some part of this loss, the manufacturers have gained overall, at the expense of State revenue. With a view to recouping this loss as well as to raise additional revenue, I propose to increase the BTT rate on cigarettes from the current 25 percent to 30 percent. The retail prices of all brands of cigarettes will go up as a result by 2 cents per cigarette.

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The additional revenue I hope to collect by this measure is Rs. 75 million.

(Q) Stamp duty

Under the provisions of the Stamp Ordinance, trust receipts were once liable to be stamped on an ad valorem basis. The rate applicable was the same as for mortgages. Trust receipts were, however, exempted from stamp duty by an amendment to the Stamp Duty Act in 1973. These trust receipts are for very large sums of money and it is my view that these documents should be properly stamped on an ad valorem basis. These transactions, however, are for short-term credit as compared with mortgages which are invariably long-term. In view of this I propose to buy a moderate rate of stamp duty on trust receipts and other credit instruments like pro-notes and letters of guarantee for imports and a slightly lower rate for similar documents for exports. The rates will be as follows:

(a) a flat rate of 0.1 percent (Re 1 per every Rs. 1,000) on the value of trust receipts and other credit instruments on imports;
(b) a flat rate of 0.05 percent (50 cts. on every Rs. 1,000) on the value of pro-notes and other documents for exports.

In the case of pro-notes, for sums below Rs. 10,000 the rate of Re. 1 will be continued.

The additional revenue expected is about Rs. 10 million.

(R) Import duties

Mr. Speaker, I am also taking this opportunity to make some changes in import duties which will be gazetted tonight. In the main, these changes will give relief to the hotel industry, the leather making industry and the paper manufacturing industry. I have also eliminated the duty on agricultural implements.

Sri Lanka: 1980 Budget Proposals

by Dr. M.P. Dominic *

A new "simplified" and restructured Income Tax Act was brought into effect in May 1979. However, the new Budget proposes to amend this Act with a view to providing further incentives and relief "to trigger off productive investment which is the surest foundation for increasing employment and raising the living standards of the people".

I. Taxation of companies

A. Reduction of company tax rate

Under present law, companies are taxed at a rate of 50 percent. In the case of a "people's company" the rate is reduced to 40 percent. A "people's company" means a company which is resident in Sri Lanka and in respect of which the Assessor is satisfied that:

(i) it is not a private company within the meaning of the Companies Ordinance;
(ii) the number of shareholders of the company exceeds 100 and the nominal value of each share does not exceed 10 Rs.;
(iii) any person may invest in one or more shares of the company at any allotment of shares by the company or in the open market;
(iv) no person either individually or together with his wife or minor children holds, either directly or through nominees, more than 5 percent of the issued share capital;
(v) there are three or more directors each owning one or more shares;
(vi) none of the directors of the company holds office as director of any other people's company; and
(vii) no other company holds any share either directly or through nominees.

However, the "people's company" concept with its restrictive conditions has not proved to be popular in Sri Lanka. The new Budget proposes to extend the concessionary rate of tax of 40 percent to cover all public limited liability companies whose shares are quoted and which make available for purchase by the general public a stipulated minimum percentage of shares.

B. Reduction of dividend withholding tax rate

At present, dividends paid by resident companies are subject to 33 1/3 percent withholding tax. If the dividends are paid to companies, whether resident or not, the withholding tax is the final tax payable on such dividends. If the dividends are paid to individuals, whether resident or not, the withholding tax is not the final tax; the dividends will be subject to income tax with a credit for the tax withheld.

The new Budget proposes to abolish the withholding tax on dividends paid by public limited liability companies whose shares are quoted and which make available for purchase by the gneral public a stipulated minimum percentage of shares. The new Budget also proposes to reduce the withholding tax on dividends paid by other resident companies to 20 percent.

It may be noted that the 5 percent levy in lieu of estate duty which is deducted, in addition to the withholding tax on dividends, from dividends paid to non-resident companies will remain.

The abolition or reduction of the withholding tax will not benefit individual shareholders; the dividends will continue to be subject to income tax at the rate applicable to them. But these proposals will reduce the effective tax burden on dividends received by companies, whether resident or non-resident; for them the effective

* Attorney-at-law, Sri Lanka.

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tax rate (both company tax and tax on dividends) is as follows:

Effective tax rates (in percent)

Quoted companies

	Dividends received by resident companies		Dividends received by non-resident companies	
	Present law	Budget proposal	Present law	Budget proposal
Company tax	50	40	50	40
Tax on dividends	33 1/3	nil	33 1/3	nil
Levy in lieu of estate duty	nil	nil	5	5
Effective tax rate	66 2/3	40	69 1/6	42.5

Other companies

	Dividends received by resident companies		Dividends received by non-resident companies	
	Present law	Budget proposal	Present law	Budget proposal
Company tax	50	50	50	50
Tax on dividends	33 1/3	20	33 1/3	20
Levy in lieu of estate duty	nil	nil	5	5
Effective tax rate	66 2/3	60	69 1/6	62.5

C. Exemption of dividends paid from exempt dividends

At present, dividends paid by a company from exempt dividends received by it are subject to tax. The new Budget proposes to exempt from tax dividends which are declared out of exempt dividends received by a company so long as they are paid out as dividends in the year in which the exempt dividends were received or in the year immediately succeeding.

D. Exemption of capital gains arising from transfer of shares

Capital gains that arise from the transfer of shares in public limited liability companies whose shares are quoted and which make available for purchase by the general public a stipulated minimum percentage of shares will be tax exempt.

E. Exemption of capital gains on te conversion of a sole proprietorship or a partnership in a broad-based public company

Capital gains arising on the conversion of a sole proprietorship or a partnership into a public limited liability company whose shares are quoted and which makes available for purchase by the general public a stipulated minimum percentage of shares will be tax exempt.

II. Taxation of individuals

A. Reduction of the maximum marginal rate

The present maximum marginal rate is 70 percent. This will be reduced to 55 percent. The Minister of Finance states:

> High marginal rates induce a greater degree of evasion and compel governments to have recourse to periodic tax amnesties. Amnesties by and large discriminate against the honest taxpayer. Greater compliance with tax laws and less evasion can be induced by reasonable rates of tax. Moreover high marginal rates can also exert an adverse effect on incentives to work, save and invest. They hamper growth. Mr. Speaker, I, therefore, propose to reduce the maximum marginal rate of tax on individuals to 55 percent. A differential of 5 percent and 15 percent respectively between this rate and 50 percent on ordinary resident companies and 40 percent on broad-based companies is intended to encourage company formation and growth. I do not expect any significant loss in revenue as a result of this measure, as less evasion is likely to take place.

This statement may be contrasted with the view taken by the same Minister in his Budget Speech, 1978.

> The previous government, in order to safeguard the new capitalist class which aided and abetted it, reduced personal income tax to 50 percent. In the interests of the common man I am increasing the rate of personal income taxation to 70 percent. Our aim is to maximise taxes on the incomes of capitalist classes that can bear the burden and use such funds to give relief to the common man.

B. Terminal benefits of private sector employees

Under the existing law terminal benefits of private sector employees are liable to a single rate of tax determined by the average rates for the last three years of assessment, subject to a maximum of 15 percent.

The new Budget proposes to tax them as follows:

		percent
on the first	50,000 Rs.	Nil
on the next	25,000 Rs.	5
on the next	25,000 Rs.	10
on the balance	—	15

This concession will be made available only if the benefits paid by an employer are on the basis of a scheme under which payments are made to all employees of the enterprise under a common set of rules.

It may be noted that under the present law, public sector employees are exempted from income taxes both on their employment income as well as on their superannuation benefits. This will continue.

III. Depreciation allowances

At present, all plant, machinery and fixtures acquired before April 1, 1980 are eligible for 100 percent depreciation allowance in the year of acquisition. The straight

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line method is to be applied to any plant, machinery and fixture acquired on or after April 1, 1980.

The new Budget proposes to extend the 100 percent depreciation allowance in the year of acquisition for another two years, i.e. until March 31, 1982.

IV. Charitable institutions

The present 23 percent tax rate will be reduced to 20 percent. Further, the first 12,000 Rs. of taxable income will be exempt. At present, such institutions are taxed on their entire income if it exceeds 12,000 Rs.

V. Wealth tax

For purposes of wealth tax, estate duty and gifts tax, the values of immovable property will be frozen, as of March 31, 1977.

VI. Exemption from income tax

Will be withdrawn from certain (government) corporations.

VII. Penalties for non-payment of tax

The current law stipulates the following penalties for non-payment of tax by the due date:

— an automatic penalty of 5 percent of the amount of tax due, if the tax is not paid on or before the due date;
— where the tax is not paid before the expiry of 30 days after the tax has begun to be in default, an additional penalty of 5 percent in respect of each further period of three months or part thereof during which tax is in default.

The maximum amount leviable as a penalty on tax in arrears is 25 percent per annum of the tax outstanding.

The penalty for each quarter in which the tax is in default will be increased by 5 percent and the ceiling on the amount of penalty payable will be increased from 25 to 50 percent.

VIII. Tax incentives

A. Construction of houses for employees

Employers who construct houses for occupation by employees with a floor area not exceeding 1500 sq. ft. may claim expenditure incurred on the construction of such residential houses as "qualifying payments". In the event of the houses being sold to employees, such sale proceeds will be taxable as capital gains. It may be noted that "qualifying payments" are deductible from assessable income up to one-third of such assessable income.

B. Contract work for Mahaweli Development, import substitution industries and industries of a pioneering nature

1. A five-year tax holiday will be granted to new companies engaged solely in:
   — contracts in respect of irrigation works, clearing of lands, etc. with the Mahaweli Development Board;
   — import substitution industries and industries of a pioneering nature;
   and which have been approved by the Minister of Finance and Planning.
2. Dividends declared out of exempt profits will also be tax exempt.
3. Investment in shares of such companies will be treated as "qualifying payments" enabling the investor to claim deduction up to 33 1/3 percent of the taxable income.

To qualify for these concessions, the companies should be broad-based public companies whose shares are quoted in the stock market.

C. Property development projects approved by the Urban Development Authority

1. A ten-year tax holiday will be given to new companies engaged in such projects.
2. Dividends declared out of exempt profits will also be exempt.
3. Investment in shares of such companies will be treated as "qualifying payments" enabling the investor to claim deduction up to 33 1/3 percent of the taxable income.

To qualify for these concessions, the companies should be broad-based public companies whose shares are quoted in the stock market.

D. Offshore banking

The Central Bank has recently introduced the Foreign Currency Banking Unit Scheme, with the objective of making Sri Lanka an offshore banking centre and making available financial facilities at competitive rates of interest to GCEC enterprises (i.e. enterprises established in the Investment Promotion Zones).

The new Budget proposes to grant the following incentives for this purpose:

1. Depositors of foreign currency with Foreign Currency Banking Units (FCBU) will be exempted from income tax on their interest income.
2. Foreign Currency Banking Units will be granted tax exemption on their profits and income from offshore transactions and on certain designated onshore foreign currency transactions.

E. Gem and jewellery industry

The following incentives will be granted:

1. Exemption from income tax will be given to profits from the sale of gems at gem auctions (to be conducted by the Chamber of Commerce).
2. Exemption from business turnover tax will be given to the sale of gems at such gem auctions.

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3. Exemption from income tax will be given on profits from all gem exports. At present, only profits from the sale of gems to the Gem Corporation and from exports made through the Corporation are exempt. Export sales, however, will be subject to business turnover tax at 5 percent.
4. Manufacturers and exporters of jewellery can avail themselves of the tax concession presently available up to 1983 for small and medium-scale industries and the five-year tax holiday available for manufacture for export.

However, exports of jewellery will be liable to a business turnover tax of 2 percent.

F. Entrepot trade

In order to develop Sri Lanka as an entrepot trade centre catering to other countries in the region, exemption from income tax will be given for profits from entrepot trade in respect of specified commodities. Some of the likely commodities that could be traded on this basis are precious metals and precious stones not mined in Sri Lanka, petroleum products and other primary produce not produced in Sri Lanka.

G. Expatriate employees

A flat rate of tax at 25 percent will apply to all emoluments arising in Sri Lanka of any non-citizen employed in any undertaking. This scheme of preferential treatment will apply for three years of employment either at one stretch or in broken periods which aggregate to three years in all.

At present, expatriate employees in a number of approved undertakings are fully exempt from income tax. Otherwise, they are subject to the normal tax rates which are very high.

H. Government awards and cash prizes given to inventors

They will be exempt from income tax.

IX Business turnover tax rates – increase

The tax rates applicable to services and professions will be increased as follows:

	percent
Professions	5
Tourist hotels	15
Travel agencies	5
Produce brokers	5
Advertising	5
Indenting and commission agents	5

X. Stamp duty

Stamp duties are charged in respect of trust receipts and other credit instruments as follows:
(a) a flat rate of 0.1 percent (1 Rupee on every 1,000 Rs.) on the value of trust receipts and other credit instruments on imports;
(b) a flat rate of 0.05 percent (50 cts. on every 1,000 Rs.) on the value of pro-notes and other documents for exports. In the case of pro-notes for sums below 10,000 Rs. the rate of 1 Rupee will be continued.

IX. Import duties

Import duty relief is given to the hotel industry, leather making industry, paper manufacturing industry and agricultural implements.

XII. Estate and stamp duties

New Estate Duty and Stamp Acts will be enacted.

XIII. Embarkation tax

The embarkation tax (at present 25 Rs.) per passenger will be increased to 100 Rs.

XIV. Registration fees

Registration fees for vehicles, annual licence fees on diesel driven passenger cars, fees on the issue of a passport, and fees charged on persons granted admission to the airport departure lounge and/or the viewing gallery will be increased.

XV. Motor vehicles

The tax on transfer of motor vehicles will be reduced to 2,500 Rs.

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Conference Diary

FEBRUARY 1980

Business Perspectives: 6th International Tax Conference (including The Unitary System of Taxing Corporations in the U.S.A.; The Legal and Tax Conditions of Trading with the People's Republic of China; Taxes on Oil, Gas, Shipping and Natural Resources), Singapore, February 3-8 (English).

Management Centre Europe: International Tax Management (including Inter-company pricing, licensing, service fees, goods valuation), Brussels (Belgium), February 7-8 (English).

British Branch of I.F.A.: The unitary basis of taxation, London (U.K.), February 13 (English).

Inter-American Center of Tax Administrators (CIAT): XXII Technical Conference of CIAT on value added sales tax administration, Bogotá (Colombia), February 11-15 (English, Spanish).

Seminars International: Foreign investment in the United States (including U.S. taxation of foreign investors), London (United Kingdom), February 19 and 20 (English).

MARCH 1980

Business International Institute: Seminar on finance; current practices, future trends (including taxation of exchange gains and losses), Zürich (Switzerland), March 3-5 (English).

Management Centre Europe: Managing and developing foreign subsidiaries (including tax in international operations), Brussels (Belgium), March 5-7 (English).

British Branch of I.F.A.: Exchanges of information and extra territorial claims by Revenue authorities (Tax Workshop), London (U.K.), March 6 (English).

Münchner Steuerfachtagung: Munich 1980 Tax Expert Conference (including tax policy and tax administration, international tax law in connection to the relation between German Federal Republic and Canada, Munich (German Federal Republic), March 20 and 21 (German).

British Branch of I.F.A.: Estate and gift tax treaties (Tax Workshop), London (U.K.), March 27 (English)

MAY 1980

Anglo-U.S. branches: Seminar (subject not yet known) New York (U.S.A., May 8 and 9 (English).

U.S. branch of I.F.A.: Technical Session (subject not yet known) New York (U.S.A.), May 10 (English).

International Tax Planning Association: The Cannes Tax Conference (including exchange of information under tax treaties), Cannes (France), May 28-30 (English).

SEPTEMBER 1980

34th Annual Congress of I.F.A.: I. The dialogue between the tax administration and taxpayer up to the filing of the tax return; II. The determination of the source of income. For the seminar the subject is the flight to tax havens, their use and abuse. Paris (France), September 14-19 (English French, German, Spanish).

FOR FURTHER INFORMATION PLEASE WRITE TO:

Business International Institute, 12-14 chemin Rieu, 1211 Geneva 17 (Switzerland).

British Branch of I.F.A.: Secretariat c/o Williams and Glyn's Bank Ltd., 20 Birchin Lane, London EC3P 3DP (United Kingdom).

Business Perspectives, 11 Alexander Place, London SW7 2SG (United Kingdom).

International Fiscal Association (I.F.A.): General Secretariat, Woudenstein, Burg. Oudlaan 50, P.O. Box 1738, 3000 DR Rotterdam (Netherlands).

Investment and Property Studies Ltd., Norwich House, Norwich Street, London EC4A 1AB, United Kingdom (Registration for the Cannes Tax Conference should apply to this address).

Inter-American Center of Tax Administrators (CIAT): Apartado 2129, Panamá 9 A, Panamá.

Management Centre Europe, Avenue des Arts 4, B-1040 Brussels (Belgium).

Münchner Steuerfachtagung e. V. c.o. Lehrstuhl Professor Dr. Klaus Vogel, Ludwigstrasse 28 RG 800 Müchen 22, Bundesrepublik Deutschland.

Seminars International, 1 Falconberg Court, London W1V 5FG, United Kingdom.

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UNITED STATES:

VAT BEFORE CONGRESS

I. INTRODUCTION *

The Honorable Al Ullman (D., Oregon), Chairman of the Committee on Ways and Means, U.S. House of Representatives, today announced that he has introduced H.R. 5665, the "Tax Restructuring Act of 1979", a bill that would provide substantial reductions in individual income taxes, corporate income taxes and social security taxes in order to promote economic growth, stability and productivity. In order to preserve fiscal and budgetary discipline, the bill provides that these reductions would be funded by the imposition of a new Federal value added tax (VAT) to be applied at each stage of business activity on an added value basis. The Chairman simultaneously announced public hearings on his bill and on alternative proposals to revitalize the economy and to restructure the Federal tax system, beginning Wednesday, November 7, 1979.

In announcing these hearings, Chairman Ullman stressed that the tax reductions and the value added tax should be viewed as a total package. He emphasized that the package is designed to be revenue neutral, with the new VAT serving as a replacement tax for certain existing revenue sources, not an additional tax. The Chairman stated that witnesses will be expected to state their position and recommendations on the entire package — not just on selected parts of the bill.

The purpose of these hearings is to re-examine the basic Federal tax structure in light of the imperative need to face up to the critical problem of persistently escalating inflation, to encourage capital formation and to increase savings, investment, and productivity in the private sector, and to provide important tax relief for individuals and businesses.

A brief summary of Chairman Ullman's bill is attached to this notice. A more detailed summary will also be available to the Committee office.

The hearings will begin on Wednesday, November 7, 1979, at 10:00 a.m. each day and will be held in Room 1100 Longworth House Office Building, the Main Committee Hearing Room.

The lead-off witness on Wednesday, November 7 will be the Honorable G. William Miller, Secretary of the Treasury, to be followed on Thursday, November 8 by other Administration witnesses and by the Honorable Paul A. Volcker, Chairman of the Federal Reserve Board. On Wednesday, November 14 and Thursday, November 15, the Committee will hear several panels of invited expert witnesses. The Committee will then begin testimony from Members of Congress and the general public who have requested to be heard on Tuesday, November 27.

Please note that these hearings are subject to interruption for conference committee meetings on urgent legislation, such as the oil windfall profits tax.

II. STATEMENT BY REPRESENTATIVE AL ULLMAN (D., OREGON) UPON INTRODUCTION OF THE "TAX RESTRUCTURING ACT OF 1979", OCTOBER 22, 1979

We all share a deep foreboding that our way of life is eroding; that the ingenuity and the competitive spirit that established America's economic leadership is lagging.

The signs of economic weakness are widely visible. Inflation — our most dreadful enemy — is quietly stealing control of our vital choices. Running higher than 13 percent, it seems all but immune to traditional economic remedies.

We've suffered two significant recessions over the last decade, yet inflation seems to have emerged stronger from each. Sending prime interest rates above 14 percent attacts inflation in some sectors of the economy — at the very real risk of sending the entire country into a prolonged recession. A balanced budget by itself won't solve inflation.

Productivity — the measure of economic efficiency — is declining. Much of the drop is explained by our national fear of spiraling inflation and the race to consume rather than save and invest. Without economic certainty and the incentives to expand, the private sector will continue to lose its technological and competitive edge.

Interest rates are perilously high, and rising. Our trade balance is deep in the red. The reckless price of gold reflects the weakness of the dollar. Public debt is at an all time high, yet is far outdistanced by consumer and corporate debt.

These symptoms of decay — especially inflation — cannot be treated on the surface. They must be fought at the source.

I have come to the conclusion that the only way we can get to the source is to restructure the tax system — now.

In recent years we have improved standards of tax fairness and equity. We have accommodated shifting economic and social demands. But the fundamental structure of the system — heavy reliance on income and payroll taxes — has become muscle bound and unresponsive to recent economic trends.

We don't have to look much beyond the ends of our noses to see that traditional responses — the "quick fix" tax cut, shotgunning tax credits, indexing — no longer carry much punch. By now we've learned that chipping away at the tax code won't solve today's economic troubles.

Income and payroll taxes — forced up by inflation — are discouraging employment and investment. The nation is pushed to spend, rather than save. As confidence in our tax system erodes, so does the tax base.

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* Extract of Press Release of October 22, 1979.

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BRIEF SUMMARY OF THE TAX RESTRUCTURING ACT OF 1979

The bill would restructure our tax system to promote investment and productivity growth. Total tax reductions would equal $130 billion on a calendar year 1981 basis. Net proceeds from the value added tax imposed by the bill would also equal $130 billion.

TAX REDUCTIONS

Social security—$52 billion.

A 2.15-percentage point reduction on the employee and the employer rates, with comparable reductions for the self-employed.

Individual income—$50 billion.

Rate reductions of $42 billion concentrated on middle income taxpayers.

A 50-percent maximum rate.

Earned income credit increased to a maximum of $750; childless couples made eligible.

Tax credit for elderly made refundable.

Increased AFDC payments.

Special savings accounts into which individuals could contribute $1,000 per year; earnings on account not taxable until withdrawn.

Individual Retirement Account (IRA) limit increased to $2,000 per year.

New Limited Individual Retirement Accounts; $1,000 a year limit for those not qualified for IRA's.

Dividend reinvestment plans for up to $1,500 per year.

Business income—$28 billion

Corporate rate cuts; maximum rate reduced to 36 percent; lower bracket rates reduced to 15, 20, 25, and 30 percent, and brackets widened to $40,000 each.

Liberalize depreciation by increasing the Asset Depreciation Range (ADR) variance to 40 percent above and below the ADR class lives; small businesses would be allowed to use ADR lives and the variance without being subject to complicated regulations.

Liberalize the investment tax credit by applying the full credit to assets with lives of five years or more; 60 percent of the full credit would apply to assets with three- and four-years lives.

VALUE ADDED TAX

The bill would impose the VAT at each stage of the production and distribution process, including the retail stage. The tax would generally be 10 percent of the value of property or services and would be included in the price which a business charges its customers. Each business in the production and distribution chain would receive a credit for the VAT previously paid on its purchases of property and services from other businesses (including purchases of plant and equipment). Thus, each business would pay a net tax equal to 10 percent of the value it adds to the product, and the total tax paid with respect to sales to consumers would be 10 percent of the retail value of the product.

To avoid narrowing the VAT base, special rules or special tax rates have been limited except where considered absolutely essential. Food, medical care, and residential housing would be taxed at only a five-percent rate at the retail level. Transactions of charities, public and private non-profit educational institutions, mass transit, and non-retail sales by farmers and fishermen have been given a zero tax rate, which means there would be no tax but the taxpayer would receive applicable VAT credits. Governments and non-profit organizations other than charities have been exempted from the VAT; they would pay no tax and get no credit. The bill provides special rules for real property, interest transactions, and insurance companies. Also, businesses which have sales of property and services below $10,000 per year could elect to be exempt from the VAT.

The VAT would be imposed on imports. Exports have been zero rated to permit a rebate of VAT previously paid for goods and services associated with the export. This "border tax adjustment" will permit American exporters to compete more effectively with foreign businesses.

This drift comes at a time when our capital needs for energy products, transportation, environmental quality and research and development have never been greater.

Restructuring the tax system must begin by rolling back social security tax by a third — from 6.65 percent to 4.5 percent. We must cut personal income taxes to counter the impact of inflation. And that includes major expansion of the earned income tax credit for the poor and the retirement tax credit for the elderly.

If business is to survive, let alone prosper, we've got to expand incentives for capital formation. A 10 percentage point cut in the top corporate tax rate (from 46 percent to 36 percent), depreciation reform, reducing the maximum personal tax rate to 50 percent, special treatment of personal savings income, and dividend reinvestment must all be components of a broad tax proposal.

Brought to bear at once, these incentives represent the largest adjustments in U.S. taxation since 1913. Combined, their effect on investment, savings, capital formation, and exports would be massive. These tax cuts amount to $130 billion a year, beginning in 1981.

There are three ways of paying for a plan of this magnitude: cut spending by $130 billion, run up the deficit another $130 billion, or create an alternative source of revenue.

No reasonably informed Amercian believes that spending can be reduced enough to compensate for such enormous tax cuts without creating severe economic and social disruption.

Likewise, to finance these tax changes with additional debt — or the promise of "feedback" — would be political arrogance. Washington has received the taxpayer's message. We understand the national demand for fiscal discipline and a balanced budget.

The remaining option is a replacement tax that raises one dollar for every dollar lost through these tax cuts. In my judgment, the best alternative available — one that would both allow deep tax cuts and directly confront our critical economic imbalance — is

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a broad-based consumption tax. In short, an Americanized version of the value added tax (VAT).

A value added tax is a novelty in this country. It stirs many prejudices and cliches. But I think the trade off for tax cuts justifies the proposal.

The goal we must keep in focus is the need to shift income from consumption to savings and investment — within the framework of a balanced budget. No painless formula exists. Any new economic course demands short term adjustment — and imbalance. The crucial question that we must address is whether we are willing to make a short term investment for a long term gain.

What is a value added tax?

A value added tax is a tax on consumer goods and services. It is a flat tax — a 10 percent tax — that falls every time the item passes from one firm to another on the way to the final market place. At every step, the tax is collected and sent to the government. Using a system of rebates on taxes paid along the line, the cumulative tax at the retail level cannot exceed 10 percent.

The VAT is not a new tax concept. It is used by most of our competitors in the free world — countries that are surpassing us in economic growth.

Many attack VAT as a "national sales tax". A sales tax is imposed only once — at the retail level. If the final seller does not collect the tax, the revenue is lost. A VAT, by contrast, is collected all along the way. It is more efficient than a sales tax, and, consequently, minimizes economic distortion. But, like all taxes on business, the value added tax is ultimately paid by the consumer.

A tax on consumption would give us an even flow of tax revenue. Today's boom and bust cycles have turned tax receipts into a guessing game. Every time we sink into recession, tax revenues fall off because more workers are out of jobs — and, at the same time, federal spending increases to pay for higher insurance protection. A value added tax would be paid all the time — by all the people. And the effect on economic certainty and stability would be dramatic.

The VAT in my bill is virtually a tax without loopholes. Everyone would pay — including those engaged in the "underground" economy. Those who spend more would pay more. Although those with limited budgets typically would pay proportionally more than those with large incomes, a VAT can be shaped into a fair tax — certainly less regressive than the payroll tax, which nearly everyone now pays.

We have made every effort to lessen the individual burden of the tax. The Americanized VAT would place a lower tax rate — five percent — on vital human necessities like food, housing, and medical costs. Mass transportation, tuition, and charities would pay no net VAT. Income and social security tax reductions will make up much of the lost purchasing power.

We cannot make everyone "whole". The price of combating the real causes of our economic crisis is high. In the long run, the rate of inflation will come down and productivity will climb — and we will share the benefits. In the meantime, we must begin to share the cost of those future benefits.

A VAT would also help improve our trade posture by putting American workers and manufacturers on a more equal footing with our trading partners. Unlike payroll and income taxes the VAT could be rebated to manufacturers when products are exported and could be imposed on imported goods. Such border taxes are now levied in most other free world countries, and help to explain our current unfavorable trade balance.

A VAT would have a one-time inflationary impact. However, retail prices would rise less than 10 percent because of offsetting payroll and income tax cuts — and a strong surge of market competition. And the consumer would also benefit from the same cuts in his own taxes. In the long run, the benefits brought with a value added tax — payroll and income tax cuts, savings and investment incentives — will give us the economic muscle to control inflation and restore productivity growth.

The value added tax is a new approach for most Americans. It will draw sharp debate, as must all new concepts for massive change. But our economy today hangs in the balance. We've got to move this country off dead center. The question ultimately comes down to our willingness to pay the freight charge.

The choices are few. An American value added tax is not the easiest answer — but it is the most realistic.

I trust the bill I introduce today [10-22-79] will intensify national focus on our economic weaknesses — and ultimately lead to a dramatic shift in our tax laws. Only then can we convince the world that America is determined to retain its leadership on the strength of a productive and stable economy.

To that end, I have scheduled full Committee hearings — beginning November 7 — on the full scope of economic trends, their meaning, and what can be done to set a new course in tax policy. It is not my intention to make the value added tax the focal point of these hearings — only a serious option.

III. VAT — TEXT OF THE LAW AND EXPLANATION

SEC. 301. IMPOSITION OF TAX.

(a) In General. — Subtitle D (relating to miscellaneous excise taxes) is amended by inserting before chapter 31 the following new chapter:

"CHAPTER 30 — VALUE ADDED TAX

"Subchapter A. Imposition of tax.
"Subchapter B. Taxable transaction.
"Subchapter C. Taxable amount; rate of tax for certain transactions; credit against tax.
"Subchapter D. Administration.
"Subchapter E. Definitions and special rules; treatment of certain transactions.

"Subchapter A — Imposition of Tax

"Sec. 4001. Imposition of tax.

"SEC. 4001. IMPOSITION OF TAX.

"(a) General Rule. — A tax is hereby imposed on each taxable transaction.

"(b) Amount of Tax. — Except as other wise provided in this chapter, the amount of tax shall be 10 percent of the taxable amount."

Explanation 1 — Imposition of value added tax.
The bill would impose a value added tax (VAT) on sales of property and services at each stage of the production and distribution process, including the retail stage. The tax would generally be 10 percent of the value of property or services sold and would be included in the price which a business charges its customers. Each business in the production and distribution chain would receive a credit for the VAT previously paid by it on purchases of property and services from other businesses. Thus, businesses would generally pay a net tax equal to 10 percent of the value they add to products and services sold. The total tax paid with respect to a sale to a consumer would be 10 percent of the retail value of the property or services.

"Subchapter B — Taxable Transaction

"Sec. 4003. Taxable transaction.
"Sec. 4004. Commercial-type transaction.
"Sec. 4005. Taxable person.
"Sec. 4006. Transactions in the United States.
"Sec. 4007. Rules relating to other terms used in section 4003.

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"SEC. 4003. TAXABLE TRANSACTION.

"For purposes of this chapter, the term "taxable transaction" means —
"(1) the sale of property in the United States,
"(2) the performance of services in the United States, and
"(3) the importing of property into the United States,
by a taxable person in a commercial-type transaction.

"SEC. 4004. COMMERCIAL-TYPE TRANSACTION.

"*(a) General Rule.* — For purposes of this chapter, the term "commercial-type transaction" means a transaction engaged in by —
"(1) a corporation, or
"(2) any person (other than a corporation) in connection with a business.

"*(b) Sales and Leases of Real Property; Imports.* — For purposes of this chapter —
"*(1) In general.* — The term "commercial-type transaction" includes —
"(A) any sale or leasing of real property, and
"(B) any importing of property,
whether or not such transaction is described in subsection (a).
"*(2) Certain imported articles.* — Notwithstanding paragraph (1)(B), the importing of an article which is free of duty under part 2 of schedule 8 of the Tariff Schedules of the United States shall not be treated as a commercial-type transaction unless such transaction is described in subsection (a).

"SEC. 4005. TAXABLE PERSON.

"*(a) General Rule.* — Except as otherwise provided in this chapter, for purposes of this chapter, the term "taxable person" means a person who engages in a business or in a commercial-type transaction.

"*(b) Treatment of Employees, Etc.* — For purposes of this chapter, an employee shall not be treated as a taxable person with respect to activities engaged in as an employee.

"SEC. 4006. TRANSACTIONS IN THE UNITED STATES.

"*(a) Sales of Property.* — For purposes of this chapter —
"*(1) In general.* — Except as provided in paragraph (2), the sale of property shall be treated as occurring where delivery takes place.
"*(2) Real Property.* — The sale of real property shall be treated as occurring where the real property is located.

"*(b) Performance of Service.* — For purposes of this chapter —
"*(1) In general.* — Except as otherwise provided in this subsection, a service shall be treated as occurring where it is performed.
"*(2) Services performed inside and outside United States.* — If a service is performed both inside and outside the United States, such service shall be treated as performed —
"(A) inside the United States, if 50 percent or more of such service is performed inside the United States, and
"(B) outside the United States, if less than 50 percent of such service is performed inside the United States.

"SEC. 4007. RULES RELATING TO OTHER TERMS USED IN SECTION 4003.

"*(a) Exchanges Treated as Sales.* — For purposes of this chapter —
"(1) an exchange of property for property or services shall be treated as a sale of property, and
"(2) an exchange of services for property or services shall be treated as the performance of services.

"*(b) Certain Transfers to Employees Treated as Sales.* — For purposes of this chapter, the transfer of property to an employee as compensation (other than a transfer of a type for which no amount is includible in the gross income of employees for purposes of chapter 1) shall be treated as the sale of property.

"*(c) Performance of Services.* — For purposes of this chapter —
"*(1) Certain activities treated as performance of services.* — Activities treated as included in the performance of services shall include (but shall not be limited to) —
"(A) permitting the use of property,
"(B) the granting of a right to the performance of services or to reimbursement (including the granting of warranties, insurance, and similar items), and
"(C) the making of a covenant not to compete (or similar agreement to refrain from doing something).
"*(2) Employers and employees.* —
"(A) Services for employer. — An employee's services for his employer shall not be treated as the performance of services.
"(B) Services for employee. — An employer's services for his employee shall not be treated as the performance of services unless such services are of a type which constitute gross income to the employee for the purposes of chapter 1.
"*(3) Performance of services treated as sale of services.* — The performance of services shall be treated as the sale of services."

Explanation 2 — Taxable transaction.

The bill would define "taxable transaction" as the sale of property in the United States, the performance of a service in the United States, and the importing of property into the United States by a taxable person in a commercial-type transaction.

The term "sale of property" would not be restricted to the sale of property in the usual sense. It would also include (1) the exchange of property, (2) the transfer of property to an employee as compensation, (3) the permanent transfer of business property to an owner of the business, (4) gifts of business property, and (5) certain transactions of governments and tax-exempt organizations.

The term "performance of services" would include certain transactions in addition to the performance of personal services for a fee. These other transactions would include (1) permitting the use of property, (2) the exchange of services, (3) the granting of a right to the performance of services or to reimbursement (including the granting of warranties, insurance, and similar items), (4) the making of a covenant not to compete or a similar agreement, (5) the use of business property or services by an owner of the business, (6) gifts of business services, and (7) certain transactions of governments and tax-exempt organizations. However, the "performance of services" would not include an employee's performance of services for his employer.

Under the bill, "commercial-type transactions" would mean a transaction engaged in by a corporation (other than a subchapter S corporation) or by any person engaged in a business. The sale or leasing of real property and the importing of property would also be treated as a commercial-type transaction and would be subject to the VAT, even if engaged in by a consumer and not by a corporation or a person engaged in a business. Importing of articles by a consumer which would be free of duty under the personal exemptions under the United States Tariff Schedules would not be subject to the VAT.

The bill would define "taxable person" as a person engaged in a business or in a commercial-type transaction. Business would include a trade as well as an activity regularly carried on for profit. Governments and tax-exempt organizations would also be taxable persons in certain circumstances.

Under the bill, the sale of property would generally be treated as occurring in the United States if delivery of the property takes place in the United States. In the case of real property, the sale would be deemed to occur where the real property is located.

Services would be treated as occurring where the services are

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performed. If services are performed both inside and outside the United States, the services would be deemed performed entirely inside the United States if 50 percent or more of the services are performed in the United States. Otherwise, the services would be treated as performed entirely outside the United States.

The bill would define "property to mean any tangible property.

"Subchapter C — Taxable Amount; Rate of Tax for Certain Transactions; Credit against Tax

"Sec. 4011. Taxable amount.
"Sec. 4012. 5-percent rate of tax for food, housing, and medical care.
"Sec. 4013. Zero rating for farmers, fishermen, mass transit, section 501(c)(3) organizations, the educational activities of governmental entities, exports, and interest.
"Sec. 4014. Credit against tax.

"SEC. 4011. TAXABLE AMOUNT.

"*(a) Amount Charged Customer.* — For purposes of this chapter, the taxable amount for any transaction for which money is the only consideration shall be the price charged the purchaser of the property or services by the seller thereof —
"(1) including all invoiced charges for transportation, and other items payable to the seller with respect to this transaction, but
"(2) excluding the tax imposed by section 4001 with respect to this transaction and excluding any State and local sales and use taxes with respect to this transaction.

"*(b) Exchanges.* — For purposes of this chapter, the taxable amount in any exchange of property or services shall be the fair market value of the property or services transferred by the person liable for the tax (determined as if such person had sold the property or services to the other party to the exchange).

"*(c) Imports.* — The purposes of this chapter, the taxable amount in the case of any import shall be —
"(1) the customs value plus customs duties and any other duties which may be imposed, or
"(2) if there is no such customs value, the fair market value (determined as if the importer had sold the property).

"*(d) Special Rule in the Case of Sales of Certain Used Consumer Goods.* —For purposes of this chapter, if —
"(1) a taxable person acquires any tangible personal property in a transaction which was not a taxable transaction, and
"(2) Such property had been used by an ultimate consumer before such acquisition,
the taxable amount in the case of any sale of such property by such taxable person (determined without regard to this subsection) shall be reduced by the amount paid for such property by such taxable person."

Explanation 3 — Taxable amount.
Generally, the taxable amount on which the VAT would be imposed would be the price charged for property or services. This would include charges for transportation and other items payable to the seller. The taxable amount would not, however, include any interest or carrying charges. In an exchange of property or services, the taxable amount would be the fair market value of the property or services exchanged by the taxable person (determined as if the taxable person had sold the property or services to the other party to the exchange).

In the case of imports, the bill provides that the taxable amount would generally be the customs value plus customs and any other duties which may be imposed. If there is no customs value, the taxable amount would be the fair market value of the property.

The bill provides a special rule for the determination of the taxable amount in the case of certain used consumer goods. When a taxable person acquires used property from a consumer for resale, the taxable amount on the resale would be the difference between the selling price and the taxable person's acquisition cost of the used property.

"SEC. 4012. 5-PERCENT RATE OF TAX FOR FOOD, HOUSING AND MEDICAL CARE.

"*(a) 5-Percent Rate for Food, Housing, and Medical Care.* — The rate of the tax imposed by section 4001 shall be 5 percent with respect to the following:
"*(1) Food.* — The retail sale of food and non-alcoholic beverages for human consumption.
"*(2) Housing.* — The sale and renting of residential real property for use by the purchaser or tenant as a principal residence.
"*(3) Medical care.* — Medical care.

"*(b) Definitions.* — For the purposes of subsection (a) —
"*(1) Non-alcoholic beverages.* — The term "non-alcoholic beverages" does not include any article which is taxable under chapter 51.
"*(2) Medical care.* — The term "medical care" means the performance of any service, and the retail sale of any property, payment for which by the purchaser would constitute medical care within the meaning of section 213.
"*(3) Mobile homes, etc., treated as real property.* — A mobile or floating home shall be treated as real property."

Explanation 4 — Five-percent rate of tax for food, housing and medical care.
Under the bill, a five-percent rate of VAT, rather than the standard 10-percent rate, would be imposed on (1) the retail sale of food and non-alcoholic beverages for human consumption, (2) the sale and rental of residential real property for use by the purchaser or tenant as a principal residence, and (3) medical care.

"SEC. 4013. ZERO RATING FOR FARMERS, FISHERMEN, MASS TRANSIT, SECTION 501 (c)(3) ORGANIZATIONS, THE EDUCATIONAL ACTIVITIES OF GOVERNMENTAL ENTITIES, EXPORTS, AND INTEREST.

"The rate of the tax imposed by section 4001 shall be zero with respect to the following:
"*(1) Sales by farmers or fishermen.* — The sale (other than at retail) of —
"(A) agricultural commodities by the producer of such commodities, or
"(B) fish (or any other form of aquatic animal life) by a person in whose business such fish (or other forms) were caught.
"*(2) Mass transit.* — The performance of mass transportation services in urbanized areas.
"*(3) Section 501 (c)(3) organizations.* — Any taxable transaction engaged in by a section 501 (c)(3) organization other than as part of an unrelated business.
"*(4) Educational activities of governmental entity.* — The providing by a governmental entity of property and services in connection with the education of students.
"*(5) Exports.* — Exports of property.
"*(6) Interest.* — Interest."

Explanation 5 — Zero rating for farmers and fishermen, mass transit, section 501 (c)(3) organizations, educational activities of governmental entities, exports, and interest.
Under the bill, the rate of tax which would be imposed on certain transactions would be zero. Thus, no tax would be imposed on (1) non-retail sales of farmers and fishermen, (2) mass transit in urbanized areas, (3) transactions engaged in by an organization described in section 501 (c)(3) of the Code other than as part of an unrelated business, (4) educational activities of governmental entities, (5) exports, and (6) interest.

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"SEC. 4014. CREDIT AGAINST TAX.

"*(a) General Rule.* — There shall be allowed as a credit against the the tax imposed by section 4001 the aggregate amount of tax imposed by section 4001 which has been paid by sellers to the taxpayer of property and services which the taxpayer uses in the business to which the transaction relates.

"*(b) Exempt Transactions, Etc.* — if —
"(1) property or services are used partly in the business and partly for other purposes, or
"(2) property or services are used partly for taxable transactions and partly for other transactions,
the credit shall be allowable only with respect to the property and services used for taxable transactions in the business. No credit shall be allowable for any transaction occurring when the taxpayer was a non-taxable person.

"*(c) Excess Credit Treated as Overpayment.* —
"*(1) In general.* — If for any taxable period the aggregate amount of the credits allowable by subsection (a) exceeds the aggregate amount of the tax imposed by section 4001 for such period, such excess shall be treated as an overpayment of the tax imposed by section 4001.
"*(2) Time when overpayment arises.* — Any overpayment under paragraph (1) for any taxable period shall be treated as arising on the later of —
"(A) the due date for the return for such period, or
"(B) the date on which the return is filed."

Explanation 6 — Credit against VAT.
A taxable person would generally be permitted to take a credit (VAT credit) for the VAT paid by its suppliers on its purchases of property and services. The VAT credit would be allowable only with respect to property and services used for taxable transactions in the business. If such property or services are used partly in the business and partly for other purposes or partly for taxable transactions and partly for other transactions, the amount of VAT credit which could be taken would have to be determined on the basis of an allocation.

The VAT credit would first be applied to reduce the VAT liability for a taxable period. If the amount of the credit exceeds the amount of tax for the taxable period, the excess would be treated as an overpayment of tax and would be refundable.

"Subchapter D — Administration

"Sec. 4021. Seller liable for tax.
"Sec. 4022. Tax invoices.
"Sec. 4023. Small business exemption.
"Sec. 4024. Time for filing return and claiming credit; deposits of tax.
"Sec. 4025. Treatment of related businesses, etc.
"Sec. 4026. Value added tax not separately stated.
"Sec. 4027. Secretary to be notified of certain events.
"Sec. 4028. Regulations.

"SEC. 4021. SELLER LIABLE FOR TAX.

"The person selling the property or services shall be liable for the tax imposed by section 4001.

"SEC. 4022. TAX INVOICES.

"*(a) Seller Must Give Purchaser Tax Invoice.* — Any taxable person engaging in a taxable transaction shall give the purchaser a tax invoice with respect to such transaction if the seller has reason to believe that the purchaser is a taxable person.

"*(b) Content of Invoice.* — The tax invoice required by subsection (a) with respect to any transaction shall set forth —
"(1) the name and identification number of the seller,
"(2) the name of the purchaser,
"(3) the amount of the tax imposed by section 4001, and
"(4) such other information as may be prescribed by regulations.

"*(c) No Credit Without Invoice.* —
"*(1) In general.* — Except as provided in paragraphs (2) and (3), a purchaser may claim a credit with respect to a transaction only if the purchaser —
"(A) has received from the seller and has in his possession a tax invoice which meets the requirements of subsection (b), and
"(B) is named as the purchaser in such invoice.
"*(2) Employees or other agents named in invoices.* — To the extent provided in regulations, the naming of an employee or other agent of the purchaser shall be treated as the naming of the purchaser.
"*(3) Waiver of invoice requirement in certain cases.* — To the extent provided in regulations, paragraph (1) shall not apply —
"(A) where the purchaser without fault on his part fails to receive or fails to have in his possession a tax invoice,
"(B) to a taxable transaction (or category of transactions) where —
"(i) the amount involved is de minimis, or
"(ii) the information required by subsection (b) can be reliably established by sampling or by another method and can be adequately documented.

"*(d) Time for Furnishing Invoice.* — Any invoice required to be furnished by subsection (a) with respect to any transaction shall be furnished not later than 15 business days after the tax point for such transaction.

"SEC. 4023. SMALL BUSINESS EXEMPTION.

"*(a) In General.* — Under regulations, a person —
"(1) whose aggregate taxable transactions for the calendar year do not exceed $10,000, and
"(2) whose aggregate taxable transactions for the next calendar year can reasonably be expected not to exceed $10,000,
may elect to be treated as a person who is not a taxable person for the next calendar year.

"*(b) Exceptions.* — Subsection (a) shall not apply —
"(1) to any sale or leasing of real property, and
"(2) to any importing of property.

"*(c) Termination of Election.* — Any election under subsection (a) for a calendar year shall terminate if the aggregate taxable transactions —
"(1) for the first calendar quarter in such year exceed $3,500,
"(2) for the first 2 calendar quarters in such year exceed $6,000, or
"(3) for the first 3 calendar quarters in such year exceed $8,500.
Such termination shall take effect on the first day of the second month following the close of the first period in which the requirements of paragraph (1), (2), or (3) are met.

"*(d) Taxable Amount Treated as Zero for Zero-Rated Transactions.* — For purposes of this section, the taxable amount of any zero-rated transaction shall be treated as zero.

"*(e) Condition of Election.* — In the case of a person who is a taxable person for any period, an election under subsection (a) may be made for succeeding periods only with the consent of the Secretary. Such consent shall be conditioned on placing such person, for all succeeding periods, in the same position with respect to the tax imposed by section 4001 (and the credit allowed by section 4014) he would have been in if all property and services he holds at the time he becomes a non-taxable person had been acquired as a non-taxable person.

"*(f) Casual Sales and Leases of Real Property Excluded.* — For purposes of this section, the term "taxable transaction" does

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not include a transaction which is treated as a commercial-type transaction solely by reason of section 4004 (b)(1)(A).

"SEC. 4024. TIME FOR FILING RETURN AND CLAIMING CREDIT; DEPOSITS OF TAX.

"*(a) Filing Returns.* — Before the first day of the second calendar month beginning after the close of each taxable period, each taxable person shall file a return of the tax imposed by section 4001 on taxable transactions having a tax point within such taxable period.

"*(b) Credit Allowed for Taxable Period in which Purchaser Receives Invoice.* —

"*(1) In general.* — Except as provided in paragraph (2), a credit allowable by section 4014 with respect to a transaction may be allowed only for the first taxable period by the close of which the taxpayer —

"(A) has paid or accrued amounts properly allocable to the tax imposed by section 4001 with respect to such transaction, and

"(B) has a tax invoice (or equivalent) with respect to such transaction.

"*(2) Use for later period.* — Under regulations, a credit allowable by section 4014 may be allowed for a period after the period set forth in paragraph (1).

"*(c) Taxable Period.* — For purposes of this chapter —

"*(1) In general.* — The term "taxable period" means a calendar quarter.

"*(2) Exception.* —

"(A) Election of 1-month period. — If the taxpayer so elects, the term "taxable period" means a calendar month.

"(B) Other periods. — To the extent provided in regulations, the term "taxable period" includes a period, other than a calendar quarter or month, selected by the taxpayer.

"*(d) Tax Point.* — For purposes of this chapter —

"*(1) Chapter 1 rules with respect to seller govern.* — Except as provided in paragraph (2), the tax point for any sale of property or services is the earlier of —

"(A) the time (or times) when any income from the sale should be treated by the seller as received or accrued (or any loss should be taken into account by the seller) for purposes of chapter 1, or

"(B) the time (or times) when the seller receives payment for the sale.

"*(2) Imports.* — In the case of the importing of property, the tax point is when the property is entered, or withdrawn from warehouse, for consumption in the United States.

"*(e) Monthly Deposits Required.* — To the extent provided in regulations, monthly deposits may be required of the estimated liability for any taxable period for the tax imposed by section 4001.

SEC. 4025. TREATMENT OF RELATED BUSINESSES, ETC.

"*(a) General Rule.* — For purposes of this chapter (other than section 4023), to the extent provided in regulations, the taxpayer may elect —

"(1) to treat as 1 taxable person 2 or more businesses which may be treated under section 52(b) as 1 employer, and

"(2) to treat as separate taxable persons separate divisions of the same business.

"*(b) Small Business Exemption.* — For the purposes of section 4023, all businesses which are under common control (within the meaning of section 52(b) shall be treated as 1 business.

"SEC. 4026. VALUE ADDED TAX NOT SEPARATELY STATED.

"If —

"(1) property or services are sold to an ultimate consumer, and

"(2) the seller has reason to believe that the purchaser is not a taxable person,

the sales ticket or other similar document shall not separately state the amount of the tax imposed with respect to such sale under this chapter.

"SEC. 4027. SECRETARY TO BE NOTIFIED OF CERTAIN EVENTS.

"To the extent provided in regulations, each person engaged in a business shall notify the Secretary (at such time or times as may be prescribed by such regulations) of any change in the form in which a business is conducted or any other change which might affect the liability for the tax imposed by section 4001 or the amount of such tax or any credit against such tax, or otherwise affect the administration of such tax in the case of such person.

"SEC. 4028. REGULATIONS.

"The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this chapter."

Explanation 7 — Administrative provisions. a. Liability for VAT and invoicing.

Under the bill, liability for the VAT would be imposed on the seller of property or services. In addition to paying the VAT, the seller would be required to provide a tax invoice (setting forth the amount of VAT imposed on the sale and certain other information) to the purchaser if the seller has reason to believe that the purchaser is a taxable person. The invoice would have to be furnished no later than 15 business days after the "tax point."

Generally, a purchaser would not be allowed to claim a VAT credit with respect to a transaction unless it has received a tax invoice in which it is named as a purchaser.

b. Small business exemption.

The bill would permit certain businesses, the aggregate taxable transactions of which are and are expected to continue to be below a certain level, to elect not to be treated as a taxable person except with respect to imports and housing. If the election is made by the small business, no tax would be collected on its sales and no credit would be permitted for VAT paid on its purchases. In addition, a recapture of previously allowed credit would be required on property held by the business at the time of the election.

A person could elect to be exempt under the bill's provisions if its taxable transactions do not exceed $10,000 for a calendar year and can reasonably be expected not to exceed $10,000 for the next calendar year. The election, however, would terminate on the first day of the second month following any calendar quarter in that next year if the following has occurred:

(1) aggregate taxable transactions for the calendar quarter exceed $3,500, in the case of the first calendar quarter; or
(2) aggregate taxable transactions for the first two calendar quarters exceed $6,000, in the case of the second calandar quarter; or
(3) aggregate taxable transactions for the first three calandar quarters exceed $8,500, in the case of the third calendar quarter.

c. Time for filing return and claiming credit.

The bill would require a taxable person to file a VAT return during the first month following the close of each taxable period. A taxable period for this purpose would generally be a calendar month.

The return would reflect the VAT due on taxable transactions with a "tax point" in the period as well as the VAT credit allowed for the period. When the VAT due exceeds the VAT credit, payment of the difference would accompany the return. If the VAT credit exceeds the VAT due, the excess would be

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treated as an overpayment of VAT, and the return would be treated as a claim for a refund.

The term "tax point" would be used to describe when a taxable transaction takes place for purposes of the requirement that a taxable person furnish a tax invoice. For a sale of property or services, the determination of the tax point would depend on whether the taxable person keeps its books on the cash basis or on the accrual basis for Federal income tax purposes. In the case of a cash basis taxpayer, the tax point would be the date the taxable person receives payment for the sale. In the case of an accrual basis taxpayer, the tax point would be the earlier of the date the taxable person (1) should accrue income or loss with respect to the sale, or (2) receives payment for the sale. For an importation, the tax point would be the date the imported property is entered for consumption in the United States.

A VAT credit with respect to a purchase transaction would be allowed for a taxable period only if certain conditions were met. The taxable person would be required to have (1) paid or accrued (depending on its method of accounting for Federal income tax purposes) the VAT as part of the purchase price, and (2) received a tax invoice from the seller with respect to the transaction. The VAT credit would generally be allowed for the first taxable period in which both of these conditions were satisfied.

d. Treatment of related businesses, etc.
The bill would allow a taxable person to elect to treat itself and all related businesses as one taxable person for VAT purposes. A related business would encompass any business under common control with the taxable person under the more than 50-percent control test described in section 52(b) of the Code. However, for purposes of applying the small business exemption, all businesses under common control would be treated as one business.

The bill would also allow a taxable person to elect to treat any of its divisions as a separate taxable person.

e. Treasury notification and regulations.
The bill would require a taxable person to notify the Internal Revenue Service if certain events occurred. These reportable events would be developed by regulations and would encompass a change in the form of a business, or any other change which could affect VAT liability, VAT credit, or VAT administration with respect to the business.

The bill would also give the Secretary of the Treasury broad authority to write regulations with respect to the VAT.

"Subchapter E — Definitions and Special Rules; Treatment of Certain Transactions

"Sec. 4031. Definitions.
"Sec. 4032. Special rules.
"Sec. 4033. Personal use by owner of business property or services.
"Sec. 4034. Gift of business property or services.
"Sec. 4035. Special rules for dispositions of non-business real property.
"Sec. 4036. Special rule for insurance contracts.
"Sec. 4037. Governmental entities; exempt organizations.

"SEC. 4031. DEFINITIONS.

"*(a) Property.* — For purposes of this chapter, the term "property" means any tangible property.

"*(b) Business.* — For purposes of this chapter, the term "business" includes —
"(1) a trade, and
"(2) an activity regularly carried on for profit.

"*(c) Employee.* — For purposes of this chapter, the term "employee" has the meaning such term has for purposes of chapter 24 (relating to withholding).

"*(d) Person.* — For purposes of this chapter, the term "person" includes any governmental entity.

"*(e) Business Day.* — For purposes of this chapter, the term "business day" means any day other than Saturday and Sunday and other than a legal holiday (within the meaning of section 7503).

"*(f) United States.* — For purposes of this chapter, the term "United States" when used in a geographical sense, includes a Commonwealth and any possession of the United States.

"SEC. 4032. SPECIAL RULES.

"*(a) Coordination with Subtitle A.* — For purposes of subtitle A —
"*(1) Treatment of credit.* — Any credit allowable to a taxpayer under section 4014 which is attributable to any property or services shall be treated as a reduction in the amount paid or incurred by the taxpayer for such property or services.
"*(2) Amount of deduction for tax.* — The amount allowable as a deduction for the tax imposed by section 4001 shall be determined without regard to any credit allowable under section 4014.
"*(3) Computation of percentage depletion.* — For purposes of sections 613 and 613A —
"(A) gross income shall be reduced by the amount of the tax imposed by section 4001, and
"(B) taxable income shall be determined without regard to any deduction allowed for such tax.

"*(b) Special Rule Where Sale of Property Includes Incidental Performance of Services.* — For purposes of this chapter, if in connection with the sale of any property there is an incidental performance of services, such performance of services shall be treated as part of the sale of such property.

"*(c) Special Rule Where Performance of Services Includes Incidental Transfer of Property.* — For purposes of this chapter, if in connection with the performance of any services there is an incidental transfer of property, such transfer shall be treated as part of the performance of such services.

"*(d) Authority to Zero Rate De Minimis Transactions, Etc.* — The Secretary may prescribe regulations providing that the rate of tax shall be zero for a taxable transaction (or category of such transactions) where —
"(1) the amount involved is de minimis, or
"(2) the revenue raised by taxing the transaction is not sufficient to justify the administrative and other costs involved in the payment and collection of the tax.

"*(e) Importing Treated as Sale and Purchase.* — For purposes of this chapter, the importing of any property into the United States shall be treated as both a sale and purchase of such property by the person importing such property.

"*(f) Subchapter S Corporation Treated as Not a Corporation.* — For purposes of this chapter, an electing small business corporation (as defined in section 1371(b)) shall be treated as a person which is not a corporation.

"*(g) Use Includes Held for Use.* — For purposes of this chapter, property and services held for use by any person shall be treated as used by the person.

"SEC. 4033. PERSONAL USE BY OWNER OF BUSINESS PROPERTY OR SERVICES.

"*(a) General Rule.* — If any business property or services are used by an owner of the taxpayer for personal purposes, for purposes of this chapter such use shall be treated as a taxable transaction.

"*(b) Taxable Amount.* — In the case of a use described in subsection (a), for purposes of this chapter, the taxable amount shall be —
"(1) except as provided in paragraph (2), the fair market value of the property or the services, or
"(2) if such use is only the temporary use of property, the fair rental value of such use.

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"*(c) Definitions.* — For purposes of this section —

"*(1) Business property or services.* — The term "business property or services" means any property or services if a sale of such property, or the performance of such services, by the taxpayer would be a taxable transaction.

"*(2) Owner.* — The term "owner" means —

"(A) in the case of a sole proprietorship, the proprietor,

"(B) in the case of any other business enterprise, any holder of a beneficial interest in the corporation, partnership, or other entity, and

"(C) any member of the family (within the meaning of section 267(c) (4)) of an individual described in subparagraph (A) or (B).

"SEC. 4034. GIFT OF BUSINESS PROPERTY OR SERVICES.

"*(a) General Rule.* — In the case of any gift of business property or services, for purposes of this chapter —

"(1) such gift shall be treated as a taxable transaction, and

"(2) the taxable amount shall be the amount determined under section 4033(b).

"*(b) Gifts Related to Business Promotion Activities.* — For purposes of subsection (a), the term "gift" includes any gift of property or services transferred in connection with business promotion activities.

"SEC. 4035. SPECIAL RULES FOR DISPOSITIONS OF NON-BUSINESS REAL PROPERTY.

"*(a) In General.* — In the case of any sale of real property which is treated as a commercial-type transaction solely by reason of section 4004(b) (1) (A), for purposes of this chapter, the taxable amount shall be the excess (if any) of —

"(1) the amount realized on such sale, over

"(2) the adjusted cost to the taxpayer of such real property.

"*(b) Adjusted Cost.* — For purposes of subsection (a) —

"*(1) In general.* — Except as provided in paragraph (2), the term "adjusted cost" means, with respect to any property, the basis of such property increased by expenditures properly chargeable to capital account (other than taxes or other carrying charges described in section 266) for periods during the holding period for such property.

"*(2) Transitional rule.* — The adjusted cost of any property shall include only amounts incurred during periods after December 31, 1980.

"*(c) Value Added Tax Not Taken Into Account.* — For purposes of this section, the amount realized on any sale of real property shall not include any amount attributable to the tax imposed by this chapter.

"SEC. 4036. SPECIAL RULE FOR INSURANCE CONTRACTS

"In the case of any contract of insurance, for purposes of this chapter, the taxable amount is the excess of —

"(1) the portion of the premium attributable to insurance coverage, over

"(2) the actuarial cost to the insurer of providing such insurance coverage.

"SEC. 4037. GOVERNMENTAL ENTITIES; EXEMPT ORGANIZATIONS.

"*(a) Taxable Transactions for Governmental Entities Only Where Separate Charge Is Made.* — For purposes of this chapter, the sale of property and the performance of services by a governmental entity shall be a taxable transaction if (and only if) a separate charge or fee is made therefor.

"*(b) Section 501 (c)(3) Organizations.* — For purposes of this chapter, a section 501 (c)(3) organization shall be treated as engaged in a business with respect to all of its activities.

"*(c) Other Exempt Organizations.* — For purposes of this chapter, the sale of property and the performance of services by any exempt organization other than a section (501 (c)(3) organization shall be a taxable transaction if (and only if) a charge or fee is made for such services.

"*(d) Definitions.* — For purposes of this chapter —

"*(1) Governmental entity.* — The term "governmental entity" means the United States, any State or political subdivision thereof, the District of Columbia, a Commonwealth or possession of the United States, or any agency or instrumentality of any of the foregoing.

"*(2) Section 501 (c)(3) organization.* — The term "section 501 (c)(3) organization" means an organization described in section 501 (c)(3) which is exempt from tax under section 501 (a).

"*(3) Other exempt organization.* — The term "other exempt organization" means any organization (other than a section 501 (c)(3) organization) which is exempt from tax under chapter 1."

(b) Clerical Amendment. — The table of chapters for subtitle D is amended by inserting before the item relating to chapter 31 the following:

"Chapter 30. Value added tax."

SEC. 302. EFFECTIVE DATE FOR TITLE III.

The amendments made by section 301 shall apply to transactions occurring after December 31, 1980.

Explanation 8—Special rules and treatment of certain transactions.

a. Coordination with income tax rules.

Under the bill, a taxable person's basis in property for Federal income tax purposes would not include the portion of the purchase price of the property which represents creditable VAT.

b. Sale of property and incidental services; sale of services and incidental property.

Under the bill, a sale of property together with incidental related services would be treated as a single transaction constituting a sale of property, rather than as separate sales of property and services. Also, a sale of services together with an incidental transfer of property would be treated as a single transaction constituting a sale of services, rather than as separate sales of services and property.

c. Authority to zero rate de minimis transactions.

The bill would provide that, under regulations, an otherwise taxable transaction would be zero rated if (1) the amount involved is negligible, or (2) the VAT revenue from taxing that type of transaction would not be sufficient to justify resulting administrative and compliance costs.

d. Importing.

Under the bill, the importer of property would be treated as both the seller and purchaser of the property at the point of importation. Thus, the importer would be both liable for VAT and eligible for a VAT credit with respect to the import.

e. Subchapter S corporation not treated as a corporation.

Under the bill, a subchapter S corporation (Code sec. 1371(b)) would not be treated as a corporation for VAT purposes. Accordingly, it would not automatically be considered engaged in business. Thus, as in the case of a non-corporate entity, the determination of whether it is engaged in business and is hence a taxable person would have to made on the basis of relevant facts and circumstances.

f. Personal use by owner of business property or services.

Under the bill, the use of business property or services by an owner of a business would be treated as a taxable transaction. In the case of services or a permanent use of property, the amount subject to tax would be the fair market value of the services or property. In the case of a temporary use of property, the amount subject to tax would be the fair rental value of the property. Property or services are considered business property or services if their sale by the taxable person would be a taxable transaction. Under the bill an owner of a business generally means a sole

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proprietor, partner, or shareholder, as well as certain related family members determined under Code section 267(c)(4).

g. Gift of business property or services.
Under the bill, a gift by a business of any business property or services would be treated as a taxable transaction. The taxable amount in the case of such a gift would generally be fair market value. However, where the gift permits the temporary use of business property, the taxable amount would be the fair rental value of the property.

h. Special rule for dispositions of non-business real property.
Under the bill, where real property is sold by a person who is not otherwise a taxable person, the person would become taxable with respect to the sale. However, in contrast to most sales transactions, the VAT would not be imposed on the selling price, but would be imposed only on the excess of the selling price over the seller's adjusted cost for the property. For this purpose, the selling price would be calculated exclusive of VAT. The seller's adjusted cost would be his basis in the property increased by certain expenditures properly chargeable to capital account. However, the seller's adjusted cost would not include basis or expenditures due to amounts incurred in periods before January 1, 1981.

i. Special rule for insurance contracts.
Under the bill, sales of insurance would be subject to the VAT. The value added of an insuror is represented by the excess of premiums collected over claims paid. Thus, the VAT would not be imposed on premiums at the rate of 10 percent because this would result in taxing an insuror on an amount greater than its value added. In addition, amounts representing savings should not be taxed because the VAT is designed to tax consumption. Accordingly, the bill would impose the VAT only on the difference between the portion of a premium attributable to insurance coverage and the actuarial cost of the coverage.

j. Taxable transactions for governmental entities; exempt organizations.
The bill would generally exempt governmental entities from the application of the VAT. An exception would be made for sales by governments for which separate charges are made. Such charges would be subject to the VAT. In the case of charges for education, however, the rate of tax would be zero. Governments would be permitted a VAT credit only on purchases relating to taxable sales, including zero-rated sales.

Charities described in section 501(c)(3) of the Code would be zero rated for all of their sales, except those engaged in as part of an unrelated trade or business (Code sec. 513). Thus, they would be eligible for the VAT credit on their purchases.

Under the bill an exempt organization not described in section 501(c)(3) of the Code would generally be exempt from the aplication of the VAT. However, sales by such organizations would be taxable if made for a charge. The organizations would be permitted a VAT credit only on purchases relating to taxable sales.

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TAX GLOSSARY

*by H.W.T. PEPPER**

PERIODICITY OF PAYMENTS — Since a government's expenditure accrues throughout the fiscal year it is important to secure a steady inflow of taxes and other revenue through the year. Accordingly sales taxes, including V.A.T,, are often collected monthly from the larger taxpayers, income taxes deducted at source, e.g., P.A.Y.E. deductions from employees, and payroll taxes are usually remitted monthly. In the U.K. ADVANCE CORPORATION TAX (q.v.) is paid over quarterly, and in the U.S.A. income tax is payable quarterly by the larger individual taxpayers and corporations. In general it is desirable that taxes be paid as soon as they become due, and particularly in the case of withholding taxes it is desirable that the withholder hand them over as soon as possible.

PERMANENT ESTABLISHMENT — A term mainly to be found in double taxation treaties, where it is customarily provided that a business in one country will not be liable to the income tax of the other country, unless it has a "permanent establishment" through which it conducts business *in* that other country. A permanent establishment is usually defined as a place of management, a branch, an office, a factory, a workshop, a mine, quarry or other place of extraction of natural resources, or a building site or assembly project which exists for more than a certain period (6 or 12 months). The definition usually excludes the use of facilities solely for purposes of storage, display, or delivery of goods belonging to the enterprise and there are often some other similar restrictions.

PERQUISITES — See BENEFITS IN KIND, FRINGE BENEFITS.

PERSONAL EXPORT SCHEME — Goods exported from a country are not normally subject to that country's customs duty or sales taxation. When goods are bought within the country by tourists who intend to take them away, there should also, in principle, be no duty or tax on such "personal" exports. Accordingly many countries have schemes whereby tourists may buy goods free of tax, etc., either in duty-free shops, or in other shops where either the goods are delivered direct to the departing ship or plane; or on initial payment of duty with subsequent refund being made at the tourists' departure.

PERSONAL HOLDING COMPANY — A personal holding company, i.e., a private company the shares in which are owned by the taxpayer (or by him and his wife) personally, is usually set up to hold his investments. The company may be set up in a tax haven in order to gain a tax advantage, but where the taxpayer resides in a developed country such as the U.S.A., the U.K. and other European countries, Australia, Japan, etc., there are usually tax laws which deem the taxpayer to have had the income of the holding company (personal family holding company in Japan) distributed to him for the purpose of calculating his tax.

PERSONAL RELIEFS — Personal reliefs, also known as personal allowances, or personal exemptions, are granted to individuals as deductions from income in computing their personal income tax. There is usually a deduction for the individual himself, and others for his dependents, wife, children, and indigent relatives. There is at present a trend among countries which grant FAMILY ALLOWANCES (q.v.), i.e., cash allowances towards the support of a taxpayer's children, to phase out personal relief for the same children.

PERSONAL TAX — This term is applied to income tax on individuals, as distinct from tax levied on corporate and other bodies of taxpayers. The term is also applied sometimes where there is a schedular tax system and the moderate amounts of schedular tax deducted from different types of income are supplemented by a tax on the total income of individuals, which may be known as a residents' tax, supplementary tax, or personal tax. (See SCHEDULAR TAXATION.)

PERSONELE BELASTING — (Belgium, Holland) A minor tax on real property.

PERSONEN BELASTING — (Belgium) Personal income tax.

PERSONENBEZOGENE GESELLSCHAFT — (Germany) Closely-held company.

PERSONEN TEN LASTE — (Belgium) Dependents of the taxpayer for whom he may claim personal tax reliefs.

PERSONFRADRAG — (Denmark) Personal reliefs.

PETROLEUM REVENUE TAX (PRT) — A tax imposed in the U.K. on profits from the exploitation of North Sea oil and gas. The tax is levied half-yearly at the rate of 60 percent. The tax commenced with half-yearly production periods ending after 12 November 1974, the tax rate being 45 percent for periods up to 31 December 1978.

PHANTOM TAX — The tax which would have been paid on its profits by a PIONEER INDUSTRY (q.v.), which has in fact been exempted under TAX HOLIDAY (q.v.) provisions, but nevertheless is "recognised" for tax relief purposes under a TAX SPARING (q.v.) article in a double taxation treaty.

PHASENPAUSCHALIERUNG SYSTEM — This is the system under a cascade tax whereby the whole of the tax due at different stages of production and distribution is covered by a single charge to tax at one stage at a rate of tax which is equivalent to the total amount likely on average to have been levied at the various different stages of distribution. (See also FORFAITAIRE.)

PHYSICAL HANDICAP, TAX RELIEF — Some countries provide additional personal tax reliefs to physically-handicapped individuals, e.g., Japan grants additional relief which varies within certain limits according to the severity of the handicap. The U.S.A. grants an additional personal exemption to blind persons. Most countries provide cash benefits to the handicapped through state welfare schemes which may make tax relief unnecessary.

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PHYSICAL INGREDIENT RULE — This is the rule in the U.S. state retail tax legislation by which it is laid down that goods becoming actual ingredients in other goods are exempt from retail sales tax.

PIONEER INDUSTRY — The term "pioneer industry" is usually encountered in legislation in developing countries designed to encourage the setting up of industries which do not already exist in the country or which exist on an inadequate scale. Such industries are often classed as "pioneers" and granted tax and other concessions which may include income tax holidays (or exceptional allowances for depreciation), freedom from customs duties on imports of building materials and equipment, and sometimes raw materials, for a limited period of years, and land and buildings, initially at sub-economic rents. (See also INFANT INDUSTRY, PHANTOM TAX, TAX HOLIDAY, TAX SPARING.)

PLANNING, TAX — The term is not exactly synonymous with TAX AVOIDANCE (q.v.) in the worst sense of that word. Nowadays it is increasingly realised that there are fields in which long-term planning can help in producing a more TAX-EFFICIENT (q.v.) way of doing something, and tax codes are in some ways designed to favour one method rather than another. For example, provision for one's retirement may be made in several ways but some tax codes give preferential treatment to saving through life assurance. Disposing of assets to those more needy, or perhaps able to make better use of them, during one's lifetime usually incurs less tax (or even none if there is no gift tax in force) than bequests on death.

PLAYING CARD TAX — Japan has a tax on manufacturers of playing cards and mahjong sets, and for a long time the U.K. had a specific excise duty on packs of playing cards. Such levies are obviously likely to be trivial in yield but are part of the pattern of taxing gambling (since cards and mahjong can be used in gaming) and leisure activities.

PLUS VALUES — (Belgium and France) Capital gains.

POLL TAX — A tax on each member (or each male adult), of the population. (See also GRADUATED POLL TAX, SELECTIVE EMPLOYMENT TAX.)

POLLUTION TAX — See ANTI-POLLUTION TAX.

POOL BASIS — For the purpose of computing DEPRECIATION or CAPITAL or WRITING-DOWN ALLOWANCES (q.v.) in respect of machinery and plant or other qualifying assets it is administratively convenient to "pool" all assets which qualify for the same rate of allowance, and this method is accepted by various tax administrations, e.g., Canada and the U.K., and in fact most countries that use the REDUCING (or DECLINING) BALANCE METHOD of computing relief. The cost of additions is added to the written-down balance of value of the machinery, etc., and the proceeds of sales of old machines or scrap is deducted from the total, the depreciation allowance being calculated on the single figure of the adjusted balance.

POOLING — For the purpose of computing capital gains tax on sale, e.g., of shares in a quoted company, where there have been several purchases of the particular shares over a period of time and the sale is of only part of the holding, pooling treatment may be prescribed (as in the U.K. capital gains law) to determine the cost of the shares sold. All purchases are totalled and the average taken to represent the cost of the part of the holding sold.

POOLS BETTING DUTY — In the U.K. a levy on the stake money on pool betting (principally applying to sums staked on greyhound track totalisators and betting by coupons, mainly on football match results). (See also FOOTBALL POOLS TAX.)

PORTFOLIO HOLDING COMPANY — A company set up to hold investments rather than to trade in them. (See also PERSONAL HOLDING COMPANY).

POSSESSIONS CORPORATION — A U.S. corporation operating in a U.S. possession overseas, e.g., Puerto Rico, receives special tax treatment, the object being to encourage investment in these areas.

POST-CESSATION RECEIPTS — Where there are post-cessation receipts related to some activity after the formal termination of the trade or profession, tax liability would arise and this is confirmed in legislation in some countries which is designed also to counteract avoidance techniques related to receipts after cessation.

POST-WAR CREDITS — In Britain, in the period from April 1941 to April 1946, covering 5 fiscal years (mainly falling within World War II), earned income relief and personal allowances for income tax purposes were reduced and the extra tax payable in respect of these reductions was treated as post-war credits repayable after the war. In the post-war period, credits were made repayable at retiring age (eventually to men aged 60, women aged 55) and in certain other circumstances, e.g., death, blindness, disablement, and long-term sickness or unemployment. Finally, all outstanding credits were made repayable unconditionally in 1972.

POST-WAR REFUND — The EXCESS PROFITS TAX (q.v.) which operated in Britain for the period from April 1939 to December 1946 was charged at 100 percent for the period April 1940 to December 1945 and of the 100 percent 20 percent was to be refundable as a post-war refund. The refunds were, in fact, made reasonably soon after the termination of the tax on December 31, 1946 to taxpayers who incurred expenditure on re-equipment, etc., against which the refunds could be used as credits.

POUNDAGE — A levy which originated in 1891 and was used for a time to pay the staff of surveyors of taxes in Britain. Since the yield from the levy depended on the amount of tax assessed and collected, there were the usual allegations encountered under such systems that taxpayers found difficulty in having their assessments reduced. The term "poundage" has other connotations. As regards LOCAL RATES (q.v.) in Britain "poundage" is the number of pence in the £ (equivalent to percentage) at which rates are levied. The charge for a postal order issued by the British Post Office is also known as "poundage".

POVERTY SURTAX — The expression is used to describe the position arising from the FAMILY INCOME SUPPLEMENT (q.v.) and other income-related welfare, educational, and other benefits and abatements. Where the family's earnings rise above certain limits, reduced benefits are due, and it may be that the cost in lost benefits represents a very high percentage of the increase in earnings, thus appearing similar to a high marginal rate of tax, or SURTAX (q.v.).

POVERTY TRAP — The position in which the breadwinner who has a low income and substantial responsibilities, when by striving to and succeeding in earn-

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ing more, finds that the loss in benefits may nearly equal or even exceed his increase in earnings. (See also POVERTY SURTAX.)

POWER TAX — A tax on power (measured by the use of electricity, fuels such as coal, gas, or oil, etc.) has sometimes been advocated on the grounds, inter alia, that a person's affluence or the profitability of a business is proportionate to the amount of power used. A completely logical case for such a tax cannot be made out because it cannot be shown that the grounds referred to are wholly valid. (See also PUBLIC UTILITY TAX.)

PRAEFERENCEAKTIE — (Denmark) Preference shares or stock.

PRECOMPTE — (Belgium, France) A pre-payment of tax, usually by withholding.

PRECOMPTE MOBILIER — (Belgium, France) A pre-payment by deduction at source, e.g., of income tax on dividends or interest paid on securities, including bearer bonds.

PREEMPTION, DROIT DE — The right of the French tax administration to buy real property at the value (increased by 10 percent) which has been declared for the purposes of the registration tax at the time of transfer of ownership. (See also UNIVERSAL VALUES.)

PREFECTURAL TAXES — Local taxation in Japan, where prefectures and municipalities, the units of local authorities, have power to levy taxation.

PREFERENTIAL DEBT FOR TAX — Most countries provide that tax unpaid should have preference over other debts in the event of the bankruptcy of an individual or liquidation of a company. This is a reasonable provision since tax was originally a debt from the taxpayer to his sovereign, but the preferential treatment is usually limited to the tax for a particular year, other tax ranking with other debts on an equal footing.

PREMIUM ON LEASE — In the U.K. the granting of a lease subject to payment of a premium involves additional income tax based on the use of a formula for spreading the premium over the term of the lease. Sale of a premium is usually a subject for capital gains tax. Most countries accord broadly similar treatment to leases.

PREMIUMS ON LIFE ASSURANCE POLICIES, ANNUITY CONTRACTS — See LIFE INSURANCE RELIEF, PENSION SCHEMES, RETIREMENT BENEFIT SCHEMES.

PRICE, ARMS' LENGTH — The concept of an arms' length price is relevant to various kinds of taxation, e.g. customs duties, stamp duties and capital gains tax on the disposal of property, the valuation of goods internally or domestically consumed by taxpayers who are subject to sales taxation, and to income taxation on their profits. The allocation of profits between head office and the branches of a concern trading in several countries, or between associated persons or companies in an integrated business may also depend on arms' length pricing, etc.

PRICE CONTROL — See QUASI-TAXATION.

PRICE, EFFECT OF TAX ON — See ESCALATION, PYRAMIDING.

PRIORITY FOR TAX — See PREFERENTIAL DEBT.

PROBATE DUTY — A tax payable when an executor or beneficiary takes out probate for the estate of a deceased person. The term may refer merely to a moderate stamp duty on documents or may be applied to the DEATH DUTY (q.v.) charged as a revenue or "redistributive" levy on the assets passing at death. In Britain, Probate Duty was in force from 1694 to 1894 (finally as a 3 percent levy on the value estates over £ 1,000) when it was replaced by Estate Duty.

PRODUCTION, FACTORS OF, TAX ON — See FACTORS OF PRODUCTION.

PRODUCTION GOODS — The term applied to goods which are, in turn, used to produce other goods. The term may be applied accordingly to equipment and machinery, but is also sometimes applied to other goods which are not embodied in the products but may serve as catalysts in the production process.

PROFESSIONAL TAX — Annual taxes are sometimes levied on those carrying on professions. Sometimes the levy may be a kind of registration fee relating to the administrative cost of supervising the activities of various professions for the protection of the public. Occasionally, and usually inadvisedly, such taxes have been levied for revenue purposes avowedly because those who exercise professions are alleged to have more favourable treatment for income tax purposes than employees, and greater opportunities for evasion and avoidance. To levy a special tax for the last reason is, of course, unsound in principle since it seems to confer a "licence to cheat".

PROFITS TAX — The term may be used to denote an ordinary income tax on profits or occasionally a special tax such as that levied in Britain in the period 1946 to 1965 on corporate profits in addition to the ordinary income tax on those profits. The various versions of the British profits tax in its lifetime included a simple levy of tax on profits which was calculated slightly differently from those chargeable to income tax — finally at the rate of 15 percent with an abatement where the profits did not exceed £ 12,000 and an exemption where they did not exceed £ 2,000. At other times the tax was charged more heavily on dividends than on retained profits and the differential rate on distributions varied from time to time with changes in government policy.

[to be continued]



IFA NEWS

Mr. DAVIES HONOURED

Our congratulations go to Alun G. Davies, President of IFA, who was made a Commander of the British Empire in Her Majesty's New Year's Honours List.

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- Interaction entre le système fiscal américain et les règles contenues dans les conventions fiscales américaines et les systèmes fiscaux intégrés applicable aux sociétés/actionnaires étrangères par ***Hugh Ault***
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- Wechselwirkung zwischen dem U.S. Steuersystem und den Bestimmungen der von den U.S.A. abgeschlossenen Doppelbesteuerungsabkommen mit integrierten Körperschaft/Anteilseigner-Steuersystemen in anderen Ländern; ***Hugh Ault***
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L'auteur analyse des concepts tels que: la capacité imposable, le potentiel fiscal, la charge fiscale et l'effort fiscal se rapportant au potentiel économique d'un pays pour l'obtention de revenus. Il conclut en indiquant que le potentiel fiscal dépend de trois facteurs principaux: le cadre légal constitutionnel, le potentiel économique et les possibilités économico-administratives.

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Discussion of a case under which the Privy Council held that a Malaysian corporation which has incurred a loss through its Singapore branch was entitled to deduct the loss from its domestic-source income.

MALAISIE: DEDUCTIBILITE DES PERTES ETRANGERES – MANGER A DEUX RATELIERS

Commentaires d'un cas juridique dans lequel le Conseil Privé affirme qu'une société malaise ayant subi une perte par l'intermédiaire d'un succursale à Singapour est autorisée à déduire cette perte de son revenu de source nationale.

MALAYSIA: ABZUGFÄHIGKEIT AUSLÄNDISCHER VERLUSTE

Stellungnahme zu einem Urteil, in welchem der Privy Council entschied, dass eine malaysische Gesellschaft die bei ihrer Betriebstätte in Singapur entstandenen Verluste vom Einkommen inländischen Ursprungs abziehen darf.

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ERRATUM

Much to our regret *Dr. Paul Gmuer's* name was omitted in the list of the Board of Trustees of the International Bureau of Fiscal Documentation on the inserted cover pages we mailed together with the December 1979 issue of the *Bulletin*. The complete list is as follows:

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Exploration of Income Tax Treaty Policy Issues in the United States

National Meeting of the United States Branch of IFA, March 15 & 16, 1979

PART I - PROPOSED AGENDA: Introduction of the Subject

by Robert J. Patrick*

IN GENERAL

Compared to many areas of U.S. tax law, there has been relatively limited public discussion of the fundamentals of United States income tax treaty policy. It was for this reason that the U.S. Branch of IFA organized a committee on tax treaties two years ago and income tax treaty policy is the theme of this year's National Meeting.

We will be devoting our program today and part of tomorrow to the exploration of certain income tax treaty policy issues. One of the recent criticisms has been that recent U.S. treaties attempt to do too much. On the other hand, it has been argued that one reason the U.S. has so few treaties, particularly with developing countries, is because U.S. treaties typically do so little with respect to changing U.S. taxation of U.S. taxpayers. Thus, an important aspect of our inquiry is what is it that our treaties should be attempting to do?

Concern is also expressed about the treaty negotiating and ratification process in the U.S. The process of negotiation and ratification of agreements will be discussed this afternoon.

Current U.S. treaties are built upon prior U.S. precedent and increasingly upon the Model Convention of the OECD (revised in 1977). One also detects some influence of the UN Group of Experts suggestions for treaties between developed and developing countries, which will be further described this morning.

I would describe the purposes and scope of coverage of comprehensive income tax treaties in this manner:

"The generally accepted underlying purpose of tax treaties is to contribute to freedom in the flow of goods, capital, technology and personnel across national boundaries by reducing substantive and procedural tax burdens (principally through elimination of double taxation), by harmonizing tax rules, by providing a mechanism for resolving tax disputes, and by authorizing national tax administrations to cooperate with each other in enforcing their tax laws. The United States Model Treaty[1] seeks to accomplish these goals by providing rules on the following questions: the right of a country to impose tax on the basis of the connection of the taxpayer, property or activities with the taxing country; the determination of allocable income and deductions to ascertain taxable net income and, in the case of certain withholding taxes, limitations on the rate of tax. The Model further provides a tax credit mechanism for avoiding double taxation of the same income; requires nondiscriminatory tax treatment for treaty partners; and provides machinery for cooperation between tax administrations to resolve tax disputes and to exchange information to enforce compliance with domestic law and treaty tax rules."

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Status of tax treaty negotiations (*Marianne Burge*)

Panel discussion

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Panel discussion

Tax treaty procedures (*David Milton*)

Panel discussion

Exchange of information under tax treaties (*Joseph H. Guttentag*)

Panel discussion

Appendix: U.S. treaties in force and under negotiation at February 28, 1979

* Vice-President of the USA Branch of IFA.

1. *Bulletin* editor's note: This Model Treaty is reproduced in 31 BULLETIN FOR INT'L FISCAL DOCUMENTATION 313 (1977).

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These rules subsume a great many policy decisions and cut across a great many substantive rules.

While the U.S. has unilaterally adopted a number of rules to relieve double taxation and accommodate to an international tax context, it is virtually impossible to legislate solutions to the detailed differences between the systems in contrast to resolving problems in a bilateral treaty (as illustrated by the recent U.S./French Protocol). Nevertheless, we need some basic policy guidelines as to what our treaties should be accomplishing and the Treasury has been encouraging such examination.

This morning we shall look at four policy aspects of treaty rules:

1) Treaty rules affecting U.S. taxation of non-resident aliens and foreign corporations;
2) Treaty rules affecting U.S. taxation of U.S. citizens and residents;
3) Issues in the negotiation of tax treaties with countries having integrated tax systems; and
4) Issues in negotiations with developing countries.

I. TAX TREATY POLICY WITH RESPECT TO U.S. TAXATION OF FOREIGN INVESTORS

Background: 1966 Foreign Investors Tax Act
1977 OECD Model and Commentary
1977 U.S. Treaty Model

A. Types of income

1. Business activities

The U.S. has adopted the standard treaty rule giving a right of taxation to the country in which a permanent establishment is located with respect to income attributable to the permanent establishment (including types of income that would be treated under separate treaty articles, but for the fact that such income is effectively connected with the permanent establishment and is therefore considered as business profits of the establishment).

The U.S. has tended to support restrictive definitions of what constitutes a permanent establishment, presumably because of the large amount of U.S. overseas activity that we would just as soon have taxable only in the U.S., including export income. There is also a desire to avoid imposing tax in cases where it is difficult to establish allocable taxable income.

— *Should this remain the U.S. position as foreign trade with the U.S. continues to develop?*

2. Withholding taxes: dividends/interest/royalties

Present U.S. treaty rules:

a. *Dividends*

U.S. withholding of 30 percent is reduced to 5 percent on direct investment dividends and to 15 percent on portfolio dividends. The direct investment rule suggests the limited amount of published debate on policy since it is virtually impossible to discover why it is 5 percent on direct investment and not 15 percent or zero, other than that 5 percent and 15 percent are OECD rules.

— *What is the rationale for these reductions?*
— *Why should the withholding rate on intercorporate dividends be 5 percent and not zero?*
— *Should reductions always be reciprocal (without regard to underlying corporate rates)? (The problems of negotiations with countries having corporate/shareholder tax integration will be discussed under* III *below).*

b. *Interest/royalties/equipment leasing*

Present U.S. policy is to seek exemption at source. The usual justification relates to the difficulty in achieving the equivalent of a net income tax if there is a positive rate of withholding.

3. Real property

In the case of real estate, the treaty provisions of the recent past have provided for taxation on a net income basis for rental income, in some instances on an annual election basis (which is no longer permitted).

4. Capital gains

U.S. Treaty rules on capital gains have tended to follow the 1966 Foreign Investors Tax Act and to exempt foreign investors not engaged in trade or business in the U.S. from tax on the sale of U.S. personal property. In form, the treaties retain the right to tax gain on real estate held directly by the seller, even though U.S. law does not at this time impose tax on a passive investor.

The 1978 Tax Legislation called for a Treasury review of U.S. taxation of non-resident aliens and foreign corporations owning U.S. real property directly or through domestic or foreign corporations.

— *Where should U.S. policy move in this area?*
— *What rules are enforceable as a practical matter?*

5. Personal services

The U.S. Treaty rules substantially enlarge the U.S. statutory exemptions for *independent personal services* (limiting taxation to physical presence for 183 days or the existence of a fixed base regularly available to the individual).

The treaty rules also expand the exemption for *dependent personal services* if the employer is not a U.S. resident.

The Model contains a stringent exception, however, for entertainers and athletes, who are limited to an exemption only if total gross receipts of such entertainer or athlete do not exceed $15,000 in the taxable year.

— *Is there a legitimate basis for this discrimination?*

B. Conduit issues

Treaties are negotiated on a bilateral basis and there is a traditional concept that "concessions" are negotiated to benefit the resident of the contracting states. In

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practice, of course, the existence of the corporate form of doing business means that third country residents owning stock in a corporation in one country can benefit indirectly from treaties entered into by that country. The significance of this depends upon the combination of the treaty rules, the domestic tax laws of the state of incorporation (e.g., the exemption of holding companies from taxation), and the tax rules of the shareholder's country of residence.

Two questions appear to be involved:

a. What verification arrangements should be employed (and who has the responsibility) to see that persons claiming treaty benefits (such as reduced withholding) are in fact residents of the other contracting state, and

b. What rules should be applicable to investments by corporate investors having shareholders from third countries?

- *Is a refund system for withholding taxes desirable or practicable?*
- *Are rules that require withholding agents to have information concerning the identity of shareholders of foreign corporations or the activities of such corporations desirable or practicable?*
- *What is the role of a "sham" doctrine in this area? What recognition should be given to treaty country corporations (see Rev. Rulings 75-23, 79-65)?*
- *Do these problems primarily arise from having treaties with countries that have or introduce "tax haven" type provisions in their domestic law? What should be done about such treaties? About investment already undertaken in reliance upon the treaty provisions?*

C. Overall policy

Can we make any general statement as to what U.S. objectives should be in changing U.S. tax rules by treaty to affect the taxation of non-resident aliens and foreign corporations under federal law?

D. State law

Should U.S. tax treaties, as a matter of policy, apply to state income taxes?

II. POLICY ISSUES WITH RESPECT TO TREATIES CHANGING U.S. TAX RULES APPLICABLE TO UNITED STATES CITIZENS AND RESIDENTS

Background: Pending U.K. treaty; Pending Israel treaty; Pending French protocol

A unique but standard provision of U.S. tax treaties, the "saving clause", states, in effect, that, with certain specific exceptions, nothing contained in the treaty shall affect the application of U.S. statutory tax rules to U.S. citizens and residents. The one major exception is that the U.S. will provide the principle of a foreign tax credit for the treaty partner's taxes that are specified in the treaty. This is basically a guaranty of a principle unilaterally provided in the Internal Revenue Code.

In considering the appropriateness of the saving clause policy (and the foreign tax credit and other possible exceptions) it appears to be useful to distinguish between different situations:

1) The first case is where a modification of U.S. statutory law by the treaty would result in an aggregate reduction or elimination of both foreign and U.S. tax for the taxpayer. This would be true of "tax sparing" and other incentive provisions, which can be discussed as a policy issue under the topic of negotiations with developing countries.

2) A second situation is that in which there would be a residual right of U.S. taxation (after a credit for the foreign country's tax) and the U.S. is being asked to cede tax jurisdiction in the first instance to the other country, as for example, by accepting a treaty source rule or a characterization of the income from an activity that differs from U.S. law.

3) An additional example of treaty coverage of current importance is the use of a treaty definition of a creditable foreign tax to treat certain foreign taxes as income taxes where their status is arguably unclear or even where the tax does not meet the technical interpretation of an income tax that is being applied administratively.

Questions:

- *In what cases is it appropriate to modify U.S. statutory law? Are there any guidelines to use?*
- *What should be the relationship of such changes in bilateral treaties to other parts of the Code, e.g., the overall tax credit limitation.*

III. TREATIES WITH COUNTRIES HAVING INTEGRATED TAX SYSTEMS

Background: Ault, "International Issues in Corporate Tax Integration", 10 Law and Policy In International Business (1978); Pending U.S./U.K. Income Tax Convention.

The standard U.S. and OECD treaty rules on taxation of income at the corporate level and upon distribution of dividends is based upon a so-called "classic" system under which income tax is imposed separately at the corporate level and again at the shareholder level. A recent development in the tax rules of a number of countries is the adoption of varying forms of corporate/shareholder integration. Such rules are now in place in Canada, Denmark, France, Germany, Italy and the U.K.

While the details vary, a common theme is that domestic shareholders are entitled to credits (and sometimes refunds) on dividend distributions from domestic corporations. These provisions thus reduce tax on domestic investment by domestic investors (compared to foreign investment by such investors) and they tend to restrict the granting of credits (or refunds) that are given in the case of distribution of dividends by companies solely to domestic investors, or to extend such refunds to only those foreign investors who qualify as portfolio investors.

In order to avoid distortions within the common

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economic union, the Commission of the European Economic Community in 1975 proposed in a draft directive that all investors resident in EEC countries investing within the EEC be entitled to the flow-through of these benefits within the community.[2] The U.S. has taken the position that countries adopting tax integration rules should extend tax reductions or credits that they give to domestic investors to U.S. portfolio and direct and investors in treaty negotiations.

- *It is proposed that the panel discuss the appropriate U.S. treaty policy with respect to such tax systems, including suggestions for implementing U.S. policy if foreign concessions are advocated. Related questions include the following:*
- *What is the U.S. interest? What is the conceptual basis for seeking such concessions, e.g., non-discrimination, unreasonably high withholding rates?*
- *To what extent would the result of extending integration rules to non-residents be a transfer of revenues between Treasuries or a benefit flowing to U.S. investors?*
- *Do different variations in the foreign systems (compare Canada which does require funding of its shareholder credit and does not give a refund, with the U.K. or Germany) suggest that different treaty approaches are appropriate?*
- *What are the implications for the tradition of reciprocal withholding rates?*

2. See the Special Issue of EUROPEAN TAXATION on the harmonisation of systems of company taxation and of withholding taxes on dividends (Nos. 2-4, 1976).

IV. TAX TREATIES WITH DEVELOPING COUNTRIES

Background: Surrey, "United National Group of Experts and The Guidelines for Tax Treaties Between Developed and Developing Countries", 19 *Harv. Int'l Law Journal* (1978).

Apart from the extension of prior U.S. treaties with former colonial powers to their former colonies, the U.S. has only a handful of income tax treaties in force with developing countries. It is proposed that the panel discuss the U.S. negotiating situation.

- *Why do we want treaties with developing countries?*
- *What is the interest of the developing countries?*
- *What are our differences?*
  A. The tax incentive issue: Is it an appropriate time to re-examine the question of incentives as a part of U.S. economic policy (tax sparing, investment credit, other proposals)?
  B. What are the substantive treaty rules that separate the U.S. and Developing countries and can we find solutions? In this connection, it would be useful to outline the work of the UN Group of Experts on the topic of Treaties Between Developed and Developing Countries.
- *Increased source jurisdiction*
- *Taxation of services*
- *Problems relating to the allowances of deductions*
- *Discriminatory tax rules*
- *Soak-up taxes*

PART II
Proceedings of the Technical Session of March 15, 1979*

Mr. Tom Jenks, chairman of the Washington Regional Branch of IFA welcomes the participants to the third annual national meeting of the USA branch of IFA.
The first speaker, Marianne Burge of Price Waterhouse and Company, brings the meeting up to date on the status of treaty negotiations.

STATUS OF TAX TREATY NEGOTIATIONS

Marianne Burge

Monitoring the status of tax treaty negotiations seems to be like trying to get a firm hold on a amoeba, it always seems to slip out of your grasp. I have tried to prepare a list of the current status of our treaties, as of February 28, 1979, [Attached as Appendix to these Proceedings] but it is probably more prudent to describe it as a discussion draft since I am sure that before the meeting is over representatives from the Treasury will have pointed out that I am not up to date on all items. But al least we will have an update as of March 15 by the time we leave the meeting.

In June, 1977, the USA branch of IFA set up the Tax Treaties Committee under the chairmanship of Bob Patrick. The first duty the committee undertook was to prepare periodic reports for U.S. IFA members on the current status of U.S. treaty negotiations. Since that time the Treasury has introduced a very welcome procedure of holding public meetings on treaties which are in an advanced stage of negotiation. Bob and I have attended each of those meetings to date and have reported on the issues discussed in considerable detail. Since June, 1977 we have prepared and distributed to the [IFA] members three reports:

1. The first report covered the six months through December, 1977.
2. The second report covered January through August 1978.
3. The third report, covering the last four months of 1979, was recently mailed to the members with the U.S.A. Branch President's 1978 report.

The first two reports were published in Tax Management International, in their issues of April and October, 1978 and the current report will also be published by them. So far, each of these reports has contained a detailed discussion of issues and trends in important treaty negotiations. They are intended to provide a record for anyone who is trying to keep track of developments in U.S. treaty negotiations. Here are some of the highlights of the first three reports.

* Reporter, Michael Mulroney, Lee, Toomey & Kent, Washington, D.C. This paper is taken from a recording of the proceedings as edited by the Reporter and by the participants. The commercial organization which taped the proceedings failed to record all participants' remarks. Where gaps in the tape occurred the participants have been gracious enough to supplement their remarks.

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1. Six months through December, 1977

The first report for 1977 covered the release of the U.S. model conventions for income tax and estate tax treaties. They represent the basic U.S. treaty negotiating positions in general terms. We also reported that the last four treaties ratified by the United States were those with Iceland and Russia in 1975 and Poland and Rumania in 1976. No treaties were ratified in 1977 or 1978. The recent record suggests that Eastern bloc countries have a better chance of concluding treaties with us than with other countries. In any event, in spite of the very active efforts of the U.S. Treasury team, we seem to be far behind other OECD countries, such as France and Sweden, in the number of treaties that we have been able to ratify and have in force, in particular modern treaties dealing with current international tax conditions.

In the first report we also reported on the July, 1977, Senate Foreign Relations Committee public hearings to consider the treaties which had been signed with the U.K., Korea and the Philippines. The report contains a discussion of the issues raised at the hearing. As regards the discussion of the U.K. treaty, Senator Church raised the question of the inclusion of the U.K. Petroleum Revenue Tax ("PRT") as a creditable income tax, and asked the Internal Revenue Service Commissioner Kurtz when the Service would complete its review of the Revenue Rulings dealing with the creditability of OPEC country taxes. As we all know, Commissioner Kurtz heeded this admonition and issued numerous rulings in 1978 revising the interpretations of what is considered as income tax.

We also reported at length on the state taxation issue contained in Article 9(4) of the U.K. treaty. The testimony in favor of the new treaty approach to state taxation was most pursuasive. Nevertheless, as you all know, and as we reported in our August 31, 1978 report, the Senate ratified the U.K. treaty on June 27, 1978 subject to a reservation on Article 9(4). As a result, the U.K. treaty, which had previously appeared in our status summary as signed and awaiting ratification is now back in the list of treaties in process of negotiation. I will be discussing portions of that treaty in a little more detail in a moment.

The 1977 report also contains a list of treaties in force, a short bibliography, and an analysis of recent Revenue Rulings.

2. Eight months through August, 1978

The August, 1978 report is of particular interest because in it we reported on the first two Treasury briefings on treaty negotiations with Italy and Jamaica. Since there are no official transcripts or published records of the discussion, the IFA reports are the only available record of the proceedings. Some other organization such as Tax Executives Institute may also be reporting to some of their members on some of the meetings.

3. Four months through December, 1978

Our third report, covering the last four months of 1978, refers to the treaty negotiations with Denmark and Canada. The meeting on Canada was the best attended to date and included several visitors from Canada. That report also contains the November 3, 1978, Treasury Release on the current status of treaty negotiations giving dates when negotiating meetings were held or are expected to be held. It also contains news of two estate tax treaties which have been signed, one with the U.K., one with France. It also contains reference to the first of a new breed of agreements which are not described as treaties — the Social Security Totalization agreements with Italy and Germany.

I will now discuss briefly the status of some of the more important treaties which are now under negotiation.

United Kingdom

The most important one which we have been watching for some years now is the 1975 Protocol for the U.K. treaty. Unfortunately, the attempt to deal with the state unitary tax systems through the treaty mechanism has had the result of bringing this treaty into the limelight where it has become a political concern on both sides of the Atlantic. Since then some people have observed that it has taken only one dissenting voice on one issue to prevent the ratification of the treaty which is acceptable in other respects. For example, the delay in the treaties with Korea, the Philippines, Egypt and Israel, all of which were submitted to the Senate Foreign Relations Committee in July of 1977 and none of which have proceeded to ratification.

British industry concerned about U.S. State unitary taxation and resulting information disclosure

The present status of the UK treaty is that the U.S. Senate ratified it subject to a reservation on Article 9(4), in order to provide the same income base for both state and federal income tax purposes for U.K.-owned subsidiaries in the U.S. This action has resulted in the negotiations of a third protocol: first, to delete the provisions of the Article 9(4) provision, and second, to meet U.K. requests for concessions to compensate them for the loss of the unitary provisions. Thus, forced into the limelight, the treaty has met with considerable opposition in the U.K. in British industry expressing itself through the Confederation of British Industries, and in Parliament.

It seems that the U.K. has placed a much greater emphasis and importance than we could predict on the unitary issue as it affects British subsidiaries in the U.S. I think U.K. companies are particularly concerned about information disclosure. U.K. companies also fear that the unitary concepts may spread to other states or become a general factor hindering U.K.-owned firms in competing in U.S. markets.

Equally important, however, many U.K. businessmen are opposed to the granting of a refund of one half of the U.K. Advance Corporation Tax, ("ACT") to U.S. parent companies. They perceive this as giving U.S.-owned firms in the U.K. a tax advantage over U.K.-owned firms.

Another growing practical problem for the U.K. is that of the retroactivity of the U.K. refund of the ACT that would apply to U.K. subsidiaries' dividends paid since April, 1975. This problem gets worse as each year passes. Questions have been asked by Members of Parliament as to how much that refund would be. It is obviously going to be very difficult for the British Parliament to explain why hundreds of millions of pounds in U.K. tax money should be sent to America. Negotiations are now underway and probably at an advanced stage. To give the U.K. an acceptable *quid pro quo* for the loss of the unitary provisions, it seems to me that one of the concessions would affect U.S. service companies operating in the U.K. North Sea Continental Shelf. Under the latest protocol they would be considered to have a permanent establishment if they operate in the North Sea for thirty days or more.

Inclusion of the British Petroleum Revenue Tax as a creditable tax

Another amendment to the protocol was included at the urging of Senator Kennedy who objected in the Senate debates to the inclusion of the PRT as a creditable tax without any limitation. His objection was that this tax which might otherwise not be creditable under the new concepts in Revenue Ruling 78-61, [1978-1 C.B. 221] could result in excess credits which could be offset against other foreign source income. Many people, including some government officials who testified at the 1977 Treaty Hearings, thought that the PRT was a creditable tax even without the aid of the treaty. This notion was challenged when Revenue Ruling 78-424 [1978-2 C.B. 197] was published at the end of 1978 just when the third U.K. protocol was being negotiated. That ruling stated that the PRT is not a creditable income

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tax. The new protocol will contain some limitation on the amount of credit which will be allowed for PRT, limiting the PRT to the U.S. tax on U.K. oil extraction income.

We hope that in spite of these difficulties, the Treasury will resist any pressures to roll forward the date for which the ACT refund is to be given by the British tax authorities since this would cause considerable confusion. The dates of the treaty do, after all, offer considerable benefit to the U.K.

One example is the elimination of Article XV as it affects the U.K. taxation of U.S. banks in the United Kingdom.

Disallowance of British Corporation Tax satisfied by payment of ACT as creditable income tax

There has also been a further development in the U.S. in regard to the U.S. foreign tax credit of the U.K. Act in the absence of the treaty. The Manhattan District Director has announced his intention of disallowing the U.K. corporation tax as a creditable income tax to the extent that it is satisfied by a payment of ACT. That part of the U.K. corporation tax according to the Manhattan District, does not meet the criteria for income tax established in Revenue Ruling 78-61 because the advance payment is not measured by gain but by distributions. This might be considered to put more pressure on interested parties to get the treaty ratified because the treaty would provide for the creditability of the U.K. corporation tax including the advance corporation tax. Nevertheless, I think it would be most regrettable if the creditability of the corporate tax was made entirely dependent on the treaty because there may be technical situations in which the U.S. taxpayer may not be able to have recourse to the treaty — situations which the Treasury has not thought of in advance — and also because of the delays in ratification which are not the fault of U.S. taxpayers who have for some years been faced with great uncertainty on the treatment of this tax. I would refer you to the letter from the U.S. Chamber of Commerce dated November 27, 1978 to Commissioner Kurtz. In this letter the Chamber urged the IRS to announce promptly that it will allow credit for taxes imposed by countries having tax treaties with the United States on the basis that the existence of the tax treaty provides implicit recognition that the income tax the treaty has dealt with is a creditable income tax.

Procedurally, the U.K. treaty is in renegotiation. When a third protocol is signed it has been agreed between the two countries that it will first go to the U.S. Senate for ratification and then to Parliament in the U.K. for ratification. We are therefore to be many months away from ratification. Quite apart from any difficulties which may be encountered in the U.S. Senate, the situation in Britain is that there will be an election sometime between now and the Fall. We cannot but wonder whether the present government will wish to debate this treaty in the last few months before an election in view of the opposition that has been voiced from several of its constituencies.

Other important nuances of the U.S.-U.K. treaty negotiations will be discussed today in the panel discussion which will follow. Let me touch on several interesting points as to other countries.

France

The recently published Protocol to the French treaty seems to be one which may have a good chance of early ratification. This Protocol makes a number of updating changes to the existing treaty. Of particular interest are those provisions which seek to avoid the double taxation of investment income of U.S. citizens resident in France. The French have precipitated the need for this protocol by changing their internal law to make U.S. citizens living in France subject to French tax on their worldwide income. That change was delayed and finally came into effect on January 1, 1979. The new protocol would also exempt U.S. citizens from French tax on remuneration for services while in the United States. This follows to some extent the French territorial concept and also prior practice in France.

Of great interest is the proposed method of avoiding double taxation on U.S. source investment income which would now be subject to worldwide taxation in both countries, with no U.S. foreign tax credit for French taxes on the U.S. source investment income. The treaty provides a complicated technique whereby the U.S. will collect a tax of 15 percent on the U.S. dividends, which is the same rate of tax the U.S. would collect from French residents. The French will allow a credit for the 15 percent U.S. tax against the French tax and the U.S. will then allow a credit for French tax on the U.S. dividend, by converting the source of the dividend to foreign source. This is called the *triple bite approach* and it seems to me that this will form the basis for dealing with this problem in other treaties, such as Canada and Denmark.

Canada

The treaty with Canada is under active negotiation but there seems to be no specific timetable for completion. There are many issues to be resolved which result from the two countries' close relations and geographical proximity The treatment of Canadian dividends is one serious difficulty. The U.S. would like to see a lower withholding rate than the present 15 percent Canadian rate under the present treaty. The treaty discussions also have to deal with the problems of capital gains taxation for individuals. Canadian rules on taxing departing aliens on unrealized gain and the U.S. rules of taxing them on realized gain can result in timing differences and in double taxation. Agreement on these issues does not seem to be imminent, and possibly the present treaty is basically viewed as adequate by the two governments for the time being.

Germany

Negotiations with Germany are still at the stage of dealing with the basic issues of German taxation of dividends paid to U.S. parent companies, and the question of discrimination against U.S. shareholders as inherent in the German imputation system. Requests for comments from U.S. taxpayers have been sought by the Treasury. So far, there are insufficient negotiations to warrant public meetings.

Italy

Negotiations on the Italian treaty seem to be moving at a steady but not frantic pace. The issues there include the treatment of Italy's imputation system, the problem of dual corporate residence (as discussed in our August, 1978 report) which the Treasury proposes to deal with on an "80-20 company" approach.[1] New source rules with respect to royalties are also the subject of discussion of this treaty, reflecting the new interest in the U.S. source rules in general. The problem of Italian local taxes seems to be aggravated by the fact that we cannot include our U.S. state taxes as taxes covered in our treaties. A new treaty does not seem to be imminent.

Jamaica

There are some negotiations with developing countries. The Treasury briefings on Jamaica are of interest because they represent some of the U.S. tentative concessions to developing countries, short of tax sparing. The principal innovations are to be found in connection with the permanent establishment rules. These are similar to those found in treaties with Korea and the Philippines. The main thrust seems to be to permit the developing country to tax U.S. taxpayers on a net income basis on projects in the country for a certain length of time. The U.S. seeks the benefit of taxation on the net income basis as opposed to a withholding tax on gross income. This will be of importance to U.S.

1. *Bulletin* Editor's note: This would mean that if a corporation would receive 80 percent or more of its gross income from sources within Italy, it would be deemed to be a resident of Italy for tax treaty purposes. Otherwise, it would be deemed to be a U.S. resident under the treaty.

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taxpayers if the IRS does not withdraw its ruling on the creditability of the Tanzanian withholding tax on management service fees. See Rev. Rul. 78-234, 1978-1 C.B. 237.[2]

Many developing countries impose heavy withholding taxes on management service fees. While the negotiations are well under way in this treaty, I think it is impractical to believe that treaties with developing countries are the way to resolve foreign tax credit problems which arise from the concept of the Tanzanian ruling, given any practical forecast of the speed with which we will conclude treaties with developing countries.

Argentina and Nigeria

Negotiations have commenced with Argentina and there are to be discussions with Nigeria, which terminated its treaty with us earlier this year.

Eastern bloc

The Eastern bloc continues to do well. We have recently seen the publication of a treaty signed with Hungary.[3]

Estate tax treaties

Two estate tax treaties have been signed recently, one with France, which has been submitted to the Senate, and one with the U.K. which may be submitted shortly. These treaties are receiving insufficient attention and they may have some serious deficiencies. Without public discussion, the U.S. seems to be abandoning its policy of taxing its U.S. citizens on the basis of citizenship with a credit for foreign estate tax on foreign situs property. The new treaty with the U.K. adopts the domicile approach, which the U.S. government always stated to be unsatisfactory as a basis of taxation because we do not know what domicile means from a federal standpoint or even from a state tax standpoint. The estate tax treaties seem to be concerned only with avoiding estate taxation of business excutives dying in a foreign country while on a foreign assignment. Little consideration seems to be given to U.S. private citizens living in those countries for other than business purposes.

Totalization agreements

Finally, I would like to mention the new breed of agreements which technically are not treaties and which are being concluded by the Social Security Administration: the *Totalization agreements*. These agreements deal with the contributions and benefits for employees working in several countries in the course of their careers. The agreements try to avoid the costs of double coverage and the loss of pension benefits through mechanisms which involve electing out of individual coverage where dual coverage arises and the aggregation or "totalization" of working time in more than one country in computing pension benefits. This is an area which bears watching because it does not come to your attention through the normal tax treaty channels.

Totalization agreements with Italy went into effect in November, 1978, and an agreement with Germany has been submitted to Congress for ratification. Fortunately the ratification procedures do not require affirmative action by Congress. The agreement must be submitted to Congress for ninety days while it is in session and during this period unless either House adopts the resolution to disapprove the agreement it takes effect. The taxation of benefits continues to be covered by the tax treaty.

Foreign social security taxes which are covered by a totalization agreement will not be creditable for U.S. tax purposes.

PANEL DISCUSSION

Jenks. Thank you very much, Marianne, for that excellent analysis of the current treaty status. I was particularly interested in the discussion of the U.S.-U.K. treaty which seems to be in serious trouble on both sides of the ocean.

At this time I would like to turn the podium over to *Bob Patrick*, formerly International Tax Counsel, now with Exxon, who will lead the discussion of current tax treaty policy issues.

Patrick. Thank you Tom. I think that we are fortunate in having here today a number of people with backgrounds and interests in the U.S. tax system and tax structure. Those that are participating on the panel this morning are *Daniel Lundy*, Tax Director IT&T, *David Brockway*, International Tax Counsel of the Staff of the Joint Committee on Revenue Taxation, *David Rosenbloom*, International Tax Counsel of The Treasury, *Professor Stanley Surrey* of Harvard Law School, *Leif Muten* of the Fiscal Affairs Department of the International Monetary Fund, and *Hugh Ault*, Professor of Law at Boston College Law School.

Fundamentals of U.S. income tax treaty policy neglected

Compared to many areas of U.S. tax law there has been relatively little discussion, or at least limited public discussion, of the fundamentals of U.S. income tax treaty policy. It was for this reason that the United States Branch of the International Fiscal Association organized a committee on tax treaties two years ago, and it is the reason that U.S. income tax treaty policy is the theme of this year's national meeting. We are devoting the technical portion of our program to the exploration of certain income tax treaty policy issues. One of the criticisms has been that U.S. tax treaties in recent years have attempted to do too much, therefore have become controversial and so have contributed to the problem of obtaining Senate consent to ratification or, indeed, have impeded the actual negotiating process with foreign countries because of what was being demanded by the U.S. negotiators. On the other hand, it has been argued that the one reason the United States has so few treaties compared to a number of developed countries, and so few treaties particularly with developing countries, is because United States treaties typically do very little with respect to changing U.S. taxation of United States taxpayers, and as a result there is no substantial reason to enter into treaties with the United States. Thus, an important aspect of our inquiry here is what it is that our treaties should be attempting to do. Obviously, concern is expressed increasingly about the treaty negotiating and ratification process with the delays Marianne Burge referred to earlier. The process of negotiation and ratification, and the input that goes into the U.S. tax treaties, will be discussed later by *David Milton's* group. David is a member of our U.S.A. Branch tax treaty committee who has been giving particular thought to the treaty processes.

Underlying purpose of U.S. tax treaties

Now, United States tax treaties themselves are of course built on the precedent of previously negotiated treaties and increasingly upon the OECD model convention including the revised version of that model in 1977. I think one also detects in negotiated treaties with developing countries the increased influence of the U.N. group of experts on treaties with developing countries. The work of U.N. group in particular will be discussed later this morning. I would like at the outset to give a description of what is a possible way of looking at the purpose, the coverage and

2. *Bulletin* Editor's note: This Ruling provides that the Tanzanian withholding tax on the gross amount of management or professional fees received by non-residents is not the substantial equivalent of a withholding tax and is therefore not creditable under section 901 of the Code. Such taxes imposed on the gross amount of dividends, interest and royalties received by non-residents, however, do qualify as creditable income taxes.

3. *Bulletin* Editor's note: See for a discussion of this treaty Edward J. Leahy: An analysis of the new Hungary-United States tax treaty in 19 EUROPEAN TAXATION 325 (1979).

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the intent of the U.S. tax treaties. I think the generally accepted underlying purpose of the treaties is to contribute to the freedom of the flow of goods, capital, technology and personnel across national boundaries and to do so by reducing substantive and procedural tax burdens principally through the elimination of double taxation, by harmonizing tax rules, by providing a mechanism for resolving tax disputes and by authorizing national tax administrations to cooperate with each other in administering and enforcing their internal tax laws.

The United States Model Treaty

The United States model treaty, which is used as a basis for starting negotiations with foreign governments, seeks to meet those rather broad goals by providing rules on such questions as the right of a country to impose tax on the basis of the connection of the taxpayer, property, or activities in the taxing country and the determination of allocable income and deductions to ascertain taxable net income. In the case of certain withholding taxes, limitations on the rate of tax are imposed which reflect a balance of considerations between the treaty partners, including revenue flows. The model further provides a tax credit mechanism for avoiding double taxation of the same income, requires non-discriminatory tax treatment for treaty partners, and provides machinery for cooperation between tax administrations to resolve tax disputes and to exchange information and enforce compliance with domestic and treaty rules. Now these general objectives and principles incorporated in the treaties subsume a great many policy decisions and cut across a great many internal rules in attempting to harmonize or accommodate the laws of two countries. Part of our focus this morning will be to talk about some of this interaction.

While the United States has unilaterally through its tax credit mechanism adopted rules to relieve double taxation and accommodate foreign tax systems to U.S. rules, it is virtually impossible to encompass all of the detailed problems and the differences which may arise between the tax laws of two countries. I think the protocol recently signed with France illustrates the difficulty in attempting to resolve a number of double taxation problems solely through statutory provisions. One of the themes of our discussion this morning should be when, if ever, it is appropriate to modify United States tax laws by treaty, and what is the proper approach when one is seeking modification to accommodate the internal tax rules of another country. It is clear that we need some basic policy guidelines as to what our treaties should be accomplishing. Fortunately, the Treasury has been encouraging an examination of policy in this area.

Aspect of U.S. tax policy for treaties

This portion of the technical session will concentrate on four aspects of U.S. tax policy for treaties. *First*, the treaty rules affecting U.S. laws on the taxation of nonresident aliens and foreign corporations; *second*, those treaty rules that affect United States taxation of United States citizens and residents, *third*, issues in the negotiation of tax treaties with countries having integrated tax systems; and, *finally*, current issues which arise in negotiations with developing countries.

U.S. taxation of foreign investors

The first of these categories, which is really a question of the development of U.S. tax policy with respect to U.S. taxation of foreign investors, also gives us the opportunity to review to some extent the structure of tax treaties and the types of substantive rules that are applicable in determining when a country has a right to tax and under what conditions. My own comment on each of these subjects hopefully will be fodder for comment by our panelists.

I think that United States policy in treaties with respect to the taxation of foreign investors or foreign persons doing business in the United States has tended to grow out of a principal focus by the United States on U.S. business or individual U.S. investors investing or operating abroad. As the historical pattern has developed, the treaty rules which were looked at had to do with when Americans should be taxed abroad, what sort of permanent establishment limitation do we want to have foreign countries apply to Americans, what sort of withholding rates do we want to have on income received by American investors, and, only in turn, through a general notion of reciprocity, have we asked what rules the United States should adopt on its side with respect to taxing foreign investors in the United States. I suggest that the orientation has been to look primarily at these rules in terms of their effect on U.S. investors abroad. This should also be put in some general context today as to what United States policy is toward foreign investment in the United States and how that is reflected in United States tax treaty considerations. Historically, we had the major change in U.S. domestic tax rules in the 1966 Foreign Investors Tax Act which in large part was intended to facilitate foreign investment in the United States. There have also been efforts in subsequent years to eliminate U.S. withholding taxes on the investment income of foreign investors and other activities to stimulate foreign investments in the United States. I asked *David* [*Rosenbloom*] if he could comment today on how the Treasury perceives U.S. tax policy with respect to foreign investment, and how that might be reflected as a general policy matter in any given treaty.

Internal Revenue Code and U.S. tax treaties are in need of harmonization

Rosenbloom. You said tax policy. I think the first point to make in regard to United States law in that regard is that the Code and our treaties are badly in need of harmonization. We use an entirely different language in a treaty than we use in the Code, a language which we have inherited from, in large part, either prior treaties or the OECD. Many of the words that are determinative under the treaties are not found in the Code and the treaty concepts have grown up as a kind of a parallel body of law.

Our basic approach to foreign investors in the U.S. is to paint in the Code on a very broad canvas, to cast our net extremely wide without any effort (with the exception of the section 864 rules) to fine tune the system. We then tend to carve away from that broad assertion of jurisdiction in individualized treaty arrangements, treaty bargains. Thus, I assume, when you speak of tax policy, what you are really asking is what policies are we following in the treaty negotiating process. There is, incidentally, work to be done in the Code, both in putting the Code and the treaties into something of a more parallel track, and in reviewing the 1966 Act — which in some respects is to say the least, a little peculiar.

In the treaties I think you are quite right, *Bob* [*Patrick*], the inherited view — and probably the still prevailing view — is to approach negotiations with most countries, (there are one or two fairly insignificant exceptions) with the background knowledge that there is greater outflow of U.S. investment to that country than inflow from that country. But I think that our policies would not be significantly reversed if the shoe were on the other foot, at least insofar as the relationship with most developed countries is concerned. We would still, as a matter of general tax and treaty policy, not want to assert source basis of taxation to the full extent that our Code allows. We have too many problems areas; after all, the residence country is ultimately in the better position to tax its own residents than the source country.

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Saving clause in U.S. tax treaties

Patrick. Let's shift gears a bit and talk about another aspect of U.S. treaty policy that is of increased importance in view of the general concern over foreign tax credit interpretations. That is, not the taxation of foreigners investing in the U.S., but rather to what extent the United States in its treaties should be modifying United States tax rules concerning the taxation of U.S. citizens and corporations. As you all know in our tax treaties we have a very standard provision, basically unique to the United States, which says that notwithstanding any of the provisions of the treaty, United States citizens, residents, and corporations will be taxed as if the treaty had not come into effect: we will simply apply our domestic law and tax United States citizens under this saving clause with some limited modifications for foreigners who are resident in the U.S. Our treaties do contain a limited exception to the saving clause that, in effect, guarantees at least the principle of a foreign tax credit for the United States citizens and residents with respect to the foreign income taxes covered by the treaty. That exception stands as a guarantee to the other treaty partner that, for those taxes considered income taxes in the treaty, the U.S. will give a foreign tax credit, substantially in the form or method which is applied from time to time in the Code. Whether it be per country or overall limitation or other procedural limitations, in any event the principle will be maintained. It seems that in considering the appropriateness of the saving clause policy, it is useful to distinguish several different situations.

The *first* case might be a modification of U.S. law applicable to U.S. citizens and residents when it results in an aggregate reduction or elimination of both foreign tax and U.S. tax. Tax sparing would probably be the best example of that, which we will talk about a little later when we get to treaties with developing countries. That is one type of case where U.S. law could be affected by effectively eliminating taxation for U.S. citizens.

The *second* situation is one in which the U.S. retains a residual right of taxation, after a credit for foreign taxes, but the U.S. in its negotiations with the foreign country is being asked in the first instance to cede tax jurisdiction to the foreign country. This would arise, for example, where they want a change from what would be our statutory source rule to give them a right to tax in the first instance, and the correlative of that taxation right would be that the U.S. would give a foreign tax credit for their tax on what is now U.S. income but would become foreign source income from that country. In this example, we are still modifying the application of U.S. tax laws to United States citizens, but it could be characterized as a determination of which country has the initial right of taxation and which has the residual right of taxation under a foreign tax credit system. We have seen previously some rulings on this dealing with the Belgian treaty, the Japanese treaty in a case involving U.S. crew members on Japanese aircraft, in which those treaties are interpreted as changing the source rules to provide a foreign tax credit for foreign taxes on what, under the Code would be U.S. source income. But in those cases it is then treated as income from the treaty country and they tax it and then the U.S. gives the credit. Similarly, as Marianne Burge explained, in relation to the protocol to the French treaty, efforts are now being made to deal with the situation of U.S. citizens residing in a foreign country that taxes on a residence basis and who receive income from U.S. sources, thus creating a very difficult foreign tax credit issue as to who taxes the income first and who gives a credit.

Now, a *third* example of treaty coverage affecting the U.S. taxation of U.S. persons that is of current importance is the question of what is a creditable income tax. Perhaps the most notable recent case is the U.K. treaty where you have both Petroleum Revenue Tax and the Advanced Corporation Tax as taxes covered under the treaty. Most people seem to agree that where there is a reasonable doubt about whether or not a particular tax is creditable, it is a proper function of a tax treaty to clarify the status of the tax. And you could have something like the provision in the Israeli treaty which treats forced loans for the period of time that they are outstanding as if they were taxes subject to being treated as a refund of tax, when and if these loans are repaid to the U.S. investor, even though contrary to previously published rulings on that type of loan, and would not be considered a creditable income tax in the absence of the treaty.

The question I would raise for the panel is *in what cases is it appropriate to modify U.S. statutory law affecting the taxes of U.S. citizens and residents?* Are there guidelines to use in this context? I think we have just seen some indication of Treasury's thinking on this in Assistant Secretary *Lubick's* testimony for [Congressman] *Rosenthal's* subcommittee two days ago in which there was some discussion in the context of oil tax credits as to the appropriateness and inappropriateness of the use of treaties to deal with the foreign credit provision. Perhaps during our discussion *David Rosenbloom* might want to summarize generally the sentiment expressed there.

May we have some comments, first, on whether there is a consensus on the panel that the types of situations described — at least the one of changing source rules — is appropriate, and second is the use of treaties for providing for the creditability of foreign taxes an appropriate and acceptable use of the treaty process?

Ault. The first one I think is easy. It seems to me it is perfectly consistent with the purposes of tax treaties. The situation is one in which double taxation would literally arise if there is not some fine tuning of the two jurisdictions. It comes out of the negotiation process in which we are not changing our domestic source rule but fitting it together unilaterally with somebody else's source rule given the fact that the source rules are not written in stone someplace. It seems to me the Japanese rule is perfectly consistent with our treaty policy and acts to fit the edges of the two systems to avoid double taxation in this particular situation.

German pension costs

Lundy. I am thinking of the situation involving German pension costs under which it is extremely difficult to fund German pensions. As a result, German companies have very large accrued but unfunded pension liabilities. They are even preferred liabilities; they are the strongest liabilities the Germany company has. When a U.S. company receives a dividend from this German subsidiary the IRS takes the position that the earnings and profits in the section 902 computations have to be made by treating those German pension costs as not being a proper charge against earnings and profits. As a result the credit can be diluted. Assume this is not a proper charge against earnings and profits, which I don't concede in any way. But even if it were, it seems to me the German treaty provisions could be applied here in order to give a credit that would override internal law. The provision in the German treaty calls for giving appropriate credit for German taxes paid. When you receive a dividend from a German company it seems to me in a case like that the treaty could be very fruitfully used to iron out a problem that otherwise creates timing differences and loss of credits where double taxation really wasn't intended.

Muten. I would say that the fact the United States stands practically alone in the world in taxing nonresident citizens would make it a rather national thing for the United States to be more ready to make such concessions than other countries. It would seem that this whole idea of taxing citizens throws a monkey wrench into the machinery, and it is up to those who throw it in to pull it out.

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Ault. I guess I would distinguish between this case and a source rule case. I think I would have a little more hesitation in saying that in the situation in which they have a different principle under which deductions are allowed should be accommodable in the treaty. I would be a little slower to say the treaty negotiation process was appropriate than I would be to say that a different source rule was appropriate which derives purely out of the application of the international aspects of the U.S. system.

Patrick. Would you take that same view with respect to, say, granting a deduction for gifts to charities in the other treaty country?

Ault. I would take the same view, yes.

Patrick. Do you have a way of drawing a line. You may be more cautious. Is it inappropriate?

Ault. I think I would try to distinguish three kinds of situations. One is a situation of international rules and it is the problem of harmonizing those international rules. That I think is the classic case for treaty harmonization. Secondly, where there are problems involving provisions in the countries which are basically determinations of income. Thirdly, since Professor Surrey is here and therefore we cannot get through the morning without saying tax expenditures, there are provisions that involve tax expenditures. In the latter two cases I think I would want to think about how I would be applying my treaty principles.

Surrey. I think I would agree with *Hugh* [*Ault*] in general, but in the source rule aspect as he indicated you are largely dealing with an overload, and the question is — should there be an overload with the two taxes. You are dealing to some extent in creditable taxes, where the line is obviously indistinct. The treaty purpose is to eliminate overload of two income taxes. When you depart from that and say the treaty is to make a concession to reduce really the basic U.S. rule of what is net income I think it is quite a different matter and I would agree with *Hugh* [*Ault*] on that.[4]

Rosenbloom. I guess I believe the treaties can be used for any of the three purposes that have been enunciated, in appropriate circumstances. I think the source rule changes presuppose that fact. Many of our treaties do indeed change United States source rules. That is a lot of water under the bridge. I think the changes are probably correct. If we were not able to change United States source rules in treaties we would have even fewer treaties than we do. I also think that a treaty should — and by this I do not necessarily mean that all U.S. treaties do — guarantee a credit independently of the Code. Now it is one thing to guarantee a credit independently of the Code for another country's taxes which would otherwise be independently creditable, or which the negotiators believe would be independently creditable. It is another thing to take the next step and credit taxes that there are some doubts about. I think that is appropriate under carefully controlled circumstances and I think *Marianne* [*Burge*] said that earlier in her exposition. Incidentally, I noted *Marianne's* [*Burge*] comment that the ruling on the Petroleum Revenue Tax settled the question of whether that tax is creditable. I think that is a very nice view, Marianne, but I do not think it is exactly accurate. Nobody really knows, and we will not know for many many years on some of these very difficult credit questions, what is creditable and what is not creditable. I think there are plenty of grey areas. At the same time, I think there are also things that we know are not creditable.

I would hesitate a long time before agreeing to credit an economically important type of payment that I felt, really flat out, did not have a chance of being a creditable income tax for United States purposes. On *Dan Lundy's* point, I think that too is probably something that can be discussed in a treaty context. The question there, really, is whether (and in describing it this way I am giving the German situation every benefit of the doubt) if you have an amount which is accrued on the books of a German subsidiary and which cannot be used under any circumstances to pay dividends to the United States parent, but for one reason or another the item does not meet United States rules for deductibility because, for example, it is a pension which does not qualify under ERISA, should the United States in order to avoid dilution of the credit recognize not that income is reduced — that's different — but that earnings and profits are reduced by that amount. That amount — remember my assumption of it not being able to be used for dividends — will never be available to reduce your earnings and profits to zero, so you will always have less than one hundred percent of the credit available. I think that is a legitimate treaty issue. But I diverge sharply from *Dan* [*Lundy*] if he is suggesting that one could find a resolution of that issue in any United States treaty as it presently exists, with the possible exception of the newly negotiated treaty with Denmark.

Patrick. Thank you. I am going to raise one more question before we take a break, and then turn to two major topics of interest: treaties with countries with integrated tax systems and treaties with developing countries. I would like to ask *David* [*Rosenbloom*] just one more question. It is part of our first topic of taxing foreigners in the United States and should be mentioned at least briefly here because it has been such a keen treaty issue for the last couple of years in connection with the U.K. treaty considerations. That is whether U.S. tax treaties affect taxation by the states of the United States and what I would simply ask *David* [*Rosenbloom*] at this point:
One, what is the U.S. negotiating position when faced with a request by foreign countries that U.S. state taxes are covered by our treaties; and,
Two, if he would give some suggestion as to how he sees the fact that the decision of the Senate on this issue has affected U.S. treaty negotiations with other countries.

Can tax treaties affect U.S. state taxes?

Rosenbloom. I think we all know the history of the United Kingdom treaty dealing with U.S. state taxation. It was clear, at least at the time of the Senate vote, that a two-thirds majority could not be mustered for a treaty that would bind the states even to the relatively minimal extent of Article 9 (4). I think we assume that continues to be the case; and if anything, Congressional sentiment is perhaps a little bit stronger today than it was then. Since we like to negotiate treaties that we have some chance of getting ratified we are not presently including any general provision covering U.S. state taxation in our treaties. That notwithstanding, the case for allowing the individual states to experiment with foreign taxation is extremely weak. My personal view is that tax treaties are really every bit as much an instrument of foreign policy as they are of taxation. It seems to me that the states are recognized to have very little legitimate role in the foreign policy areas. It is only when the word "tax" appears in the caption that everybody gets excited. I like to believe that the right long-range answer is for the United States to cover state taxes generally in its tax treaties, particularly since we regularly insist that any country that has significant state taxes cover its own state taxes on its side, since our state taxes are usually by no means as substantial as theirs. But it is not in the cards immediately. I do not exclude it in the long run.

* * *

4. At this point in the proceedings the tape failed to pick up additional remarks by Professor Surrey. In general, those comments paralleled several that were contained in his article, "United Nations Group of Experts and the Guidelines for Tax Treaties between Developed and Developing Countries", 19 Harvard International Law Journal pp. 1-70 (1978). The essence of this article also appears in PUBLICATIONS OF THE INTERNATIONAL BUREAU OF FISCAL DOCUMENTATION No 25: THE EXCHANGE OF INFORMATION UNDER TAX TREATIES at 34 (1978).

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Patrick. Next, let us try to divide the world up into a couple of major problems geographically for our treaty negotiations. I think it is fair to say that the major issue today with negotiations with developed countries is basically the question of the interaction of our tax system and our tax treaty rules with countries having integrated corporate — shareholder tax systems. I refer everyone to *Hugh Ault's* article for examples on some of the international issues in corporate tax integration in the volume of Law and Policy in International Business in 1978 that was dedicated to Nate Gordon.[5] I have asked *Hugh* [*Ault*] today if he would introduce this topic for our discussion and then we will let the panel comment on what they perceive as the relevant considerations and issues; what U.S. policy has been in this area; and, indeed, what it should be. Hugh.

5. Hugh Ault, International Issues in Corporate Tax Integration, 10 Law and Policy in International Business 401 (1978).

INTERACTION OF THE U.S. TAX SYSTEM AND U.S. TAX TREATY RULES WITH FOREIGN INTEGRATED CORPORATE-SHAREHOLDER TAX SYSTEMS

Hugh Ault

With an audience like this I am assuming you all are generally familiar with the integration systems as such and also are in general familiar with the problems that we are going to be talking about. I think it would be useful to give a little background about exactly how the problems arise and what are the arguments. Basically, the treaty questions in the integration context arise because all of the integration systems in their internal structure do not grant the imputation credit to foreign shareholders. Having finally to grant the credit as a matter of domestic law, the issue then moves to the treaty level which is our principal concern today.

I think discussions can really be divided into two parts. First, questions of theology, and second, questions of applied religion. I think maybe you can understand the applied religion better if you get the theology first.

Basic principles of corporate-shareholder tax integration

If you look at the integration countries their theological principles are something like this: The first commandment is that the integration system operates entirely at the shareholder level. At the corporate level all corporations, as such, are taxed the same regardless of the nationality of their shareholders. At the shareholder level where the integration system operates it is appropriate to distinguish between shareholders who are subject to worldwide taxation and shareholders who are not subject to worldwide taxation. And therefore it is appropriate to grant the credit to worldwide tax shareholders and inappropriate to grant the credit to foreign shareholders. This failure to grant the credit to foreign shareholders is not a matter of discrimination because everything is operating at the shareholder level rather than at the corporate level, and there are legitimate distinctions between foreign and domestic shareholders.

Now, assuming that some heresy creeps in and you are going to grant some credit to foreign shareholders, the second integration commandment is that in any event you will not give the credit to foreign corporate shareholders. There are really two reasons: *one*, granting the credit to corporate shareholders does not have anything to do with the basic idea of integration which is after all to integrate individual and corporate taxes and integration is not appropriate as long as the income is still in the corporate level solution, and *secondly*, the integrationists say that the responsibility for granting relief comes at the point of distribution to individual shareholders and from the country of residency of the corporation that is making the distribution. So when, for example, dividends come from a German company or a U.K. company to a U.S. company under the European view as expressed in the E.E.C. draft model directive it is the responsibility of the U.S., if anyone, to give distribution relief when the ultimate individual shareholders get the distribution.

United States: existing corporate-shareholder tax integration systems are discriminatory

The U.S. sees the world quite differently. We have a different set of ten commandments. Traditionally, the U.S. has argued that the failure to grant the credit was discriminatory and this argument has taken several forms.

Most simply stated it says there is really no corporate tax in an integration system since it is really just a withholding tax on shareholders and therefore it is a withholding tax that violates international withholding norms, Germany's 36 percent, for example.

A somewhat more sophisticated view, I think, is to say that despite its formal structure the integration system does operate at the corporate level. It operates at the corporate level because it gives the corporation the ability to increase the return to shareholders by increasing the level of distribution. This is true whether the system takes the form of a split rate system, in which an increased distribution lowers the corporate rate, or in the case of imputation system in which a dollar of dividend paid allows the corporation in effect to distribute through the government an additional amount of dividends to the shareholders. So, if the imputation system is really seen as operating at the corporate level then it is a discriminatory system and the failure to grant the credit to U.S. shareholders is discrimination.

This principle of U.S. theology is usually joined with a second principle, that is, that withholding tax rates ought to be reciprocal and that because a country has a lower corporate rate than we do is no reason for it to have a higher non-reciprocal withholding rate. Those are the ten commandments, slightly summarized, of integration in the U.S.

Corporate-shareholder tax integration in practice

When we move to the level of applied religion where theological purity has to be tempered with political and economic reality the situation gets a little bit more complicated. There have been two important developments here. One as you all know, France is granting the credit in its treaties to portfolio investors. Also, the U.K. in the U.S.-U.K. treaty which still awaits ratification, granted one half of the distribution relief to direct investors. The U.K. solution works in part because the U.K. had only partially integrated its system; that is, only about half its corporate tax was integrated at the shareholder level. This brings us to the situation with Germany where the process of tempering theology with reality really has not made much progress.

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I think the German situation puts most starkly the conflicting views and concepts as to the integration problem. The Germans, rooted in their view of integration theology and pointing to the fact that U.S. subsidiaries of German corporations pay 46 percent plus a 15 percent withholding tax, refused to consider granting the credit. Indeed, the German Parliament forbade the granting of the credit to foreign shareholders in its enabling legislation. A quite elegant piece of bootstrapping I think. The United States on the other hand, viewing it from our perspective, says that the 36 percent German tax is really a withholding tax. Thus, a comparable German company which distributes all its income has really zero tax and therefore the German controlled company bears a lower rate of tax than the U.S. controlled company. As a result, Germany has in effect financed its integration system by making up the revenue loss by increasing the tax on foreign-owned German companies. Therefore, the credit ought to be granted. I think it is a fair statement of the impasse in the current treaty negotiations.

There are some other factors which further complicate this problem. Whatever the theoretically right answer is I think the U.S. has to ask itself if it wants to encourage portfolio investment in German or other integration country corporations. If Germany is not a real problem, then look to Canada. Do we really want to insist that portfolio shareholders get the imputation credit? On the other hand, with respect to direct investors, it is clear that both the Treasury and the investors have an interest in getting the German rates down to approximately the U.S. rates, since presently Germany is a potential excess credit-generating country. One possibility there would be to go to a zero withholding rate by Germany. Just giving up reciprocity as a principle is a possibility although one that breaches our principle that we are entitled in fact to the imputation credit. On the other hand, Germany is arguing non-reciprocity in the other direction. It is that arguing because of its split rate and the famous foreign effect when you compare wholly-owned German companies with foreign controlled companies that distribute out and reinvest. They are entitled to non-reciprocal withholding rates only in the other direction. Ten percent of zero rather than zero and ten percent.

Where does this all leave us? I hope *Dave* [*Rosenbloom*] can tell us more after I have completed this summary. But I think, to summarize: Germany really puts in a very stark way the implications of the two ways of looking at integration; if the traditional U.S. position that we are entitled to get the imputation credit is correct, and if we apply OECD withholding rates, then Germany is really only going to be collecting 5 percent withholding tax on U.S. investments in Germany. That seems an improper division of the investment tax base. On the other hand, if you look at it from the U.S. point of view, Germany has indeed taken advantage of the fact that shareholders are not going to get the credit in structuring both the financial and international aspects of their integration system. How these theological principles will be worked out in this world of sinners I am not sure but I think they are very difficult questions.

PANEL DISCUSSION

Patrick. Thank you *Hugh* [*Ault*]. If it is possible *David* [*Rosenbloom*] may like to make some comment on the general U.S. negotiating position; it being understood that the fact that the U.S. is now engaged in negotiations, poses some constraint on details.

Variety in corporate-shareholder tax integration systems significant

Rosenbloom. I think Hugh's exposition was really superb. The only missing aspect was the treaty policy vis-a-vis a less developed country with an integration system. That does come up with more frequency than you might expect, since the old British system was in effect an integrated tax system.

We encounter that system in one form or another in a large number of former British colonies and what we do in that instance may be a little different than what we would do with respect to developed countries. In dealing with developing countries, we tend not to try to reduce source basis taxation below the credit limit. Another point here: there are variations in integrated taxes and to my way of thinking, the variations make a difference. For example, some countries have relatively low corporate rates, Denmark and Italy, for example. Some countries integrate relatively small portions of the corporate rate so that you can say that there remains a fairly substantial domestic tax on dividends at the shareholder level, Denmark for example. Some countries are concerned about funding the imputation credit. Canada allows the credit irrespective of whether it has collected any taxes at the corporate level. Italy is the same. There are other differences. For example, Canada grants a non-refundable credit. These variations on an integrated system do have an effect on an appropriate United States posture. I also believe that an integrated system, which is normally adopted to improve local investment in local corporations, has concomitantly the effect of disadvantaging foreign investment in local corporations. This is the other side of the coin, and it is inevitable. The negotiating question is what should we be asking to alleviate that disadvantage. In the United Kingdom context, as you know, we asked for refunds. Quite apart from the theology that *Hugh* [*Ault*] discussed, the refund mechanism is rather complex and, as anybody who has read the technical explanation of the U.K. treaty knows, it raises phenomenal issues regarding the foreign tax credit computations. Personally, at some point I would be willing to give up a little bit of the theoretical purity in favor of a result that achieves justice and simplicity, and that kind of thinking may lead toward dealing with withholding rates. Passing to Germany for a moment, I think Hugh's explanation of the situation therefore is really pretty accurate. There is really a difficulty in communicating. We are dealing with two extremely different world views.

Muten. To begin with, let me say that I speak here purely in a personal capacity, not representing the views of the International Monetary Fund. I shall mainly deal with issues concerning less developed countries.

Some issues affecting less developed countries

One important issue is the extent to which a country like the United States establishes very precise rules on matters dealt with in Section 482 and 861 of the Code. By their way of applying these rules, the United States authorities put taxpayers dealing with them into a position where they really have to listen very carefully to what the Internal Revenue Service has to say. In doing so, these taxpayers may show correspondingly little interest in the attitudes of other competing tax administrations. If I were in charge of a tax department like *Bob Patrick's*, and forced to make a choice between making the U.S. Internal Revenue Service my enemy or getting in trouble with the Inland Revenue, say, in The Gambia, I would in all likelihood find it prudent to be friendly with the I.R.S. and care little about The Gambia.

This is at least what the less developed countries suspect. Therefore, they would very much like to have some feed-back from the big countries, since they feel that they cannot cope adequately with the problems arising.

They hope to get a favorable deal, not least through exchange of information and other administrative assistance, as a result of tax treaties. They are also interested in treaties as a way of assuring a positive result of their tax incentive measures by way of tax sparing. The performance of the U.S. has been disappointing to them, however. It is difficult for foreigners to understand the ratification procedure, under which the U.S. Senate unilaterally

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changes treaties that are the result of bargaining. Delays in ratification and reservations against important treaty provisions make the negotiation of tax treaties with the U.S. a rather frustrating experience.

A simple first line of defense for countries fearing the conflict of interest between their tax administrations and the Internal Revenue Service is the mandatory local incorporation. It might not stop at that, however. By making conditions too harsh on the capital-importing countries on issues such as arm's length pricing, cost allocation, and foreign tax credit — the latest developments in regard to the definition of creditable taxes has really been a very hard nut to crack for these countries — the industrialized countries, and notably the U.S., may force the less developed countries into a situation where they simply feel they have to give up. If they feel that it is beyond their capacity to administer the U.S. kind of a tax system, they might well go for something else. And the alternative might be less then appetizing for those who feel strongly about free enterprise, free trade and free movements of capital across borders.

I apologize for having been perhaps too critical in what I have said, but being the only non-American in this discussion I thought I should try to interpret some of those foreign voices I hear. Outside of this country, I feel more need than in this gathering for explaining and defending the U.S. position.

Patrick. I am sure that there are many of us who take it as very constructive criticism. We appreciate that. If not in rebuttal, at least in comment on this subject I will interject my observation that I do think some of the developed countries, including the United States, could adopt treaty rules to accommodate some requests of the developing countries that are not burdensome concessions and which are reasonable in accommodating the two systems. This is something that can be encouraged, not only for the United States, but for foreign countries as well. Perhaps there is a very real basis for bringing more and more countries into a reasonable tax system but I would like to have *David Rosenbloom* comment on what the LDCs are requesting, what he sees as the possibilities, not merely on the tax sparing issue or the incentive issue, but on the accommodation of some of the substantive rules.

Rosenbloom. We have been through a number of negotiations with developing countries fairly recently and there are a couple of things I am not sure are so apparent when you are dealing with the U.N. group, which we hear when you are dealing across the table from another particular foreign delegation.

There are political implications to the treaties between the United States and particular developing countries, and in some cases I think the political implications may be predominant in the minds of at least the other country. Whether it is possible to secure a treaty conforming to our guidelines — which I take it means pushing a lot of items of income into net basis taxation at source, and being relatively generous with net basis taxation at source — is a hard question. I think, generally speaking, we are moving in that general direction in the United States; but the ability to sell that approach to a particular developing country — which may feel much aggrieved and extremely mistrustful — is really a function of the background and personality and, indeed, the political standing of the people you are dealing with on the other side of the table.

That would not be true, I suspect, if I were representing the United Kingdom, or France, or Germany, but it is true since I am representing the United States. I think that developing countries behave in negotiations in ways — at least in my relatively brief experience — that are not always predictable on the basis of their participation in group discussions of policies. I think the reason for that is a different setting for the negotiations; the country can be extremely reasonable when it is dealing with broad guidelines, but when the question really is posed as to whether they are going to tax equipment leasing on a net basis of sorts, as opposed to imposing a stiff withholding tax, different considerations may result. I think there are serious implications to that decision which some treaty negotiators are not willing to accept.

In any event, we are spending a fair amount of time negotiations with developing countries. I quite agree that the procedure for having these treaties ratified on the Hill has not been altogether satisfactory in recent times. We are hoping that the treaties that we have there now can get ratified fairly early, not so much because the treaties are necessarily wonderful agreements in their own right, but because we have to start somewhere to broaden our treaty network with the developing world.

* * *

Jenks. We are going to start with another panel session dealing with tax treaties. It is chaired by Dave Milton as moderator and includes Mordecai Feinberg and William Gifford. Later, we will have with us my colleague George Beatty, and Joseph Guttentag. At the outset the discussion will consider treaty procedures and the process of those procedures in the U.S. from the initiation to the ratification of treaties.

TAX TREATY PROCEDURES

David Milton

Milton. Thank you, Tom. This does open a new subject for consideration. We had a small band of courageous people who agreed to try and do this, most of whom you see here at the table. *Marianne* [*Burge*] also has agreed to join us together with *Mort Feinberg*, our treaty negotiator, also known as the Associate Director of the Office of International Tax Affairs, and *Bill Gifford* of Wilmer, Cuttler & Pickering.

To introduce the subject and to attempt to set the stage for the panelists I would like to sketch some background color. In common with the range of topics that was discussed this morning, the historical procedures used for negotiation of tax treaties have become a matter of public and private concern over the last several years. Perhaps the most raucous voices heard were those of certain state tax administrators who, in my view, were caught with their hands in the cookie jar by the recently revised U.S.-U.K. income tax treaty as signed December 31, 1975, but who at this point appear to have made away with not just the cookies but also the jar.

Beyond that, there are many tax practitioners who have observed the increasing perplexity of the tax laws around the world and the increasing tendency of the U.S. and some other countries to reach beyond their borders. We have also seen an increasing tendency towards the use of the tax structure, and its application and interpretation, for specific political purposes. The inevitable result of this, of course, is an increased conflict of law and an increased possibility of multiple tax burdens and potential discrimination — as to the kinds of problems you heard about this morning.

The treaty system is a principal weapon in meshing conflicting laws and easing multiple taxation and discrimination. It must become even more significant than it has been. So taxpayers obviously are going to have a greater interest in the treaty

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process and so are those individuals, including members of Congress, who may feel that the Internal Revenue Code should not be altered by forces outside of the control of one or both of the Houses of Congress.

Congressional interest would not be new. There are a number of instances, both recent and past, where legislation or proposed legislation has included provisions dealing with executive branch agreements which have tax subjects.

Recent examples of that would be: (a) [Congressman] *Al Ullman's* modified integration proposal last year which would purport to give the Secretary of the Treasury authority to add a portion of a corporation's foreign tax credit to the shareholder account as a result of agreements with foreign government. These agreements were to be made subject to approval by both the House and the Senate. (b) Then there was the Social Security Act amendment referred to earlier which would provide authorization to the President to enter into agreements establishing totalization arrangements between the Social Security System of the United States and the social security systems of any foreign country.

There are two interesting aspects of the Social Security Act amendment. First, the Act describes certain mandatory and optional provisions for inclusion in the arrangements. In other words, Congress speaks to the content of the agreements in advance. Second, the mechanics provided are for the agreements to be transmitted to Congress whereby they will become effective after a stated time period unless either House adopts a resolution of disapproval of the agreement.

In the past we have had significant acts such as the Mutual Security Act of 1954 which provided that the President should accelerate a program of negotiating treaties for commerce and trade including tax treaties. The Foreign Assistance Act of 1961 is almost the same. Note that here Congress calls the document a "treaty", whereas in the current Acts we have referred to before, they are called "agreements".

You get the question of what is the applicable law. Are there fixed legal parameters that deal with the shape of the tax agreement process? Are these parameters mainly political?

The governing rules that I have found seem to be rather few in number. We have, of course, Article II Section 2, Clause 2 of the U.S. Constitution which reads, in effect, as you all probably know: I, the President, shall have power by and with the advice and consent of the Senate to make treaties provided two-thirds of the Senate is present and concur.

Now, the scope of those words "advice and consent" have not been fully explored by the courts, and to my knowledge the precise division of functions between the President and the Senate, and the treaty making process, has not really been debated fully in recent years. In looking at history, we find that from virtually the beginning the Senate seems to have been content in practice to have the Executive branch negotiate treaties, usually as an independent activity, and then present them to the Senate for consent. The "advice" side seems to have been generally inactive except for such things as the instructions to accelerate negotiations of treaties contained in the Mutual Security Act which we mentioned earlier, and in multilateral negotiations. There are a number of examples of what seem to be "advice" in the multilateral area: Congressional advisors appear to have attended the SALT discussions in sequence, while the Law of the Sea delegation had Congressional members, the International Energy Agency has also had Congressional attendance. But generally, the members of Congress are there as observers and not as delegates. However, there are some who feel that even this moves close to the Constitutional line.

As you all know the President also has the power to enter into other forms of international contracts either as the country's Chief Executive or otherwise under authority of law. Those that are made as Chief Executive do not require the consent of the Senate. So we have an interesting question as to whether an agreement made under one of the Constitutional sources of authority, for the President to make international agreements, could cover tax issues, rather than calling it a treaty. Now we have seen Congress do a similar thing in reverse in the social security area, calling the operative document an agreement rather than a treaty, and then imposing requirements beyond the Senate's advice and consent called for by treaties.

Delegation of tax treaty negotiation function to the Treasury

Within the Executive branch, the President has delegated the treaty negotiation function to the State Department, as I understand it. State has, in effect, redelegated that power to Treasury as to tax treaties. Now those treaties that have some tax provisions, such as the treaties of friendship, commerce and navigation, were negotiated by State with Treasury input. So in theory it could be that Treasury would adhere to State's rules as to procedure.

The only State Department procedure which I have come across that pertains to this topic appeared in the July 24, 1974 revision of the Circular 175 procedure. [Foreign Affairs Manual, Volume 11 (Chapter 700) at sections 720.2D, 722.3, and 723.1.] Circular 175 is an internal State Department guideline and information manual on negotiation and signature of treaties and other international agreements. The procedure provides that as a general objective where in the opinion of the Secretary of State or his designee the circumstances permit, the public will be given an opportunity to comment on treaties and other international agreements. While this was adopted in 1974 its implementation has not been formalized to this time, to my knowledge. Under this procedure the request for authorization to negotiate a treaty is in a form of an action memorandum addressed to the Secretary. Among other things, the action memorandum is to indicate what arrangements are planned with respect to Congressional consultation and also to the opportunity for public comment on the treaty or agreement being negotiated. The officer who is responsible for negotiation is specifically charged with keeping in mind that the interest of the public is to be taken into account and where, in the opinion of the Secretary of State or his designee as the circumstances permit, the public is to be given an opportunity to comment. Of course, this does not say whether that should be a onetime opportunity or only at intervals. This procedure also establishes an objective that timely and appropriate consultation is to be had with Congressional leaders and committees on treaties and other international agreements. The officer responsible for negotiation is to keep the appropriate Congressional leaders and committees advised of the intention to negotiate significant new international agreements, consulted concerning these agreements, and informed of developments affecting them, especially if there is need for implementing legislation (which, of course, we would not find frequently in tax areas).

Treasury practice as to tax treaty procedure negotiations

With this general background, what has been the past practice of Treasury as to treaty procedure negotiations. It generally has followed these lines: First of all, tax negotiation has assumed that the resulting document was a treaty and not an executive agreement. The procedure would be to announce the list of current and proposed negotiations and ask for comments. This list, as you all know, was not kept on an active basis and these comments could be a little old. Since the U.S. model treaty was developed it has been used as a base. In the

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background there was a handbook, I believe a classified handbook, which is not disclosed. As to consultation with Congress, The Treasury Department obviously has, to some extent, consulted with the Chairman and other members of the Senate Foreign Relations Committee in the course of negotiations. Treaty language was not known until the treaty was published at some point after signing, and then there were hearings before the Senate Foreign Relations Committee.

Recently, in response to suggestions and expressions of interest in opening treaty negotiations to public comment, including informal comment from IFA members, and obviously in line with his own views [Treasury representative] *David Rosenbloom* scheduled public review and comment sessions on four treaties. Italian, July, last year; Jamaica August, last year; Danish November, last year; Canadian December, 1978.

You have seen these reports, I am sure, and they were referred to earlier, but to summarize very briefly for those who have not read the reports, and who were not there, the meetings were informal and no transcript was made. *David Rosenbloom* and several members of the Treasury negotiating team were present. There were also IRS representatives present at the Canadian treaty session and at the Danish session. I am not aware of their being at the others. Treasury summarized the major issues and the state of the negotiations. The participants could raise questions and make comments. Apparently you could turn in papers, but there was no formal paper presented at the session by anyone, to my knowledge.

These latest events would seem to be of great potential significance in the treaty process and we would like to start talking about them. *Mort* [*Feinberg*] was at three of the four meetings on behalf of Treasury and we would like him to review them from the Treasury side pointing out what the ground rules were for the meetings. I believe Treasury viewed the meeting as a success.

PANEL DISCUSSION

Ground rules for tax treaty meetings

Feinberg. Thank you. A word about the ground rules. First, in each instance, we discussed with the partner our plans to do this and in every case they agreed that this was an appropriate procedure. We made it clear both to our partners and to the participants in the meetings that we were speaking only for the U.S., not for the treaty partners, and that what we discussed would be the U.S. negotiating positions given the nature of the two tax systems and the nature of the problems we have to deal with, and the conceptual approaches we were taking to some of these problems — they were not necessarily agreed solutions. We were not discussing the negotiating position of the other country or where there were final agreements; we were not necessarily indicating what those agreements were. It was an effort to indicate to the public where we were coming from in these negotiations. I think we found them very useful. I think I speak for all of us at Treasury who have been involved. It provided us with knowledge of some of the specific issues that were of concern to the taxpayers that we may not have been aware of, or areas where the standard or model approaches we have taken in the past may not precisely deal with the problems that were raised in that particular treaty and that particular relationship. In a number of cases we did receive proposals for resolutions for some of those issues that we may not ourselves have thought of or were able to think of.

Along the same lines attention was called to problems that would arise in meshing two particular tax systems that may not be able to be dealt with in a model treaty in a standardized approach. It is equally important that we were involving to a much greater extent the public in the process of negotiating a treaty. I think in addition we generated considerable interest outside of the meetings, and as a result of the meetings, additional representations from the public with respect to the problem that they face. I think that we do intend to continue these meetings, where appropriate, and we appreciate the input that we have received.

Milton. Mort, do you intend to continue them? These were done at an intermediate state of the process of negotiations as distinct from at the beginning. Do you intend to continue them in that intermediate stage or also do this kind of things for openers?

Feinberg. I think it is most appropriate to do this at the stage where we have been doing it. That is at the point where we have achieved probably our greatest understanding of the issues and we have identified all the issues at that point and that is the time we need as much help as we can get. At the beginning, what we have practised for a number of years now, is issuing an announcement that negotiations will be held and soliciting comments. At the early stages this is the more appropriate way to deal with it. We have a clear picture of where we intend to go and what issues we may not be able to resolve ourselves. It is a better time to involve the public in this kind of a form.

Burge. What kind of response does the announcement usually elicit, Mort? A hundred letters or five letters?

Feinberg. There is no way to generalize. In some, very very few. Are we talking about Canada or Bangladesh? It varies tremendously.

Milton. Marianne, you were at all four of these public meetings as I understand it. What is your view of their worth, looked at from the taxpayer's side?

Burge. From the taxpayer's side I would say I am wholeheartedly in favor of the public briefing procedure. And certainly for the advisers to the taxpayer. The public briefings are a one hundred percent improvement over the previous method of obtaining information from somebody in Washington who heard it from somebody in Washington, who heard it from somebody in Washington. This is a tremendous improvement and I am wholly in favor of continuing the procedure and also having IFA report on the proceedings to its members and giving the report as wide a circulation as possible and in other publications, and to encourage more taxpayers and their advisers to participate.

Advantages of public briefings

I think the specific advantages are that the taxpayers can find out at a stage before the treaty is signed and almost fixed in stone as to what the issues are and they can then review their own operations and comment on the effect of that proposed treaty to the Treasury. The taxpayers and their advisers also can learn for the first time what Treasury policies lie behind some of the treaty provisions. It is difficult to know what the policy is behind some of the language in the treaties. So there is a cumulative educational effect, I think, of the public briefings to those who attended all four so far. I think it is very important to the taxpayers. Treaty issues are something of a mystery to most people and they are different and a part of the international tax law that a lot of people are just getting involved with. So it is very important that taxpayers and their advisers should know what is in store for them in the treaty area because if the taxpayers are not kept informed of what is being planned in the treaty area they may find out that the costs and the problems of the treaty might even exceed the benefits.

I say this because I think we may be getting into deep water in some of the treaties in trying to create perfect accommodations between two tax systems and the results may be that we end up having something that's so abstract that it is unworkable, in the effort to try and be very fair and very perfect. So I think we

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end up not being able to complete treaties at all. Taxpayers may not as yet respond as you might have hoped to the Treasury, and I suppose you could see why that might be the case so far. I suppose the only treaty of major interest that we have had a briefing on so far has been Canada. The public session was very well attended. I think you will generally find that taxpayers will not respond unless they see something important or immediate for them in their own operations in a certain country because there certainly isn't time for everybody to keep informed on everything.

Also, the briefing procedures are new. It is possible that people are not really aware of them and that the meetings are being held. The briefings were a bit one-sided. I suppose a briefing is intended to be for information giving, and not much time was left for audience participation. The issues were also discussed somewhat in the abstract. Some of us found it a bit hard to follow the policy concepts. I found that this grew easier from one meeting to the next as one came to recognize the policy issues that were being discussed. So I think it is very important that one attend them. I think that even with a limited discussion we found that some comments and information that was of use to the Treasury came out of them.

Panelist. Marianne, I do not want to interrupt, but could you tell us whether the majority of the people there were there for education as distinct from having an interest in a given country?

Burge. I think most of the people there were there because they had an interest in the country or a particular industry. There were certain industry representatives there.

Panelist. If I may, I think it was particularly clear in the Canadian meeting that a number of people were there to hear about one particular article, one particular kind of issue. I think that may well be why there was so much larger crowd at the Canadian meeting because there were many more people who had interest in particular issues rather than in the treaty process in general.

Burge. I think it is a bit too early perhaps to say whether the comments the taxpayers have made are going to be taken in account in the negotiations. I do not know how you feel about that, Mort.

Feinberg. In general, sure they will be taken into account. We will consider them; whether we consider them appropriate or whether in fact there is anything we can do about it in a give and take negotiation is another matter.

Milton. We did not make any opening comment about taking questions but I do not see any reason why we should not take any.

Question from audience. Is there any follow-up by people asking questions and giving thoughts to you?

Feinberg. As I said before I think these meetings generated a great deal of additional interest and submissions and meetings and conversations that we would not have had otherwise.

Audience comment. I was wondering if there will be an opportunity for the partners that are negotiating the treaty to have their own advisers and representatives participate and give their own position at the briefing. Does this occur in fact? For instance could they hire U.S. tax counsel to participate in the briefing?

Feinberg. Yes, they are open meetings. Anyone can attend. We have advised the other government, in each case, as to when the meetings were and there have been at least embassy representatives. In the Canadian case there were people from Canada who came down and I do not recall whether they participated actively or not, but they were certainly free to.

Milton. Let us pursue this question of openness from another side. I know my understanding is that the business community in the OECD has indicated that they would like further openness in treaty negotiations from the side of their governments. *Mort* [*Feinberg*], do you think that from your experience in dealing with the treaty partners that if there is increased openness on the U.S. side that that will foster the same kind of thing with other governments with respect to their taxpayers?

Feinberg. That is hard to say. I think it will inevitably put some pressure on them, at least those in countries where they are aware of what is going on here. There undoubtedly would be calls for similar meetings at home in their countries. Whether they can feel they can respond to that kind of pressure I really cannot say. I have the impression that without limited openness they tend to be much more open in these matters than most other countries and my guess is that relatively few will pick up the idea. I mentioned before that there are now more long standing practices of issuing announcements before the meetings. I believe we were the first to do that. Several other countries have picked up that idea and have found it profitable.

Milton. There are some countries that I know of, but I cannot of course speak for many of them, that do circularize their trade organizations and such at the commencement of [treaty] negotiations to get them into the picture. The U.K. does that for instance. They send a notice around to the Confederation of British Industries and I think the U.K. branch of the International Chamber, and accounting groups, and others. There is someone doing these things.

And speaking of trade groups, in conversations that *Bob Patrick* and I had about a year ago with *David Rosenbloom* a suggestion that was tossed out for consideration involved the use of the IFA U.S. branch as a private clearing house to identify taxpayers' interest and to try to get a focus on problems by countries. *Bill* [*Gifford*], what do you think about that from a practical point of view? Are there a lot of legal problems and such involved?

IFA as a private clearing house for international tax problems

Gifford. Without advocating for or against the idea, I would identify one of the problems as when in the process IFA would play a role as a private clearing house. If it is before negotiations are undertaken, or when the Treasury's initial announcements come out, I suppose that it could be a fairly free and open forum for exchange of ideas. As the issues get more specific and narrowed in the course of negotiations, I think it gets more difficult for taxpayers to participate, whether through a trade association or other group. To the extent that effective participation consists in sharing empirical data, rather than technical legal suggestions as to what the treaty ought to contain, it of course becomes more difficult. To pick up on the specific question, about the legal issues that come up, the commercial secrecy questions come to mind immediately, but I do not find that area in itself too troublesome. Taxpayers would be largely self-selecting, and they simply will not participate when the matters involve extreme confidentiality.

Jenks. Well, we have certainly had a summarization of differing views on this topic. Thanks to all of you. It is now time to pass on to other things.

Competent authority procedure

I would now like to ask *George Beatty* to offer some ideas of his about the competent authority mechanism.

Beatty. Thanks, Tom. We are fortunate enough to have *Dave Reizes* of OIO [Office of International Operations] here with us this afternoon to participate in the discussion.

As you know, one of the principal functions of the U.S. competent authority program is to deal with cases involving the section 482 requirements of our Code and the equivalent rules of other developed countries. The interplay between their transfer price rules and ours necessitates

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some mechanism to avoid double taxation of the same income.

It is difficult to assess the qualitative and quantitative effects of our present approach to competent authority proceedings. Perhaps the best success, not surprisingly, is the experience we have had with the Canadian program — a program that is, in many respects, a pioneering one. Of course, we have had competent authority proceedings with Canada for some years, but certainly not on the scale of the modern program which dates from the early 70's.

To me, one of the threshold problems with competent authority cases is deciding whether or not competent authority relief should be invoked in the first place.

Initially, the reaction of most people is that if double taxation has been proposed as a result of conflicting adjustments in different countries, the obvious solution is to initiate competent authority proceedings and let the two governments battle it out. But there are some threshold considerations that may in many instances make it undesirable to do that. One that I think is most often encountered in practice is the notion that cases can be more expeditiously settled on audit if the taxpayer is willing to forego competent authority rights as part of what amounts to a package settlement with either the agent, or in some cases, the appellate conferee. This, in effect, uses the availability of competent authority proceedings as a negotiating weapon or at least a consideration to be weighted in settling the case. The argument is that because relief is available, the taxpayer should get some benefit for giving up his rights to invoke formal competent authority proceedings. This happens not only here, but certainly abroad as well. To a certain extent I think it can be viewed as undermining the integrity of the competent authority relief mechanism. On the other hand, by definition the end result must be one that is satisfactory to the taxpayer. For a variety of reasons — the aggravation, the expense, the time and effort involved — the taxpayer may be willing to unilaterally absorb a certain amount of double taxation in order to get its case closed.

On other factor that enters into the decision in a number of cases is the threat or possibility, either real or imagined, of retaliation in the foreign jurisdiction if the taxpayer invokes competent authority proceedings. *Dave* [*Reizes*], do you get any feel from your experience to date as to whether the threat of retaliation that is often talked about is real or not?

Retaliation by foreign tax authorities

Reizes. I have a feeling that many taxpayers are worried about retaliation and have not sought competent authority assistance just because of those fears, real or imagined. As of today, we have looked into many cases. Wherever there is an allegation of retaliation, we get into it very quickly and very strongly. We have not yet run across a single case of retaliation. There are two potential cases we are looking into now. I sent a group manager and one of my team leader senior analysts over to Europe yesterday and they should be meeting this afternoon, as a matter of fact. The meetings will continue on through next week. Our initial investigations of the cases they are working on disclose that a negotiating factor is involved. Here in this country there is often a question whether a taxpayer should come and seek competent authority. I am sure most of you have handled difficult complex examinations, gotten in at the audit level, and very often, once a case has been developed and the issues have been pretty well defined, the International Examiner, the agent and the case manager are seeking agreement on a case in which you are not really that far apart. It is very similar to the negotiation or settlement of a law suit. You have all your points in issue, all your litigating positions, you have all the auditor's issues that have been raised. Some are pretty solid; some might be weak; some have a little bit of water in them, but are basically very arguable. When you sit down to discuss those issues and determine whether or not you are going to agree, I am sure one party or the other starts trading off. Basically one party says, "these are the cards we have on the table; if you will agree to these three points, we will be willing to wipe out the other one or two points, or whatever. But if you are going to go forward, and you are going to contest it, we are going with the whole ball of wax on all of the issues."

I think that some of the fears of retaliation are really a réflection by foreign tax advisors at the foreign office of some of the accounting firms or the law firms. Those advisers are saying that the foreign revenue officials have so many issues, so many points that they have developed in their examination, and if the case is settled, if it is agreed, then some of those issues or points are going to be dropped. If it is not agreed and it goes to competent authority and is subject to review, the officials are going to submit a very complete and full report. That explains a good portion of it. What it does not explain is, where there has been an examination or there has been an agreement in a foreign country, and then at a later time, because our audit cycle is slower than in most other countries and a little bit more complete, we start proposing an adjustment. At that point the taxpayer wants to go to the foreign competent authority or a foreign revenue authority to get a refund, or credit. We then hear that there are fears of retaliation because if the foreign country has to give a correlative adjustment, the company better look out in its succeeding years or it is going to be dealt with harshly. I think those are the fears we are particularly concerned with, but we have not yet hit one case where they have been justified.

Beatty. But if I understand your comment, you do in fact investigate and follow up on any serious assertion that retaliation has in fact been threatened.

Reizes. Yes. It would be unthinkable for us to allow it to continue.

Question from audience. What happens if the taxpayer believes that a foreign government will come up with a different type of interpretation and in effect will create a tax liability which did not exist?

Reizes. Let me see if I understand your question. You are saying, in other words, we have a proposed adjustment. A taxpayer hesitates ...

Comment from audience. What I am talking about is that under the existing treaties is it not a question of interpretation of the treaty? I do not believe we distinguish competent authority cases we have which are interpretations on issues when we are dealing directly with foreign governments, in contrast as to how to interpret them, for example, in terms of our view of whether specific prices are reasonable. When you get a question of interpretation, where can you discuss it with the taxpayer? And what about retaliation?

Reizes. It is part of the competent authority's role to be interpretative. The U.S. competent authority is the Assistant Commissioner of Compliance. In the interpretative area the Assistant Commissioner of Compliance acts with the concurrence of the Assistant Commissioner Technical. At the present time, we have 33 non-allocation cases of which, let us say, maybe 10 of them deal with interpretations, the treaty language or entitlement of treaty benefits, things of that nature. Where there is a dispute between our interpretation and a foreign country's interpretation of the treaty language — who the provision was meant to cover, whether there is qualification for particular benefits, what is meant by permanent establishment, whatever it may be — of course we will entertain it. The question is retaliation. What I cannot really discern from your question is, how would this come about in a retaliation setting? We handle cases involving conflicting interpretation. We are happy to; that is our job.

Reizes. Well, there are cases in which there is an awful lot of coordination and consultation with International Tax Counsel in Treasury. There are cases where we find

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that the foreign competent authority is proposing to treat a class of taxpayers in a particular way. If they are going to be interpreting the treaty language in administering their laws in a way that we do not think is appropriate, we are very interested in that.

I think the United States competent authority has an affirmative duty to represent its taxpayers. The question really is, depending upon the particular case, at which point is it appropriate for the competent authorities we are talking about — the administrative competent authority in negotiation of cases and controversies, and interpretations — to get involved, versus at which point is it a question of negotiation between International Tax Counsel and the foreign government. In this country, of course, we do have that separation between policy and administration. It is not necessarily the case in most other countries. So it is a difficult issue, but I think we would see an affirmative obligation to do something about that.

Comment from audience. When you reach an interpretation agreement with the other country, do you ever publish the results?

Reizes. Yes.

Panelist. Dave, was the recent ruling with respect to the interpretation of the Japanese Treaty and the application of sections 861 and 482 to a U.S. permanent establishment of the Japanese company, was that agreed with the Japanese competent authorities or that ruling ...?

Beatty. I promised Dave that we would not get into a discussion of that problem because of its current status.

Comment from audience. At least that is an example of the kind of issue you are talking about, I think, and where there has been a question of interpretation, the interpretation was made and it was published.

Comment from audience. In what percent of the cases brought to the U.S. competent authority by U.S. taxpayers is the competent authority relief denied either by the U.S. or the foreign government?

Competent authority cases accepted

Reizes. The figures I have are of cases that have been accepted for competent authority consideration, for negotiation. Of those figures, in allocation cases we are talking about 86 percent full relief and an additional 14 percent partial relief. In most cases relief was given. What is not included in those figures is the number of cases that have come in where we did not think that competent authority consideration was warranted. We did not find there was double taxation; we found in certain cases taxpayers may have come in without clean hands for any number of reasons; we have found that in certain cases, the statute of limitations had expired. This was a recurring issue, where the statute of limitations had expired previously and the taxpayers had been on notice. The statute expired again, there was nothing we could do as far as obtaining a correlative adjustment from our treaty partner, and the taxpayers came in just after the statute expired. So we turned them down the second time around.

There are several questions involved here, and cases which we felt were inappropriate for consideration are not included in these figures. There have been a number of those cases, I do not know exactly how many, but in the last five years you are maybe talking about 8 or 9 cases.

When a case is submitted for competent authority consideration, it can either be accepted or rejected. If it is rejected that decision is appealable under an appeals procedure. Rev. Proc. 77-16 [77-1 C.B. 573], or Rev. Proc. 70-18 [1970-2 C.B. 493]. There are cases right now in appeal on that very issue — whether a case is appropriate for competent authority consideration. Competent authority consideration, and the efforts the competent authority goes through once a case is accepted, can range from the advocacy of the taxpayer's position with the foreign government to the other side of the coin. In other words, to help the taxpayer secure relief via a correlative adjustment, or sometimes the relief that is given is unilateral, that is, *we* will give relief. Sometimes, we might find the case is not developed substantially enough so that we could carry a burden of proof with the foreign government and persuade them to make a correlative adjustment. In such a case we may well withdraw an issue. We might find various reasons why we will give relief unilaterally under this bilateral procedure. Sometimes we split the issues, but that is once the case is accepted.

Question from audience. Did you say that competent authority cases were published?

Reizes. No.

Comment from audience. Oh. Because I was going to say I had never seen one.

Competent authority cases are not published

Reizes. Well, that's good! (laughter) I really hate to anticipate some of the things *George* [*Beatty*] wants to talk about, but we are dealing here with questions of privacy and disclosure, and the competent authority plays a very different role than the Revenue Service in general. Officially it advocates *for* the U.S. taxpayer. There has to be a somewhat confidential relationship where taxpayers can feel free to disclose to the competent authority facts that they would not even disclose in arguments with an examining agent. If we have to go forward and argue *your* case to the foreign government, we have to know all the facts and we cannot be surprised. That is one of the reasons for our announced policy that we do not raise affirmative issues. If a company, for example, has been examined and that examination is complete, we are not going to raise an affirmative issue when the case is under competent authority jurisdiction so long as there's no fraud or misrepresentation. We will just argue what we think to be the good solid points on behalf of the taxpayer. And this confidential relationship obviously is going to get into business operations and data about the company that cannot be disclosed.

Another factor that really is not a matter for publication is what goes on in the negotiations between the governments. We normally do not go over to negotiate a particular case. Very often we will have a group of ten cases which will be negotiated together, and there are a number of trade-offs that can occur. And so, really very often, at least in allocation areas as opposed to the treaty benefit non-allocation entitlement type cases, the competent authority decision cannot be a precedent for a later case. We would not want to publish and give people the wrong opinion.

Transfer pricing and the customs impact

Beatty. In addition to the whole problem of disclosure of trade secrets or sensitive information, the possibility of encouraging joint audits, and other exchanges of information which *Joe* [*Guttentag*] will touch on later, there is one other factor which I think often influences people in deciding whether or not to go to competent authority. In pricing cases, the potential customs impact can clearly be significant. As you know, *Robert M. Brittingham* [66 T.C. 373 (1976) affirmed — F.2d — (5th Cir. 1979)] refers to the relationship between customs duties and proper transfer pricing in section 482 cases. There was also a recent situation where what started out as an anti-dumping investigation in this country turned into a section 482 case with some of the files and data that had been made available to the customs people being turned over to the tax authorities. I think that there is going to be an increasing relationship between customs considerations and pricing considerations, particularly in foreign countries where the two are administered by the same governmental agency, with the result that there is more likely to be cross checking of data.

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Competent authority procedure and timing requirements

There are a whole variety of procedural questions that arise if the decision is made to seek competent authority relief, but the most obvious is the timing requirement for invoking the procedures. There have been statements made in the past to the effect that nothing need be done until the U.S. taxpayer receives the standard form letter from OIO advising the taxpayer that section 482 adjustments are under consideration. I think Dave's feeling, if I understand it correctly, is that it is not always possible to wait until that point, if by so doing the taxpayer is going to let an applicable statute of limitations expire in the foreign country that would be affected by the potential adjustment. Am I right Dave, that in a case where the past history and nature of the audit clearly indicate that a section 482 adjustment is under consideration, you would expect the taxpayer to take protective action abroad even though a form letter had not been officially delivered by the IRS?

Reizes. Yes. There was a lot of confusion, about a year and a half ago, as to exactly when the taxpayer was on notice, that is, when was the taxpayer required to take this protective action. There was a statement made. I think half of that statement was, "if the taxpayer is not given the form letter and the statute of limitation expires, the U.S. competent authority would unilaterally withdraw a proposed adjustment." But the other half of the statement, was that the time a taxpayer is on notice — the time that his entitlement to relief is considered to have expired — is when he *knew or should have known* that he had to take protective action in the other countries!

Every situation is different. In some cases there is a recurring examination with the same issues recurring, and the taxpayer already knows that this issue is going to be examined again, the same facts are going to be found. He can protect himself in the other country. What we in the Service find very difficult to determine is, when is the proper time to give the pattern letter in order to be fair to taxpayers? I think a while ago it was being given at the point that the issues became pretty firmed up. We do not think it is proper to unnecessarily have the international examiner walk in and say he has arrived and hand you a pattern letter, particularly when you have a client or you have a company that has subsidiaries all over the world. If you have to start rushing out and keeping the statutes open without knowing what adjustments may be involved, certainly you are going to get into trouble. We realize that. What we are really trying to do is find an appropriate time when taxpayers can be reasonably sure of what the potential adjustments are and so be able to make a business decision as to which procedural impediments in foreign countries they can stop from being interposed against future relief. That is certainly before the 30-day letter and it is probably in an overwhelming number of cases sometime after the opening conference. But we really have not yet firmed this up and we go on a case by case basis.

Tax treaties and statute of limitations

Beatty. As I am sure most of you know, the statute of limitations problem falls into three distinct categories. In our most recent treaties — the Polish treaty, the Egyptian proposed treaty, the pending Israeli treaty, and in our model treaty — there is a provision stating explicitly that any competent authority relief that is granted shall be reflected in an appropriate adjustment notwithstanding any procedural bar in either of the countries involved. There is no statute of limitations problem when you are operating under a treaty of that sort.

In a second group of treaties involving countries such as Finland, France, Iceland, Japan, Korea, Netherlands, Norway, Rumania, Russia and Trinidad, there is a provision in the treaty stating that if the adjustment is agreed to be made, it "shall" be made. The U.S. interpretation of those treaties has generally been that they were intended to override any local statute of limitations problems. However, in at least two instances involving Germany and the U.K. where that type of treaty is presently in effect, there is disagreement on the other side of the fence as to the meaning of those provisions. This is particularly true in the U.K., although the competent authorities have been able in one fashion or another to solve most of the problems that have arisen to date. The official U.K. position is that the statute of limitations may not be waived under the existing treaty and indeed under the new one that has been negotiated. As a result, anybody who has a U.K. problem should certainly proceed under the assumption that the U.K. statute can and will operate as a barrier if you do not institute competent authority proceedings in timely fashion. I would hope that in the near future the IRS would issue some sort of release warning people of this because there is a published ruling, Rev. Rul. 72-437 [1972-2 C.B. 660], that catalogues the treaties of this sort and indicates that the statute of limitations is not a problem.

The third category of cases involves our older treaties which contain no provision at all with respect to the statute of limitations. In those instances, if relief is not sought in timely fashion, the statute operates as an absolute bar. Canada is one outstanding example. There is simply no way that the competent authority here has been able to persuade the Canadians to override their statute in one fashion or another. In Australia, where the treaty is in the same form, the problem has been solved through what has been called telescoping the adjustment, by having the Australians reflect adjustments that really relate to prior years in a current year which is open. This can raise some very difficult foreign tax credit questions that we will touch on later if we have got time.

Guidelines for competent authority procedures in Canada and the United States

On the content for a claim for relief we have got explicit guidelines for two countries in the world. Rev. Proc. 70-18 [1970-2 C.B. 493] provides the procedures for U.S. taxpayers involved in allocation cases. The only other country to publish procedures is Canada which has issued information circular 71-17 spelling out the procedures to follow there. I think it is interesting and encouraging that an explicit provision has been added as Article 25-5 of the U.N. model treaty in effect directing or strongly encouraging competent authorities to develop specific procedures implementing their competent authority programs by spelling out in some detail the route that taxpayers are supposed to follow in invoking the procedures.

I think the heart of the whole competent authority program is the jurisdictional aspect of it, because the effectiveness of the program depends on the willingness of the authorities in the affected countries to deal with issues as they are presented. A number of questions in this area arise. For example, where you have a double inclusion in income or disallowance of a deduction which results not from different factual treatment of the same item, but rather from differences in the internal law of the two countries involved, should the competent authority try to deal with that type of case? Does the answer depend on whether or not the treaty explicitly gives the competent authority directions to deal with problems arising, for example, as a result of different sourcing rules? Or should it be within the broad general discretion of the competent authority to deal with those cases even though there is no explicit direction? Should the U.S. negotiate questions that involve just earning and profit matters, as opposed to allocations of taxable income or expense? Should the U.S. negotiate on section 861 adjustments which, depending on the circumstances, may have the same effect for somebody who is in limitation under section 904(a) as

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a disallowance of the deduction for the amount that is being allocated to foreign source income under the section 861 rules? How should the competent authority deal with de minimis cases where the amount involved is relatively small with respect to any one country but in the aggregate is perhaps significant? For example, a pricing adjustment on export sales by a U.S. parent to subsidiaries in 25 different treaty countries may involve a relatively small amount with respect to each one of those countries viewed separately, but in the aggregate it may be significant enough so that the revenue agent is properly raising the issue in the first instance. To what extent should the competent authority exercise its discretionary jurisdiction if there are overtones of negligence or, worse yet, actual fraud in the case? All of these, it seems to me, are difficult and important questions. *David Rosenbloom* is in the back and I would appreciate, Dave, any thoughts that you have on what the proper scope of competent authority proceedings ought to be.

Rosenbloom. George, only in non-allocation cases does the issue arise. I think in the allocation cases the question of what a competent authority can or cannot do is really not currently creating much of a problem. Maybe one way to interpret a treaty for purpose of the competent authority function in re-allocation cases is to take much the same position that we would in regard to ruling requests under the Internal Revenue Code. I think that we are really in the first stages of asking ourselves what the appropriate competent authority role is, and I think that is a major treaty problem.

Beatty. In addition to the competent authority relief that is available under treaties we have also been developing a mechanism to deal with allocation issues arising in the possessions. Dave, am I right that we have a formal agreement with the Virgin Islands and that we are working on one with Puerto Rico?

Allocation issues in connection with U.S. possessions

Reizes. We have an agreement with the Virgin Islands. We talk about it somewhat procedurally in the nature of the treaties. But it is wholly different than the treaties. The basic document is modeled the same way that the Internal Revenue Service has agreements with all of our state taxing authorities, the cooperation and coordination agreements for exchanging information, verifying return data, programs to assist one another in the administration of the laws. Now of course, the Virgin Islands is in a unique position of having people who are dealing with essentially the same taxing document. Under Article 28-A of the Revised Organic Act of the Virgin Islands, U.S. citizens and U.S. taxpayers generally must pay taxes under our tax system to the United States where their income is sourced. But they are excused from filing with the United States and paying to the extent that an individual is an inhabitant of the Virgin Islands and they file and pay with Virgin Islands. There is a lot of interplay between corporate taxation, the Virgin Islands industrial incentive act, and the tax benefits that are granted to business taxpayers under the Code. And we do coordinate our taxes. In as much as we are applying the same basic legal document — the Internal Revenue Code of 1954 as amended and as interpreted up to the current date — it is fairly important that we deal consistently with it. So, under this cooperation and coordination agreement we have a mutual agreement procedure very much like the treaty procedure that we are talking about that handles just the same type of questions as far as allocation facts, taxation facts, jurisdictional facts and questions of residence are concerned. If we have the same law, and there should be only one set of facts, we should arrive at the same result. We are attempting to resolve problems of double taxation in those cases. That is an easy situation.

Now you bring up Puerto Rico. We have been negotiating with the Secretary of the Treasury of Puerto Rico. We have a basic negotiating document, identical pretty much to the Virgin Islands document. The difficulty here, and one of the reasons why we do not have yet anything implemented, is that we are not dealing with an identical code; we are dealing with the Puerto Rico Code (which is taken from the 1939 Internal Revenue Code). There are possible differences of law and interpretation. While we are looking forward, hopefully, to something in the near future, we do not have anything final with Puerto Rico yet.[6]

Beatty. Let me move on at this juncture to a brief consideration of some of the negotiating policies. There are a number of situations where an issue which arises in both treaty countries and non-treaty countries will be disposed of satisfactorily in competent authority proceedings. The question arises at to whether that disposition should be given effect by the IRS in dealing with section 482 adjustments in the non-treaty countries. My understanding of current policy is that it is not given effect, because the result reached in competent authority treaty discussions represents a compromise of competing positions; it represents one of the benefits that is attributable to the existence of the treaty and you would be denegating the status of the treaty if you applied the same result and gave similar relief in the non-treaty context. Is that essentially right?

No competent authority procedure in non-treaty situations

Reizes. The competent authority has its basic power deriving from the treaty. The competent authority, which is a centralized function, has no authority to tell the district what to do with the non-treaty case. The second factor to consider is the negotiating position of Treasury. As they have represented it in the past, to the extent that a non-treaty country can obtain for taxpayers and companies having tax relationships with it the same benefits that treaty countries can obtain, then there is no advantage to having a tax treaty. We defeat our system.

Beatty. In cases where an agreement has been reached and provision has been made for repatriation of the amount of section 482 allocation adjustments, am I right that under the typical competent authority closing agreement there will be no interest charged on the amount of that repatriation in contrast to the procedure that is used in non-competent authority cases where a Rev. Proc. 65-17 [1965-1 C.B. 833] receivable is created and interest is charged?

Reizes. Almost every one of our closing agreements providing for repatriation has allowed the U.S. taxpayer to forego interest.

Jenks. George, I think time is running out on us. I would like to thank you on behalf of the group for a very fine presentation.

* * *

Joe Guttentag will be our next speaker. He will comment on exchange of information under treaties.

6. IR 2123 released April 25, 1979, sets forth the U.S.-Puerto Rican mutual agreement procedure which was adopted after this conference.

EXCHANGE OF INFORMATION UNDER TAX TREATIES

Joseph H. Guttentag

This subject has moved from a position of being completely ignored to one of extreme, importance to tax administrators, taxpayers and their advisors within recent years. Provisions for exchange of information in tax conventions have long existed and in substantially the same form as they appear in the current Article 26 of the OECD draft, and in the U.S. model treaty. In the past technical explanations and the Senate reports listed exchange of information as one of the standard tax convention administrative provisions and with some exceptions paid little attention to what it meant or how it was administered.

Why the recent interest in exchange of information? First, it appears that tax administrators are becoming increasingly concerned about the tax consequence of transactions extending beyond their national boundaries. This concern exists regardless of whether the tax system uses a territorial or worldwide approach. Information available only outside the country of residence or home country of the taxpayer may be necessary in order to determine whether the taxpayer is paying his appropriate share of taxes on income earned within the home country or entitlement to tax credit. Secondly, there are problems of tax evasion which can only be detected and determined with information obtainable outside the home country. There is also increasing concern over the use of tax havens. Through information exchange tax administrators, even though not able to obtain information directly from tax haven countries, can through the use of triangulation zero in on transactions and determine the extent of income which may be sheltered overseas.

The United States has always supported the broadest type of information exchange, with certain caveats which we will mention and which are reflected in the current U.S. model convention. It is very natural for the United States to do so. The United States has an extremely extensive taxing jurisdiction and needs all of the information it can obtain. The U.S. also has the ability to use such information effectively. It is also in the interest of the United States to provide information to other tax authorities to enable them to enforce their tax laws. From a competitive point of view, the multi-national resident in a country which has low enforcement may very well have a competitive advantage over a competitor located in a strict enforcement jurisdiction. Accordingly, to the extent that the United States is able to provide information which assists countries in a stricter and more equitable enforcement of their tax laws, the competitive position of the U.S.-based multinational is enhanced. On the other hand, to the extent that the information exchange system provides assistance to the United States for even stricter enforcement of its extensive taxing jurisdiction, the competitive position of the U.S. companies may be weakened. We are dealing exclusively, at least in the case of the United States, with bilateral provisions for information exchange. Accordingly, more equitable tax enforcement, meaning probably stricter tax enforcement by the United States and its treaty partner, country "X", may provide a more equitable competitive position between companies resident in those two countries, but may create a greater competitive disadvantage for both companies vis-a-vis a company located in country "Y", which has no tax treaties with either the United States or country "X". The United States has more information available and better means to obtain it than any other country in what we used to call the free world.

The imbalance in providing information and the use of the information is probably most viable with respect to the developing countries. The subject of information exchange was one of great concern in the development of the draft model convention for treaties between developed and developing countries. The developing countries were quite concerned, and rightfully so, that a treaty which was imbalanced as far as the economic consequences, the flow of investment and the flow of trade, had to be balanced and protected on the fiscal side by enabling tax administrators in developing countries to ensure, to the extent possible, that they were receiving the appropriate share of revenue from income earned by residents of their treaty partner.

LDC's fear imbalance in the provision of information

Furthermore LDC's interested in broader taxing jurisdiction at source thus require more available information. The lack of sophistication or the ability to enforce effectively the tax laws of the developing countries made these information exchange issues of much greater significance than in treaties between developed countries. There are still relatively few treaties in effect between the developed and developing countries and it will be some time before we see the results of the efforts of the group of U.N. experts in the development of the information exchange article, and the effect on the multi-nationals involved as well as the developing countries.

With this background of a few of the significant issues, let me turn briefly to what the United States is doing in the area of information exchange, and then to a few suggestions as to possible developments in this area and additional matters which should be considered.

The United States is restricted by the Internal Revenue Code from disclosing tax information. The present statutory pattern creates privacy for tax return information and then lists specific exceptions which permit disclosure. One of these exceptions permits the United States to provide tax information under the terms of any tax convention which provides for such exchange of tax information. It would appear that information exchange could be covered in a convention other than a typical tax convention. The Code provides for the disclosure to the competent authority of the other country involved and specifically limits the provision of information to the extent provided for in and subject to the terms and conditions of any such convention. The transfer of tax information contrary to the provisions of the Internal Revenue constitutes a criminal offense punishable by five years in prison and a $5,000 fine. Accordingly, we can anticipate that the Internal Revenue Service would be more cautious in its information exchange program since the enactment of the Revenue Act of 1976, and this appears to be the case. Under present procedures, information is furnished by the United States to the competent authorities of treaty partners only under the signature of the United States competent authority, who at the present time is the Assistant Commissioner (Compliance), *Singleton Wolfe*. While certain other responsibilities of the competent authority may be delegated, particularly to the Director and other officials of the Office of International Operations, and while the responsibility for gathering information and handling information requests may be so delegated, the actual transfer is apparently a non-delegable function under present procedures.

Four different methods to provide information

I have classified four different methods by which the United States provides information to its treaty partners. One of these, however, does not involve tax information of the type which is subject to the Code restrictions. These methods of furnishing information are as follows: (1) routine; (2) specific request; (3) simultaneous

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examination; and (4) meetings with the competent authority.

The most significant number of information items furnished is through the *routine disclosure* of information as provided on the Forms 1042 and 1042S reflecting payments of periodic-type income to residents of treaty countries, U.S. persons making payments of U.S. source income to nonresidents. During 1976, the last year for which figures are available, there were 652,000 separate documents filed with the Internal Revenue Service reflecting payments to foreign persons. Of those, 531,000 reflect payments to residents of treaty countries, or at least to persons whose addresses were in treaty countries. These information documents reflected total income payments of approximately $3.4 billion, of which approximately $3 billion were to treaty countries. The total tax withheld is just under a half billion dollars, or approximately 15 percent of the total income payments. The United States receives an almost equivalent number of information items from its treaty partners. In 1976, there were approximately 392,000 such items received indicating payments to U.S. residents by residents of U.S. treaty countries, and in 1977 the figure increased to 562,000.

The increase in items received indicates a greater importance attached to these items by both U.S. and foreign tax administrators. Even the procedures for furnishing these items have been improved, and at the present time several countries receive and furnish information through the use of computer-generated tapes or disks. The use to which this information is put varies, of course, from country to country. The Internal Revenue Service was criticized by a Congressional committee several years ago for failing to maximize the use of not only these information documents but other information documents. Currently, the IRS maintains a staff of specially trained persons at the Philadelphia Service Center who receive information forwarded from other countries, classify or translate as required, and furnish appropriate items of information to local District Directors.

The second type of information exchange is by *specific request.* During the past year the IRS received approximately 170 specific requests for information and made approximately 118 requests of treaty partners. The specific requests are reviewed most carefully to ensure that they meet the standards set forth in the treaties and other policies which guide the furnishing of such information. The Internal Revenue Service must be satisfied that the foreign country has exhausted to a reasonable extent its ability to obtain the information from other sources. It must also be satisfied that the information will be used solely for the purposes set forth in the treaty, that is, the enforcement of the tax laws which are the subject of the convention. Note that current treaty language does not limit the use of the information, however, to persons covered by the treaty. For example, Japan could ask for information from the United States relevant to the determination of the Japanese tax liability of a Canadian company not resident in Japan. On the other hand, while the United States has proposed broader language so that the treaties cover any taxes, the tax involved must be a tax covered by the treaty, which would generally exclude, therefore, sales excise taxes and value added taxes.

The information furnished by the U.S. is kept to the minimum necessary to meet the needs of the foreign tax administrators. For example, if the foreign government is interested in the salary paid to a U.S. citizen, the foreign government would not be provided with a copy of the 1040 but merely would be given the information requested — the salary paid by a particular employer. The request must be very specific as to the information required and why. Only in rare and unusual cases would a document such as the 1040 be provided. The IRS would have to be satisfied that the document was needed, for example, if there was a court case involved, and would also have to be satisfied as to the use to which the document might be put. In such cases, the U.S. response will vary from country to country. Canada, for example, would be furnished information in such form and I assume that would be reciprocal also.

I have heard stories from time to time of widespread disclosure of U.S. tax information to foreign tax authorities. One story is that through a computer error, the German competent authority was furnished with the Federal income tax return of every U.S. citizen reflecting an address in Germany. Needless to say, the IRS categorically denies these stories and stands by its policy, which I believe I have set forth accurately. It is, of course, possible for foreign tax authorities to obtain copies of U.S. tax returns. One way that they can do this is by authority under their local law to demand of U.S. citizens a copy of their U.S. federal returns.

Tax files timely removed from Iran

There are other ways, of course, some of them accidental. Those of you with interest in the Middle East will be pleased to know that the U.S. did recover all of its files from Iran prior to the revolution. As you know, Tehran was landlord of 14 OIO post outside the U.S. The Revenue Service Representatives located there covered the Middle East. Tax returns under audit for U.S. persons living in the Middle East were located at that office. You will be relieved to know that all of the files were removed safely and the Ayatollah Khomeini does not have any returns of your clients or employers.

The IRS not only is authorized and directed to furnish information from its files in response to requests, but to obtain information from third parties to the same extent that it would be enforcing U.S. tax law. This principle was tested in the *Burbank* case [*United States* v. *A.L. Burbank & Co., Ltd.*, 525 F.2d 9 (2d Cir. 1975)]. The IRS now cites the Burbank case in any situation under which it requests information from a third party for use in answering a specific request under a tax convention. If it has to issue an administrative summons, it will do so and it is only in those cases that the U.S. taxpayer involved may be notified that a request is made involving his foreign tax liability and the U.S. taxpayer must be advised as a result of the changes to the Code made by the Revenue Act of 1976. I have been concerned that the information furnished pursuant to the eleven and now four question procedure regarding sensitive payments would be the subject of many requests for the IRS.

Apparently foreign governments have been satisfied by the procedures established by the Justice Department in obtaining information from other sources. I have been advised that there have been no requests for information of the type which would be generated by the eleven questions procedure. While the U.S. is obviously concerned about the use and sensitivity of information in these exchanges other countries are too, and since no one wants the information exchange procedures to be weakened, they all realize that discretion must be used. In one case, for example, a foreign country that had received information from the United States was about to put it to use and decided that the use of the information or the type of information, I do not know what, would be embarrassing to the United States. The foreign competent authorities advised the United States that it would not use the information and returned the information to the U.S. competent authority.

Now, *simultaneous examination.* This is really another form of information exchange. We have entered into an agreement with Canada and with the UK. I understand there are examinations underway with Canada and the UK and procedures have been initiated to identify appropriate cases to handle under the simultaneous examination procedure.[7] Negotiations are

7. *Bulletin* Editor's note: see for the US-UK simultaneous examination procedure 18 EUROPEAN TAXATION 175 (1978).

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also underway with other countries to institute similar types of agreements. These are all, so far as I know, bilateral not multilateral agreements.

The last type of information exchange involves *a meeting of the competent authorities and other tax officials* on a bilateral and multilateral basis to discuss tax avoidance and evasion problems generally. Usually these do not involve exchanges of tax information. That is, they are not talking about a specific taxpayer but in general about the latest techniques which have been devised possibly by some of you here in the room, and specific transactions which may be used for tax avoidance or tax evasion. Such meetings are increasing in frequency and usefulness. Tax administrators, the OECD, and the group of UN experts have encouraged such meetings and the IRS has engaged in several meetings and thought that it was important enough even to mention it in the Commissioner's last annual report that such meetings were taking place.

While we continue to provide this, that is the type of information exchanged under the U.S. treaties, let us take a look just for a minute at what is happening in the Common Market. A directive in 1977 provided that beginning January 1, 1979 there would be an exchange of information among the Common Market countries covering taxes on income and capital but not covering value added tax, so that has been the subject of a separate notice and has been proposed to include value added taxes because of the substantial number of avoidance and evasion problems that they think exist.[8] These provisions provide for exchanges on request, the kind we have described. They also provide for automatic exchanges, and then a new type of information exchange which the United States does not presently use, the spontaneous exchange of information.

Spontaneous exchange of information not used by the U.S.

This requires that the tax administrators furnish information to any other country when they find that there is a possibility that this information would be useful to the other country in enforcing its tax laws. But what are they supposed to do? Well, they are supposed to furnish information to the other tax authority if there are grounds for "supposed", I think that is the word, loss of tax to the other state. For example, I suppose, it would cover a case where a taxpayer reported X dollars of income and only claimed a foreign tax credit say of 20 percent. The tax auditor knows that the foreign tax is 60 percent. Now, I guess in that case you could assume that there may be some tax avoidance in the other country, so that he is then spontaneously to provide this information to the other country. When there has been a reduction or exemption of tax in one state which would increase the tax in the other state, the tax official is required spontaneously to furnish this information. When there is a use of tax havens by the companies located in two different states with the tax haven country in the middle this could be another case for spontaneous disclosure. And in section 482-type cases on pricing, when information has been received from another country and then through the use of that information it appears that there would be return information which would be useful, they are supposed to send that back as well.

The EEC directive also provides for giving the tax administrators of one country access to and the ability to work in another; it provides the usual secrecy rules similar to the model convention, and it also provides something that is not specifically covered under our treaties, that is, the transmission of information which has been received by the competent authority of one country to a third country. The EEC directive says that it is supposed to go back to the country from which the information was received for permission to send it on to a third country. So the EEC is quite a bit ahead of the United States in this area, or a bit behind, however you want to look at it.

Let me give you some areas now which I think we should be looking at. Some of these are pretty simple and straightforward, but others require some further discussion.

Question from audience. One basic problem. The information documents that come into the United States do not have the U.S. taxpayer identification number on them. The entire U.S. computer system is based on the taxpayer identification system. Why does not the U.S. request of the foreigners that at least before they give a reduction or rebate or exemption under a tax treaty that the U.S. person receiving the income is required to furnish the taxpayer identification number so it can be put on the information item sent to the Philadelphia Service Center?

Guttentag. The U.S. is working with the OECD in the development of a standard information exchange and there is a meeting of the working party, this week actually, trying to work on that standardized form which very likely would include some sort of identification numbers or the equivalent overseas.

Possibly we should be exchanging more information on *income which is exempt*; for example, bank interest. Should we furnish to our treaty partners information on foreigners living as residents of treaty countries who get exempt bank interest which is not considered U.S. source income and so require no reports that furnish that information? On the other hand, should we ask for the same information from our treaty partners?

Tax havens: What can we do about the tax haven problem? One of the biggest problems is the lack of information. Do we try as has been suggested in the past, to enter into treaties with the tax haven countries to obtain information, solely for the purpose of obtaining information, even though they may not have an income tax to be the subject of a regular tax treaty? What is our leverage in trying to obtain this, and is it worthwhile to obtain it from half a dozen tax haven countries if there are going to be another half a dozen which do not have such conventions? What do we do about bearer instruments, and (their effect, for example), in the case of corporations which invest in the United States? Do we have the optimum coordination of our treaty exchange of information and competent authority between the IRS and the Treasury? I think not without any disrespect to any of the people involved. I think it is rather an awkward procedure that we have the Office of International Operations under the Assistant Commissioner (Compliance) and we have the Office of Assistant Commissioner (Technical) involved, all under the Commissioner; but then we also have the Office of International Tax Counsel and there are really no direct lines of communication or coordination among them. I think in many cases we have to rely on the personalities involved to communicate effectively and I think that is an area in which we ought to take another look.

Spontaneous exchanges. What should the U.S. do? Should the U.S. make spontaneous exchanges? Should we ask revenue agents, or district directors, who think that somebody may have avoided a Swiss tax to notify the Swiss competent authority? We have to worry about protecting the rights of the individual involved. It may be unequal exchanges of information, depending on the seriousness with which the revenue administration approaches the problem. Imagine, for example, a spontaneous exchange arrangement between this country and Italy. I think that it will require some considerable thought before we adopt a spontaneous exchange system.

8. *Bulletin* Editor's note: See for this directive SUPPLEMENTARY SERVICE TO EUROPEAN TAXATION, Section D and 18 EUROPEAN TAXATION 139 (1978).

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Question from audience. Why don't we advise taxpayers before we exchange information so that the taxpayer has the opportunity to make sure that the information is accurate or require the foreign government to explain that the information is not really wanted for tax purposes but is wanted for exchange control or some other criminal procedure? Why should we not provide the taxpayer with that information the same way that we do when a third party summons is used in the U.S.? What about the balance of information? Is the balance of information significant? Is this a one way street? We have just signed a treaty with Hungary which contains, it appears at a quick look, the standard exchange of information provisions. Now we can provide these routine items. I do not know how much flows to Hungary, and I do not know that much about the Hungarian tax system, but will we receive anything of much significance from Hungary and does that mean that we are going to use a different method of enforcing and carrying out our obligations under what appears to be the standard exchange of information article in this type of treaty which may have been entered into for really limited purposes?

Maybe *Dave Reizes* would like to put his nickel in at this point.

Reizes. I would be happy to, Joe. One of the first things I did when I moved to OIO to take over this area was to separate the competent authority cases of double taxation or double benefit from the staff work. In one group we have all the equity cases. In the other group are hard-nosed compliance types that handle the exchange of information requests. The routine exchange of information is one of the continuing projects in that particular group. I think you have covered it fairly well. We are making some significant progress. That area is becoming much more coordinated and is becoming subject to a lot of cooperation. We have always tried to use our procedure as a model. But of course every country resents using the U.S. model. You talked about using the identification number; we have had problems with five or six countries lately who would be happy to give us a number but not the social security number. Canada recently tried to pass a law to provide for it. In fact, one Canadian form has a block (at our request) for insertion of the social security number. Canada has an SIN as we have our SSN. In Canada we found that there is a political, moral movement against big brotherism, where using one number to identify citizens for social insurance *and* tax purposes is antipathetic to many Canadians, I am sure there are many Americans who feel the same but who have just not been as vocal.

Introduction of an international tax identification number

We find the same thing in several of the other countries. We have been talking to the Scandinavian countries for the past several weeks. Perhaps in your IFA committee, or in the OECD committee, you could possibly put forward our most recent suggestion: that we develop among the various treaty partners an international tax identification number. The first time a name comes up with a flow of, say, investment income between countries, that name is assigned some "clearinghouse number" just for that particular purpose, and subject to all the treaty secrecy and confidentiality requirements. We think in this way we can get around the problem and keep the purpose of this information strictly for passive investment tax information.

You have said so much it is hard to respond. In the first 40 minutes you covered almost every point that this group of mine is working on, and you have covered it fairly well. I think that between the several persons involved in the administration of tax treaties, that just by the very force of character they are keeping communications open, and an operation running which could really get bogged down in the bureaucratic morass.

Guttentag. I wondered if anybody here has been involved in, or knows about, and is willing to talk about, any simultaneous examinations and what's happening with them. I do not think we have that many going on.

Comment from audience. I do not have one going on, but exchange of information, the treaties, is supposed to be between the competent authorities. I notice that the simultaneous examination procedures provide for consultation at the agent level, and was wondering what the authority for doing that was.

Reizes. In Professor Surrey's article on the UN Treaty the statement is made, if I recall, that the exchanges of consultations can be at the various levels, it can be between the competent authorities, it can be in writing, it can be in face to face meetings, it can be between delegated subordinates. At this particular time, where it has been different in the past, but at this particular time there is no delegation of the actual competent authority. However, the simultaneous examination program is called simultaneous, as opposed to joint, because they are two separate examinations and the way it has been structured is to in effect have parallel examinations with exchanges of information at certain points pursuant to formal requests and pursuant to specific delegations or authorizations to receive or act as an agent. As I have said, I have not been along on one of them. I have watched the development of the program from a distance. What we see is that when the agents get together, they are getting together at a planning stage. They are talking about issues; they are talking about approaches; they are talking about time schedules; allocation of resources; development of issues by economists; and they are not necessarily exchanging tax information. Formal exchange is going on. The agents can exchange documents as authorized and be designated to, perhaps, ask a question about it for further clarification. This is being done very formally.

Comment from audience. There was, you know, an agreement entered into by the Commissioner and the Minister of Revenue and I suppose that resulted in a delegation of the competent authority to exchange that information because one of the provisions, for example, says that the individual case managers from the audit team will exchange information. Now the Commissioner signed that and I suppose he has authority to do that. He is delegating an unnamed person by title only.

Guttentag. You think that cannot be delegable in that way or at all?

Comment from audience. Well, I feel that the people might be concerned about confidentiality because of the information.

Guttentag. In what way?

Comment from audience. Well, that it is being discussed among a large group of IRS officers in the United States?

Beatty. Joe [*Guttentag*], is there any possibility that the restrictions on the disclosure of tax information that are governed by the Code extend to the foreign recipients of return information exchanged under the simultaneous audit program? Is there, in other words, the same restriction on the UK auditor who obtains U.S. data that there would be on the U.S. agent himself?

Guttentag. You mean does the Code have extra-territorial impact on this ...

Beatty. Is there an obligation on the part of the IRS to insist as one of the conditions of the transfer ...

Guttentag. The limitation on the use of that is contained in the treaty itself. It provides for the secrecy in the handling of that information and the improper disclosure of that information. I do not know as to what detail the IRS goes with respect to specific requests. With respect to routine pieces of information, that information is just put in a bundle and shipped off to the competent authority overseas, and to what extent there are any requirements beyond the treaty language as to what can be done with it, I do not know of any.

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Reizes. I would like to add that we have gotten agreements to use restrictions similar to our Code restrictions. Information is given upon specific understandings. Now, the Canadian treaty is our only treaty that does not have a secrecy provision in it. It is an "old" exchange of information provision. The commitment we have received from the Canadians is that, notwithstanding that secrecy is not specifically mentioned, we read it into the exchange provision. They have agreed to consider our internal domestic statutes. Our agreement is to respect the use restriction. It will be read in, and we will follow it.

Question from audience. Is there any way of checking the sanctions for violations of restricted use to make sure that any individual in a foreign administration who makes improper use of such administration will be proceeded against with reasonable severity?

Reizes. You are getting into a diplomacy type of argument. I really do not know how far we can go on that. Our primary consideration is that treaty partners get so many significant information exchanges that we both would hesitate to violate the confidentiality provisions either of the treaty or agreed to provisions of a specific exchange, because it would cut off further exchanges. It could impact the entire program with that particular country. We, and they, just would not do it.

Questions from audience. Political organizations of a particular foreign country may be capable of requesting tax information for purposes of their own. What I am thinking about is whether there are instances in which the government uses other means to find out about overseas wealth of internationals. Is somebody there to make that kind of political assessment?

Reizes. It is made, if necessary, by the competent authority but it is a very broad consultational process. I think Treasury is directly involved in situations of this nature. I know that anybody with any expertise or experience throughout IRS is consulted and brought into the progress. I have not seen a bad case of that type yet.

Question from audience. Under the U.S.-Canada joint audit agreement there are some directives in which some areas of the exchange are set forth some of which pertain to tax savings and it seems that through the issuance of these directives through joint tax audits that the U.S. will eventually accomplish what the EEC is doing under its exchange of information provisions.

Reizes. I think they are heading towards the same place but I think they have two different purposes. The EEC in exchanging information, is trying to develop an information pool for each country to do what they will with. The simultaneous audit program is an attempt to maximize the use of resources where two countries have significant interest. One of the things that *Joe Guttentag* mentioned was the method of exchanging information where we try to triangulate, for example, where we have a tax haven situation. If you look at the news releases about the simultaneous examination program, whether it is with U.K. or Canada or other countries, I think you will see a particular emphasis on existence of tax haven subsidiaries. This is always one of the criteria that will be evaluated in the selection process. The important thing in the program is that the U.S. and its simultaneous audit partner will get together and actually select cases which have high impact for both countries. This way they are able to triangulate and also conserve resources.

U.S. overseas audit program

We have an overseas audit program. OIO, either at the request of a District, or where an OIO taxpayer is involved, sends people overseas to examine books and records. We send people from the various foreign posts that we also have in 13 foreign countries to do on-site audits of subsidiaries of U.S. parents, and foreign branch operations. It is a tremendous saving of our limited resources to know that the same examination of that foreign country operation is going to be performed by our treaty partner who will be able to give us the same information we will need to verify the tax return. The additional benefit that might come from this is at the same time there is a simultaneous examination there is also fact finding; so, for example, you do not have two different sets of pricing proposals. There are many benefits to be derived from this program as long as you go about it cautiously and make sure that it is not abused, which I think is the common fear, as expressed here today.

Beatty. We might mention one other thing on triangulation cases that we did not touch on in the discussion of competent authority proceedings. There have been several cases that have developed where goods were being sold from one treaty country to another treaty country through an intermediate tax haven. An example would be exports running from a United States to a Bahamas company which in turn resold the goods to France. In the days when it was possible to shelter Subpart F income from U.S. tax, that sort of structure could have an impact in the U.S. obviously. It would also clearly create a potential for French tax avoidance. If the U.S. and France independently proceeded to make section 482 type allocations, the net result of both allocations might be to put the tax haven company in a loss position because its adjusted cost of goods sold for the goods purchased from the U.S. was greater than the selling price into France permitted by the French authorities. You then have a very interesting type of competent authority proceeding. Can and should the U.S. and French competent authorities proceeding under the treaty grant relief in that situation?

Special aspects of triangulation cases

I gather from *Dave* [*Reizes*] that a number of European competent authorities, particularly the Swiss and the French, tend to analyze the transaction in accordance with its forms and say that it simply is not a competent authority case. They say, "We have adjusted the inter-company transfer price from the Bahamas to France. We have no treaty with the Bahamas and there is no reason to talk with you."

Unidentified comment. I think it is just another reflection of the whole attitude toward correlative adjustment in Europe. I think the idea is if a company makes a reasonable effort to come to a reasonable price, we are going to leave it alone — we are not going to have these crazy rules that the Americans have. On the other hand, if they are way out of line we are going to hit them. And in addition to paying the additional tax the price they pay is the loss of that correlative adjustment. They do not care about correlative adjustments. This is going to help keep people honest. The U.S. does not take that approach, of course.

Unidentified comment. I think we are overly concerned with the competitive posture of business and the stated effect of a treaty: avoidance of double taxation. We try to stay away from this punitive idea that, if this is the way the taxpayer set up the transaction, let him lie in the bed he has made.

Question from audience. What percentage of volume of information is there between the developed countries with the United States as opposed to the United States with undeveloped countries.

Volume of information regarding less developed countries

Reizes. The volume is almost entirely with the developed countries, because we can only exchange under the tax treaties. Section 6103 specifically contains an exception from the prohibition on disclosure, if information is exchanged pursuant to a treaty. If there is no treaty, we cannot disclose the tax information.

Question from audience. There are a few

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treaties with undeveloped countries. Are they getting any volume out of that? British Virgin Islands, Netherlands Antilles.

Unidentified comment. Yes. I think we are talking about a little bit of information in the less developed countries, a couple of Caribbean countries. But we are really concerned with the volume countries, the countries where we have passive investment income flowing through.

The Netherlands Antilles does give us information on either a specific request or routine use basis. As to most of the others, the overseas departments of France and former British colonies, I do not know. If it were significant, I am sure I would know. I do not think we get very much, and I do not think we really supply very much. It is a reciprocal relationship. Sometimes we will give first in order to convince a treaty partner that that is the way to do it, and then we hope we will get exchanges in return. Somebody has to start the procedure. But looking at the list of these former British colonies and the overseas departments of France I really do not think we are talking about any substantial volume of exchange.

Comment from audience. My suspicion is even if we had a treaty with them, I do not think they are equipped to handle it, to receive or give.

Reizes. I agree with you. It is probably one of the reasons why they do not have very sophisticated tax systems. They get by with the sun, most of them.

Question from audience. In the foregoing discussion it was said that we generally would not exchange information in some instances. Do we give a U.S. government independent auditing group that is auditing the effectiveness of the foreign tax authorities sufficient information to see whether the tax authorities are covering the job capably or not?

Reizes. We have not been faced with that yet. I would tend to resist it. I think our position has been, so far, that we are still trying to define the parameters of what the secrecy clause of the convention means, and whether a U.S. government organization can look at specific case information in our treaty cases. I do not think we have come to a very strong, hard, answer as to whether they can do it. We certainly are not going to authorize it or allow it overseas until we have arrived at that situation. In the United States, GAO does audit our operation, they look at our statistics, they look at our procedures, they see, I think they see, the bulk of our files, but I know that as far as protected information, my people are very careful about what we will let anybody see. I think it is still up in the air, so until we clean our own house we are certainly not going to let anything happen overseas.

Question from audience. Joe [*Guttentag*], you mentioned that because of the exchange of information under treaties the Service might want to require the reporting of bank interest. In 1966 I believe they proposed such a rule, a rule that was much broader, a broader reporting requirement, but withdrew it because of substantial adverse comments from banks and others.

Guttentag. I think we need to do some more work in this area. In looking at the statistics developed by the IRS there is some discrepancy in them as far as the tax collected and so forth which I do not quite understand and for which I have not received a satisfactory explanation. I think we need some more work. Is this useful information? Are our treaty partners interested in it? If you take a look for example at the new French estate tax treaty which has just been sent to the Senate you will find there that we excluded from U.S. estate tax most assets of French domiciliaries except real estate from a permanent establishment, but we maintained a requirement that we still keep records as to the nature and the amount of those assets for furnishing to the French to make sure that they were able to tax those assets. But I think that this is just another area where we need more, but we have to see whether it is useful. If the foreigners are not interested in knowing how much their residents earn in U.S. bank interest then why should we bother? Is there something reciprocal that we can get in return?

Comment from audience. I understand that the Danish tax authorities or the Danish Parliament has such a reporting law and that right after they did that many non-residents just pulled their money out of Danish bank accounts and transferred them to others.

Guttentag. We could bring a lot more foreign investment into the United States if we eliminated other reporting requirements and taxes. Why have this exception? Are the banks right? I don't know.

Jenks. I think we are out of time for this afternoon. Thank you all very much for your participation in the program.

Appendices on the following page

ERRATUM

Article by Pedro F. Massone: Recent Developments in Latin America; The Mexican Value Added Tax in 32 BULLETIN FOR INTERNATIONAL FISCAL DOCUMENTATION, December 1979.

Please make the following changes:

Page 544, second column, line 11: "more" should read "minor".
Page 545, first column, line 29: "1,500 pesos" should read "1,500,000 pesos".

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APPENDIX

U.S. TREATIES IN FORCE AND UNDER NEGOTIATION AT FEBRUARY 28, 1979

U.S. tax treaties in force at February 28, 1979

Australia
Austria
Belgium
Canada
Denmark
Finland
France
Germany
Greece
Iceland
Ireland
Italy
Japan
Luxembourg
Netherlands
Netherlands Antilles
New Zealand
Norway
Pakistan
Poland
Romania
South Africa
Sweden
Switzerland
Trinidad and Tobago
United Kingdom
U.K. overseas territories (see below)
U.S.S.R.

The following are United Kingdom overseas territories and former territories:

Aden
Antigua
Barbados
British Honduras
Dominica
Falkland Islands
Gambia
Grenada
Jamaica
Malawi (formerly Nyasaland)
Montserrat
Nigeria*
St. Christopher, Nevis and Anguilla
St. Lucia
St. Vincent
Seychelles
Sierra Leone
Virgin Islands (British)
Zambia (formerly N. Rhodesia)

Treaties or protocols signed and submitted to the Senate for approval

France
Korea
Morocco
Philippines

Treaties signed but not yet submitted to the Senate

Hungary

Treaties on which negotiations completed

Republic of China
Egypt
Israel

* Terminated for assessment years beginning on or after January 1, 1979 for U.S. purposes and April 1, 1979 for Nigerian purposes.

Treaties or protocols in process of negotiation

Argentina
Bangladesh
Brazil
Canada
Cyprus
Denmark
Germany
Indonesia
Italy
Jamaica
Malta
Nigeria
United Kingdom

Negotiations initiated but currently inactive

Australia
Botswana
India
Iran
Kenya
Netherlands
Singapore
Spain
Sri Lanka
Tunisia
Yugoslavia
Zambia

Estate tax treaties in force at February 28, 1979

Australia (also Gift Tax Treaty)
Canada
Finland
France
Greece
Ireland
Italy
Japan (also Gift Tax Treaty)
Netherlands
Norway
Switzerland
South Africa
United Kingdom

Estate tax treaties signed and submitted to the Senate

France

Estate tax treaties signed

United Kingdom

Estate tax treaties in process of negotiation or contemplated for the future

Denmark
Germany
Luxembourg

Totalization agreements in force

Italy

Totalization agreements signed and awaiting ratification

Germany

Totalization agreements under negotiation

Belgium
Canada
Iran
Israel
Spain
Switzerland
United Kingdom

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Estimation of Tax Potential and Tax Efforts of State and Local Governments

by G.Thimmaiah*

The burgeoning literature on the modern theory of public finance has thrown up new concepts both to replace and to supplement the old ideas on various aspects of public finance. This process has also led to some confusion regarding the specific connotation of some concepts. A case in point is the terms tax potential *and* tax efforts, *which have been used in place of* taxable capacity *and* tax burden *respectively. The purpose of this paper is to analyse certain conceptual issues relating to* taxable capacity, tax potential, tax burden *and* tax efforts *in their historical context and to highlight their analytical contents with a view to evaluating their usefulness in policy formulation. These concepts have been used mostly with reference to governmental units such as national, state and local governments. Hence, their analysis in this paper refers only to governmental units rather than to individuals. In the case of individuals, the concept of* tax incidence *is more prominent, although the concept of* tax burden *is also used to indicate the nature and extent of final incidence of a tax on individuals. However, the concept of* tax incidence *has received sufficient attention from economists* [1] *although the result has not been encouraging from the point of view of specification for empirical measurement.*

I. CONCEPT OF TAXABLE CAPACITY

The concept of *taxable capacity* has engaged the minds of economists for a considerable period of time. Perhaps the earliest attempts to analyse the concept of taxable capacity were made by European economists, particularly in Great Britain. They confined their discussion to "tax", without extending their analysis to the non-tax revenue of the government. This was obvious from the fact that the role of government was confined to very essential activities, and the private sector was considered the sine qua non of any civilized society. Any large-scale interference by the government in private sector economic activities was considered an evil; hence organized pressure groups were always watching the role of the government. In view of the necessity of having the government, the need to raise revenue for supporting even such a "minimum government" was willy nilly permitted. Here again such issues as how to raise the required revenue, and what would be the maximum amount of taxation a country could afford, were discussed at length by using concepts like *absolute taxable capacity* and *relative taxable capacity*.

The concept of absolute taxable capacity was popularized in the U.K. by Sir Josiah Stamp [2] in the early part of the 20th century. He used the Ricardian theory of surplus to formulate the concept of absolute taxable capacity, interpreting absolute taxable capacity as total production minus the subsistence level of consumption plus some essential investment. So defined, the concept of absolute taxable capacity becomes cardinally measurable. He noted, however, that such absolute taxable capacity cannot remain constant as it would vary with the production. The cardinal concept of absolute taxable capacity was used by Findlay G. Shirras [3] to measure the absolute taxable capacity of the U.K. and British India for the pre-World War I and inter-war years. He defined absolute taxable capacity as "the surplus of production over minimum of consumption required to maintain that volume of production per head of population, the essential standard of living remaining unchanged over a number of years". [4] Shirras deducted from the gross national income the minimum of consumption including the necessary expenses for efficiency and savings for ordinary replacement and addition to capital; the surplus he considered as the amount of absolute taxable capacity. The influence of this concept can be noticed even now in academic circles as is evident from a recent attempt

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1. See for details R.A. Musgrave, *Theory of Public Finance* (Tokyo, McGraw Hill, Inc., 1969), Part III, and George F. Break, "The Incidence and Economic Effects of Taxation", in Alan S. Blinder et al. *The Economics of Public Finance* (Washington, D.C., The Brookings Institution, 1974).
2. *Wealth and Taxable Capacity* (London, P.S. King & Son Ltd., 1922).
3. *Science of Public Finance*, Vol. I (MacMillan & Co., Ltd.).
4. Ibid., p. 229.

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to measure the absolute taxable capacity of the agricultural sector in India by using the following formula: [5]

$$\bar{t} = (\bar{y} - \bar{c}_m) - \bar{i} = (\bar{s} - \bar{i})$$

$\bar{t}$ = per capita absolute taxable capacity
$\bar{y}$ = per capita income
$\bar{c}_m$ = per capita minimum consumption requirements
$\bar{s}$ = per capita potential surplus
$\bar{i}$ = per capita allowance for minimal investment

If taxable capacity is strictly interpreted as equal to total production minus necessary consumption plus replacement costs, it equals the net savings of a country. Such a concept may be useful for measuring the taxable capacity of a socialist country where there is no private sector. In such countries taxable capacity can be theoretically made equivalent to the net savings of the country. But in a country where the private sector is predominant and is as important as the public sector, the government cannot tax away the entire net savings of the people. It would amount to discouraging or even restricting investment in the private sector.

Even if an allowance is made for depreciation and some addition to the existing capital in the form of new investment, the concept of absolute taxable capacity becomes arbitrary because there are no objective criteria to determine how much surplus should be allowed in the form of additional investment in the private sector. Another weakness of the concept of absolute taxable capacity is its static nature, in the sense that it suggests that the government should allow only the existing standard of living to continue intact and need not allow it to rise over time. It is true, in the context of the low level of savings in a country like India, that we must reduce the level of consumption through taxation in order to divert an increasing proportion of national income to public investment. But such a policy should be selective so that those whose level of consumption is above an objectively determined reasonable level should be made to reduce it by paying taxes and those whose level of consumption is just at subsistence or below should be allowed to maintain or reach that objectively determined reasonable level. Furthermore, as and when the economy develops the consumption standard should also increase to match the rising expectations, for the very purpose of economic development is to increase the standard of living of the masses. Hence, the static concept of absolute taxable capacity does not fit into the dynamics of economic growth and development. Even the socialist countries which curbed the consumption standards of their people during the initial stages of their economic development are now allowing them to rise. This only suggests that the concept of absolute taxable capacity as it has been interpreted and used becomes static over time even in socialist economies. Therefore, it loses its analytical validity. Hugh Dalton was right when he observed that "absolute taxable capacity" is a myth and relative taxable capacity is a reality". [6]

The concept of relative taxable capacity can be considered as an ordinal concept, [7] because we can only indicate whether the relative taxable capacity of a nation or a sector or different states in a country has increased or not over time or at one point of time. For this purpose we must know the determinants of relative taxable capacity such as the levels and rates of growth of national/sectoral/state incomes, changes in the distribution of national/sectoral/personal incomes, the levels, rates of growth and patterns of consumption of different income groups, and the levels, rates of growth and distribution of government expenditure. These are some of the important economic determinants, leaving aside a host of non-economic variables such as wars, *displacement effect*, [8] etc. on which the relative taxable capacity depends. On the basis of the direction of movement of these determinants of relative taxable capacity over time, we can infer whether the relative taxable capacity has increased or not.

Until recently economists used to find out the changes in the determinants of relative taxable capacity and conclude whether relative taxable capacity of a country/state/sector had increased or decreased in an ordinal sense. But in recent years, with the advent of econometrics, attempts have been made to use regression analysis to quantify the extent of increase in the relative taxable capacity of a country/state/sector of an economy. This method of estimating the relative taxable capacity has come to be known as the *regression approach*. [9] It should be noted here that the pioneering studies of Jeffrey G. Williamson, [10] Harley H. Hinrichs [11] and

5. S.L. Shetty, "An Inter-Sectoral Analysis of Taxable Capacity and Tax-Burden", *The Indian Journal of Agricultural Economics*, July-September 1971, p. 217.
6. *Principles of Public Finance* (fourth Indian edition) (New Delhi, Allied Publishers, 1971), pp. 117-122.
7. See for details G. Thimmaiah, "Taxable Capacity of Agricultural Sector: A Comment", *Economic and Political Weekly*, February 8, 1969, pp. 331-332.
8. The need to finance war leads to the introduction of new taxes in democracies. But these new taxes are not abolished after the war. Instead, they are continued under the justification of post-war reconstruction and other social security programmes. Thus new justification displaces the original justification for new taxes. This situation is characterised as "displacement effect" by Alan T. Peacock and Jack Wiseman in their book: *Growth of Public Expenditure in the United Kingdom* (Princeton, Princeton University Press, 1961).
9. See Joergen R. Lotz and Elliot R. Morss, "Measuring 'Tax Effort' in Developing Countries", *IMF Staff Papers*, November 1967, and "A Theory of Tax Level Determinants for Developing Countries", *Economic Development and Cultural Change*, April 1970; Charles Montrie, Kenneth J. Feder and Harlan Davis, "Tax Performance within the Framework of the Alliance for Progress: A Comparative Evaluation", *National Tax Journal*, September, 1970; Roy W. Bahl, "A Regression Approach to Tax Effort and Tax Ratio Analysis", *IMF Staff Papers*, November 1971; and Raja Chelliah, Hessel J. Baas and Margaret R. Kelly, "Tax Ratios and Tax Effort in Developing Countries, 1961-71", *IMF Department Memoranda* (74/47), May 2, 1971.
10. "Public Expenditure and Revenue: An International Comparison", *The Manchester School of Economic and Social Studies*, January 1961, pp. 43-56.
11. "Determinants of Government Revenue Shares Among Less-developed Countries", *Economic Journal*, September, 1965.

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Richard S. Thorn [12] relating to the determinants of government revenue in the developed as well as the developing countries (and which used regression analysis) were the precursors of the aggregate regression approach to measuring the relative taxable capacity and tax efforts. In a way these studies themselves can be said to have been inspired by the attempts [13] to estimate the income elasticity of taxation (revenue elasticity) by using regression analysis. In the regression approach, both univariate and multivariate methods have been used to quantify the relative taxable capacity. The univariate method has been christened *income approach* because, in the U.S., the relative taxable capacity of the states was measured mainly by using state income as the sole determinant of taxable capacity, though in the case of local governments the taxable property was used as the main determinant of relative taxable capacity. Paul Studenski's and Selma J. Mushkin's studies are worth mentioning in this context. [14] Some recent studies have shown that income is the best available index of the relative taxable capacity of even the local governments in the U.S. [15] In the income approach it is assumed that all taxes are ultimately paid out of income and hence income can be taken to indicate the relative taxable capacity of a country/state/sector as the case may be. [16] Accordingly, the total revenue is regressed on income and the resulting regression coefficient is considered as the effective tax rate. This rate is applied to the actual or projected income to get the aggregate potential revenue. However, it is realised that although all taxes are paid out of income, all of them are not levied directly on income. Therefore, the income approach, by confining itself only to income as the main tax base, cannot explain the extent to which governments have cultivated and exploited various tax bases as specified in the Constitution or tax legislations. Besides, the income approach cannot capture the taxable capacity arising from "tax-exporting" or taxation of non-residents. Therefore, the income approach is now broadened to include various other relevant variables which determine the relative taxable capacity such as per capita income, ratio of exports and imports to GNP, degree of urbanization, ratio of agricultural income to GNP, ratio of non-agricultural income to GNP, etc. However, even this comprehensive multivariate regression method gives only the hypothetical taxable capacity and hence cannot give a clear idea about the true taxable capacity because the determinants of taxable capacity are chosen on an *a priori* basis and are therefore only proxies (best possible substitutes) for the true tax bases which alone can indicate the true taxable capacity.

II. CONCEPT OF TAX POTENTIAL

During the post-World War I period the science of public finance developed rapidly on the American continent. This development also had its influence on the concept of taxable capacity. In America the concept of taxable capacity as expounded by the British economists remained mostly in textbooks. The policy makers did not pay much attention to this concept apparently because of its limited applicability to policy formulation. During the 1920s and 1930s some attempts were made in the U.S. to arrive at more pragmatic approaches for the purpose of providing quantitative guidelines for policy makers, particularly at local and state government levels. [17] Perhaps the earliest attempt in this direction was made by a committee appointed by the National Tax Association. [18] The committee suggested what is known as a "model tax system" which included a personal income tax, a business income tax for the states and a property tax for local governments. Specific rates of these taxes were suggested, keeping in view the tax bearing capacity of the business, trade and income earners as well as the revenue requirements of state and local government in the U.S. This model tax system was suggested as an alternative to what was then considered as an anarchy of several taxes which were hindering business and trade. But the model tax system has been criticized as "...little more than the values and opinions of an individual researcher. This is because there is little in the way of consensus concerning what constitutes the ideal or optimal state-local revenue system.... As such they may bear litte relation to the devices that are actually used or are available to raise revenues." [19]

However, some of the studies made at Teachers College, Columbia University, New York, relating to the tax paying capacity of the local school districts were the forerunners of the representative tax system approach in which the concept of revenue potential has been widely used. It has been reported that as early as 1923 Strayer and Haig [20] suggested a formula for measuring the relative taxable capacity or the tax potential of

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12. "The Evolution of Public Finances During Economic Development", *The Manchester School of Economic and Social Studies*, January 1967.
13. See for details G. Thimmaiah, "Sensitivity and Built-in-flexibility", *The Asian Economic Review*, May 1964.
14. See Paul Studenski, *Measurement in Variations in State Economic and Fiscal Capacity*, Social Security Board, Federal Security Agency Bureau Memorandum No. 50, Washington D.C., March 1943, and Selma J. Mushkin, *The Measurement of State and Local Tax Effort*, U.S. Social Security Board, Bureau of Research and Statistics, Washington D.C., June 1944.
15. See Harry H. Landreth, *The Measurement of Local Fiscal Capacity*, Ph. D. dissertation, Harvard University, 1960, and E.B. Oppermann, *The Potential Usefulness of Uniform Tax Burden Distribution Measures of the Tax Efforts of State and Local Governments*, Ph.D. dissertation, Indiana University, 1965.
16. See for details James H. Lynn, *Comparing Provincial Revenue Yields: The Tax Indicator Approach* (Toronto, Canadian Tax Foundation, 1968), Ch.III.
17. These early attempts have been reviewed by Harry H. Landreth, in his Ph.D. dissertation, *The Measurement of Local Fiscal Capacity*, Harvard University, 1960, Ch.III.
18. See "Preliminary Report of the Committee Appointed by the National Tax Association to Prepare a Plan on a Model System of State and Local Taxation", *Proceedings of the National Tax Association*, New York, 1919, pp. 401-470.
19. Robert D. Reischauer, "Measuring Fiscal Capacity", in *Rich Governments — Poor Governments*, (Washington, D.C., The Brookings Institution, 1974), pp. 3-22.
20. *The Financing of Education in the State of New York*, Vol. I. Educational Finance Commission, American Council of Education (New York, MacMillan & Co., Ltd, 1923), pp. 173-76.

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the school districts for the purpose of guiding the state governments in making foundation grants for school districts. The formula they suggested is as follows:

$$A_i = N_i\, u - rY_i$$

A_i = subsidy to the i^{th} school district

N_i = number of pupils in attendance in the i^{th} school district

u = foundation expenditure per pupil

Y_i = tax base of the i^{th} school district (i.e. equalized value of taxable property)

r = average effective tax rate

The tax rate, r, was common for all districts and was chosen in such a way that a "representative" rich school district of the state did not get any foundation grant (i.e. A equals zero). This formula was further improved by Swift in his *Federal and State Policies in Public School Finance in the United States* in 1931. [21] However, it was Mabel Newcomer [22] who conceived for the first time in 1935 what is now known as representative tax system approach, though her approach was inspired by the model tax system approach.

Thus American scholars have coined the concept of *tax potential* for the purpose of guiding policy decisions instead of using the traditional concept of *taxable capacity*. It should be emphasised here that the concept of tax potential ultimately means the same as the concept of relative taxable capacity, as both of them refer to the potential tax paying capacity of a country, state or a sector as the case may be. This is evident from Roy W. Bahl's observation that "taxable capacity is defined... as the tax ratio that would result if a country applied to its tax bases a set of 'average' effective rates on those bases, these rates are computed as net regression coefficients... The variable indicators of taxable capacity are proxy measure of tax bases." [23] In the case of relative taxable capacity only a hypothetical estimate is made based on proxy tax bases to indicate whether it has increased or not, whereas in the case of tax potential the relevant true tax bases and some economic determinants are used to measure the existing true tax potential. As in the case of relative taxable capacity, tax potential is also a relative concept "because the size of the public sector depends upon society's willingness to substitute public goods for private goods". [24]

Two methods have been used to estimate the revenue potential through the representative tax system approach: (i) the direct method and (ii) the regression method. Apart from Swift, Cornell, Newcomer, and Strayer and Haig in the 1930s, in 1962 the American Advisory Commission on Inter-Governmental Relations [25] (ACIR), used the direct method to estimate the tax potential of state and local governments in the American federation. This method was also used again in 1971 by the ACIR to estimate both the tax and non-tax revenues potential of state and local governments. [26] The same method has been used by scholars like James H. Lynn in Canada to estimate the revenue potential of the provinces in the Canadian federation. [27] In Australia a slightly different version of the direct method has been used since 1933 to measure the revenue efforts of the claimant states which applied for special grants. This method was developed by the commonwealth Grants Commission, particularly under the guidance of L.F. Giblin. [28]

The direct method of the representative tax system approach used by ACIR first of all estimates the tax base of each tax of individuals state and local governments. Then the actual revenue raised by these state and local governments from a particular source of revenue is divided by the estimated tax base of that source of revenue of the state/local governments to obtain what is known as the "effective average tax rate". This is the effective rate which should be applicable to all the states/local governments in a federation. In other words, it is an average rate at which the tax bases prevailing or located in each state/local government area should be taxed. This rate is applied to the estimated tax base of each state/local government and the potential revenue is estimated. This is the potential revenue from a particular source of revenue in a particular state/local government. [29] Thus the formula of the ACIR direct method can be written in the following way:

$$RP_j = \frac{\sum_{j}^{n} r_i}{\sum_{j}^{n} b_i} \times (b_{ji}) + \ldots\ldots + \frac{\sum_{j}^{n} r_m}{\sum_{j}^{n} b_m} \times (b_{jm})$$

RP_j = estimated tax potential of j^{th} state

$\sum_{j}^{n} r_i$ = total tax yield of all the states from j to n in a federation from i^{th} tax

$\sum_{j}^{n} b_i$ = total estimated/actual tax base of all the states from j to n in a federation relating to the i^{th} tax

b_{ji} = the estimated/actual tax base of i^{th} tax in j^{th} state

b_{jm} = the estimated/actual tax base of m^{th} tax in j^{th} state

21. See Francis G. Cornell, *A Measure of Tax Paying Ability of Local School Administrative Units* (New York, Teachers College, Columbia University, 1936).
22. *An Index of Tax Paying Ability of State and Local Governments* (New York, Teachers College, Columbia University, 1935).
23. "A Regression Approach to Tax Effort and Tax Ratio Analysis", *IMF Staff Papers*, November 1971, p. 572. See also Raymond John Krazniewski, *The Derivation and Application of Measures of Revenue Capacity and Relative Effort for Local Governments in Indiana.* Ph.D. dissertation, Purdue University, July 1972, Ch. 2.
24. Krazniewski, op.cit., p. 10.
25. *Measures of State and Local Fiscal Capacity and Tax Effort*, (Washington, D.C., ACIR, 1962).
26. *Measuring the Fiscal Capacity and Effort of State and Local Areas* (Washington, D.C., ACIR, 1971).
27. Op.cit.
28. See *Commonwealth Grants Commission: Third Report (1933)* (Canberra, Commonwealth of Australia, 1933), Ch. VIII.
29. For a detailed analysis see Reischauer, Op.cit., pp. 1-56 and

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The actual revenue raised as a proportion of this potential revenue is known as the "revenue or tax effort" as the case may be. In the direct method, the difference between potential and actual efforts arises mainly due to variation in tax rates, though variations due to different sizes of the tax base located or assessed in difference states cannot be dismissed. However, this method requires true estimates of legal tax bases; in the absence of such estimates, if near proxies are used the estimated tax potential becomes arbitrary. Further, because of the use of an average tax rate, the tax potential of those governmental units whose tax base is below average gets overestimated and that of those units whose tax base is above average gets underestimated in terms of the principle of progressive taxation. Furthermore, it has been pointed out by W. Douglas Morgan that the ACIR direct method assumes base and rate elasticities of the tax yield equal to unity. [30]

In Canada the direct method of the ACIR has been used for estimating the revenue potential of the Canadian provinces. [31] In fact the equalization payments made by the Dominion Government to the provinces in Canada are determined on the basis of the revenue potential of the provinces estimated on the basis of the representative tax system approach by using the national average rate. The equalization grants are provided only to those provinces whose per capita actual revenue yield is below the estimated national average per capita revenue from twenty sources. [32]

The method used by the Australian Commonwealth Grants Commission differs to some extent from the ACIR direct method. The Australian Commonwealth Grants Commission (ACGC) has been concerned with recommending special grants to the claimant states which are in need of special financial assistance. For this purpose, it first takes into account the level of government services provided in the richest states in the Australian federation. In order to provide those services (both the level and quality) in the states which ask for special financial assistance, the Commission expects the claimant states to apply to their tax bases the rates which the richest states apply to their tax bases located within their boundaries. Therefore, the Grants Commission estimates the tax bases of the claimant states and applies the rates prevailing in the richest states to the estimated tax bases of the claimant states to arrive at the potential tax yield. The difference between what is actually raised by the claimant states and what is estimated by the commission is adjusted for the amount of special grants provided. This method has been replaced by a more direct method in the Forty-First Report of the Grants Commission [33] in keeping with the changed methodology of the Commission. Now the Commission estimates the revenue efforts of the claimant states as equivalent to the "revenue of claimant state assuming standard revenue-raising capacity and standard revenue-raising effort (average per capita modified revenue of standard states multiplied by claimant state's population), *minus* revenue of claimant state assuming claimant state's revenue-raising capacity and standard revenue-raising effort (average of standard states' revenue effort applied to claimant state's revenue base)". [34]

In recent years many economists have advocated that multiple regression analysis should be used to estimate the revenue bases and also the effective rates even under the representative tax system approach. It is maintained that multiple regression analysis will take into account all those factors (including the interdependence of different tax/revenue bases) which influence the yield from a particular tax or the entire tax system as the case may be. Under the regression method, in addition to the relevant tax base of a particular tax or a source of revenue, certain other important economic determinants of the yield from the source such as per capita income, etc. are used and their relative impact on the revenue potential is estimated. The regression coefficients so obtained are converted into standardized beta coefficients and are treated as "marginal effective rates". They are applied to the relevant tax/revenue base and to other independent variables used in the regression analysis, and accordingly the potential revenue from a particular tax/revenue or the entire revenue system, as the case may be, is estimated. This regression method takes into account the influence of not merely the relevant tax or revenue base but also other possible economic factors which might influence directly or indirectly the yield from a particular source. The tax/revenue potential estimated by using the multiple regression method, therefore, is weighted by the relevant tax/revenue base and other important variables used therein. As the regression method yields marginal effective tax rates and takes into account the influence of other important determinants of the tax potential, there will be a difference between the tax potential as estimated by the ACIR direct method and that estimated by using the regression method. The ACIR direct method yields a simple average tax/revenue potential whereas the regression method yields a weighted marginal tax revenue potential. Although the regression method helps in identifying the relative influence of other relevant economic factors on the revenue yield in addition to the relevant tax/revenue base, whether it is appropriate to take into account such influence while estimating the revenue potential of state and local governments is a moot question. [35]

Allen D. Manvell, "Differences in Fiscal Capacity and Effort: Their Significance for a Federal Revenue-Sharing System", *National Tax Journal*, June 1971, pp. 193-204.

30. "An Alternative Measure of Fiscal Capacity", *National Tax Journal*, June 1974, p. 362.

31. See Lynn, Op.cit. Also see *Measurement of Relative Provincial-Municipal Tax Efforts in Canada as of Year-end 1970* Dominion-Provincial Relations Division, Ministry of Finance, (Ottawa, 1971).

32. See for details David B. Perry, "The Calculation of Equalization Payments to the Provinces", *Canadian Tax Journal*, March-April, 1974, pp. 166-173.

33. *Grants Commission Forty-First Report, 1974, on Special Assistance for States* (Canberra, Australian Government Publishing Service, 1974).

34. Ibid., p. 34.

35. See for details, Allen D. Manvel, "Tax Capacity Versus Tax Performance: A Comment", *National Tax Journal*, June 1973, pp. 293-294.

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It may be mentioned here that this regression method was first used by Roy W. Bahl in an IMF study [36] to estimate the tax potential and tax efforts of 49 developing countries. Recently it has been used by John S. Akin [37] to estimate the revenue potential and efforts of the states in the American federation. He has claimed that the regression method yields a marginal effective tax rate which he considers more relevant for estimating the revenue potential of the States. On this ground he has maintained that the ACIR direct method which uses an average effective rate is methodologically inferior. But it may be argued that the multiple regression method is appropriate for estimating the tax potential of an individual country/state/local government taken in isolation as it does not involve any comparison with the tax potential of other countries/states/local governments. In such an estimation, it is necessary to take into account the influence of other factors, in addition to the relevant tax base, on the tax potential of a country/state/local government. However, the ACIR direct method is appropriate for estimating the tax potential of several countries/states/local governments with a view to knowing their relative tax potentials. In such comparative studies it may reasonably be assumed that the effect of "tax exporting" by the countries/states/local governments is offset by the effect of "tax importing".

III. TAX EFFORT AND TAX BURDEN

The concept *tax burden* has been used in the orthodox theory of tax incidence to indicate both absolute tax burden and relative tax burden on both individuals and countries. *Absolute* tax burden indicates the absolute amount of tax paid or borne by individuals and/or a country. The *relative* tax burden indicates the proportion of the amount of the tax paid/borne to income in the case of an individual, and the proportion of tax revenue raised to GNP in the case of a country, state or sector, as the case may be. However, these indices do not throw much light on the true burden of taxation. Therefore, Henry J. Frank, Richrd M. Bird and Vito Tanzi have suggested some alternative methods of measuring inter-state and inter-country tax burdens. [38]

Frank's index of tax burden is measured by the proportion of state and local taxes to personal income divided by per capita personal income. Bird has suggested a slight modification to this index in the following way:

$$\left[\left(\frac{T}{Y-T}\right) \times 100 \div \frac{Y}{P}\right] \times 100$$

T = tax revenue
Y = gross domestic product
P = population

Henry Aaron has maintained that this index of tax burden implies excessive progressivity of taxation while referring to countries. [39] Therefore, not satisfied with this kind of estimation of inter-State and inter-country tax burdens, Vito Tanzi has suggested a variant of the ACIR-ACGC and regression method. [40] According to his method,

> "If the total tax 'burdens' — consisting of the ratios of the aggregated federal, State and Local taxes to the States' incomes — could be determined for each State, and these burdens could be related to the per capita income of the States, one could obtain an estimated relationship which would tell us what would be the most likely tax 'burden' that a foreign country would have if, *ceteris paribus*, it were a State of the United States. In its simplest form, that relationship could be written as:
>
> $$\frac{T_i}{Y_i} = a + \overline{Y}_i \text{ ",}$$
>
> (where T_i stands for total taxes, Y_i and $\overline{Y}_i$ for total personal income and per capita personal income respectively)." [41]

This method assumes that the U.S. personal income tax system is ideal in the world merely because it is progressive. Further, it does not take into account the process of structural change in the tax system which takes place in the course of development of a country. Finally, all these measures of tax burden disregard the influence of distribution of income on the tax burden of a country and/or State. Richard Bird and Henry Frank also disregard the value judgement involved in comparing tax burdens; they also use the concept "tax burden" synonymously with "tax sacrifice", although Richard Bird has clarified that no value judgement relating to interpersonal comparison of utilities

36. "A Representative Tax System Approach to Measuring Tax Effort in Developing Countries", *IMF Staff Papers*, March 1972, pp. 87-122.
37. "Fiscal Capacity and the Estimation Method of the ACIR", *National Tax Journal*, June 1973, pp. 275-91. Also see his Ph.D. dissertation, *Estimation of Local Fiscal Capacity*, University of Michigan, 1971.
38. See for details Henry J. Frank, "Measuring State Tax Burdens", *National Tax Journal*, June 1959. and Richard M. Bird, "A Note on 'Tax Sacrifice' Comparisons", *National Tax Journal*, September 1964.
39. "Some Criticisms of Tax Burden Indices", *National Tax Journal*, September 1965. It may be noted here that V.P. Gandhi has suggested the following degree of progressivity to make the index of tax burden a policy tool:

" $\frac{t}{(y-s)^{e_o}}$, $(1 < e_o < 2)$, where t is taxes per capita, y is income per capita, s is subsistence per capita and e_o is the exponent whose value lies between one and two".

Some Aspects of India's Tax Structure: An Economic Analysis (Bombay, Vora & Co., 1970), p. 130. However, Richard Bird has criticised this kind of injecting progressivity into the tax burden index as arbitrary. See for details Richard M. Bird, "Assessing Tax Performance in Developing Countries: A Critical Review of the Literature", *Finanzarchiv*. Vol. 34, No. 2, 1976, pp. 244-265.
40. "Comparing International Tax "Burdens": A Suggested Method", *Journal of Political Economy*, September/October 1968.
41. Ibid., p. 1080.

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of income and disutilities of tax payment is assumed. He has further observed that the concept "tax burden" does not imply any excess burden of taxation. If this is so, then there is no justification for using this term to indicate the relative tax efforts of the governmental units. In any case, the suggested methods of measuring the relative tax burdens of states and/or countries are not useful for policy formulation, particularly to estimate the extent of tax potential tapped by the state and local governments.

It was in this context that the concept *tax effort* was coined by the American economists who attempted to measure the tax potential. Tax effort refers to the ratio of actual tax revenue raised to the estimated potential tax revenue. The "relative tax effort is the percent relationship between tax revenue and estimated tax capacity".[42] It does not involve any kind of value judgement relating to "burden" or "sacrifice" implied in tax payment. Here again, the concept "tax effort" has been used only with reference to governmental units and not in the context of individuals and hence does not get itself entangled in the problem of tax incidence.[43]

IV. A COMPREHENSIVE VIEW

The foregoing analysis of the concepts of taxable capacity, tax potential, tax burden and tax effort refers to the relative economic capacity/potential to raise tax revenue. However, in democracies a more comprehensive view of the tax potential and tax effort will have to be taken in order to make these concepts useful for policy analysis and policy formulation. Tax potential may be viewed comprehensively from three angles, all of which are relevant for any democratic government in its tax policy formulation. They are: (1) the constitutional-legal potential, (2) the economic potential and (3) the political-administrative potential.[44] The constitutional-legal capacity/potential refers to the constitutionally allocated powers of a governmental unit to raise revenue from constitutionally specified sources, and the legal definitions specified in the tax law to cover the tax base of such sources for purpose of tapping the revenue. This legal potential depends upon the limitation placed on the government through exemptions, deductions, etc. to tax a particular tax base. Thus, for example, if we compare the tax potential of the states in India, which do not have the constitutional power to raise revenue through a general income tax, with their counterparts in the U.S. which do have such power to tax income, it becomes arbitrary. Any attempt to measure taxable capacity/potential without reference to such constitutional-legal potential is merely a hypothetical exercise without any relevance to practical tax/revenue policy formulation. It is in this sphere that the traditional concepts of absolute and relative taxable capacity become obsolete, and the ACIR method scores over other methods of measuring tax potential in regard to legal power to tax. For it takes into account the legally defined source of revenue as given and tries to measure the potential revenue yield by applying an average rate to the specific tax base.

The economic capacity/potential refers to various indicators of the tax base discussed earlier. However, the existing statistical data relating to potential "taxable base" may not be appropriate from the point of view of its legal coverage. Any discrepancy between legal definition and economic definition of the tax base created by the absence of relevant data to measure the tax base will be reflected in the estimated tax potential and hence in tax effort. In the ACIR method, for want of appropriate data to represent the legal tax base, some proxies have been used. This invariably results in some arbitrariness apart from the earlier mentioned defects of this method.

The political-administrative capacity/potential is difficult to measure and hence economists have not attempted to measure it. Nevertheless, this aspect is a very important determinant of tax effort. In modern democracies the political will to tap the tax revenue to the hilt by utilising the constitutional powers is determined by support from the people of the party in power, group interests and the willingness on the part of the government to risk power in elections. As the main objective of a democratic government is to continue in power *à la* Anthony Downs,[45] one may remark that governments very rarely risk their popularity in tax measures. For instance, the cry for taxing the agricultural sector by the Indian states does not recognise the political risk involved for the state governments which are dependent on rural votes. Economists have no suggestions to make to get over this difficulty except to suggest centralizing agricultural income tax. They forget that that policy itself has its political implications. This is also true of local governments' unwillingness to utilize their revenue sources in India. Economists sidetrack the issue of local governments' nearness to their voters and the consequences of taxing them without providing proportionately apportionable benefits. This aspect of tax potential has not been appreciated by economists in their discussion of tax potential and tax effort.

Given the constitutional-legal and political potentials, the administrative efficiency is a major determinant of tax effort. Unfortunately all the methods developed so far to measure tax potential have failed to take into account the administrative efficiency. Even the modified method suggested by Akin to take into account the influence of interdependence of tax bases and also the taxing of non-residents has not attempted to allow for variations in the political capacity and administrative

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42. Krazniewski, op.cit., p. 14.
43. It may be noted here that Richard M. Bird has maintained that the usefulness of the concept of "tax effort" in guiding the foreign aid policies of international agencies has been overemphasized without realizing the inherent subjective judgement involved in the concept. See, for details, his article "Assessing Tax Performance in Developing Countries...".
44. See Leo Cohen, *Comparative Fiscal Capacity and Tax Effort of Units of Government in Madison and St. Clair Counties, Illinois: 1950-1960.* Public Administration and Metropolitan Affairs Program, Southern Illinois University, Edwardsville Campus, March 1963.
45. *An Economic Theory of Democracy* (New York, Harper and Row, 1957).

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efficiency in tapping the tax potential. It may be argued that the representative tax system approach takes implicitly into account the efficiency of tax/revenue administration through the process of estimating the average effective rate. This is not necessarily true. It only assumes the actually existing level of efficiency of tax/revenue administration as given and does not specify variations in tax/revenue efforts arising from varying levels of efficiency of tax/revenue administration. For instance, a state, by raising the level of the tax administration above an average level, may raise more revenue from a given average tax base by applying a rate of tax lower than the average effective rate. On the other hand, a state may raise more revenue from a given average tax/revenue base by applying a higher rate with a below average level of tax/revenue administration. In view of these possibilities it is very difficult to justify that average effective tax rate reflects an average level of efficiency of tax administration.

Therefore, future attempts to measure tax potential and tax effort of state/local governments should use specific indicators of administrative efficiency as explanatory variables in regression equation or weight the average rate of tax for variations in administrative efficiency in the ACIR method of estimating the true tax potential. Because of the difficulties inherent in specifying and quantifying the indicators of administrative efficiency, the tendency is to use dummy variables in a regression equation. This method is arbitrary and hence its results cannot be used for the purpose of tax policy formulation.

Thus taxable capacity/potential and tax effort are not merely economic concepts. They also have their legal, economic, political and administrative aspects which have got to be covered in any useful estimation of tax potential and tax effort of governmental units in democratic societies. Hence, the tax experts who are called upon to advise governments in developing countries have to take into consideration all these aspects while formulating their recommendations.

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NIGERIA:

An Epilogue to a Decade of Federal Government Budgeting

An Appraisal of the 1979/80 Government Budget

by F. Akin Olaloku*

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I. INTRODUCTION

II. FISCAL POLICY

III. THE 1979/80 BUDGET

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APPENDICES

I. INTRODUCTION

The 1979/80 Federal Government Budget is the last in a decade-long series of annual budgets by the Federal Military Government of Nigeria which began in the fiscal year 1970/71 and were directed initially at the adverse effects on the Nigerian economy of a thirty-month-long civil war which ended in January 1970. [1] *Later on, as the decade proceeded, subsequent annual budgets were designed to solve the problems of later developments in the economy, some of which were still directly or indirectly traceable to the effects of the war. Although each of these budgets focused on the general objectives of fiscal policy, attention was directed to specific objectives: holding down inflation, promoting economic growth and development and maintaining a health balance of payments position. While the emphasis by the Government varied from time to time as the need arose, fiscal measures to achieve these objectives featured in all the budgets throughout the period in question.*

Beginning with the rehabilitation of a completely war shattered economy in the immediate post-civil war years, budgetary measures were subsequently aimed at easing the scarcity in the supply of essential goods and services, first by stimulating domestic output and secondly by liberalizing imports through the relaxation of wartime import and foreign exchange controls. Both of these measures were designed to control the inflation that had developed out of wartime public spending which stimulated the growth of income rather than that of output.

In the meantime, the post-civil war surge in oil production and export, coupled with the quadrupling of oil prices in 1973, led to a great improvement in the country's balance of payments and government revenue position, thereby providing the means to sustain what could be described as a boom in imports as well as the continuous upward trend in government spending at a more rapid rate than ever before. While the former development was expected to relieve the scarcity of domestically produced goods and services and thus reduce the inflationary pressure on the economy, this objective was not realised due to the port congestion and distribution bottlenecks that developed because of the inadequacy of infrastructural facilities to cope with the flood of imports. Additionally, the continued upward trend in government expenditure, especially on defence and other non-productive government activities, worsened the inflationary situation in the economy, despite the Government's efforts to dampen this down through anti-inflationary fiscal measures in subsequent budgets, inflation continued although the rate decelerated somewhat towards the end of the period.

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1. This is the last budget by a Federal Military Government in Nigeria as the administration of the country was handed over to civilian politicians from October 1, 1979.

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As already hinted above, the buoyancy in the country's balance of payments and Government revenue position in the immediate post-civil war years lasted until about 1976, after which the favourable trend became reversed due to other developments. First, the rapid build-up of foreign exchange resources through increased oil export earnings and the boost given to domestic resources through the escalation in oil revenues both put the Government in a position to declare at the time of the launching of the country's Third National Development Plan, 1975-80, that finance was no longer a constraint on the country's economic development. Thus, with the launching of the latter Plan, the Government was committed to an unprecedented development expenditure of some ₦32 billion [2] — a commitment for which complete self-reliance was envisaged. This, however, later proved to be an illusion, not only because the commitment was revised upwards by about one third of the original amount, but also because of the drop in oil revenues and export earnings after 1976, necessitating the need to borrow from abroad to augment the country's own resources. [3]

II. FISCAL POLICY MEASURES

Against the above background of recent developments in the economy, fiscal measures in various annual budgets since 1976 continue, by the encouragement given to local industries through incentives, to focus attention on the solution to the problem of inflation through systematic cuts in Government expenditure and also increases in the output of locally produced goods and services. Also, as increased imports worsened the country's balance of payments position, foreign exchange controls became more intensified through licensing, restrictions and sometimes outright ban of imports on a selective basis. These measures were also introduced in pursuance of the economic development objective in the form of the encouragement given to the growth of domestic industries by the restriction and in some cases the complete prohibition of those imports that compete with locally produced goods, while at the same time liberalizing imports which constitute vital inputs for these industries.

Fiscal policy measures have also been undertaken to increase Government revenue, especially non-oil tax revenue, given the relative decline of Government revenue from the oil sector of the economy.

III. THE 1979/80 BUDGET

The 1979/80 Federal Government Budget completely falls in line with the above pattern of the application of fiscal measures since 1976. More specifically, fiscal measures in this particular budget, as disclosed by the Federal Commissioner for Finance in his briefing to the Press, are directed at the "*.... need to save foreign exchange by placing on import licence some of those goods that can be locally produced in adequate or near adequate quantities, and to promote local employment. These measures are designed to further encourage the mobilisation of local resources to increase production in both industry and agriculture.* [4]

Other objectives in the Budget at which fiscal measures are directed are those of maximum revenue productivity and equitable distribution of income. While measures for the solution to the problem of inflation in the economy are not specifically articulated as in the budgets of the past years, most of the measures designed to achieve the other objectives spelled out above are likely to have favourable implications for price stability.

For the achievement of the first two objectives above, i.e. foreign exchange savings and increased export earnings for attaining a healthy balance of payments position on the one hand and the increased output of domestic goods on the other, the Government is clamping down a complete ban on some imports and putting under open licence a wide range of other imports as well as an upward revision of duties on some others (see Appendices 1, 2 and 3 for details). While these measures would conserve foreign exchange, it would also help the growth of domestic industries by affording them some measure of effective protection. A completely novel measure in this connection is the decision of the Government to afford certain selected local industries protection through long term import controls by the promulgation of a decree against imports for a period of at least eight years. [5]

With respect to the desire to increase foreign exchange earnings, especially of non-oil exports, and thus reduce the great dependence of the country on oil, the Government is to adopt the strategy of export promotion by the granting of fiscal and other incentives, the details of which are yet to be worked out.

In order to further the objective of maximum revenue productivity, particularly of non-oil tax revenue, the Government is to make good the loss of revenue from import duties through import controls by the imposition of a nominal excise duty of 5 percent on a wide range of manufactures (see Appendix 4 for details).

In addition, certain measures are to be undertaken in order to increase the revenue productivity of the income tax. [6] These are in the form of plugging the

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2. This was later revised to ₦42 billion.
3. Among the more important factors which caused the drop in oil revenue and export earnings after 1976, (i) the general cut back in output due to the world recession at this time, (ii) the general reaction of consumers to oil price increases as well as (iii) the official policy of oil reserve conservation in producer countries.
4. "Statement on the 1979/80 Budget", by Major General J.J. Oluleye, Federal Commissioner for Finance (Mimeo, Lagos: April 1979), p. 1.
5. This will, however, be subject to periodic reviews, preferably annually.
6. These measures are essentially the Government's adoption of some of the proposals made by the Task Force on Tax Administration set up by the Federal Military Government in 1978. See *The Interim Report of the Tax Force on Tax Administration*, (Lagos: Cabinet Office, July 1978).

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loop-holes that make the evasion of income tax easy, [7] the codification and unification of all the country's personal income tax laws and the discontinuation of certain generous exemptions and allowances granted to companies for tax purposes. [8]

In pursuance of the policy objective of income distribution for the attainment of an egalitarian society, the Government is to embark on a programme of highly subsidised housing for the low income group with units costing as low as ₦5,000. The achievement of this objective will also be furthered by the complete exemption of the relatively low income group from the current wage freeze in the country, while the abolition of non-taxable allowances of the relatively high income group will also help to redress the income distribution imbalance. [9]

IV. AN APPRAISAL

From the above review of Government economic policy objectives and the measures designed to achieve them, the current financial year's budget strictly conforms to the budgets of the preceding years. There is therefore nothing in it that is particularly striking, although the prospects of success with respect to particular objectives appear better with the greater articulation of the measures aimed at their achievement. In this connection the fiscal measures to conserve and increase foreign exchange reserves in order to improve the current worsening of the country's balance of payments are all in the right direction. They should have the desired effects, given the fact that other non-fiscal complementary measures such as the abolition of foreign private expenditure on primary and secondary education, the control of the repatriation of share sales and the banning of gambling and casinos as it affects the repatriation of the proceeds of the latter should all increase the possibility of success in achieving this objective.

The measures aimed at economic growth and development in the form of incentives and encouragement to both agriculture and industry are also the right ones, but doubt exists about their effectiveness. For example, the encouragement given through quantitative and qualitative effective protection may lead to inefficiencies in domestic production either through poorer quality manufactures or the inability to satisfy the domestic demand for these goods, with the consumers ending up worse off. This is observed to be happening currently. Although the Government has constantly warned domestic manufacturers against such exploitation of the consumers, the persistent complaints of the latter against the poor quality and high prices of home-made goods is indicative of the fact that manufacturers have failed to heed such warning. But their profits have been increasing by leaps and bounds from year to year. The Government should not only take positive steps to enforce standards for the quality of domestic goods, but also make manufacturers reduce their prices to the benefit of consumers. It should also ensure that protection aimed at the growth of particular industries is not extended beyond the full growth of such industries so as to make them efficient.

One other objective which is well articulated in the current budget is that of equity as implemented through income redistribution in favour of the low income group. While the Government had taken some income redistribution measures in the past, all of which are supposed to continue, the measures announced in this Budget of very low cost housing and the exemption of the low income group from the wage freeze as well as the abolition of non-taxable allowances for the high income group should all lead to a greater measure of income redistribution than in the past. However, the latter measure, if not extended to the private sector quickly enough, may result in the movement of labour resources from the public to the private sector. But in practice it is difficult to predict results because of other factors, such as inertia, which may serve as barriers to intersectoral mobility of labour resources.

An important aspect of the 1979/80 Federal Government Budget is the determination of the Government to maximise the productivity of its tax revenue, especially of non-oil tax revenue, with the aim of reducing the economy's dependence on oil. The announced measures, as they affect the personal and company income taxes, should go a long way in achieving this objective. This is already in evidence, judging from the rush with which members of the public are paying taxes, both due and in arrears, in order to obtain Tax Clearance Certificates to undertake particular transactions in the public sector. The Government should extend these measures as soon as possible to the private sector as it has promised, so as to ensure maximum effectiveness.

One remarkable feature of this year's Budget is that for the first time ever in this decade, employment as an economic policy objective is specifically mentioned for attention by the Government. [10] Although, there

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7. For example, in order to identify relatively easily all taxable individuals, a systematic numbering of streets is to be undertaken all over the country by the relevant responsible local government authorities. For the same purpose, registration of all business names and premises must be renewed annually, while the registration of all professionals in private practice must be made by the appropriate Registries to the relevant tax authorities. In addition, individuals undertaking certain business transactions with Government ministries, departments and agencies are now required to provide evidence of tax payment, for at least three previous years, by the presentation of Tax Clearance certificates before such transactions can be approved. A list of these transactions is provided in Appendix 5. This measure is also expected to be extended to private business transactions at some date in the future.

8. The provision in Section 33 of the Company Income Tax Law which grants an exemption of the first ₦6,000 of every Nigerian company's profits from tax has now been abolished. Also, Section 21 of the same Law is to be amended to make any excess life assurance premiums transferred to profit and loss accounts of Life Assurance Companies taxable. See "Statement on the 1979/80 Budget", by Major General J.J. Oluleye, p. 6.

9. One such allowance enjoyed by the relatively high income group is the basic car allowance. This income class also enjoyed in the past the privilege of obtaining car loans from the Government at highly subsidised rates of interest.

10. Government indictment for the neglect of the employment objective in its past budgets was, some time ago, the subject of comment (on the 1976/77 Federal Government Budget) by

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are no specific measures designed to promote this objective, as already noted above, the measures aimed at stimulating domestic production should have favourable effects on the level of employment in the economy. However, the measure to ban betting and gambling as socially undesirable activities is likely to have a negative effect on the employment objective, by increasing the rate of unemployment in the economy. This is being witnessed already from the several thousands engaged in the betting and gambling industry losing their jobs with the closing down of the betting and gambling houses. Thus, while the Government regards betting and gambling as social ills which should be eliminated as a matter of social policy, it conflicts seriously in this case with the economic policy objective of full employment.

With respect to the objective of price stability, as already observed, while a good many of the measures discussed above should help in furthering this objective, it appears as if the Government is not as articulate as in the budgets of the past years as far as the fight against inflation is concerned. Perhaps the reason for complacency is due to the Government's sense of considerable achievement — having brought down the rate of inflation by more than half, from about 36 to 15 percent in the last three years. But this is a very wrong attitude to adopt, given the fact that gains from the battle against inflation can be quickly wiped out if they are not consolidated by the continuous application of specific anti-inflationary measures.

In my opinion, the related anti-inflationary measures adopted in this Budget will not go far enough. Although encouragement to domestic production would tend to ease domestic shortages, on is, however, not sure of the extent of its impact. For one thing, the inclusion of certain essential food items such as flour in the list of imports for which licences are required may create the problem of shortages in the event of inadequate domestic supply. Moreover, the cut in Government expenditure (which has constituted the greatest single source of inflationary pressures in the economy for quite some time now) is rather marginal. For example, a reduction of only ₦76 million in the relatively huge defence budget is not likely to have much impact on the price level.

Finally, there are two changes with respect to taxation introduced in this year's Budget which are worth mentioning. The first is the separation, once more, of the company from the shareholder for tax purposes. [11] Thus, the former practice, whereby a certain rate of the company's profits tax (fixed at 50 percent last financial year) was payable while dividends to shareholders accrued *net* of this rate of tax, will now cease. (See Appendix 6, table 1.) [12] From April 1, 1979, the company profits tax rate is fixed at 45 percent while shareholders will be subjected to a deemed withholding tax rate of 12.5 percent on their gross dividends. One important advantage of this separation of the shareholder from the company as a corporate entity is the fact that it reduces the burden of company taxation on the shareholder, thereby making the tax system more equitable and thus encouraging investment in shares. [13]

Editor's note:

The new system can be illustrated as follows:

Company profits		100
Company income tax (45%)		45
Dividend distribution		55
Deemed withholding tax (imputation credit) (12.5%)		6.875
Taxable dividend (gross up)		61.875
Personal income tax (assume 30%) is 30% of 61.875 or	18.5625	
Less imputation credit	6.875	
Personal income tax due		11.6875

Total tax burden (45 + 11.6875) or 56.6875

Since the total tax burden under the previous tax system amounted to 65% (50% company tax plus 30% personal income tax on the distribution), the new system will undoubtedly be much more attractive for equity investment.

the present author. It is rather gratifying to note that the policy suggestion in that comment is well taken. See F. Akin Olaloku, "The Employment Implications of the 1976/77 Federal Government Budget: A Comment", 31 *Bulletin for International Fiscal Documentation* 83-85 (1977).

11. Company profits and dividend taxes in Nigeria have been subjected to frequent periodic changes in the last eight years or so. For example, prior to the fiscal year 1972/73, the company profits tax was fixed at the rate of 40 percent, while dividends to shareholders were paid *net* of this tax. Beginning from the 1972/73 fiscal year, however, the company profits tax rate was increased to 45 percent, while dividends were paid *gross* to shareholders and taxed in their hands by the appropriate income tax authorities. As from April 1, 1975, i.e. during the fiscal year 1975/76, a change was again effected in the company profits tax, which represented a reversion to the 1972/73 period whereby dividends were paid to shareholders *net* of tax. In the 1978/79 fiscal year, the company profits tax rate was further increased from 45 to 50 percent. With the maximum rate of dividend payable to shareholders being at the same time increased from 30 to 40 percent of *gross* profits, the shareholder received a rate of 20 percent while the other 20 percent represented a dividend tax deducted at source. This was the state of affairs before the change in the current financial year's Budget.

12. Editor's note: see the editor's note accompanying Appendix 6.

13. One of the traditional arguments used to support the inequity of the company income tax is the *additional* burden which it imposes on the individual stockholder. This additional burden takes the form of what has come to be regarded as the "double tax" on dividend income. In order to remove, or at least minimize, this "double tax" element, methods have been suggested as to how the personal and company income taxes can be integrated. One such method, which is of relevance in our case here, is the "Withholding method", or "partial imputation credit", whereby the Nigerian Federal Government, with effect from April 1, 1979, is deemed to have withheld 12.5 percent of dividends

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A possible effect of this change, also, is the discouragement to profit retentions as opposed to distributions on the part of companies. The likely advantage of this effect is the greater scope for the development and growth of a more virile capital market.

The second change in taxation in the current financial year's Budget is the introduction of what the Government has called a "capital transfer tax" — a tax which essentially tries to combine the gift and inheritance taxes that are in use in some industrialized countries. Although, the Government's intention for introducing the tax is to encourage the children of relatively rich families to work harder and depend less on the wealth of their parents, I think its impact will go beyond this. For example, it is likely to help the income redistribution objective since the rate structure will be progressive. But I personally think that the exemption level of less than ₦100,000 is rather high, considering the fact than an individual with an accumulation worth ₦50,000 is relatively wealthy in a society like ours. In terms of revenue yield, the Government should not expect much from the tax, as the base will be quite restricted.

V. CONCLUSION

The 1979/80 Nigerian Federal Government Budget, being the last by a Military Administration in Nigeria, at least for now, rounds off the series of annual budgets of the last ten years. The measures in this particular Budget are designed to provide solutions to most of the nagging problems in the Nigerian economy. These problems, which include inflation, balance of payments deficits, economic development and growth as well as unemployment among the more prominent ones, have engaged the attention of the Government throughout the decade since the end of the Nigerian civil war in January 1970.

Although the Government achieved some measure of success in finding solutions to these problems, they are still more or less with us in varying degrees of severity. This fact is reflected in the Government economic and social policy objectives as set out in the current budget and the corresponding measures designed to achieve them. For example, while the danger of inflation, which was very serious at the beginning of the decade and for most of it, appears to have been warded off somewhat, with its rate having been brought down considerably, it still persists in the economy. The problem of balance of payments deficits, which appeared to be solved towards the middle of the decade, has reappeared with renewed vigour. The problem of economic growth and development, especially as it relates to dependence on oil is still a source of concern, while the Government has now identified unemployment, though rather belatedly, as a problem that must also be taken care of.

The limited success of the Government in tackling these problems is partly due to conflicts in the application of fiscal and other policy measures, but more importantly to developments in the international economy, which is completely outside the control of the Government. Most of the measures in the 1979/80 Budget are in the right direction that will lead to solutions to the above problems. As we go into the 1980s and with the takeover of the management of the economy by a Civilian Administration from October 1, this year, it is hoped that measures in future budgets will continue in the right direction, not only to consolidate the past successes of the outgoing regime, but also for the attainment of a greater measure of success in achieving the stated economic and social policy objectives of the Government.

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in the form of tax paid at source by stockholders, which is later credited against their income tax liability with respect to the dividends.

In Table 1 (Appendix 6), we demonstrate the amount of additional tax burden on the stockholder by the imposition of a 50 percent rate of company income tax as it operated in Nigeria before April 1979. In Table 2 of the same Appendix, we try to show how the newly introduced imputation credit of 12.5 percent results in the removal of some 12.5 percent of the additional burden, for all income groups, of the 50 percent company income tax as it operated previously. The calculations in these two tables are based on those used by Joseph A. Pechman in his *Federal Tax Policy* (Washington, D.C.; Brookings Institution, 1971), pp. 141 and 145.

(Appendices on next pages)

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APPENDICES

Appendix 1

The list of banned or prohibited imports

(i) Artificial flowers or fruits or parts thereof
(ii) Fireworks
(iii) Footwear uppers
(iv) Tooth paste

Source: "Statement on the 1979/80 Budget", by Major General J.J. Oluleye, p. 4.

Appendix 2

The list of items under import licence

(i) Plastic pipes (39.02D and 39.07M)
(ii) Polyethylene and regenerated cellulose film (chapter 39)
(iii) Blankets (61.01)
(iv) Asbestos roofing sheets (68.12B)
(v) Tubes and pipes of cast iron or steel (not exceeding 8 cm in diameter) (73.17C and 73.18C)
(vi) Corrugated galvanized roofing sheets (73.13A)
(vii) Primary cells and batteries (1.5 volts) size "D", "UM1," "B.20" and all batteries of physical size similar to U2 size "D"
(viii) Paper napkins, paper serviettes and similar tissue paper (48.21)
(ix) Cosmetics and perfumery (33.06)
(x) Sewing thread (55.05A and 55.06A)
(xi) Trailers (87.14B)
(xii) Sugar (cube and granulated) (17.01)
(xiii) Sewing machines (84.41)
(xiv) Jute fibre and similar vegetable fibre (57.03 and 57.04)
(xv) Wheat and meslin (mixed wheat and rye) (10.01)
(xvi) Rye (10.02)
(xvii) Barley (10.03)
(xviii) Oats (10.04)
(xix) Rice (10.06)
(xx) Buchwheat, millet, canary seed, grain sorghum and other cereals (10.07)
(xxi) Butter (04.03)
(xxii) Cheese (04.04)
(xxiii) Footwear soles and heels
(xxiv) Frozen beef

Source: As for Appendix 1, p. 5.

Appendix 3

The list of items for which import duties have been increased

Items		Old rates of import duty %	New rates of import duty %
(i)	Refrigerator components	5	20
(ii)	Plastic pipes	20	331/3
(iii)	Tubes and pipes of cast iron and steel	331/3	30
(iv)	Flat galvanized iron sheets		
(v)	Fabricated steel/aluminium structures	10	20
(vi)	Recorded tapes (excluding master tapes)	20	662/3

Source: As for Appendix 1, pp. 3-4.

Appendix 4

The list of home-made goods on which a nominal duty of 5% has been imposed

(i) Sound recorders
(ii) Reproducers and record players
(iii) Kerosene cookers
(iv) Clocks and watches
(v) Socks and stockings
(vi) Mattresses and pillows
(vii) Glassware
(viii) Calenders and greeting cards

Source: As for Appendix 1, p. 4.

Appendix 5

The list of business transactions with the Government for which tax clearance certificates are prerequisites

(i) Application for small business loans from non-government applicants
(ii) Registration of vehicles for the first time
(iii) Application for a gun licence
(iv) Permission to remit funds abroad
(v) Tenders for government contracts
(vi) Property transfer documents
(vii) Trading licence
(viii) Acquisition of Certificate of Occupancy
(ix) Approval of building plans
(x) Seeking election for political office
(xi) Application to acquire plots of land
(xii) Application to acquire import/export licence
(xiii) Application to acquire Buying Agent's licence
(xiv) Application for pools or gaming licence (as and when applicable)
(xv) Application for registration as contractor with the Government
(xvi) Application for distributorship
(xvii) Application for Approved Users Certificate

Source: As for Appendix 1.

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Appendix 6

Table 1

Nigeria: Additional burden of the company income tax on ₦100 of company's income at a 50% rate as it operated before the 1979/80 fiscal year

(1) Marginal personal income tax rate percentages)	(2) Company income before	(3) Company tax at 50%	(4) Dividends received by stockholders	(5) Stockholders personal income tax	(6) Total tax burden	(7) Additional burden of company's tax
0	100	50	50	0	50.0	50.0
10	100	50	50	5.0	55.0	45.0
20	100	50	50	10.0	60.0	40.0
30	100	50	50	15.0	65.0	35.0
40	100	50	50	20.0	70.0	30.0
50	100	50	50	25.0	75.0	25.0
60	100	50	50	30.0	80.0	20.0
70	100	50	50	35.0	85.0	15.0

Notes: Column (4) = column (2) – column (3)
Column (5) = column (4) – column (1)
Column (6) = column (3) – column (5)
Column (7) = column (6) – column (1)

Table 2

Nigeria: Protion of the additional burden of the company income tax removed through the withholding of 12.5 percent of dividends received as from April 1, 1979

Marginal individual income tax rate percentages)	Additional burden resulting from company's income tax	Deemed withholding credit			Percentage of additional burden of company's income tax removed by dividend credit
		Amount deemed to be withheld at source	Tax on amount deemed to be withheld	Net credit	
(1)	(2)	(3)	(4)	(5)	(6)
0	50	6.25	0	6.25	12.5
10	45	6.25	0.62	5.63	12.5
20	40	6.25	1.25	5.00	12.5
30	35	6.25	1.87	4.38	12.5
40	30	6.25	2.50	3.75	12.5
50	25	6.25	3.12	3.13	12.5
60	20	6.25	3.75	2.50	12.5
70	15	6.25	4.37	1.88	12.5

Notes: Column (2) = column (7) of table 1
Column (3) = 12.5% of ₦50
Column (4) = column (1) x column (3)
Column (5) = column (3) – column (4)
Column (6) = column (5) ÷ column (2)

Editor's Note

The following illustrates the Nigerian corporate-shareholder tax system applicable prior to April 1, 1979:

Company profits	100
Company income tax (50%)	50
Dividend distribution	50
Personal income tax (assume 30%)	15
Total tax burden	*65*

In a fully integrated corporate-shareholder income tax system the shareholder would have been subject to a tax of 30% of 100 or 30. Therefore, the *additional* burden of the company income tax is 65 — 30 or 35 (cf. Appendix 6, table 1, column 7, line 4).

Under the new system which is applicable on or after April 1, 1979 the computation is as follows (*note that for convenience's sake the rate of corporate income tax is also deemed to be 50%, whereas in fact it was reduced to 45%):*

Company profits		100
Company income tax (50%)		50
Dividend distribution		50
Deemed withholding tax (imputation credit) (12.5%)		6.25
Taxable dividend (gross up)		56.25
Personal income tax (assume 30%) is 30% of 56.25 or	16.87	
Less imputation credit	6.25	
Personal income tax due (which equals 15 (cf. Appendix 6, table 1, column 5, line 4) less 4.38 (cf. Appendix 6, table 2, column 4, line 4))		10.62
Total tax burden (50 + 10.62) or (which equals 65 (cf. Appendix 6, table 1, column 6, line 4) less 4.38 (cf. Appendix 6, table 2, column 4, line 4)).		*60.62*

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Indonesia:

Tax Incentive Package to Support the Third Five-Year Development Plan (1979–1984)

by Jap Kim Siong *

Contents

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I. INTRODUCTION

The guidelines of the taxation policy in Indonesia for the third Five-Year Development Plan, April 1, 1979 to March 31, 1984 — also referred to as Pelita III (an abbreviation of the Indonesian term "Pembangunan Lima Tahun") — were announced by the President of the Republic of Indonesia in his Instruction No. 6 of 1979, dated March 26, 1979.

The taxation policy is in conformity with the existing "Development Trilogy" of the earlier Pelitas of Indonesia, in fact, the Development Trilogy in Pelita III is the same as in the first two Pelitas. It encompasses the following aims:

(1) the equalization of economic development including the furthering of an equal distribution of income from development;
(2) the achievement of a greater economic growth; and
(3) the maintenance of a reasonably stable economic equilibrium which is strong and sufficiently high, but without developing substantial unemployment on the one hand or upward or downward movements in the general price level on the other hand. [1]

The target of the economic policy of Pelita I (1969-1974) was to rehabilitate the economy devastated by four years of civil strife. The 1970 tax amendments were more enterprising for they were to provide people with enough purchasing power to encourage consumption and saving as well as investment. [2]

Pelita II (1974-1979) focussed more on stimulating a rapid growth in the gross national product and concentrated on the development of the petroleum and gas sectors of the economy. Amendments in production sharing contracts for petroleum and in the work contracts for mineral mining reflected this tax policy of Pelita II. [3]

At present, Pelita III (1979-1984) is concentrating on the development of the non-petroleum sector of Indonesia's economy. It therefore strives to develop the agricultural sector and to increase investments in labour-intensive and export-oriented industries, with special emphasis on small and medium-sized manufacturing enterprises. [4] It will concentrate now on developing export-oriented industries and move away from the import-substitution policy adopted during the first two Pelitas.

The three objectives of the taxation policy are in conformity with the Developmental Trilogy scheme of the Pelitas:

(1) to provide that tax revenue is the main source for the stage budget, not foreign aid (see Table 2);
(2) to encourage an increase in investment and production; and
(3) to equalize the distribution of income in the society.

The taxation policy followed by the government to support the Development Trilogy of Pelita III emphasizes a better calculation of the corporate income tax. To achieve this, it is considered necessary that companies keep open and orderly business records in order to facilitate the assessment and the collection of tax by the tax administration.

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1. "Kebijaksanaan pemerintah dibidang perpajakan yang baru hakekatnya mancari wasit yang obyektip" (Government policy in the field of new taxation essentially to find a referee who is objective), *Berita Pajak* (Tax News), Jakarta, No. 582, April 2, 1979, at 12.
2. "Berkenaan Dengan Disahkannja Lima R.U.U. Perubahan dan Tambahan Dibidang Perpadjakan" (Concerning the Enactment of Five Bills with Amendments and Additions in the Field of Taxation), *Perpadjakan Indonesia* (Indonesian Taxation), Jakarta, No. 10, 1970, at 4; see also Jap Kim Siong, "Tax incentives and income tax liability of foreign business enterprises operating in Indonesia as affected by the 1970 amendments laws", *Bulletin for International Fiscal Documentation* 26:3 (1972), at 105.
3. See Mochtar Kusumaatmadja, *Mining Law*, (Bandung, 1974) and Robert Fabrikant, *Oil Discovery and Technical Change in Southeast Asia. Legal Aspects of Production Sharing Contracts in the Indonesian Petroleum Industry*, Second Edition (Institute of Southeast Asia Studies, Singapore 1972).
4. "Kebijaksanaan perpajakan 27 maret 1979 menguntungkan badan usaha kecil dan menengah" (Tax policy of March 27 1979 favours small and medium-sized enterprises), *Berita Pajak*, Jakarta, No. 583 April 9, 1979, at 7.

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In addition, tax incentives will be granted to increase investment by the private sector, to equalize redistribution of income and to increase state revenue. [5] See further, Table 3 through 9 for the steady increase in revenue since the establishment of the Five-Year Development Plans.

As a consequence of the announced taxation policy for Pelita III, the Minister of Finance has enacted the following tax measures:

(1) Indonesian enterprises which use an Indonesian public accountant to prepare their audit reports are granted a reduced corporate income tax and tax amnesty;
(2) Revaluation of fixed tangible assets of enterprises will be taken in 1979;
(3) Reduction of the general corporate income tax and the special corporate income tax for cooperatives;
(4) The use of the LIFO (last in, first out) system of inventory if the company keeps good and complete bookkeeping records and its financial statements are audited by an Indonesian public accountant as of the tax year ending June 30, 1979;
(5) Amendments to the tax incentives granted to companies which go public through the Indonesian stock exchange;
(6) Tax amnesty will be granted to local investors who invest in priority industries in Indonesia;
(7) Tax incentives will be granted to companies in which capital is divided into shares and which reinvest their undistributed profits;
(8) Reduction of the domestic sales tax; and
(9) An increase in import duty and sales tax on importation.

This article aims to set out the major provisions of the tax incentive package designed to support and achieve the goals of the Development Trilogy in the third Five-Year Plan. [6] The tax measures must be seen in the light of the purposes of the plan: to improve tax compliance by corporate taxpayers on the one hand, and to increase revenue to the tax administration on the other.

The tax incentive package designed to improve tax compliance by corporate taxpayers is known as the March 27, 1979 Tax Package — (1)-(7) above — whereas the tax incentive package concentrated on indirect taxes is known as the April 19, 1979 Tax Package.

I. TAX AMNESTY AND REDUCED CORPORATE INCOME TAX TO ENTITIES WHICH USE PUBLIC ACCOUNTANTS

In order to increase the participation of the entire community, and in particular the business society, in the development of Pelita III, it was considered necessary to provide measures to encourage and increase the collection of corporate income tax. To achieve this goal it was believed important to create a favorable climate for the business world in the form of more objective and reasonable tax assessments based upon the existence of an orderly and open commercial administration by businessmen disclosing the actual results of their business operations.

The use of Indonesian public accountants by Indonesian business enterprises to administer, control and prepare their audited reports is to serve as a yardstick for this purpose. Therefore, specially prescribed tax incentives may be granted to business enterprises who keep proper records and conform to the governmental policy of disclosure. If companies are ready "to go naked", they will not be prosecuted for previous tax evasion or other abuses.

In addition, reduced corporate income tax will be given to companies using public accountants to audit financial statements. At present, many local enterprises refuse to open their books to independent auditors, apparently preferring to negotiate tax assessments with tax officials directly.

The tax incentives given to companies using public accountants to audit financial statements are designed to eliminate secrecy and bargaining about taxes.

Major General Slamet Danusudirjo of the State Planning Agency stated in Jakarta on September 3, 1977 that more than US$ 3.8 billion, or about 40 percent of the national budget, would be saved annually if all Indonesians were to work honestly without resorting to corruption or taking bribes. [7]

Of the 730 registered foreign companies in Jakarta only 444 or 61 percent use a public accountant and of the 841 registered Indonesian or domestic companies situated in Jakarta only 46 or 5.5 percent use a public accountant. [8]

Effective as of the 1979 and subsequent tax years, tax incentives will be granted to entities which are subject to corporate income tax in Indonesia and which use an independent public accountant to audit their financial statements, all in accordance with the requirements prescribed in the Decree of the Minister of Finance No. 108/KMK.07/1979, of March 27, 1979.

Requirements of the Decree of March 27, 1979

Public accountants must be in possession of a legal permit to perform the services of a public accountant in Indonesia.

No employee or member of the management of a public accountant's office or their families must have work or financial relations, directly or indirectly, with the business enterprise or its subsidiaries to be audited by them.

The conduct of the accountant's audit must be in accordance with the accountant's audit norms and Code of Ethics prescribed by the Accountants' Association of Indonesia. Further requirements on the norms and

5. "Serangkaian Kebijaksanaan pemerintah dibidang pajak perseroan" (Efforts of the Government Policy in the Field of Corporate Income Tax), *Berita Pajak*, Jakarta, No. 582, April 2, 1979, at 5.
6. *Peraturan Perpajakan Dalam Pelita III (Pajak Perseroan)* (Tax Regulations within the third Five-Year Plan (Corporate Income Tax))(Jakarta, 1979).
7. *Singapore Economic Bulletin*, October 1977 at 51.
8. "Keringanan pajak menuju Keterbukaan" (Tax incentives directed to open administration), *Berita Pajak*, Jakarta No. 582, April 2, 1979.

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content of the financial reports prepared by public accountants are prescribed in the Annexes to the Decree.

The financial report of an enterprise audited by a public accountant shall be submitted to the Head of the Tax Inspection Office within a maximum period of 12 months after the end of the tax year. It shall be used as the basis for obtaining reduced corporate income tax rates and tax amnesty.

The public accountant may use any one of the following qualifications when submitting his report:
— unqualified opinion;
— qualified opinion;
— no opinion;
— adverse opinion.

"Unqualified opinion" means "correct without reservations", "qualified opinion" means "correct with reservations".

With respect to audit reports on which an unqualified opinion has been given, the Head of the Tax Inspection Office may only make limited tax corrections on matters which are of a juridical tax nature based on the provisions of the tax law.

In cases when a qualified opinion has been given, besides the limited tax corrections based on tax law provisions, the Head of the Tax Inspection Office may make corrections on matters involving the reservations made.

If the audit report contains "no opinion" or an "adverse opinion", the taxpayers are not eligible for tax relief and the Head of the Tax Inspection Office may make an assessment at his discretion.

In cases of an unqualified opinion or a qualified opinion, before the tax assessment is made, the Head of the Tax Inspection Office shall notify the enterprise in writing of the fiscal corrections made, and send a copy to the public accountant involved. When an enterprise objects to the corrections made it can submit its case to the Director General of Taxes within a period of 14 days after the receipt of the notification. As long as the case has not yet been decided upon by the Director General of Taxes, the Head of the Tax Inspection Office concerned shall postpone his tax assessment.

Tax incentives

(a) Tax amnesty

Taxpayers subject to corporate income tax will not be prosecuted for tax evasion nor will they be assessed on any taxes payable in 1978 and earlier years, if new facts result from the use of an independent public accountant to audit the financial statements of the enterprise.

(b) Reduced corporate income tax

The reduced corporate income tax effective as of the tax year ending after June 30, 1979 and in following years with respect to entities which use independent public accountants to audit their financial statements is as follows:

Taxable profits	*Percentage*
— on the first 100 million Rp	20
— on the next 250 million Rp	30
— on the remainder	45

For normal rates, see below.

III. THE 1979 REVALUATION OF FIXED ASSETS

Due to the development of economic and monetary conditions and the increase of prices at present, both within Indonesia and in foreign countries, it is considered necessary to give businesses the opportunity to revalue their fixed assets. Granting the right to such a revaluation is further aimed at creating a favorable climate for the business world and to achieve an appropriate taxation system in conformity with the Development Trilogy.

By virtue of the Decree of the Minister of Finance No. 109/KMK.04/1979 of March 27, 1979, entities domiciled in Indonesia which are subject to corporate income tax may opt for revaluation of their fixed tangible assets acquired between 1960 and 1978 in order to deal with inflation, except for land and rights on land.

The date for the revaluation of fixed assets is January 1, 1979. Taxpayers who desire to make use of the revaluation of fixed assets may do so at the latest on December 31, 1979 in accordance with the rules set out in the Decree involved. The date has been extended to March 31, 1980 by virtue of the Decree of the Minister of Finance No. 551/KMK.04/1979 of December 20, 1979.

Fixed assets which qualify for revaluation include:
(1) buildings, construction sites and their supplementary facilities (such as roads, bridges);
(2) machinery, heavy equipment and accessories;
(3) transportation means and office equipment;
(4) ships, airplanes and their equipment;
(5) plantations of hardy plants that are more than two years old.

For multipliers see Table 1.

Fixed assets eligible for revaluation must fulfill the following requirements:
(a) they must be in use by the enterprise at the moment of revaluation;
(b) according to the enterprise's plans they are not intended to be transferred or sold; and
(c) the fixed assets were acquired during the tax years 1960 through 1978.

Entities which decide to revalue have to revalue all their qualified fixed assets. Only those entities which keep books of accounts in Indonesia in such a manner that the value of acquisition of the fixed assets, repairs and changes as well as the amount of the depreciation of the fixed assets can clearly be seen are eligible. In addition revaluation is not granted to entities which are permitted to keep their bookkeeping in foreign currency instead of in Indonesian rupiahs.

The acquisition value of a fixed asset and its aggregate depreciation up to the moment of revaluation shall be

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multiplied by the multiplier pertaining to that fixed asset and the balance of the adjusted acquisition value and depreciation constitute the new value of the fixed asset on January 1, 1979. The difference between the new value of the fixed asset and its fiscal book value at the moment of revaluation is recorded as "Balance of revaluation of fixed assets January 1, 1979".

For plantations the acquisition value is the value at the moment the plantings are ready to start production.

Fixed assets whose value is in old rupiahs (which were valid before 1966) shall first be converted into new rupiahs at the ratio of 1,000 old to one new rupiah.

Depreciation with respect to revaluation of fixed assets

Depreciation taken on the new value of fixed assets is computed as follows:

(1) For fixed assets the useful life of which at the moment of acquisition is estimated to be ten years or less, the depreciation is spread over the remaining useful life increased by three years, up to a maximum of ten years;

(2) For fixed assets the useful life of which at the moment of acquisition is estimated to be more than ten years, the depreciation is calculated as follows:
   (a) where the remaining useful life is five years or more, the depreciation is spread over this period;
   (b) where the remaining useful life is less than five years, its depreciation is spread over five years.

Tax incentives

1) The balance between the new and the old fiscal book value of the fixed assets is exempt from corporate income tax.
2) That part of the revaluation gain which is capitalized is exempt from stamp duty on corporate rights.
3) Distribution of bonus shares or registered increases in the nominal value of stock, without additional payments by the shareholders, resulting from the capitalization of the revaluation gain is exempt from: (i) the corporate income tax; (ii) the individual income tax; and (iii) the tax on interest, dividents and royalties.
4) In case revaluation of fixed assets has taken place and tax evasion has been found no corporate income tax assessment will be made retroactively for the 1978 and previous tax years.

Sanction

If later it is proved that the obligations and requirements set out in the 1979 Decree concerning revaluation of fixed assets have been violated, corporate income tax shall be levied on the amount of the revaluation gain at the rate of 10 percent and other sanctions shall apply in accordance with the current law.

V. REDUCTION OF CORPORATE INCOME TAX

In order to support the Development Trilogy in the third Five-Year Plan it is necessary to create a more favorable tax climate for businessmen. In addition an appropriate taxation scheme should be devised which may also become the basis of improving the taxpayers' discipline and compliance. As a consequence a reduction of the general rate of corporate income tax with respect to cooperatives was introduced by the Decree of the Minister of Finance No. 110/KMK.04/1979, of March 27, 1979. The rate structure of the corporate income tax in comparison with the old rate structure is shown in the following examples.

A. Normal rate of corporate income tax

(1) Prior to 1979

Total taxable profit was subject to a 20 percent rate. In addition, if the profit exceeded 10,000,000 Rp., an additional tax was levied at the rate of 25 percent of the amount in excess thereof. In practice when computing the tax the normal rate of 20 percent was levied on profits of up to 10,000,000 Rp. The excess, if any, was taxed at 45 percent. Both methods of calculation have the same result and produce a tax burden of 20 to 45 percent.

Prior to 1970 the rate of the corporate income tax was progressive, ranging from 20 to 60 percent. As of 1970 the rate of tax was reduced to a flat 20 percent, with an additional rate of 25 percent if the taxable profit exceeded 5,000,000 Rp. It was further provided that the amount which is exempt from the additional tax of 25 percent will be fixed for every tax year.[9] The amount of 5,000,000 Rp. has been increased to 10,000,000 Rp. for tax years ending after June 30, 1974.[10]

(2) 1979 and subsequent years

Taxable profits	*Percentage*
— on the first 25,000,000 Rp.	20
— on the next 50,000,000 Rp.	30
— on the remainder	45

B. Special corporate income tax rates for cooperatives

(1) Prior to 1979

The balance of the cooperative proceeds after deduction of refunds to its members in percent of the contributed capital	Within a 5-year period of its establishment (percentage)	After a 5-year period since its establishment (percentage)
— up to 5 percent	0	5
— between 5 and 10 percent	5	10
— more than 10 percent	10	20

9. At the moment of this amendment effected by Law No. 8, 1970 (LN 1970 No. 43) it was found that, in general, corporations in Indonesia earned less than 5,000,000 Rp. in profits per year. Jap Kim Siong, "Tax incentivies and income tax liability of foreign business enterprises operating in Indonesia as affected by the 1970 amendment laws", *Bulletin for International Fiscal Documentation* 26:3 (1972), at 105.
10. Decree of the Minister of Finance, No. KEP-1169/MK/II/11/1973, dated November 20, 1973.

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(2) 1979 and subsequent years

	Within a 10-year period of its establishment	After a 10-year period of its establishment (percentage)
— profit up to 10,000,000 Rp.	exempt	2.5
— on the next 25,000,000 Rp.	exempt	5
— on the remainder	exempt	10

The reduction of the general corporate income tax can be illustrated as follows:

I. Old corporate income tax rate

1. Taxable profit up to 10,000,000 Rp. — 20 percent
2. Remainder — 45 percent

Example I.
Assume the taxable profit is 80,000,000 Rp. The corporate income tax is calculated as follows:

10,000,000 Rp. x 20 percent	=	2,000,000 Rp.
70,000,000 Rp. x 45 percent	=	31,500,000 Rp.
Total tax amount		33,500,000 Rp.

Effective rate — 41.9 percent

Example II.
Assume the taxable profit is 500,000,000 Rp. The corporate income tax is calculated as follows:

10,000,000 Rp. x 20 percent	=	2,000,000 Rp.
490,000,000 Rp. x 45 percent	=	220,500,000 Rp.
Total tax amount		222,500,000 Rp.

Effective rate — 44.5 percent

II. New corporate income tax rate

1. Taxable profit up to 25,000,000 Rp. — 20 percent
2. The following 50,000,000 Rp. — 30 percent
3. The remainder — 45 percent

Example I.
Assume the taxable profit is 80,000,000 Rp. The corporate income tax is calculated as follows:

25,000,000 Rp. x 20 percent	=	5,000,000 Rp.
50,000,000 Rp. x 30 percent	=	15,000,000 Rp.
5,000,000 Rp. x 45 percent	=	2,250,000 Rp.
Total tax amount		22,250,000 Rp.

Effective rate — 27.8 percent

Example II.
If the taxable profit is 500,000,000 Rp. The corporate income tax is calculated as follows:

25,000,000 Rp. x 20 percent	=	5,000,000 Rp.
50,000,000 Rp. x 30 percent	=	15,000,000 Rp.
425,000,000 Rp. x 45 percent	=	191,250,000 Rp.
Total tax amount		211,250,000 Rp.

Effective rate — 42.25 percent

V. THE USE OF THE LIFO SYSTEM FOR INVENTORY

One of the decisive factors in calculating the taxable profit of a company is the system of inventory valuation. In general, inventory may be valued at cost or at market value, whichever is lower. However, where the price level tends to increase, the application of this rule may result in a loss for the enterprise.

Considering that the development stategy in Indonesia is based on the Development Trilogy, including a sufficient economic growth, it is deemed necessary to provide a relief for the survival and growth of the business world.

By virtue of the Decree of the Minister of Finance No. 111/KMK.04/1979, of March 27, 1979, companies may opt to apply the LIFO (last in, first out) system for the first time in the 1979 tax year. The use of the LIFO system may only be applied if the company keeps a good and orderly bookkeeping system and its financial statements are audited by an independent public accountant. The Head of the Tax Inspection must approve the use of the LIFO system after the company submits a written application. Once the LIFO system is applied it must be used consistently and continuously.

VI. TAX INCENTIVES TO COMPANIES GOING PUBLIC

The Development Trilogy in the third Five-Year Plan emphasizes the importance of an equal distribution of income to improve the welfare of the people. In an effort to achieve a more equitable income distribution and to mobilize public funds for productive development projects, various tax incentives are offered to Indonesian companies selling their shares through the stock exchange to private individuals of Indonesian nationality or to entities specified by the Minister of Finance in his Decree No. KEP 1677/MK/II/12/1976, of December 28, 1976. This decree provides tax incentives to those companies selling their shares through the stock exchange only during the calendar years 1977 through 1981. (There have only been three listings on the Jakarta stock exchange since 1977, namely, P.T. Semen Cibinong, a U.S.-Indonesian cement venture, P.T. Century Textile Industry (abbreviated Centex), a Japanese-Indonesian integrated textile venture), and P.T. British-American Tobacco Manufacturers (abbreviated B.A.T.).)

To support the Development Trilogy in the third Five-Year Plan the temporary rules of the 1976 decree were amended and supplemented to become permanent by the Decree of the Minister of Finance No. 112/KMK. 04/1978, of March 27, 1979. In other words, the temporary 1976 decree applies to the years 1977 to 1981 whereas the permanent 1976 decree applies to 1979 and subsequent years. However, both rules in the said decrees apply for the calendar years 1979 through 1981. The provisions at present may be summarized as follows:

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A. Revaluation of fixed assets

The revaluation value is to be the maximum reasonable value as determined by the appraiser appointed for this purpose by the Minister of Finance.

The term fixed assets does not include land and rights to land nor are intangibles and current assets eligible for revaluation. The Director General of Taxes must approve the revaluation value of the assets determined by the appointed appraiser.

Depreciation of the reasonable (revalued) value of the fixed assets of the company is computed as follows:

1. Fixed assets the useful life of which at the moment of acquisition is estimated to be ten years or less: the depreciation is spread over the useful life which remains according to the records increased by two years (maximum ten years);
2. Fixed assets the useful life of which at the moment of acquisition is estimated to be ten years or more: the depreciation is calculated as follows:
   (a) where the useful life which remains according to the records is three years or more, the depreciation is based on the useful life which remains according to the records;
   (b) where the useful life which remains according to the records is less than three years, depreciation is based on a useful life of three years.

B. Reduced corporate income tax rates for companies going public

(1) 1977 to 1981

Companies selling their shares during the calendar years 1977 through 1981 through the stock exchange obtain a reduced corporate income tax liability as follows:

- for companies selling at least 30 percent of their shares, the corporate income tax on taxable profits exceeding 10,000,000 Rp. shall be reduced to 35 percent; and
- for companies selling at least 51 percent of their shares, the corporate income tax on taxable profits exceeding 10,000,000 Rp. shall be reduced to 25 percent.

(2) 1979 and subsequent years

Companies selling their shares through the stock exchange in 1979 and later years obtain the following reduced corporate income tax:

- for companies selling at least 20 percent of their shares:
  - on the first 200,000,000 Rp. 20 percent
  - on the next 350,000,000 Rp. 30 percent
  - on the remainder 45 percent
- for companies selling at least 35 percent of their shares:
  - on the first 300,000,000 Rp. 20 percent
  - on the next 450,000,000 Rp. 30 percent
  - on the remainder 45 percent
- for companies selling at least 51 percent of their shares:
  - on the first 450,000,000 Rp. 20 percent
  - on the next 600,000,000 Rp. 30 percent
  - on the remainder 45 percent

Companies selling their shares during 1979, 1980 and 1981 may opt for the reduced corporate income tax rate mentioned under either (1) or (2) above, whichever is more favorable for them.

C. Tax exemption from individual income tax for private Indonesian individuals buying shares

By virtue of the Decree of the Minister of Finance No. KEP.1676/MK/II/12/1976, of December 28, 1976, individuals buying shares through the stock exchange shall be exempt from net wealth tax, individual income tax and tax on interest, dividends and royalties. No investigation into the origin of the capital used for share purchases shall be made if the capital does not exceed 10,000,000 Rp. However, this exemption applies only to private individuals buying shares through the stock exchange not in connection with their business or profession, e.g. not a stockbroker.

Capital gains derived by private individuals from the sale of shares through the stock exchange are exempt from individual income tax notwithstanding any provision to the contrary in the Income Tax Ordinance. Note that the purchase must have taken place during the validity of the present Decree, i.e. during the calendar years 1977 through 1981.

D. Stamp duty on the purchase or sale of securities

Stamp duty is payable on the purchase or sale of securities by a stockbroker who performs his services in Indonesia in the stock exchange. The stamp duty levied is 25 Rp. on each note or bill drawn for the purchase or sale of securities.

E. Sales tax on services rendered

The 5 percent sales tax will not be levied on services rendered by stockbrokers in connection with purchases and sales of shares through the stock exchange.

F. Stamp duty on corporate rights

Any retained profit found in a company which goes public and where the retained profit is transferred into share capital is exempt from stamp duty on corporate rights. The stamp duty on paid-up capital of a company is 0.1. percent; the duty is 0.05 percent on issued but not paid-up capital.

VII. TAX AMNESTY FOR LOCAL INVESTORS WHO INVEST IN SPECIFIED PRIORITY SECTORS

In order to increase investment to achieve the Development Trilogy in the third Five-Year Plan, the period for laundering of capital has been extended and revised by virtue of the Decree of the Minister of Finance No. 114/KMK.04/1979, of March 27, 1979, in line with the investment need in selected sectors.

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No investigation by the tax authority shall be made in order to impose corporate income tax, individual income tax and net wealth tax in case Indonesian capital is invested in accordance with the Domestic Capital Investment Law of 1968, as amended. The investment must take place between April 1, 1979 and March 31, 1984 (i.e. the period of Repelita III) in sectors still open for investment in accordance with the prevailing Investment Priority Rating List. In general, the investments are divided into:

(a) investment made outside Java,
(b) investment made within Java,
    (1) in top-priority enterprises;
    (2) in labor-intensive enterprises; or
    (3) in enterprises producing for export.

VIII. REINVESTMENT OF PROFITS BY COMPANIES

To support a sufficiently high economic growth in accordance with the Development Trilogy, it is necessary to increase private savings, especially when they are re-invested in the company. By virtue of the Decree of the Minister of Finance No. 113/KMK.04/1979, of March 27, 1979, provisions are introduced which may enlarge the business capacity by increasing the production activities and accordingly creating new employment.

Companies whose capital is divided into shares, which re-invest their undistributed profits after payment of corporate income tax by adding such profits to their share capital, are granted the following tax incentives:

— Exemption from stamp duty on corporate rights with respect to the increase of the share capital of that company;
— The tax on interest, dividends and royalties is reduced to 5 percent on bonus shares distributed to shareholders or on registered increases of the nominal value of stock (without additional payment by shareholders);
— Exemption from tax on interest, dividends and royalties on distributed bonus shares or on registered increase of the nominal value of stock (without additional payment) by the shareholders so far as the increase of the share capital is financed from:
    (a) undistributed profits derived during the tax holiday period granted to entities as provided under the Foreign Capital Investment Law or the Domestic Capital Investment Law;
    (b) undistributed profits derived during the first two years from the moment of the start of production by entities which have not been granted a tax holiday but instead an investment allowance under the Foreign Capital Investment Law or the Domestic Capital Investment Law.
— Exemption from the individual income tax with respect to bonus shares and registered increases in the nominal value of stock (without additional payments) and obtained by non-shareholder employees of that company.

The company concerned is obliged to re-invest the undistributed profit in the company and to keep orderly bookkeeping records as required under the corporation tax law.

In addition, the company must declare in writing to the Head of the Tax Inspection its intention to increase its share capital and indicate that it wishes to distribute bonus shares to its shareholders as well as to its non-shareholder employees, or to increase the registered nominal value of stock, without additional payments.

IX. REDUCTION OF DOMESTIC SALES TAX RATES

To support the Development Trilogy in the Repelita III, [11] it is necessary to create a more beneficial climate for businessmen with more appropriate taxation, so that investment and production may increase. The improved climate will also become the basis for increasing discipline and compliance by the taxpayers.

With a view towards stimulating industrial growth and the use of domestically produced goods, it is considered necessary to revise the rate structure for domestically produced goods and services which are subject to sales tax and to provide a reduction in the sales tax burden. There were several objectives achieved by revising the sales tax structure which can be summarized as follows:

— the imposition of sales tax more in line with the capacity and level of income of the group consuming the goods and services concerned;
— to stimulate exports and increase the capacity of small businessmen in economically weak groups; and
— to reach an overall reduction of the sales tax burden notwithstanding the cascade effect of the Indonesian sales tax system.

By virtue of the decree of the Minister of Finance No. 175/KMK.04/1979, of April 19, 1979 effective as of April 21, 1979, the rate structure of domestic sales tax was revised. Previous rates were nil, 5, 10 and 20 percent and currently these rates are nil, 1, 2.5, 5, 7.5, 10 and 20 percent. Sales tax on services rendered has been reduced from 5 to 2.5. percent, whereas the services of auctioneers and the sales of shares by brokers through the stock exchange are exempt from sales tax. The following principles are used in classifying the goods under the respective sales tax rates:

List I contains goods which are subject to sales tax at the rate of nil percent, namely goods which were also formerly exempt from sales tax. It includes goods which are regarded as most essential in the economic development of the country.

List II contains goods which are subject to sales tax at the rate of 1 percent, such as goods which are regarded as essential: raw materials, basic materials for industry, agrarian, fishery, cattle-breeding and mining production, goods which are mostly to be exported and certain goods which directly back up the development of the infrastructure.

11. "Repelita" refers herein to the Five-Year Development Plan whereas "Pelita" to the Five-Year Development. The terms are abbreviations derived from the Indonesian expressions, Rencana Pembangunan Lima Tahun and Pembangunan Lima Tahun respectively.

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List III contains goods which are subject to sales tax at the rate of 2.5 percent, namely, goods in the form of auxiliary materials, semi-finished goods which are still to be further processed by manufacturers to be turned into finished goods which can be consumed, including also packing materials, tools, as well as several specified finished goods which are largely consumed by the public.

List IV contains goods which are subject to sales tax at the rate of 5 percent, i.e. finished goods for general consumption.

List V contains goods which are subject to sales tax at the rate of 20 percent, i.e. finished goods for consumption of a luxury character as well as certain goods which are mechanically or automatically produced so that they use much less manpower.

All other goods not listed in those five lists are subject to sales tax at the rate of 10 percent, i.e. finished goods for consumption of a less essential character.

List VI contains household and office appliances which are subject to sales tax at the rate of 7.5 percent, i.e. refrigerators, freezers, washing machines, electric or gas stoves, cameras, pianos and organs and color television sets.

Reductions in sales tax on domestically manufactured goods as of April 23, 1979 are, for instance:

- from 10 to 5 percent: sugar, porcelain goods, soap, shoes, sandals and photographic and recording equipment;
- from 10 to 2.5 percent: coffee and cacao beans, pepper, tea, automotive body parts and spare parts and electrical appliances;
- from 5 to 1 percent: vegetables and animal foodstuffs, industrial raw materials, mineral products, red bricks, bicycles and pedicabs.

The aim to be achieved by reducing sales tax on domestically manufactured goods is to stimulate businessmen to increase their production in an effort to successfully achieve the Development Trilogy of the Repelita III.

To ease the implementation of levying the sales tax at the delivery of goods and rendering of services, it is to be applied at the moment of payment by the buyer or user of services as of April 21, 1979 irrespective of whether delivery of goods or rendering of services will take place before or after that date. [12]

X. INTRODUCTION OF SPECIFIC TAX ON IMPORT DUTY AND SALES TAX ON IMPORTATION

In line with the objective of the third Five-Year Development Plan to move from promoting import substitution operations during the first two Five-Year development plans to encouraging export-oriented manufacturing operations in the following Five-Year development plans, import protection for goods manufactured by infant industries in Indonesia was considered necessary. To this end, increase of import duties and sales tax at importation on a number of such goods has been enacted by the Decree of the Minister of Finance No. 185/KMK.05/1979, of April 20, 1979, which went into force on April 23, 1979.

In addition, in order to improve the process of determining more effciently the value for purposes of the import duty on the goods, and thereby effectively raising the import duties, they will now be levied on a specific basis in lieu of an ad valorem basis on those imported goods which are also produced in Indonesia. Some items now subject to specific tax include ready made clothes, shoes, some foodstuffs, kitchen and tableware and video cassette recorders and tapes.

The use of a specific tax is considered more efficient for collecting purposes than an ad valorem tax in order to avoid abuse by importers. For instance, importers once imported their finished trademarked goods without a trademark so that the check price or standard price of the imported goods would be low. The customs duty is imposed on the counter-value of the imported goods against the check price determined periodically by the Directorate General of Customs and Commodities. After importation of the goods and their entry into the open market the trademark would be attached again to the imported goods.

It is hoped that the use of a specific tax will eliminate the need for arbitrary assessment of a product's value and corresponding duty by the customs officials.

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12. "Mulai 21 April 1979 Tarip Pajak Penjualan Diturunkan" (As of April 21, 1979 Sales Tax Rates are Reduced), *Berita Pajak*, Jakarta No. 585, April 23, 1979, at 5.

(Appendices on next pages)

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Appendix

Table 1 — Multipliers for the 1979 revaluation of fixed assets

Year of acquisition/ planting	Building, construction and its supplementary facilities	Machinery, heavy equipment and accessories	Transportation means and office equipment	Ships, airplanes and their equipment	Plantations, hardy plants of more than two years old
1960	7.6	5.3	2.9	5.2	3.1
1961	7.6	5.3	2.9	5.2	3.1
1962	7.6	5.3	2.9	5.2	3.1
1963	7.6	5.3	2.9	5.2	3.1
1964	7.6	5.3	2.9	5.2	3.1
1965	7.6	5.3	2.9	5.2	3.1
1966	7.6	5.3	2.9	5.2	3.1
1967	7.6	5.3	2.9	5.2	3.1
1968	5.7	3.6	2.9	3.1	2.5
1969	3.2	2.1	2.9	2.6	2.0
1970	2.7	1.9	2.9	2.2	1.8
1971	2.4	1.8	2.9	1.9	1.7
1972	2.3	1.6	2.6	1.8	1.5
1973	2.2	1.5	2.0	1.7	1.4
1974	1.7	1.4	1.7	1.5	1.3
1975	1.4	1.3	1.4	1.4	1.2
1976	1.3	1.3	1.3	1.3	1.2
1977	1.2	1.2	1.2	1.2	1.1
before 15-11-78	1.1	1.1	1.1	1.1	1.0
after 15-11-78	1.0	1.0	1.0	1.0	1.0

Table 2 — Central Government revenues (millions of rupiahs)

	1974/1975 Actual	1975/1976 Actual	1976/1977 Actual	1977/1978 Actual	1978/1979 Original Budget	1979/1980 Original Budget
1. Normal revenue	1,753,663	2,241,850	2,905,990	3,535,454	3,970,000	5,440,500
1. Direct taxes	1,228,621	1,592,028	2,046,613	2,511,332	2,808,000	4,113,100
— Income tax	43,257	61,725	84,179	104,566	138,300	144,600
— Corporation tax	91,163	128,136	127,249	169,532	195,300	228,200
— Corporate tax on oil	973,100	1,249,059	1,619,400	1,948,700	2,067,400	3,344,800
— Withholding tax (MPO)	83,265	97,308	148,396	201,750	312,000	289,900
— Land tax	27,977	34,600	42,150	52,473	57,500	64,100
— Others	9,859	21,200	25,239	34,311	37,500	41,500
2. Indirect taxes	458,397	539,413	740,903	880,505	1,042,700	1,160,100
— Sales tax	84,899	119,231	162,284	203,379	259,200	277,400
— Sales tax on imports	68,904	72,442	102,241	114,556	132,100	112,800
— Excises	74,020	97,307	130,658	181,859	225,100	298,500
— Import duties	160,635	174,011	257,407	286,944	326,200	280,600
— Export tax	70,300	61,600	61,700	81,250	82,400	172,800
— Net profit from oil	−15,933	−1,078	15,899	—	—	—
— Others	15,190	15,900	10,714	12,517	17,700	18,000
3. Non-tax receipts	66,645	110,409	118,474	143,617	119,300	167,300
2. Development receipts	232,046	491,639	783,800	773,368	856,300	1,493,500
1. Program aid	36,146	20,269	10,200	35,800	45,100	64,700
2. Project aid	195,900	471,370	773,600	737,568	810,200	1,428,800
Total	1,985,709	2,733,489	3,689,790	4,308,822	4,826,300	6,934,000

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Table 3

Revenue from direct taxes [1]
1969/1970 – 1979/1980
in 1,000,000,000 rupiah

Budget year	Amount	Increase	
		Amount	In percentage
Repelita I:			
1969/1970	43.2	–	–
1970/1971	52.9	+ 9.7	+ 22.5
1971/1972	68.5	+ 15.6	+ 29.5
1972/1973	103.3	+ 34.8	+ 50.8
1973/1974	160.4	+ 57.1	+ 55.3
Repelita II:			
1974/1975	255.6	+ 95.2	+ 59.4
1975/1976	343.0	+ 87.4	+ 34.2
1976/1977	427.2	+ 84.2	+ 24.5
1977/1978	562.6	+ 135.4	+ 31.7
1978/1979 [2]	740.6	+ 178.0	+ 31.6
Repelita III:			
1979/1980 [3]	768.3	+ 27.7	+ 3.7

1) Tax on oil excluded
2) Annual budget
3) Draft annual budget

Source: Financial Statement and Annual Budget 1979/1980.

Table 4

Revenue from indirect taxes [1]
1969/1970 – 1979/1980
in 1,000,000,000 rupiah

Budget year	Amount	Increase	
		Amount	In percentage
Repelita I:			
1969/1970	131.6	–	–
1970/1971	179.4	+ 47.8	+ 36.3
1971/1972	191.3	+ 11.9	+ 6.6
1972/1973	222.3	+ 30.9	+ 16.2
1973/1974	375.3	+ 153.1	+ 68.9
Repelita II:			
1974/1975	474.3	+ 99.0	+ 26.4
1975/1976	540.5	+ 66.2	+ 14.0
1976/1977	725.0	+ 184.5	+ 34.1
1977/1978	880.5	+ 155.5	+ 21.4
1978/1979 [2]	1.042.7	+ 162.2	+ 18.4
Repelita III:			
1979/1980 [3]	1.160.1	+ 117.4	+ 11.3

1) Tax on oil excluded
2) Annual budget
3) Draft annual budget

Source: Financial Statement and Annual Budget 1979/1980

Table 5

Revenue from oil
1969/1970 – 1979/1980
in 1,000,000,000 rupiah

Budget year	Corporation tax on oil	Other receipt from oil	Increase		
			Amount	Amount	In percentage
Repelita I:					
1969/1970	48.3	17.5	65.8	–	–
1970/1971	68.8	30.4	99.2	+ 33.4	+ 50.8
1971/1972	112.5	28.2	140.7	+ 41.5	+ 41.8
1972/1973	198.9	31.6	230.5	+ 89.8	+ 63.8
1973/1974	344.6	37.6	382.2	+ 151.7	+ 65.8
Repelita II:					
1974/1975	973.1	– 15.9	957.2	+ 575.0	+ 150.4
1975/1976	1,249.1	– 1.1	1,248.0	+ 290.8	+ 30.4
1976/1977	1,619.4	15.9	1,635.3	+ 387.3	+ 31.0
1977/1978	1,948.7	–	1,948.7	+ 313.4	+ 19.2
1978/1979 [1]	2,067.4	–	2,067.4	+ 118.7	+ 6.1
Repelita III:					
1979/1980 [2]	3,344.8	–	3,344.8	+ 1,277.4	+ 61.8

1) Annual Budget
2) Draft Annual Budget

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Table 6
Revenue from non-tax receipts
1967/1970 – 1979/1980
in 1,000,000,000 rupiah

Budget year	Amount	Increase	
		Amount	In percentage
Repelita I:			
1969/1970	3.1	–	–
1970/1971	13.1	+ 10.0	+ 322.6
1971/1972	27.5	+ 14.4	+ 109.9
1972/1973	34.6	+ 7.1	+ 25.8
1973/1974	49.8	+ 15.2	+ 43.9
Repelita II:			
1974/1975	66.6	+ 16.8	+ 33.7
1975/1976	110.4	+ 43.8	+ 65.8
1976/1977	118.5	+ 8.1	+ 7.3
1977/1978	143.6	+ 25.1	+ 21.2
1978/1979 1)	119.3	– 24.3	– 16.9
Repelita III:			
1979/1980 2)	167.3	+ 48.0	+ 40.2

1) Annual Budget
2) Draft Annual Budget

The term non-tax receipts includes receipts from Departments and other Government institutions for services rendered, sale of agrarian produce, cattle, sale of houses, court fees, repayment from loans, profit from state-run enterprises and government owned banks.

Table 7
Income from revenue according to draft annual budget 1979/1980
in 1,000,000,000 rupiah

I	Direct taxes		4,113.1
	Individual income tax	144.6	
	Corporate income tax	228.2	
	Corporation tax on oil	3,344.8	
	MPO (withholding taxes)	289.9	
	IPEDA (land tax)	64.1	
	Others	41.5	
II.	Indirect taxes		1,160.1
	Sales tax	277.4	
	Sales tax at importation	112.8	
	Excise	298.5	
	Import duty	280.6	
	Export tax	172.8	
	Others	18.0	

Source: Extract from Financial Statement and Annual Budget 1979/1980.

Table 8
State revenue, semester I 1977/1978 – 1978/1979
in 1,000,000,000 rupiah

	1977/1978 semester I	1978/1979 semester I 1)	Increase in percentage
Direct tax	1,230.8	1,327.7	7.9
Indirect tax	392.9	473.8	20.6
Non tax	53.8	88.2	63.9
	1,677.5	1,889.7	12.6

1) Estimates

Table 9
Direct taxes, semester I 1977/1978 – 1978/1979
in 1,000,000,000 rupiah

	1977/1978 semester I	1978/1979 semester I 1)	Increase in percentage
Individual income tax	46.0	50.3	9.3
Corporate income tax	62.8	74.6	18.8
Corporation tax on oil	983.1	1,050.5	6.9
MPO (withholding tax)	97.1	102.9	6.0
IPEDA (land tax)	27.8	33.1	19.1
Others	14.0	16.3	16.3
	1,230.8	1,327.7	7.9

1) Estimates

Table 10
Indirect taxes, semester I 1977/1978 – 1978/1979
in 1,000,000,000 rupiah

	1977/1978 semester I	1978/1979 semester I 1)	Increase in percentage
Sales tax	81.0	92.8	14.6
Sales tax at importation	53.6	62.7	17.0
Excise	83.0	112.4	11.4
Import duties	131.0	145.9	39.5
Other proceeds from oil	0.3	–	–
Others	6.0	7.0	16.7
	392.9	473.8	20.6

1) Estimates

Table 11
Local Government revenue in Special District Jakarta in 1977/1978
in million rupiah

Casino tax (tax on gambling)	11,000
SWP 3 D (motor vehicle tax)	9,300
BBN (motor vehicle transfer tax)	7,600
Entertainment tax	3,000
Development Tax I	2,700
Alien Tax	600
Surcharge on net wealth tax	100
Advertisement tax	200
Slaughter tax	60
Radio tax	50
Non-motor vehicle tax	2
Other taxes and fines	197
Total	34,809

About one third of the revenue from taxes in the Special District of Jakarta is obtained from the tax on gambling paid by the casinos. Notwithstanding strong opposition by the public to the maintenance of casinos, the tax on gambling remains the sole permanent source of local revenue necessary for the maintenance and development of the infrastructure of the Special District of Jakarta.

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Solomon Islands: **BUDGET 1980**

Extracts from the Budget Speech 1980 which was pronounced on November 15, 1979

To carry out the recurrent operations of the national government, and to finance the development projects that are now running or planned to start in 1980, we estimate that we shall require to spend a total of just over $ 56 million.

Of this total, $ 27 million will be for the Recurrent Budget end $ 29 million for the Development Budget.

Detailed estimates of expenditure have been in the hands of Members for three weeks. I hope very much that the House will have received the report of the Public Expenditure Committee, before we reach the Committee of Supply to examine the Draft Estimates in detail. The unwillingness of some Honourable Members to play a full part in the work of this Committee is disappointing, but I am sure I speak for the House in thanking the Chairman and those Members who have taken part, for their work in scrutinising the Draft Estimates, examining Accounting Officers, and preparing the report.

Turning now to the revenue required to finance the Budget, I remind the House of our two-pronged policy that

- we should move as quickly as possible to self-sufficiency in funding the recurrent budget
- we should steadily increase our contribution of local funds to the development budget.

With that in mind, we aim to raise about $ 26.5 million of local revenues in 1980, that is $ 7.25 million more than we originally budgetted for in 1979, and $ 6.4 million more than we now expect 1979 to produce. This increase, of about one-third, represents a major step in self-reliance and mobilising our own finances. About half of it will come from the "natural" growth of various forms of revenue; and about half will come from the net result of changes to direct and indirect taxation.

Export duties will be unchanged except for copra export duty. This will be changed from a c.i.f. basis to f.o.b. and the free limit before duty will be raised from $ 150 to $ 180. The effect of this change is to reduce the probable tax to be paid by the copra industry in 1980 from $ 2 million to $ 125 million. The saving to the producers is about three quarters of a million dollars. Companies of course will pay tax on their increased profits, but smallholders will benefit in full through the increased prices the Copra Board will be able to pay, worth about $ 25 a ton at expected price levels.

Import duties will be increased on about forty items. I will mention here only the most important ones; full details are being released by the Controller of Customs and Excise at eleven o'clock today. The Order amending the tariff came into effect this morning.

Duty on beer is increased from 47.5 cents to 55 cents per litre, that is an increase just under three cents a bottle of the most popular brand. A similar increase, from $ 5.20 to $ 6.50 per litre, is made in the duty on spirits.

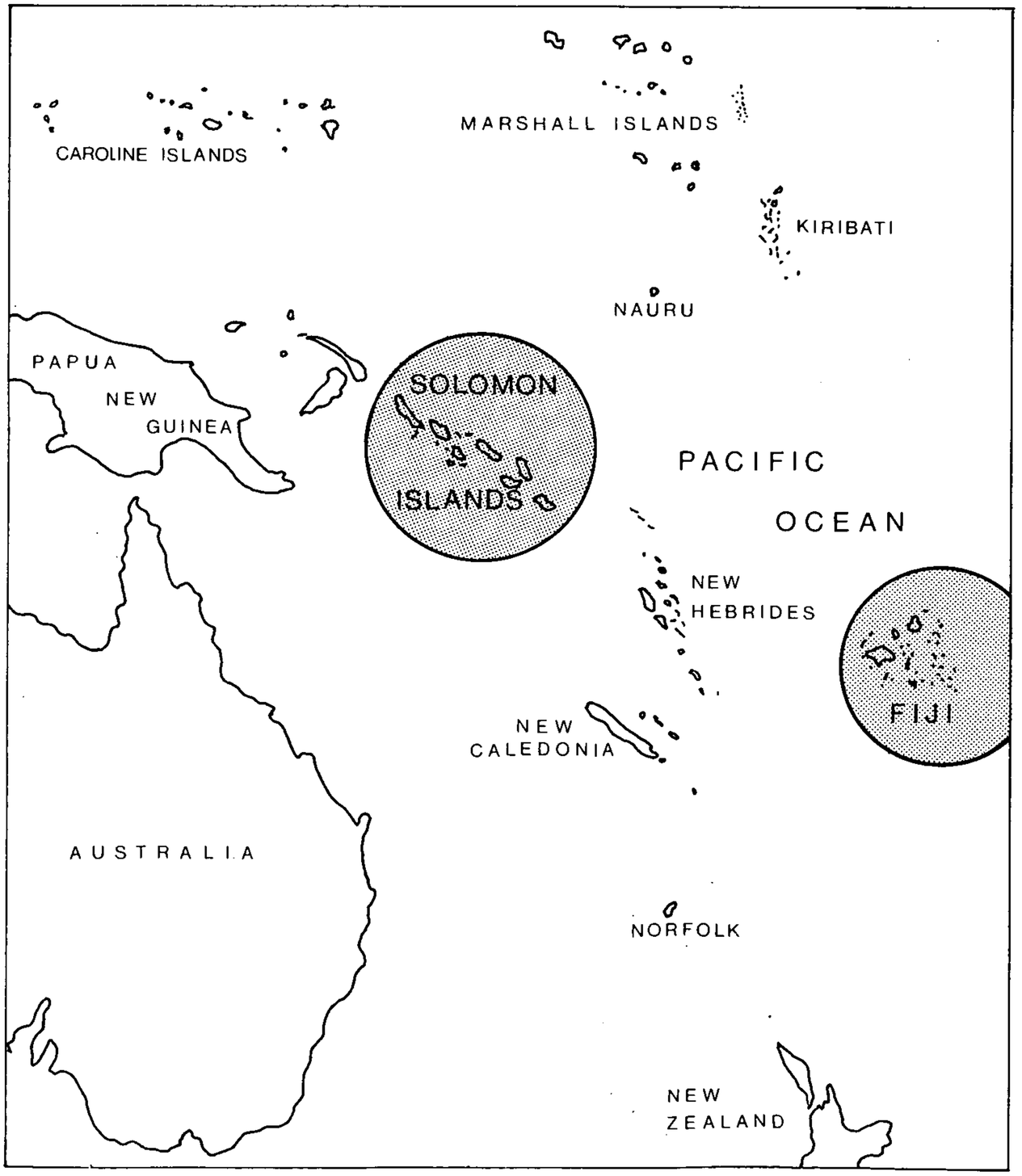
The tariff on cigarettes and tobacco is raised from $ 17.50 per kilogram to $ 22.50. This means an increase in duty of 12½ cents on a packet of 20 cigarettes, and a similar amount on imported tobacco. The excise duty on locally-manufactured tobacco is not changed.

Duty on sugar is increased from the present 3.3 cents per kilogram to 10 cents. The tariff on imported sweets, confectionery and soft drinks is raised to 50 percent.

I come now to income tax, on personal and business incomes. Next week I will be presenting to the House the Income Tax (Amendment) Bill, 1979. This Bill seeks to make a number of important changes to our income tax structure. Most of these arise from the Report of the Working Party on Income Tax, which members have received. We shall be debating the Bill, in the normal way, and I will go into more detail at that time.

Here I will mention only those changes that have an important impact on revenue, and people's incomes, in the 1980 Budget.

The level of income at which personal income tax starts to be paid will be raised from $ 600 to $ 1,200 for single persons, and from $ 1,200 to $ 2,400 for a married couple. This change is intended to recognise the wide family responsibilities of



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HIGHLIGHTS OF SOLOMON ISLANDS TAXATION

General: The scope of income tax is limited to income derived or received from the Solomon Islands. A "pay as you earn" system operates for both employment and business income.

Company tax: The rate for both private and public companies is 30 percent. Shareholders are liable to individual income tax on dividends received but receive a tax credit of 30 percent of the gross dividend thereby ensuring that company profits are taxed on a once-only basis. There is no undistributed profits tax.

Personal tax: Total income less personal deductions is subject to a progressive rate commencing at 11 percent for the first $ 360, which rate increases by 1 percent for every successive $ 360 of chargeable income until a maximum of 40 percent is reached on all chargeable income in excess of $ 10,440. Personal deductions are:

Basic personal allowance —	$ 600, or $ 900 for a widow or widower with a dependent child.
Wife allowance —	$ 600.
Child allowance —	$ 120 for each child up to four in number.
Education allowance —	the cost of the full time education of a dependent child up to four in number with a maximum of $ 1,200 in respect of each child.
Life insurance and superannuation allowance —	the actual cost of contributions up to a maximum of 20 percent of total income, less any tax free contribution by the employer.
Medical allowance —	actual cost of medical treatment.
Passages for medical treatment —	actual cost.
Passages for school children —	actual cost with maximum of two visits per year for each child up to four.
Holiday passages for persons not domiciled in Solomon Islands —	actual cost with maximum of two single journeys between Solomon Islands and country of domicile.
Home mortgage interest relief —	actual cost to extent that mortgage does not exceed $ 15,000.
Alimony and maintenance allowance —	actual cost apportioned on basis of world income to Solomon Islands income.

Withholding tax on non-resident income:

Interest, know how payments, royalties, insurance premiums	15 percent
Income from contracting	6 percent
Income from shipping or air transportation subject to Sec. 8 Income Tax Act	30 percent

Local tax: The local councils established under the Local Government Ordinance have a wide range of rating powers including basic rates and rates on possessions and property. Basic rates vary between $ 1 and $ 60 a year and are generally at a uniform amount per capita, although some councils have introduced graduated rates according to the occupation or assessed income of the ratepayer. Basic rates are payable by all persons of or above the age of 18 and resident within the area of a council's authority unless generally or specifically exempted. Only the Honiara Town Council has introduced general property rates based on the unimproved value of rateable land in the town. The current property rate is seven and a half percent.

Solomon Islands income earners. The change will remove the burden of income tax from about seven thousand people, all Solomon Islanders, who pay tax at present. It will reduce the number of persons paying personal income tax in 1980 to about three thousand, of whom about two thousand will be nationals and the remainder expatriates. This change will provide an immediate cash benefit to almost all taxpayers, but the proportionate benefit is greatest for married people on income between $ 2,000 and $ 3,000 a year.

In making this change, together with the reduction in copra export duty, we are deliberately opening up greater opportunities for the Provincial Assemblies to adopt a more progressive attitude to taxation through basic rate collection from people earning up to $ 100 or so a month. It is very important that Provincial Governments, with their much simplier collection methods and direct contact with taxpayers, do take these opportunities to increase their own revenues and reduce to some extent their dependence on national government grants. This change will also greatly ease the pressure on the Income Tax Division, and enable much more attention to be given to making sure that companies and people on higher incomes, where payment by each taxpayer is significant, do pay all the tax they ought to pay.

At the same time as the starting point for income tax is raised, we intend to increase the starting rate to 15 cents in the dollar, and take it up in 2 cent steps for each thousand dollars of income to a new maximum rate of 45 cents in the dollar, which will be reached on taxable incomes of $ 17 to $ 18,000 dollars a year. Revised valuations will be introduced, for tax purposes, of housing supplied by employers, so as to keep a fair balance between those who receive subsidised housing and those who do not.

Business tax rates will also be changed. The basic rate will go up from 30 percent to 35 percent, and a new rate of 45 percent will apply to companies operating here but not incorporated here, that is, local branches of overseas companies.

Tax on dividends will be greatly simplified. Under the proposed changes, a withholding tax of 20 percent will be paid on dividends paid to shareholders resident here, and 35 percent on dividends to overseas shareholders. The company itself will pay tax at 35 percent on the profits that are not distributed as dividends.

The increased revenue from these changes will go a long way towards balancing the annual revenue reduction of $ 0.5-0.75 million that we estimate will result from the changes in the personal income tax. The new rates of company tax are fair and reasonable, and we believe strike a good

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balance between the needs of companies and the needs of the wider community.

In this context, I am pleased to inform the House that good progress has been made in talks with our co-investor in the oil palm project, CDC, about changing the taxation arrangements for SIPL. This project has performed very well indeed, thanks to skilled management, hard work, and favourable market prices. Under the proposed new arrangement, SIPL will start to pay tax four years earlier than it otherwise would have done, yielding a substantial benefit to government revenues during the coming Development Plan period. It is this which has mainly enabled me to make the major reduction in copra export duty I announced a few minutes ago. As a result of these talks we expect to make an agreement with CDC that will recognise the valuable role CDC can play in Solomon Islands national development, in partnership with Solomon Islands interests, and pave the way for further CDC investment on appropriate terms.

Mr. Speaker, the changes I have described in taxation, together with the growth of the monetary economy which we expect to take place, are estimated to bring in tax revenues of between $ 17 and $ 18 million in 1980, about two-thirds of our estimated recurrent revenue requirements. This represents an increase in tax revenues of $ 4 million or 30 percent above the revised estimates for this year, and is three and a half times greater than in 1975, the first year of the current National Development Plan.

Fiji: BUDGET SPEECH 1980

Extracts from the Budget Speech 1980 pronounced on November 16, 1979 by the Minister of Finance, Mr. Charles Walker.

It has been widely recognised in Government and in the private sector, and also strongly endorsed by the Financial Review Committee that an Economic Development Board should be established to give direction and thrust to investment and job creation. A Tripartite Forum Committee has been meeting to define the role and powers of such a Board. They are expected to make their recommendations shortly and legislation will be introduced early in 1980 to set up the Board. This move will give much needed impetus to an area that has tended to lag and which in the next few years will become very critical.

Arising out of a thorough evaluation of the Financial Review Committee's recommendations Government will implement the following taxation measures:

1. Allowance for the first child and second child, without income limitation, will be increased from $ 130 to $ 200;
2. Maximum deduction for interest on housing loans will be raised from $ 200 to $ 500;
3. Taxpayers earning less than $ 8,000 a year will be given a rebate of 12½ percent on new savings for home ownership;
4. Rates of normal tax on companies will be raised as follows:
   (1) non-resident companies from 37½ to 42½ percent;
   (2) non-resident life insurance companies from 22½ to 27½ percent; and
   (3) every other company from $30^5/_6$ to 35 percent;
5. Write-off of depreciation on assets acquired after 31st December 1979, and used in a business, will be changed to a straight-line method;
6. Profit from sale of a business asset being replaced will be available for set-off against the cost of replacement asset, at the option of the taxpayer;
7. Initial depreciation allowance for plant and machinery will be raised from 20 to 30 percent;
8. Consideration is being given to exempt from tax bonus shares issued out of trading profit;
9. Gift duty exemption will be increased to $ 10,000, and spouse to spouse gift will be exempted from duty subject to certain safeguards against tax avoidance;
10. Export incentives allowance for timber sales will be equal to 10 percent of the f.o.b. value of arm's length sales, with a maximum of 50 percent of the chargeable income;
11. Method of claiming export incentives relief will be simplified so that separate records need not be maintained, and export profit to be based on export sales over total sales of total profit;
12. Withholding tax on royalty payments will be increased from 15 to 25 percent;
13. Deductions for the Fiji National Provident Fund contribution by employers will be raised from $ 600 to $ 1,000;
14. Expatriate employees will be able to join the Fiji National Provident Fund but on withdrawal of contributions must comply with current legislation;
15. Period of tax exemption for co-operatives will be increased from 5 to 8 years, and amounts transferred to reserve for expanding the business will be allowable deductions for tax;
16. Hotel aid will continue to apply to expanding hotels and concessionary treatment will be accorded where in-

HIGHLIGHTS OF FIJI INCOME TAXATION

Income taxation consists of (i) basic tax, (ii) normal tax and (iii) a number of withholding taxes.

Basic tax: This is levied on income before deduction of any allowance of individuals and companies. Individuals whose income does not exceed $ 600 are exempt.

Normal tax: This is levied on individuals whose income exceeds $ 600 at progressive rates ranging from 7.5 percent for the first $ 600 to 50 percent for income exceeding $ 24,000. Companies are also subject to normal tax at varying flat rates as follows:

— standard rate	$30^5/_6$ %
— non-resident shipping companies	2 %
— non-resident mutual insurance companies	22.5 %
— other non-resident companies	37.5 %

Withholding taxes:

Dividends distributed by a Fiji company to a resident individual	5 %
Dividends distributed by a Fjji company to a resident corporation	0 %
Dividends distributed by a Fiji company to non-resident individuals and corporations	15 %
Royalties paid by a Fiji company to non-resident individuals and corporations	15 %
Interest paid by a Fjji resident to non-resident inviduals and corporations	10 %

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vestment allowance is not utilised in full within 5 years;

17. Estate duty exemption will be raised.

In addition to implementing the foregoing recommendations of the Financial Review Committee, with minor modifications where considered appropriate, following measures will be taken to give further impetus to development:

18. Film-makers will be encouraged by special tax treatment dependent on the amount to be spent in Fiji; and
19. Third schedule income tax concession will be raised on sliding scale dependent on the number of employees, with a maximum relief equivalent to 25 percent of the paid up capital where over 50 employees are engaged by the enterprise, and minimum tax concession will be raised from $ 5,000 to $ 8,000.

To remove an anomaly which exists in the legislation:

20. A 15 percent withholding tax will be levied on all film hire paid to non-resident film suppliers.

Netting out all the above means an overall loss in revenue of about $ 100,000. The aim has been to provide some relief through the increased child allowance, inject incentives for greater savings and inducement for greater investment for job creation. No doubt there will be other views on what could or should be done but these are significant measures.

I should mention that when considering the Financial Review Committee Report, a number of tax recommendations could not be accepted by Cabinet. One was that Fiji National Provident Fund contributions should be taxed. Government has also not agreed that the income derived by a wife from her assets, or a salary or wage received from a business which is conducted or controlled by her husband should not be aggregated with husband's income. The recommendation would encourage income splitting among families and other tax avoidance schemes; it would be hard for the Commissioner of Inland Revenue to counter such avoidance schemes without a large increase in staff.

On deemed distribution and self-employed taxpayers, the Committee made two recommendations. The first was all companies should be allowed to retain profits without dividends being paid provided the profits are reinvested in the business. The short answer to this is that the Income Tax legislation adequately covers this point and we see no reason to change the existing law.

The second recommendation was self-employed taxpayers be taxed only on their personal spendings provided the minimum amount to be taxed be set at 60 percent of their income after tax. The immediate loss of revenue arising from the implementation of this proposal would exceed $ 8,600,000. If implemented the benefit would accrue to only a very small sector of the community, which I might add, would mainly include taxpayers who are already wealthy in our context.

On group assessment Government has not agreed with the Committee's recommendation that companies with 75 percent common shareholders be taxed as one unit. The Committee did not give any reasons for making this recommendation, but nevertheless, we consider that there would be little economic benefit accruing to Fiji should such a system be implemented. It could, in fact, have the reverse effect, in that such companies would not accept further equity investment by others for fear of being denied the benefit of group assessments.

Turning now to customs and excise, Government has decided to restore revenue from this source to the level obtained prior to 1974 by increasing taxes and excise on some traditional items and introducing new items.

One of our difficulties when trying to raise revenue from imported goods is that the burden tends to fall hardest on a limited number of items. We have been guided this year by the advice given by the Financial Review Committee and the measures we have taken are based on their lists.

Importation of cars and other passenger vehicles will continue to be under licence. Total import quotas for both classes of vehicles will remain unchanged, that is 1,100 units and 300 units respectively. In addition, goods vehicles of a gross unladen weight of two tonnes and less designed primarily for transport of goods, will be brought under annual quota. The 1980 quota for this class of vehicle is 850.

To provide additional incentives to local substitution for imports, help conserve foreign exchange and to broaden our indirect tax base, we are immediately raising duties on the following items:

1. Meat fresh or frozen; raised from 5 to 10 percent.
2. Fowls, ducks, in pieces and poultry liver fresh etcetera: increased by 15 percent to 45 percent.
3. Geese, turkeys etcetera: increased by 35 percent to 45 percent.
4. Butter: raised from nil to 10 percent.
5. Honey natural and artificial: raised by 20 percent to 45 percent.
6. Vegetables frozen, preserved and dried: raised by 25 percent to 30 percent.
7. Dried leguminous vegetables: raised from nil to 5 percent.
8. Fruits fresh, fruits preserved by freezing and fruits dried etcetera: increased by 25 percent to 30 percent.
9. Brown rice: raised from nil to 5 percent.
10. Polished rice: raised from nil to 10 percent.
11. Sausages etcetera: increased by 45 percent to 50 percent.
12. Canned fowls and ducks: increased by 5 percent to 45 percent.
13. Ice cream: increased by 25 percent to 35 percent.
14. Import duty of 15 percent has been increased to 40 percent for textile fabrics which are so processed that they are clearly suitable for conversion by a minor operation into made up articles.
15. Garments: increased by 10 percent to 55 percent.
16. Corsets, brassiers etcetera: increased by 15 percent to 55 percent.
17. Table and household linen: increased by 10 percent to 55 percent.
18. Parts of hats and headgear: increased by 27½ percent to 60 percent.
19. Headgear and hats: increased by 22½ percent to 60 percent.

In addition Customs duty on bulk tea and wheat and meslin has been raised from nil to 5 percent. It will be noted that we are levying Customs duty on imports of bulk tea and wheat rather than making packaged tea and the products of wheat excisable.

Items on which duties are raised for revenue purposes are:

1. Imported Beer: fiscal duty of $ 1.00 per litre is increased to $ 1.05.
2. Spirits: duties of $ 6.08 per litre on spirits containing 57.12 percent or less alcohol by volume and $ 10.64 per litre of spirits containing more than 57.12 percent alcohol by volume have been increased to $ 6.58 per litre and $ 11.52 per litre respectively.
3. Imported Cigarettes, Cigars and Tobacco: duties of $ 21.70 per kilogram on cigars and cheroots, $ 21.15 on cigarettes and $ 19.30 tobacco have been increased to $ 22.40, $ 21.85 and $ 20.00 per kilogram respectively.
4. The existing duty free list has also been extended by the addition of clocks, cigarette lighters, figurines of ceramics, audio amplifiers, speakers and household pewter ware. Duty has been reduced to 5 percent Fiscal and 5 percent Customs.

Opportunity has also been taken to regularise concessions granted to duty free shops at International Airports by suitably amending Code 214.

Excise duties have also been raised to yield additional revenue. The following changes become effective immediately:

1. Local Beer: increased from 30 cents per litre to 32.5 cents per litre.
2. Local Cigarettes: currently 10.395 cents per 10 cigarettes with local tobacco content and 16.52 per 10

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cigarettes with imported tobacco content, increased to 13.60 cents and 18.05 cents respectively.

3. Local Tobacco: currently $ 9.15 per kilogram with local tobacco content and $ 14.54 per kilogram with imported content increased to $ 9.88 per kilogram and $ 15.94 per kilogram respectively.
4. Matches: increased to $ 1.44 per gross from 15 cents per gross. Since the manufacture of matches started in Fiji in 1966, the excise duty on matches has remained at 15 cents per gross. On the other hand the import duty on matches containing not more than 60 matchsticks per box is presently $ 3.14 per gross.

Honourable Members will recall my predecessor's statement last year of Government's policy to progressively levy excise duties on local manufactures so as to ensure a wider revenue base. In line with this policy the following new items are being made excisable:

1. Ice cream: an excise rate of duty of 5 cents per litre.
2. Aerated Waters: an excise rate of duty of 4 cents per litre.
3. Cement: an excise rate of duty of $ 1.00 per tonne.
4. Toilet Paper: an excise rate of duty of 2 cents per roll.
5. Soap and Detergents: an excise rate of duty of 5 cents per kilogram.

The impact of these measures on the Consumer Prices Index has been evaluated and I am assured it would not be increased by more than one percent in a full year.

All these new measures together will yield a total of about $ 4.3 million, which added to the net loss of about $ 100,000 from income tax will mean a net additional yield of $ 4.2 million. This will enable us to maintain a balance in the operating budget for 1980.

There is no question that another "cycle" of hard economic times has begun with the international economy facing a slow down of economic growth and inflation endemic and increasing. And it is upon us just as we were energing out of the 1974 oil crisis and recession. None of us, neither the Government nor the responsible Opposition nor the country at large can duck our allotted responsibilities. The Budget I have presented is clear evidence that Government is prepared to take the first step and balance its operating budget; it is clear evidence that Government has noted the views of the Financial Review Committee and will have to move forward cautiously making adjustments so as to be sure to better cope with the difficult times ahead.

Mr. Speaker, Sir, I commend the Bill to the House.

Steuer und Studium

The Editors received from the German publishing house "Verlag Neue Wirtschafts-Briefe" the following announcement with respect to a new tax journal which is in particular aimed at assisting persons being trained to become tax inspectors or tax counsel. Since this announcement will be of interest primarily to our German readership the text of the announcement is reproduced in German.

Ab 1. April 1980 erscheint im Verlag Neue Wirtschafts-Briefe eine neue Zeitschrift: Steuer und Studium. Steuer und Studium ist eine Zeitschrift für die Aus- und Fortbildung im Steuerrecht. Sie berücksichtigt in der Konzeption besonders pädagogische Gesichtspunkte und dient dem Lernenden gleichzeitig als Repetitorium. Die Zeitschrift will vorhandene Lehrbücher wirksam ergänzen. Wer Steuer und Studium regelmässig liest, ist während seiner Ausbildung und zur bevorstehenden Prüfung bestens vorbereitet.

Steuer und Studium ist speziell konzipiert für die Ausbildung der künftigen Steuerinspektoren an den Fachhochschulen für Finanzen. Gleichzeitig wendet sie sich an die Personen, die sich auf die Steuerberaterprüfung vorbereiten. Auch der Student an der Hochschule sollte Steuer und Studium lesen. Darüber hinaus spricht Steuer und Studium den Mitarbeiter in der Steuerpraxis oder im Betrieb an, der etwas für seine Weiterbildung tun will und sich z.B. auf die Bilanzbuchhalterprüfung vorbereitet.

Erfahrene Dozenten, die an Fachhochschulen für Finanzen der Bundesrepublik und an Steuerschulen tätig sind, sowie Fachleute aus der Steuerpraxis schreiben für Steuer und Studium. Interessierte Leser können ein Probeheft beim NWB Verlag, Postfach 16 20, 4690 Herne 1, anfordern.

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Malaysia: BUDGET 1980

Extract from the Budget Speech pronounced by the Minister of Finance Yang Berhormat Mulia Tengku Razaleigh on October 18, 1979.

A detailed discussion of the Malaysian tax system appears in the Bureau's publication: TAXES AND INVESTMENT IN ASIA AND THE PACIFIC

However, these strategic goals of increasing economic growth and stepping up Government and private investments, must be directly linked to increasing the national capacity to produce the increasing supplies of especially essential consumer goods, that will be needed, to meet the rising demands of our people. Increased production dampens inflation. Conversely reasonable price stability promotes steady economic growth and improves the standard of living of our people.

The budget impact

I am therefore presenting to this House a *package of bold budgetary measures* to help ensure the attainment of the 1980 Budget Objectives.

I propose:

(a) A total appropriation of $ 20,724 million for the 1980 Budget - $ 10,868 million for Operating Expenditure and $ 9,856 million for Development Expenditure; and

(b) A *tax cut* amounting to $ 482 million. This is the biggest tax cut in our history. If we were to include the tax concessions and the subsidies, to Lembaga Letrik Negara and for petroleum products amounting to $ 491 million, the total amount of Government assistance will be $ 973 million.

Operating expenditure alone represents an increase of $ 2,159 million or 24.8 percent over the original 1979 estimates of $ 8,709 million. These high expenditures will enable Government to provide better and wider services to the public. At the same time Government will be able to expand and increase the effectiveness of its implementation capacity for the vast development efforts, programmes and projects, that have been increased under the *Third Malaysia Plan.* Indeed the recent *Operasi Isa Penuh* will be financed from these increases in the Operating Expenditure. This exercise will help establish an even stronger manpower base, for the planning and implementation of the *Fourth Malaysia Plan,* 1981-1985. It will also strengthen the rapidly growing Government machinery to better serve the private sector.

Retiring gratuities and pensions

In order to maintain and strengthen the Government's capacity to effectively implement the Fourth Malaysia Plan, it is necessary to retain the senior and experienced Government staff. In view of this need I now propose to withdraw the exemption of the tax on retiring gratuity and pension paid to an employee in the public sector who retires before the age of 55.

The exemption of tax on gratuity and pension now will only be given to an employee in both the public and private sectors who retires from employment on reaching the age of 55 or on reaching the compulsory age of retirement specified under any written law. Although the proposal will take effect from assessment year 1980, there is provision to preserve the rights and obligations of employees whose retirements were approved by their employers before today.

Commodity taxes

As a further measure to expand economic growth I am therefore proposing a major reform in the export commodity tax structure. This reform is to enable producers of primary commodities, particularly rubber, palm oil, and pepper smallholders, and operators of marginal tin mines to benefit from lower taxes which will result in higher disposable income thereby increasing demand and stimulating further economic growth.

The new concept of commodity taxation will be based on a cost plus approach. Under this concept the cost of production of the commodity will be taken into account and the appropriate duties will only be imposed at prices above the prevailing cost of production.

It is discerned that the average cost of production for rubber is 53 sen per pound, tin $ 1,110 per pikul, crude palm oil $ 455 per tonne, and for black and white pepper $ 130 per pikul and $ 160 per pikul respectively.

It is also felt that the duty structure should not, however, create disincentives to the producers. Thus it is proposed that the maximum marginal rate should not exceed 50 percent for all the commodities.

Based on the new concept of taxation, the export duty on rubber will now commence at a price level exceeding 60 sen per pound. When the price exceeds 60 sen but does not exceed 65 sen, duty will be applied at a rate of 20 percent for every sen increase within this price range. Similarly, for every sen increase in price thereafter but not exceeding a price of 70 sen, a rate of 25 percent will be applied. This progression of the marginal rate by 5 percentage points for every 5 sen increase will be applied up to a price of 90 sen above which the maximum marginal rate of only 50 percent will be levied.

As for tin, it is proposed that the duty will apply only at prices exceeding $ 1,200 per pikul. When the price exceeds $ 1,200 but does not exceed $ 1,250, duty will be levied at a rate of 20 percent for every ringgit increase within this price range. Similarly, for every ringgit increase in price thereafter but not exceeding a price of $ 1,300, a rate of 25 percent will be applied. The marginal rate progresses by 5 percentage points for every $ 50 increase thereafter until a price of $ 1,500 after which a maximum marginal rate of 50 percent begins to apply.

In view of the restructuring of the export duty on tin which will benefit the profitable mines more, it is proposed to revise the top marginal rate of tin profits tax from 12½ percent to 15 percent on taxable tin profit which exceeds $ 400,000.

The export duty on crude palm oil is also revised so that the duty is levied only when price exceeds $ 500 per ton. When the price exceeds $ 500 but does not exceed $ 550, duty at a rate of 30 percent will be levied for every ringgit increase within this price range. For every ringgit increase in price above $ 550 but not exceeding $ 600, a rate of 35 percent will be applied. Thereafter the marginal rate progresses by also 5 percentage points for every $ 50 increase in price until a price of $ 700 after which the maximum marginal rate of 50 percent will apply. The present export duty differential of 30 percent between Peninsular Malaysia and Sabah and Sarawak will remain unchanged.

It is also proposed that the by-products of processed palm oil namely palm stearin and palm kernel oil be subject to a nominal duty of 5 percent.

As can be seen the new duty structure for rubber will achieve two main Government objectives. It will reduce the higher tax

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incidence on the rubber industry vis-à-vis palm oil and it will give the rubber industry a better edge over palm oil in keeping with the Government's dynamic policy on rubber to encourage the expansion of the industry.

As for pepper, duty will only apply at prices exceeding $ 130 per pikul for black pepper and $ 160 per pikul for white pepper. For prices in excess of the threshold levels which I have just mentioned, marginal rates ranging from 10 percent to a maximum of 50 percent will apply.

In order to encourage the development of the spice industry, it is proposed that the export duty on spices other than pepper be abolished.

Hon'ble Members will agree that the private sector can only operate effectively in an environment of business confidence and the availability of, and accessibility to, basic infrastructure facilities. Business confidence is largely a function of political stability and business opportunities. Therefore, at this time of economic slowdown the private sector is particularly encouraged and understandably so, by Government's own initiatives to sustain and increase its own investment.

For this reason, the Budget has provided $ 585 million to improve and expand the telecommunications system. With this allocation, it is expected that the telephone exchange capacity would be increased by about 164,000 lines, underground cable network by 374,000 pairs, trunk and junction circuit by 120,000 circuit miles and the installation of about 80,000 additional direct subscriber exchange lines. This large allocation for telecommunications projects would not only help to overcome some of its present problems, but would also enhance the facilities for investors as well as traders particularly in the Commodity Exchange that will soon be established.

Similarly, $ 581 million will be provided for the expansion of our capacity to supply electricity in order to keep pace with the increase in private investment expansion.

Individual income tax

The commodity tax reforms and the provision of more efficient basic infrastructure facilities will provide new incentives to the private sector to invest and produce. To ensure that consumers at the same time have the necessary means to avail themselves of the goods and services, the Government is particularly conscious that such demand is effectively backed by sufficient purchasing power in the hands of consumers. I therefore propose to make significant adjustments in the individual income tax structure.

Relief for the individual which currently stands at $ 2,000 is to be revised to $ 5,000. The increase by $ 3,000 consists of a $ 1,000 increase in actual personal relief, another $ 1,000 to replace the present earned income relief and another $ 1,000 to provide relief for dependents. The present personal rebate of $ 60 is also retained.

Wife's relief of $ 1,000 is now proposed to be increased to $ 2,000. The relief for wife's earned income is to be withdrawn but the rebate for wife of $ 30 is to be retained.

Having regard to the increasing cost of education abroad, it is proposed that the allowance for children educated abroad which currently is double the amount of children's relief be now quadrupled.

Currently chargeable income exceeding $ 50,000 but not exceeding $ 75,000 is taxed at a rate of 50 percent while income exceeding $ 75,000 is subject to a rate of 55 percent. With the objective of providing more incentive for work effort, it is proposed to reduce the tax liability on chargeable income exceeding $ 50,000. Under the proposal, chargeable income exceeding $ 50,000 but not exceeding $ 75,000 will be subject to a reduced rate of 45 percent and for income exceeding $ 75,000 but not exceeding $ 100,000, the rate will be 50 percent for income exceeding $ 100,000 the rate will be 55 percent.

For *excess profits tax*, the present exemption limit of $ 75,000 for any person (other than a company) is raised to $ 100,000. Therefore, an individual will be liable to excess profit tax only on chargeable income which exceeds $ 100,000.

Review of estate duty

At present there are three separate estate duty legislations for the States of Malaysia. It is proposed to unify the three separate legislations as soon as the necessary administrative preparations are finalised. In the meantime, I would like to make the following proposals with a view to making the structure more equitable and improving income redistribution.

(a) The present exemption level of $ 50,000 for the estate of the deceased who died domiciled in Malaysia will now be raised to $ 300,000 in view of present prices and values of houses and other properties so that beneficiaries will be relieved of undue hardship from estate duty liability on estates left to them by the deceased. Thus, only values of estates in excess of $ 300,000 will now be liable to estate duty.

(b) The present provision of 50 percent abatement against estate duty is at the same time withdrawn.

(c) It is also proposed to revise the estate duty structure under which the estate duty liability will be lower under the proposed structure as compared with the existing structure for estates below $ 700,000 in value. For an estate worth more than $ 700,000 the liability will be higher under the proposal compared to the present structure. A cut-off value of $ 700,000 is considered reasonable and justified taking into account the objective of income and property redistribution.

(d) Finally, I propose to raise funeral expenses to $ 3,000.

The proposals I have just mentioned are applicable to Peninsular Malaysia pending extension of the legislation to Sabah and Sarawak.

In addition to the tax measures which I have just proposed, the Government will continue to adopt a flexible monetary policy that would facilitate the growth of domestic demand, particularly private sector demand so as to stimulate economic growth, private investment and employment generation.

The monetary policy will be formulated with the following objectives: to expand money supply and credit to mitigate any recessionary forces which may be transmitted from abroad and to facilitate a sustained growth of economic activity, especially private investment, without aggravating the underlying inflationary forces; to regulate the liquidity situation in order to generate conditions favorable to the stimulation of private demand for credit at reasonable cost; and to ensure that bank credit is distributed equitably among national priority uses.

The construction sector remains one of the most dynamic sectors in the economy. A significant part of its activity has been in the construction of residential houses. At present, housing loans provided by the commercial banks and other financial institutions have a maximum maturity period of up to 15 years. The monthly repayment terms would be eased considerably and placed within the reach of a larger cross section of the lower and middle income groups if the maturity periods were to be extended to 25 years and beyond. To enable the financial institutions to do so in a prudent manner, we need to establish a secondary mortgage market. I have since directed that the feasibility and technical details of an appropriate scheme be undertaken by Bank Negara in consultation with the major financial institutions. Such a scheme, when introduced, would certainly go a long way in ensuring that home ownership will be within the reach of a vast segment of the population and provide a timely boost to construction activity in the 1980s.

Accelerated depreciation allowance

Hon'ble Members will recall that *accelerated depreciation allowance* comprising an initial

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allowance of 20 percent and an annual allowance of 80 percent for capital expenditure on plant and machinery was extended in the 1978 Budget to all industries for assessment years 1979 and 1980.

I now propose that the period of offer be extended by 3 more years ending with assessment year 1983.

Reinvestment allowance

Similarly, in the 1979 Budget, a *reinvestment allowance* of 25 percent of capital expenditure on plant and machinery and on industrial building was offered for assessment years 1980 to 1982 to manufacturing and processing industries. To be in line with the extension of the accelerated depreciation allowance, I propose to extend the period of offer of the reinvestment allowance by another year to end with assessment year 1983.

Long-term Credit Bank (Bank Kemajuan Perusahaan Malaysia)

When presenting last year's Budget, I had proposed the provision of long-term financial assistance to the ailing shipping industry, so that domestic shipyards could expand and compete internationally in building vessels for export and in undertaking repairs.

Towards this end, Bank Kemajuan Perusahaan Malaysia Berhad was incorporated on August 7, 1979 with an authorised capital of $ 100 million to provide long-term finance to the shipping as well as other industries in Malaysia. Funded jointly by the Federal Government and Bank Negara Malaysia, Bank Kemajuan would assist domestic industries to expand and upgrade their production technology and capacity and to re-finance their export at internationally competitive terms.

The Bank has already launched its ship repairs financing facility. Invoices for ship repairs of domestic and foreign ships would be eligible for financing under this facility for a maximum period of 1 year at concessionary interest rate of 4.5 percent per annum. Bank Kemajuan is currently working on a range of industrial financing schemes, including medium and long-term suppliers' and buyers' credit for the export of ships, machinery, equipment and other capital goods manufactured in Malaysia.

Tax incentive for inward reinsurance

In encouraging investment we need to provide investment incentives in the *service sector* of the economy as well. This is particularly important since, as in the case of the insurance industry, there is much scope for expansion.

Presently, profits from inward reinsurance business are subject to the company tax rate of 40 percent in Malaysia. In comparison, concessional rates of only 10 percent and 17 percent are levied in some neighbouring countries. Given the heavier tax liability, the insurance industry in Malaysia is constrained from being able to develop the business of inward reinsurance.

I therefore propose to accord preferential tax treatment by reducing the present 40 percent rate applicable to profits from inward reinsurance to 5 percent so that the insurance industry in Malaysia will be able to compete effectively. Dividends paid out of profits from inward reinsurance will be exempt from tax in the hands of shareholders. With lower tax liabilities, domestic insurance companies should be able to quote lower premiums to attract inward reinsurance which should therefore help expand the scope and performance of the insurance industry.

Tax incentive for reafforestation

It is proposed that the cultivation of timber be encouraged by extending to reafforestation the same tax treatment which presently applies to the planting industry. Cultivated timber will therefore be brought within the definition of "approved crops" in the Income Tax Act. Any expenditure incurred on replanting will be allowed to be deducted against the revenue of the year in which such expenditure is incurred. Further, plant and machinery used in reafforestation will qualify for an increased initial allowance of 60 percent.

Tax incentive for exports

Manufacturing exports have been increasing at an impressive rate of 20 percent in the last few years. This is the kind of economic trend that needs encouragement especially at this time of global economic slowdown. Our own economic growth could be stimulated and supported by sustaining the good performance of our manufacturing exports. We cannot allow the recession abroad to adversely affect our own long-term industrial and modernisation plans.

I therefore propose to introduce additional incentives to encourage export oriented manufacturing industries by allowing the cost of maintaining sales offices overseas for the promotion of exports to be elibible for additional deductions. Also I propose to replace the present export allowance, with an outright allowance of 2 percent of ex-factory value of all export sales, and an additional 10 percent on the increase of export sales over that of the previous year.

The Hon'ble the Minister of Trade and Industry will be moving an appropriate Amendment Bill to the Investment Incentive Act in this House during the current session for debate and approval so that the proposed revision to export incentives could be implemented.

Export refinancing facilities

Hon'ble Members will recall that as a part of the Government's policy to promote manufactured exports, Bank Negara has been providing the export trade with concessional post-shipment as well as pre-shipment refinancing facilities. We have reviewed these facilities and I now propose to further expand pre-shipment facility, to include rubber and plastic products, footwear, metal products, sports goods and furniture. With the proposed expansion, the coverage will now be increased to about 25 percent of the total manufactured exports.

The battle against inflation cannot be the responsibility of the Government alone. The private sector must also play its part. Among others, I have often alluded to the need for a strong and well organised consumer movement. Businessmen and manufacturers also have a role. In particular, they owe it to their customers to purchase always from the cheapest markets. Since the onset of the Third Malaysia Plan, the ringgit has appreciated against the US dollar by more than 20 percent, against sterling by over 10 percent and in 1979, against the Japanese yen by 18 percent. Importers and manufacturers must take advantage of our inherent strength and react promptly to diversify their sources of supply to the cheapest sources, to alleviate the impact of imported inflation on the domestic price level.

On the whole, we have done well in expanding the nation's manufactured exports, which are directed mainly at the more traditional markets in the major industrial nations. While we need to nurture these markets, greater efforts must be made to develop the growing dynamic markets nearer home through regional cooperation.

The East-Asian countries and ASEAN have great potential for trade and industrial expansion. Furthermore, there are a vast potential and prospects for trade and industrial cooperation within the great Pacific Basin. This vast and rich region provides tremendous opportunities for the future. Indeed, while we are on the threshold of the 1980s, Malaysia must begin to think hard about planning for the promising possibilities and potential for trade and industry within the context of the larger Pacific Basin. We must look further ahead. We must raise our sights.

We cannot continue to look to the industrial countries so-called, The North. Time and again the developing countries have been turned down in their legitimate case for the establishment of a New International Economic Order.

As agreed by the developing countries at the last Unctad V Meeting, we must do much more to increase trade and industrial

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cooperation amongst developing countries themselves. Besides the great potential that there is in ASEAN and other Asian developing countries, we can and should also look forward with confidence to expanding our trade relations with *Islamic* countries, with whom we have increasingly strong fraternal relations.

Establishment of a warehousing system in Malaysia

As Hon'ble Members are aware, warehousing facilities are currently very limited. It is felt that the facilities should be expanded as it will lead to better Customs supervision and more competitive prices as the importers will be able to import "bulk". Thus, it is proposed that more licences to establish warehouses will be issued throughout the country. The private sector is expected to play a major role in owing and operating these warehouses. It is also proposed that spare parts, fruits and canned food, cosmetics, watches and chemicals be included as items which may benefit from the bonded warehouse facilities. The list of items may be extended from time to time.

The operation of a warehouse requires a licence from Customs Department to whom applications could be made.

Proposal to reduce tax burden on public transport sector - taxis, hire-cars and buses

In order to improve the public transport service to the people it is felt that some incentives should be given. Towards this objective, I propose to:

(a) Reduce the excise duty on taxis and hire-cars by 50 percent.
(b) Reduce the road tax on taxis and hire cars by 50 percent.
(c) Reduce the engine tax on buses by 25 percent.

Proposal to increase road tax on privately owned diesel cars

As Hon'ble Members are aware, the subsidy on diesel is aimed to benefit the industrial users as well as the public transport industry so as to restrain price increases and was never intended to benefit owners of private diesel cars. Therefore, I propose that the road tax on privately owned diesel cars be increased to five times that of the road tax on cars using petrol compared to the present rate of four times.

Import duty and excise

Hon'ble Members will observe that the 1980 Budget has not given much attention to the reduction of import duties. This is not because the Government does not wish to reduce import duties, particularly for the goods consumed by the lower income groups. On the contrary, I can assure you that the Government has been reducing or eliminating import duties, on essential food items as well as other items of mass consumption. Whatever dutiable items there are, it is largely to protect our own domestic industries against competition and could not be reduced at the moment.

For this year's Budget therefore, I have little to offer except to propose duty reductions on a very restricted number of items as follows:

(a) Import duties on durians, mangoes and jackfruits are reduced by another 50 percent,
(b) import duty on film/negatives for movie industry is reduced from 40 to 50 percent,
(c) import duties on some sports goods such as racing bicycles, sports gloves and appliances for gymnastics are removed,
(d) import duty on cylinder block is reduced from 75 to 25 percent.

I also propose to remove the excise duty on reconditioned batteries so that the treatment is the same as for retreaded tyres. Excise duty on foam rubber mattress is also reduced from 44 sen per kg. to 33 sen per kg., so as to be on par with the duty on artificial foam plastic mattresses.

Tax incentives to encourage investment and restructuring

As Hon'ble Members are aware the Government is taking the lead to promote overall economic growth and investment in particular. However, the private sector has to support and supplement the Government's investment initiatives more strongly, in order to sustain and strengthen the growing importance of the private sector's role in promoting balanced economic growth and investment under the New Economic Policy. We therefore need to ensure that the NEP goals for restructuring are achieved on schedule. This requires concerted effort on a sustained basis through all aspects of Government policies which include fiscal policy. I therefore propose the following tax measures as incentives to accelerate the pace for restructuring and the promotion of investments and economic growth:

(a) Currently all companies have to pay income tax at a rate of 40 percent. Under the proposal, companies with a paid up capital of not less than $ 1 million or with a net asset of not less than $ 1 million which conform to the equity restructuring requirement of the Government, will only pay income tax at a lower rate of 35 percent.
(b) I am also proposing that companies which conform to restructuring with respect to employment and/or marketing network be exempted from Development Tax of 5 percent.

Both these exemptions are to be accorded upon the production of annual certification by the Foreign Investment Committee (F.I.C.). These incentives are to be offered for only 3 assessment years from assessment year 1980 to assessment year 1982.

Hon'ble Members are aware that the Government is determined to set up the pace of corporate restructuring, not only through fiscal incentives but in participating directly in the commercial and industrial sector of the economy.

The promotion of a more rapid rate of growth in private investment, in conjunction with the attainment of our national restructuring objective, will ensure not only balanced, but also stable and steady industrial growth and expansion. Thus, the 1980 Budget provides $ 1,086 million to promote and strengthen the Government's industrialisation policy. Of this large amount, a sum of $ 227 million will be provided to State Economic Development Corporations to promote industrial development in conjuction with the private sector. The Government's industrial participation in joint-enterprises with the private sector, will help to achieve our socio-economic objectives, in a mutually reinforcing manner, since both the public and the private sectors will stand to gain much from mutual cooperation to achieve our common objectives.

As a further measure to accelerate the progress that has so far been achieved in increasing the equity ownership of the Bumiputra community, an additional sum of $ 300 million is provided to supplement the present capital of $ 200 million in the Bumiputra Investment Fund.

We recognise that one of the major constraints to the expansion of Bumiputra ownership and participation in the corporate sector is the lack of finance. Therefore the 1980 Budget provides $ 256 million to supplement the credit resources and facilities of Government's major institutions, that have been established to achieve the objectives of restructuring i.e. Pernas, UDA and MARA.

I might add that these additional resources will help supplement the new guidelines on bank lending which were introduced two months ago for commercial banks and finance companies.

It is clear therefore that the Government is doing its best, in cooperation with the banking sector, to provide increasing amounts of loanable funds to the Bumiputra community and small scale enterprises, and agricultural food production to accelerate private investment and our restructuring objectives.

In line with the New Economic Policy, the Government is now making preparations for the transfer of shares in successful Government-owned companies to Bumiputras. The transfer process will take time as it may involve amending some existing

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legislations. However, it is hoped that the transfer could be effected by mid-1981 through a scheme now being formulated, which will ensure that a majority of the shares in Government-owned companies will come under the control of a large segment of the lower-income population. The Bumiputra Investment Fund, operating under its own scheme, will be one of agencies for this purpose. In this way it is hoped that the lower-income groups will be able to enjoy the fruits of this *share transfer plan* as they will be able to control the biggest portion of the shares in successful Government companies.

As a preparatory measure to encourage small investors or low-income individuals to save and invest their money in profitable schemes, I propose that the profits of approved unit trusts will be exempted from income tax and that dividends not exceeding $ 4,000 a year received by the taxpayer, who is a unit holder, will also be exempted from income tax.

Malaysia's Economic and Budget Forecast for 1980

I have outlined the 1980 Budget Strategy and presented my proposals to achieve the Budget's Strategic Goals. The question that now remains is: *What then are Malaysia's economic and budgetary prospects for 1980?*

Hon'ble Members will agree that it is extremely diffcult to be precise about economic and financial estimates for the future, particularly when there is so much international economic uncertainty and monetary instability.

Be that as it may, current indicators point to a real growth in the domestic economy of about 6-7 percent for 1980 as a whole. Implementation of the Budget Strategy I have outlined would provide a firm foundation for the economy to grow faster than envisaged, not just in 1980 but also in the immediate years beyond. Both the tax cuts of $ 482 million and the tax concessions as well as subsidies relating to electricity and petroleum products amounting to $ 491 million in 1980, will have the effect of achieving the Budget objectives. With these firmly in place, we can reasonably expect the domestic price level to stabilise at about 5-6 percent in 1980.

The big tax cuts have been possible not only because of the basic resilience of our economy, but also because of the consistently strong Budget performance and the favourable outturn estimated for next year. The 1980 Budget's Current Account surplus is estimated at $ 515 million before tax changes and $ 33 million after tax changes.

These big tax cuts together with large Expenditures and subsidies have enabled us to design the Budget Strategy of promoting Economic Growth and Combatting Inflation, to not only encourage further investment and expand production but also to help, particularly the poverty and lower income groups, to face the economic difficulties that lie ahead.

SOME MAJOR PROPOSED TAX AMENDMENTS

A. INDIVIDUAL INCOME TAX

Under the existing tax structure, the tax burden for various chargeable income, after allowing all possible deductions is as follows:

Chargeable income ($) (1)	Marginal rate (%) (2)	Marginal liability ($) (3)	Liability ($) (4)	Average tax rate (%) (5)
1,000 – 2,500	6	150	150	6.0
2,501 – 5,000	9	225	375	7.0
5,001 – 7,500	12	300	675	9.0
7,501 – 10,000	15	375	1,050	10.5
10,001 – 15,000	20	1,000	2,050	13.7
15,001 – 20,000	25	1,250	3,300	16.5
20,001 – 25,000	30	1,500	4,300	19.2
25,001 – 35,000	35	3,350	8,300	23.7
35,001 – 50,000	40	6,000	14,300	23.6
50,001 – 75,000	50	12,500	26,800	35.2
75,001 and above	55	–	–	–

The tax burden on chargeable income is shown in column (5).

It is proposed that the following measures be taken in respect of the individual income tax structure:

(a) Relief for individual

At present the reliefs for the individual are in the form of:
(i) personal relief of $ 2,000
(ii) earned income of 1/10 of income or $ 1,000 whichever is lower;
(iii) rebate of $ 60. This is to be deducted from tax payable.

It is proposed that for 1980, the individual relief be replaced by a single individual relief of $ 5,000 and relief on earned income be withdrawn. Out of the $ 3,000 increase, the first $ 1,000 is an actual increase of individual relief, while the second $ 1,000 is to provide relief for dependents and the final $ 1,000 is to convert earned income relief into an additional individual relief. The present rebate of $ 60 is to be retained.

(b) Wife's relief

At present the reliefs for wife are as follows:
(i) wife's relief of $ 1,000;
(ii) wife's earned income of 9/10 of income of maximum of $ 500; in case where earned income exceed $ 5,000 1/10 of income or maximum of $ 1,000.
(iii) a rebate of $ 30. This is to be deducted from tax payable.

It is proposed that the relief for wife be increased to $ 2,000 and that the relief for wife's earned income be withdrawn. The rebate for wife of $ 30 is to be continued.

(c) Allowance for children educated abroad

The current allowance for children educated abroad is double the amount of children's relief.
It is proposed that the allowance for children educated abroad be *four times* the normal deductions which currently are as follows:

1st child	$ 800
2nd child	$ 700
3rd child	$ 600
4th child	$ 500
5th child	$ 400

(d) Revision of top chargeable bracket

Currently chargeable income exceeding $ 50,000 but not exceeding $ 75,000 is taxed at a rate of 50 percent while income exceeding $ 75,000 is subject to a rate of 55 percent. With the objective of providing more incentive for work effort, it is proposed to reduce the tax liability on chargeable income exceeding $ 50,000. Under the proposal, chargeable income exceeding $ 50,000 but not exceeding $ 75,000 will be subject to a reduced rate of 45 percent and for income exceeding $ 75,000 but not exceeding $ 100,000, the rate will be 50 percent. For income exceeding $ 100,000 the rate will be 55 percent. For excess profit tax, the present exemption limit of $ 75,000 for any person (other than a company) is raised to $ 100,000. Therefore, an

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individual will be liable to excess profit tax only on chargeable income which exceeds $ 100,000.

The table below gives a comparison of tax liability under the present and proposed reliefs for individual and wife at various income levels:

Income	Tax payable ($) Present	Proposed	Tax saving to taxpayer
5,000	nil	nil	nil
10,000	345	120	225
20,000	2,085	1,560	525
30,000	4,885	4,110	775
50,000	12,410	11,410	1,000
75,000	24,550	22,400	2,150
100,000	39,010	35,710	3,300

The above proposal is to take effect from assessment year 1980.

B. EXTENSION OF PREVIOUS BUDGET MEASURES

(i) Accelerated depreciation allowance

The *accelerated depreciation allowance* comprising of an initial allowance of 20 percent and an annual allowance of 80 percent for capital expenditure on plant and machinery was introduced in the 1977 Budget for the agro-based and related industries for a period of 3 years from assessment years 1978 to 1980. The scope of accelerated depreciation allowance was extended in the 1973 Budget to all industries undertaking capital expenditure for assessment years 1979 and 1980. It is proposed that the period of offer be extended by 3 more years up to and including assessment year 1983.

(ii) Reinvestment allowance

In the 1979 Budget, a *reinvestment allowance* of 25 percent of capital expenditure on plant machinery and on industrial building (deductible from adjusted income) was offered for a period of three years from assessment years 1980 to 1982 (basis years 1979 to 1981) to manufacturing and processing industries undertaking expansion as approved by the Ministry of Trade and Industry. To be in line with the extension of the accelerated depreciation allowance to assessment year 1983, it is proposed that the period for reinvestment allowance should also be extended by another year up to and including assessment year 1983.

C. TAX INCENTIVE FOR INWARD REINSURANCE

Income from inward reinsurance business is assessable to income tax at 40 percent, development tax at 5 percent and excess profit tax at 5 percent on the chargeable income which exceeds the appropriate franking limit.

It is proposed that preferential tax treatment be accorded to inward reinsurance business in order to encourage the flow of profitable reinsurance business to Malaysia from other countries. It is proposed that the present 40 percent rate applicable on profits from inward reinsurance business be reduced to 5 percent. The proposal will be made effective for assessment year 1980 and subsequent years of assessment.

D. TAX INCENTIVE FOR REAFFORESTATION

It is proposed that the growing of timber be encouraged by extending to reafforestation the tax treatment which presently applies to the planting industry. Cultivated timber will be brought within the definition of "approved crops" in the Income Tax Act to enable reafforestation to qualify for capital expenditure incurred on clearing of land, new planting and construction of roads to be written off over 2 years. Capital expenditure on labour lines will be allowed to be written off over 5 years and capital expenditure on other buildings allowed to be written off over 10 years. In addition, any expenditure incurred on replanting will be allowed to be deducted against the revenue of the year in which such expenditure is incurred. Further, rules will be introduced under the Income Tax Act to enable plant and machinery used in reafforestation to qualify for an increased initial allowance of 60 percent compared to the normal rate of 20 percent.

E. TAX INCENTIVES FOR EXPORTS

At present export incentives are given under the Investment Incentives Act, 1967, and these are:

(i) Deduction for promotion of export

These are given in respect of expenses incurred for promotion of exports of manufactured products. Export expenses that qualify for deductions are:

(a) advertising expenses
(b) provision of free samples
(c) market research
(d) preparation of tenders
(e) overseas travel for negotiations and contracts
(f) expenses for giving technical information to buyers.

The deductions allowable are given in addition to any deductions allowable under Section 33 of the Income Tax Act 1967.

(ii) Accelerated depreciation allowance

Under this incentive about 90 percent of the initial outlay or capital could be written off in 5 years, instead of the 20 or more years at normal rates of depreciation allowance.

(iii) Export allowance

An allowance at the rate of 5 percent of the increase in export over the average exports of the preceding five assessment years is given as deduction from gross income. The rate is increased to 8 percent in the case of companies which use not less than 50 percent of local material in their export products.

It is proposed that the export incentives be given by:

(a) allowing additional deduction for the cost of maintaining sale offices overseas for promotion of export;
(b) replacing the present export allowance with an outright export allowance of 2 percent of ex-factory value of export sales and an additional 10 percent of ex-factory value of export sales on the increase of export sales over the export sales of the previous year. It is proposed that this allowance be given on all export sales irrespective of local content.

Crude olein and stearin, neutralised olein and stearin, neutralised palm oil, and neutralised bleached palm oil, tapioca chips, fresh fruits and vegetables, cocoa beans, coffee beans, sand, clay and stones (including granite and limestone), livestocks, and products of industries engaged in the manufacture or assembly of electrical and electronic components are to be included in the list of products not eligible for export allowance.
The proposal is to take effect from assessment year 1980.

F. TAX INCENTIVE FOR RESTRUCTURING

It is proposed that the following tax measures be adopted as incentives for restructuring:

(a) Equity restructuring

Exemption of 5 percentage points of the company income tax

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of 40 percent is to be allowed to any company conforming to the equity restructuring requirement of the NEP with at least 30 percent equity ownership for Bumiputras, 40 percent for non-Bumiputra Malaysians and 30 percent for foreigners.
In order to expedite the achievement of the target, the above incentive is initially suggested to be offered on a yearly basis for 3 assessment years from assessment year 1980 to assessment year 1982. The attraction of this proposal is that it encourages companies to restructure early in order to reap the benefit of the tax reduction. In order to qualify for exemption, the company must either have a paid-up capital of $ 1 million unimpaired by contingent liabilities or have a net asset (before revaluation) of not less than $ 1 million. Pioneer companies and companies enjoying tax incentives will not qualify for this incentive.

(b) Employment and/or marketing network restructuring

Any company conforming to the employment and/or marketing network restructuring will be exempted from the development tax of 5 percent.
The period of offer is similar to (a) above i.e. on a yearly basis for three assessment years from assessment year 1980 to assessment year 1982.

Both exemptions above are to be accorded on annual certification by the Foreign Investment Committee (FIC). FIC will issue the certificate after consultation with the relevant authorities.

G. TIN PROFITS TAX

In view of the proposed restructuring of export duty on tin which will benefit the profitable mines more, it is now proposed to raise the present maximum rate of tin profits tax from 12½ percent to 15 percent as follows:

Taxable tin profits (after providing for exemptions)	Rate Present (%)	Proposed (%)
First $ 200,000	5	5
next $ 200,000	10	10
exceeding $ 400,000	12½	15

The proposal is to be made effective from assessment year 1980.

H. TAX EXEMPTIONS FOR APPROVED UNIT TRUSTS AND MALAYSIAN UNIT-HOLDERS

The incentive proposed is to exempt unit trusts which are approved by the Minister of Finance. Also resident unit holders who are taxpayers are exempted from the individual income tax in respect of the dividends they receive subject to a maximum amount of $ 4,000 per year which works out to a return of 8 percent on an investment of $ 50,000 in unit trusts.
The proposal is to take effect as from assessment year 1980.

I. REVIEW OF ESTATE DUTY

Three policy changes proposed are:
(a) The present exemption level for the estate of deceased person who died domiciled in Malaysia which presently is at $ 50,000 is proposed to be raised to $ 300,000. Only values of estates in excess of $ 300,000 will now suffer estate duty. The exemption level for the estates of a non-domiciled deceased which presently is at $ 10,000 is proposed to be revised to $ 60,000.
(b) It is also proposed that the present 50 percent abatement against estate duty be abolished.
(c) The estate duty structure for estates of domiciled deceased is to be revised as in the attached table. Under the proposed structure, the estate duty liability will be lower as compared with the existing structure for an estate not exceeding $ 700,000 in value. For an estate with value exceeding $ 700,000 the liability will be higher under the proposed than under the present structure.
(d) Funeral expenses are now proposed to be raised to $ 3,000 from the present $ 1,000 or 2½ percent of ascertained value of estate, whichever is lower.
(e) Any money received under a personal accident insurance policy will not be subject to estate duty.

The amendment will apply to the estate of any person dying on or after 18th October 1979.
The above proposals are applicable to Peninsular Malaysia, pending extension of the law to Sabah and Sarawak.

ESTATE DUTY

Taxable income		Proposal Rates (%)	Proposal Amount payable	Proposal Effective rate (%)	Existing Amount payable after 50% abatement	Existing Effective rate (%)
		(1)	(2)	(3)	(4)	(5)
On First	300,000		nil		$15,000	5
next	100,000	12	12,000			
first	400,000		12,000	3	25,000	6.2
next	100,000	16	16,000			
first	500,000		28,000	5.6	50,000	8.3
next	200,000	20	40,000			
first	700,000		68,000	9.7	65,000	9.3
next	300,000	25	75,000			
first	1,000,000		143,000	14.2	115,000	11.5
next	500,000	30	150,000			
first	1,500,000		293,000	19.5	215.000	14.3
next	500,000	35	175,000			
first	2,000,000		468,000	23.4	327,500	16.4
next	1,000,000	40	400,000			
first	3,000,000		868,000	28.9	577,500	19.3
next	1,000,000	45	450,000			
first	4,000,000		1,318,000	32.9	827,500	20.7
next	1,000,000	50	500,000			
first	5,000,000		1,818,000	36.4	1,102,500	22.0
next	1,000,000	55	550,000			
first	6,000,000		2,368,000	39.5	1,377,500	22.9
on remainder		60				

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MALAYSIA:
Deductibility of Foreign Losses
– Two Bites at the Cherry –

Hock Heng Co. S'dn. Bhd. v. Director-General of Inland Revenue

by C.S. Yeoh *

Malaysian Income Tax – Malaysian resident company with Singapore branch – whether company can set off Singapore branch's loss against Malaysian income – Income Tax Act, 1967 (Malaysia) – Malaysia/Singapore Double Taxation Agreement 1966.

Three main factors affect any claim for loss relief by an enterprise if such losses arise from activities in a foreign territory. These factors are-
(i) the local law,
(ii) double taxation treaties, if relevant, and
(iii) case law.

In *Hock Heng Co. Sdn. Bhd. (private limited) v. Director-General of Inland Revenue*, the taxpayer, a Malaysian company, which was ordinarily resident in Malaysia, had its head office in Malaysia and a branch in Singapore. For the year of assessment 1968, the head office made a profit of M$ 31,415 whilst the branch incurred a loss of M$ 538,335.

Under Section 3(a) of the Income Tax Act, 1967 (hereinafter referred to as "the Act") the global income of a Malaysian company was subject to Malaysian income tax. This section as applicable to the year of assessment 1968 reads :

> ". . . income tax shall be charged . . .
> (a) in the case of a person ordinarily resident . . . upon his income from wherever derived; . . ."

By virtue of Paragraph 1(a), Article IV of the Double Taxation Relief (Republic of Singapore) Order, 1966 (hereinafter called "the Agreement" or "treaty"), profits of a permanent establishment in Singapore of a Malaysian enterprise were exempt from Malaysian tax. The relevant paragraphs of this Article are reproduced below:

> "1. (a) The profits of a Malaysian enterprise shall not be taxable in Singapore unless the enterprise carries on business in Singapore through a permanent establishment situated in Singapore. If the enterprose carries on business as aforesaid, tax may be imposed in Singapore on the profits of the enterprise but only on so much of them as is attributable to that permanent establishment. No further tax shall be imposed in Malaysia in respect of profits of the permanent establishment which are remitted to Malaysia. . . .
>
> 2. Where an enterprise of one of the Contracting States carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing independently with the enterprise of which it is a permanent establishment.
>
> 3. In determining the profits of a permanent establishment, there shall be allowed as deduction all expenses, including executive and general administrative expenses, which would be deductible if the permanent establishment were an independent enterprise in so far as they are reasonably allocable to the permanent establishment, whether incurred in the Contracting State in which the permanent establishment is situated or elsewhere."

The Agreement was silent as regards losses of a permanent establishment and Paragraph 1 of Article XVII of the treaty confirmed that unless otherwise provided in the treaty, the laws of Malaysia should continue to govern the taxation of income in that country. Paragraphs 1 and 2 of Article XVII are set out below:

> "1. The laws of each Contracting State shall continue to govern the taxation of income in that State except where express provision to the contrary is made in this Agreement. Where income is subject to tax in both Contracting States, relief from double taxation shall be given in accordance with the following paragraphs of this Article.
>
> 2. Where a resident of one Contracting State derives income from sources within the other Contracting State and that income in accordance with the income tax laws of each Contracting State and the provisions of this Agreement is subject to tax in the other Contracting State, the former Contracting State shall exempt such income from tax."

In computing the taxpayer's income for Malaysian tax purposes the Inland Revenue refused to allow a claim to have the Singapore loss be set off against the Malaysian income.

The taxpayer appealed to the Special Commissioners of Income Tax who decided in its favour. At the request of the Revenue a case stated was presented to the High Court.

At the High Court the learned Judge reversed the decision of the Special Commissioners. He based his judgement on the reasons given by him in the *United National Finance Bhd. v. Director-General of Inland Revenue* case of 1975. In disallowing a similar set-off of Singapore losses against Malaysian income in that case the learned Judge reasoned that such losses, if allowed, would have been deducted twice, once in Singapore and again in Malaysia.

The taxpayer then appealed to the Federal Court. The arguments put forward on behalf of the taxpayer may be briefly summarised as follows:

(a) At the relevant time under Section 3(a) of the Act, tax was payable on its income from wherever derived, i.e. upon world income. In computing its world income, losses suffered in Singapore should be deducted from profits in Malaysia - else, how could its world income be determined?

(b) In accordance with Section 44(2) of the Act, losses may be deducted and these must include, it was submitted, losses suffered in Singapore.

(c) Certain deductions were not allowed; these were enumerated in Section 39 of the Act. Losses suffered in Singapore were not included; therefore, such losses could be set against Malaysian profit.

(d) According to the ordinary principles of commercial accounting, all gains and losses must be brought into account when computing income.

(e) The Agreement and its enabling authority, Section 132 of the Act, provide for relief against double taxation; such relief was only in respect of profits made and taxed in Singapore. As the taxpayer had not claimed any relief against double taxation, the Agreement was not applicable and the losses should be allowed under Section 44(2).

The Court, however, found in favour of the Director General of Inland Revenue on the following grounds:

(i) Singapore losses, if allowed against Malaysian income, would have been doubly deducted. As Lee Hun Hoe CJ (Borneo) put it, "They cannot have two bites at the cherry".

(ii) Article IV (2) and (3) of the Agreement — business profits — provides that the Singapore branch and Malaysian head office were to be regarded as separate and distinct. In other words, the world income scope of Malaysian taxation had been transformed to the derivative scope and the Singapore losses could not be attributed to activities in Malaysia. Singapore losses should be deducted from Singapore profits and Malaysian losses from Malaysian profits.

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(iii) Section 3(a) of the Act has been overridden by the Agreement insofar as Singapore losses were concerned in that the branch and head office were to be regarded as distinct and separate.

An appeal by the taxpayer to the Privy Council followed. It was common ground that but for the said tax treaty, the appellant would have been entitled to set off the Singapore losses against its Malaysian income. The Privy Council was therefore faced with the question as to whether or not there were provisions in the Agreement which modify the 1967 Act insofar as the Singapore losses were concerned.

Viscount Dilhorne in his delivery of the Majority Judgement referred to Articles IV and XVII of the Agreement. In connection with the former Article he noted that any profits of a permanent establishment in Singapore of a Malaysian enterprise were taxable only in Singapore whether or not such profits are remitted to Malaysia. To this extent therefore the tax treaty qualified and modified the Act under which Malaysian tax was chargeable on all income wherever derived.

His Lordship added that expenses, as one would expect, are deductible in computing profits. Article IV was concerned with profits and what would happen to them. It did not purport to provide the tax consequences if losses were incurred.

With reference to Article XVII — Elimination from double taxation — their Lordships pointed out that paragraph (2) thereof was not applicable to the case because that paragraph referred to income only as opposed to losses. Paragraph (1), which provided that the laws of Malaysia should continue to govern the taxation of income in that state except where express provision to the contrary was found in the Agreement, was, in the opinion of their Lordships, determinative of the appeal. There were no express provisions regarding losses; hence the Act applied.

In their Lordships' view the *United National Finance Bhd.* case referred to earlier was incorrectly decided. They had sympathy for the concept that if profits from the Singapore branch were not taxable in Malaysia then, conversely, Singapore losses should not be allowed to reduce Malaysian income, but they said that the Agreement did not so provide. Lord Russel of Killowen chose to part company with the rest of the Board on this point. In his opinion an exemption from tax necessarily involved an exclusion from loss relief.

It was therefore held by a majority, Lord Russel of Killowen dissenting, that the appeal should be allowed and the Deciding Order of the Special Commissioners restored. The M$ 538,335 loss incurred by the Singapore branch could therefore be set against Malaysian income when ascertaining the company's income for Malaysian tax purposes for the year of assessment 1968.

CONCLUSION:

(1) The 1966 Order was made when the Income Tax Ordinance, 1947 was operative in Malaysia. Under this Ordinance tax was exigible on income accruing in or derived from the States of Malaya or received in the States of Malaya from outside territory.

(2) An immediate consequential amendment to the 1966 Order did not follow the replacement of the Ordinance by the 1967 Act which introduced the global scope of taxation.

(3) The said Order of 1966 has since been replaced by the Double Taxation Relief (Singapore) Order 1968 which had effect from the year of assessment 1969. Under this latest Order, Singapore profits attributable to a permanent establishment of a Malaysian enterprise in Singapore are no longer exempt from Malaysian tax.

(4) The scope of Malaysian income tax was altered as from the year of assessment 1974. There has been a reversion to the scope of the 1947 Ordinance and in its amended form Section 3(a) states:
". . . income tax shall be charged . . . upon income of any person accruing in or derived from Malaysia or received in Malaysia from outside Malaysia."
A loss cannot of course be remitted, so that under current law losses incurred through a Singapore branch are no longer deductible.

EDITOR'S NOTE

Double deduction of losses — two bites at the cherry — by a taxpayer incurring a foreign loss will occur where there exist provisions (usually a tax treaty) which exempt foreign-source income from domestic income tax. In those cases where double taxation is prevented by allowing a credit for foreign tax against domestic income tax the problem will not arise. However, where the exemption-method is used the question immediately arises whether disregarding foreign income necessarily means that foreign losses must also be disregarded. Should this be allowed then the losses may usually be deducted twice, i.e. first in the country where the taxpayer is resident and later — when there is foreign-source income — in the country where the loss was incurred. Some countries like the German Federal Republic and Luxembourg, therefore, disregard foreign losses. Other countries, like Belgium and the Netherlands introduce a special clause in their tax treaties under which foreign losses are recaptured.

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CONFERENCE DIARY

APRIL 1980

Management Centre Europe: International Tax Conference (including Possibilities and limitations of treaty shopping; Tax problems arising from the entrance of East European Countries and China into the international investment field), Montreux (Switzerland) April 14-16 (English, French, German).

Business International Institute: The Seminar on International Finance (including: Taxation of exchange gains and losses), White Plains, New York (U.S.A.) April 14-17 (English).

Seminars International: International Finance Conference ("Multi-choice") (including Taxation of foreign currency gains and losses), London (United Kingdom) April 16-18 (English).

Seminar Services International: 12th International Tax Planning Symposium (Part I: two introductory courses; Part II: muli-choice programme with 4 separate seminars running simultaneously), London (United Kingdom) April 23-25 (English).

MAY 1980

Anglo-US branches: Seminar (subjects not yet known), New York (U.S.A.) May 8 and 9 (English).

U.S. branch of I.F.A.: Technical Session (subject not yet known), New York (U.S.A.) May 10 (English).

International Association of Assessing Officers: Fifth International Symposium on the Property Tax, Amsterdam (The Netherlands) May 7-10, Paris (France) May 11-15 (English).

International Tax Planning Association: The Cannes Tax Conference (including exchange of information under tax treaties), Cannes (France), May 28-30 (English).

JUNE 1980

Business International Institute: The Seminar on International Finance (including: Taxation of exchange gains and losses), Port Chester, New York (U.S.A.) June 9-12 (English).

JULY 1980

Management Centre Europe: The China Briefing (including: Tax aspects of doing business in China), Brussels (Belgium) July 3-4 (English).

SEPTEMBER 1980

34th Annual Congress of I.F.A.: I. The dialogue between the tax administration and taxpayer up to the filing of the tax return; II. The determination of the source of income. For the seminar the subject is the flight to tax havens, their use and abuse. Paris (France), September 14-19 (English, French, German, Spanish).

NOVEMBER 1980

Confédération Fiscale Européenne (C.F.E.): Second Congress of European Tax Consultants (subject: "La pratique de la Fiscalité en Europe"), Rome (Italy), November 6-8 (English, French, German).

FOR FURTHER INFORMATION PLEASE WRITE TO:

Business International Institute, 12-14 chemin Rieu, 1211 Geneva 17 (Switzerland).

Confédération Fiscale Européenne, Secrétariat Général (C.F.E.), D-5300 Bonn 1, Dechenstrasse 14, German Federal Republic or Siège Social F-75008 Paris, 9 rue Richepanse, France.

Investment and Property Studies Ltd., Norwich House, Norwich Street, London EC4A 1AB, United Kingdom (Registration for the Cannes Tax Conference should apply to this address);

International Association of Assessing Officers, 60th Street, 60637 Chicago 1313 East, U.S.A.

International Fiscal Association (I.F.A.): General Secretariat, Woudenstein, Burgemeester Oudlaan 50, P.O. Box 1738, 300 DR Rotterdam (Netherlands).

Management Centre Europe, Avenue des Arts 4, B-1040 Brussels (Belgium).

Seminars International, 93 Chancery Lane, London WC2A 1DT, United Kingdom.

Seminar Services International see Seminars International.

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TAX GLOSSARY

*by H.W.T. PEPPER**

PROGRESSION — See GRADUATION.

PROGRESSIV SKAT — (Denmark) Progressive tax.

PROOF SPIRIT — "Proof" is a concept adopted in the U.K. in connection with the levy of customs and excise duties on spirits (i.e., drinks such as brandy, gin, whisky, containing distilled alcohol). Proof spirit contains 57.06 parts of alcohol by volume in each 100 parts of spirit at a temperature of 51°F.

PROPERTY APPRECIATION TAX — A form of CAPITAL GAINS TAX (q.v.) operated by municipalities in Italy. The tax is at graduated rates imposed between upper and lower limits set by the central government, and is of interest because it contains a simple form of "index" adjustment to "write up" the original cost of the property, by a percentage for each year it has been held, when computing the capital gain.

PROPERTY TAX — This term, which was originally applied to the income tax introduced (in 1798) by Pitt in Britain, is more usually applied to local taxes on real property, although there are examples of the term being applied to a wealth tax (on the total "property" of the taxpayer in Guyana). As a levy on real property, property tax may be charged on unimproved land values, but the term is more usually applied to a tax on land plus improvements generally levied by a local authority as a means of obtaining revenue to meet local expenditure, which may be of benefit to the owners and occupiers of property in the local administrative area.

PROPORTIONAL SKAT — (Denmark) Flat rate tax.

PROPOSITION 13 — A proposal, referring to a referendum in the State of California, that property tax in that State on residential and commercial property should be levied at a rate not higher than 1 percent on capital, and that assessments should be based on 1975/76 appraised values, or the current value when purchased in the case of newly-built properties. The Californian law permits such proposals to be initiated by a minimum number of voters. Proposition 13 succeeded and resulted in a cut in property tax revenue to the State of approximately two-thirds, as well as evoking admiration and a desire to emulate among taxpayers in other States.

PRO RATA RULE — The credit due under the V.A.T. system used by E.E.C. members in respect of the trader's inputs may be restricted where some of his sales are taxable and some are not. It is logical to restrict the credit proportionately to the taxable sales and the use of the pro-rata rule is contained in Article II (2) and .22 of Annexe 'A' of the 2nd Directive to E.E.C. members.

PROSPECTING — See EXPLORATION EXPENDITURE.

PROSPECTING, ABORTIVE — See ABORTIVE PROSPECTING.

PROSPECTORS AND GRUBSTAKERS — The Canadian tax code makes special provision for prospectors and grubstakers who sell mineral properties they have acquired by successful exploration. Where the prospectors and grubstakers receive shares in a corporation in exchange for their interests they will not be taxed on the proceeds of such sales. The shares will, however, be deemed to have a nil cost if the question of capital gains tax later arises on their subsequent disposal, and the corporation acquiring the properties is deemed to have done so at nil cost.

PROTECTIVE ASSESSMENT — Where an assessment of a person's tax liability has not been made, because of delay in obtaining information, or in obtaining agreement as to basis, etc., and the time limit for making assessments is in danger of expiring, an estimated assessment may be made to protect the position of the Revenue department. Such assessments are also known as JEOPARDY ASSESSMENTS (q.v.).

PROTECTIVE DUTIES — See PROTECTIVE TARIFFS. The term "protective duty" in Britain was used to refer initially to the batch of duties which were introduced in 1932, which applied only to non-Commonwealth goods, and were chargeable at an ad valorem rate of 10 percent on all imports not held dutiable or not included in a free list. Additional protective duties above the 10 percent level could be imposed on the recommendation of the Import Duties Advisory Committee. The duties supplemented an initial instalment of protection which was conferred in respect of a few products by the KEY INDUSTRY DUTIES (q.v.) of 1921.

PROTECTIVE TARIFFS — Protective tariffs may either erect a "tariff wall" of very high duties which effectively eliminate competition altogether from a home enterprise, which is either an INFANT INDUSTRY (q.v.) or which represents a traditional activity which is in danger of destruction by cheap competitive imports. Otherwise, protective tariffs may merely give partial protection so that although foreign imports are not excluded, the corresponding local industries are allowed a price "margin", equivalent to the amount of duty, which enables them to continue to supply part of the home market.

PROVIDENT FUND — The term generally refers to a fund to which both employer and employee contribute sums which are invested and accumulated to produce a retirement benefit for the employee in the form of a lump sum, representing moneys accumulated on his account plus the interest, dividends, etc. thereon. Such funds are usually approved for income tax purposes, subject to certain conditions, in countries where this form of provision is customary, so that contributions are tax-deductible. The final lump sum benefit may be exempted from tax, but if invested or converted to an annuity, the resulting income will be taxable. PENSION SCHEMES (q.v.) or FUNDS are the more usual type of retirement provision for employees by employers. (See also PURCHASED ANNUITY.)

PUBLIC SECTOR BORROWING REQUIREMENT (PSBR) — The total sum which a government budgets to borrow from the private sector during

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the fiscal year. PSBR determines tax policy to some extent, e.g., if it is desired to reduce PSBR this can only be done by reducing government spending or increasing taxation, or both.

PUBLIC UTILITY TAX — In some countries, public utilities are not subjected to taxation, particularly where run as state enterprises, on the basis that such taxation would be regressive on the poor and increase the cost to industry of the products or services supplied by the utility. In other countries, taxes are levied on the profits of public utilities, whether or not they are state owned. Under general sales tax codes, including V.A.T. systems, it is not uncommon to find tax, usually at modest rates, being applied to the services provided by these undertakings in order to have a wider revenue base. (See also POWER TAX, TAX BASE.)

PURCHASED LIFE ANNUITY — The purchase of an annuity for life produces an income for the annuitant higher than he could obtain by investing the purchase price at the going rate of interest, dividends, etc. Some of the income yield is attributable to a return of capital. It is usual in tax legislation to levy income tax only on the income element in the annuity, exempting the capital element.

"PURCHASE FROM SALES" METHOD — The method of computing V.A.T. by charging tax on the gross sales and then deducting the tax embodied in purchases and other inputs in order to determine the tax payable by the trader on the values added to the products or services he is selling.

PURCHASE TAX — The term used in the U.K. and a few other countries to refer to a wholesalers' or manufacturers' sales tax. The U.K. levied the tax basically on *sales* at the wholesale level so that in one sense the name was a misnomer, but it reflected the original purpose of the tax which was to discourage the purchase of scarce goods during World War II, as well as to raise revenue.

PYRAMIDING — See ESCALATION.

Q

QUASI SALES TAX — Various minor levies on goods, e.g., PACKAGE TAX, CUSTOMS HANDLING CHARGE, INVOICE TAX, TRANSACTIONS TAX, STAMP DUTIES (q.v.) on documents, etc., particularly if related in any way to the value of goods, amount in substance to a tax on the goods, which inevitably will be reflected ultimately in the price.

QUASI TAXATION — Some government measures, although not regarded as taxation, place a financial burden on one section of the community usually to the short-term benefit of another section, by means of arbitrary and often illogical sorts of transfer payments.
For example, price control, when it reduces profit margins to the trader below the normal level for the trade, constitutes a levy upon him in favour of his customer, which still applies even when the trader is a small shopkeeper and the customer comparatively wealthy. The result may be to deter some traders from dealing in the controlled commodity, giving the customer more trouble and expense in obtaining it. Rent control may restrict rent on long-let property well below the current economic rent, which is a levy on the landlord in favour of the tenant, but the latter may be more affluent than the former. The result is to reduce the inclination of entrepreneurs to build houses to let, placing an even greater burden on the government itself to fill the need.
Some governments decree arbitrarily that employers should increase their employees' remuneration, or pay them bonuses, or refrain from discharging redundant employees when a business shrinks in size. All these measures represent a levy or "tax" on the employer in favour of the employee, which may, however, result ultimately in the closure of the business and the loss of jobs, and, in the short-term, a reluctance of employers to engage more staff even when needed, and a reluctance by entrepreneurs to set up new enterprises.
Sound fiscal policy is to eliminate all types of quasi-taxes so that ordinary market forces and competition can make for a healthier economy.

QUICK SUCCESSION RELIEF — A form of relief normally applied to ESTATE DUTY (q.v.) where the duty has been paid on the inheritance of the estate of A (deceased) by B and then further duty arises where B dies within a short period of A's death, leaving his estate to C. To avoid the full rigour of duties being paid twice within a few years on the same assets, quick succession relief would be applied on B's death. The relief tends to be very substantial where the second death occurs within a few months, but it tapers off, and usually disappears after, say, 5 years. The current tendency, e.g., under CAPITAL TRANSFER TAX (q.v.) in the U.K. is for bequests to a surviving spouse to be free of tax, which, however, applies when the estate passes to a member of the next generation.

QUOTAS, IMPORT — Import quotas are a method of restricting imports to protect home industries without levying customs duties of a protective nature, the protection afforded being mainly a quantitative limitation of imports. Although in general such devices are frowned upon by G.A.T.T., they are sometimes preferable in being less likely to lead to exceptional price increases by the protected industries because of the existence of at least a modicum of imports at competitive prices.
Recent trends, e.g., in the U.S.A., have been to use the euphemism "Orderly Marketing Arrangement" (OMA) to describe arrangements, falling short of actual fixed quotas, whereby the exporting country, whose goods are damaging the importing country's own industries, is constrained to agree a voluntary restriction of its exports.

QUOTATION OF TAX IN PRICE — Although it is often required under sales tax laws that the marked price of goods sold by manufacturers or wholesalers should clearly indicate the tax element (this is a normal requirement, e.g., of V.A.T. schemes), the requirement does not normally extend to sales by retailers to consumers though some traders make a point of indicating the tax separately. There is a considerable extra burden of work involved in marking the tax as well as the price on goods displayed for sale, and although it is desirable that retail prices should be clearly marked on goods there is no apparent virtue in requiring the tax to be shown as well. Where price control is imposed, the main requirement of the administration is to know the price at which goods are sold to the consumer and there is usually comparatively little additional difficulty in ascertaining wholesale prices and mark-ups. On the other hand, retail sales taxes which are calculated as a flat percentage on total sales are required to be separately calculated on the bill to the consumer in the state sales taxes operated in most states of the U.S.A. Since most retailers in the U.S. have cash registers, the task of calculating the tax is usually delegated to the machine, although there are some complications when the retail sales tax is levied at more than one rate, so that goods have to be classified when preparing the bill. One school of thought suggests that it is in any event preferable not to bring the tax element in the prices too pro-

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minently to the consumers' attention, since the virtue of indirect taxation compared with direct taxation (that it is borne unheedingly and, therefore less resentfully would thereby be lost. (See UNMERKLICHKEIT.)

QUOTITE FORFAITAIRE D'IMPOT ETRANGER — (Belgium) Fixed credit for foreign tax imposed on foreign dividends, interest, and royalties.

R

RATCHET EFFECT — Where there is a change in the incidence of sales taxes and other indirect taxation such that there is a reduction of tax on some goods and services and an increase on others, there may be a tendency for traders selling the former category not to reduce prices (taking the tax reduction as an extra profit) while other traders increase prices to allow for the additional tax. The tendency described is known as the "ratchet effect", namely, as in the mechanical working of a ratchet, the price, where it moves, moves only in one direction. See, however, QUOTATION OF TAX IN PRICE.

RATE OF TAX — In systems of direct taxation it is usual for the rate of tax to be graduated or progressive (see GRADUATION) whereas with indirect taxes it is more usual for the rate of each particular commodity or service to be levied at a flat rate percent or as a specific charge per unit (see, however, D SCHEME as an example of an attempt to levy graduated indirect taxation on different parcels of the same commodity). An exception to the general rule of graduation for direct taxes is that flat rate tax may be levied on income under a SCHEDULAR TAXATION (q.v.) regime or on the income arising within a country which is acquired by non-residents. (See also STANDARD RATE.)

RATE REBATES — In the U.K. a system of rebates of rates (property tax) for those in the lower income groups was introduced in 1967, the maximum rebate being two thirds. Somewhat akin to these rebates were the fixed cash rebates from property tax granted in some States of the U.S.A. representing the additional sales tax on food items arising when sales tax which had formerly been levied at a lower (or nil) rate on food was raised to the same level as sales tax on other goods for administrative simplicity. The rebates were related to the extra cost to a family of the increased tax on their food purchases, hence the relief was of more importance to those in the lower income brackets.

RATING (OF PROPERTY) — The method of rating real property within the administrative area of a local authority is a feature of the system whereby the expenditures incurred by the authority on providing various services to those working or dwelling within its boundaries are divided "rateably" among the occupiers of property in proportion to the annual value or capital value of such properties. In Britain rates charged on property are levied at a lower poundage (percentage) on residential than on commercial and industrial property and are not charged at all on agricultural land and buildings. (See also RATE REBATES and LOCAL RATES AND TAXES.)

REAL ESTATE TAX — See PROPERTY TAX.

REAL PROPERTY TAX — A tax upon the owners or occupiers of real property within the area of jurisdiction of the taxing authority. (See PROPERTY TAX.)

RE-ALIGNMENT — The term has been used as a euphemism for the process whereby, under a general amnesty for tax fraud, a taxpayer may revise past declarations of income (or re-align them) in accordance with the actual figures, usually incurring only a modified penalty, and always with the guarantee of freedom from the risk of imprisonment for fraud. (See also COMMUTATION.) Since the capacity of any tax department to conduct lengthy Court proceedings in the many cases of understatement of income is limited, the use of some form of "out of Court" settlement rectifying or realigning (or some other euphemism) the tax in the years of understatement is customary.

REALISATION — The realisation of an asset, normally by exchanging it for money, is a transaction which is relevant for the levying of various kinds of tax, e.g. capital gains tax charged on the gain resulting from the realisation or disposal of property at a price higher than was paid for it. Sometimes a tax law deems various events to have resulted in a realisation, e.g. a gift of an asset to another person, or its bequest on death, is sometimes regarded as a realisation, leading to a charge to capital gains tax where the value at the time of transmission is greater than the cost price. See also FIRST LETTING TAX regarding the deeming of letting, instead of selling real property, as being a form of realisation.

REBATES, EXPORT: INTERNAL TAXATION — See EXPORT REBATES.

RECAPTURE — A term used in the U.S.A. and Canada to denote the subsequent withdrawal or cancellation of all or part of a relief formerly given. Examples include the withdrawal (U.S.A.) of the RESIDENTIAL PURCHASE INCENTIVE (q.v.) where the new residence is re-sold within 36 months of acquisition, and of foreign oil-related losses, where in subsequent years foreign oil-related income is earned. In Canada disposal proceeds of depreciated assets are taxable to the extent to which they exceed UN-DEPRECIATED CAPITAL COST * (q.v.), and there are similar provisions under other nomenclature in the tax codes of other countries. For example, STOCK RELIEF in the U.K. may be subsequently "recaptured" in certain circumstances.

* The recapture will not exceed relief already allowed.

RECEIPTS — The receipts or takings, or cash inflow from the sale of goods and services, of a business or profession may sometimes form the basis for taxation (see CASH BASIS), e.g. a simplified method of computing profits as receipts less payments may be allowed in the case of a small trader whose accounting records make it difficult to adopt a more sophisticated method. The option of paying tax upon receipts instead of sales may also be allowed for sales tax purposes under certain sales tax regimes. "Receipt", in the other sense of a document acknowledgeing that money has been received in return for goods or services, has relevance to tax administration in that some countries require receipts of some form to be given for all transactions, copies being compulsorily kept by the traders so that checks may be made by tax officials of the accuracy of a trader's records. See also GROSS RECEIPTS TAX, LOTTERIES FOR CONSUMER.

RECHTSPERSONENBELASTING — (Belgium) Income tax on public bodies (State and local authorities) and on non-profit enterprises.

RECOGNITION (OF LOSS, ETC.) — A term used in the U.S.A. and elsewhere to denote the acceptance of a loss, or various other types of expenditure, as qualifying for tax relief.

RECOVERY (OF BAD DEBT, ETC.) — While a deduction is normally afforded from income taxation for a com-

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mercial debt written off as "bad" (see BAD DEBTS), if the debt is subsequently recovered the amount received is regarded as taxable. (See also RECAPTURE.)

REDISTRIBUTIVE LEVY — A tax imposed by a government, intended to fall most heavily on the rich, to provide revenue to finance social welfare expenditure intended to benefit mainly the poor. The term applies particularly to direct taxes such as income tax, surtax, wealth tax, and death duties.

REDUCING BALANCE METHOD — A way of calculating depreciation allowances whereby a fixed percentage rate of depreciation is applied initially to the cost of a depreciating asset which qualifies for tax relief and subsequently to the cost as reduced by the depreciation allowance for previous years. The system, also known as the DECLINING BALANCE METHOD, purports to grant allowances on the basis of the actual value of the asset, the market value of which obviously depreciates (other things being equal) by reason of the wear and tear which takes place during each year of use. (See also WRITTEN DOWN VALUE and, by contrast, STRAIGHT LINE METHOD, SUM OF THE YEARS' DIGITS METHOD, and UNIT OF PRODUCTION METHOD.)

REDUNDANCY PAYMENTS — In the U.K., income tax exemption is afforded in respect of payments by an employer to an employee who has been continuously employed for a certain period, but has been dismissed as redundant with compensation. (see also LOSS OF OFFICE, SEVERANCE PAYMENTS.)

REGIONAL EMPLOYMENT PREMIUM (R.E.P.) — Under the provisions of the SELECTIVE EMPLOYMENT TAX (S.E.T. — q.v.) in Britain, the contributions by employers, based on a fixed sum for each employee, were refunded wholly to manufacturing industries in the period from 1966 to March 1968 and an additional payment was also made. The additional payments or premiums ceased in March 1968. Thereafter when manufacturing industry was carried on in Development Areas where the government wished to encourage the siting of industry, Regional Employment Premiums, i.e. payments in excess of the tax initially paid by way of S.E.T., were made during the period April 1968 to March 1970 (to March 1971 in Northern Ireland). Premiums were paid for some time as a subsidy after the halving of S.E.T. contributions in July 1971, and their abolition in April 1973.

REGISTRATIERECHT — (Belgium) Registration duty.

REGISTRATION DUES AND TAXES — Certain types of trade, business or profession are required to register for various purposes, which may include the supervision of the activities under statutes relating to public health, public order, fire safety regulations, etc. Sometimes the registration is subject to an annual levy which may be little more than a sum sufficient to cover the administrative costs of exercising the various forms of statutory control. In some countries, the registration requirement relates to all forms of gainful activity by self-employed traders, professionals and artisans, and such registration may also be required in connection with a cascade tax or under a V.A.T. system.

REGISTRATION FOR SALES TAX — A feature of many single stage sales taxes is that traders who deal in taxable goods are required to register and are then allowed to buy such goods tax-free, subject to their accounting for tax on re-sale of the goods. The tax is then payable only on sales to non-registered traders and to consumers. (See also RING.)

REGRESSION — A tax is said to be regressive (in contrast to progressive — see GRADUATION) when the burden of paying it falls more heavily on the lower income groups. As far as direct taxes are concerned, regression is avoided by establishing exemption limits and providing reliefs for dependents and commitments such as superannuation payments or health insurance contributions, and sometimes for premiums on life assurance policies. Indirect taxes on commodities and services are more likely than direct taxes to be regressive, but the regressive effect of such taxes may be mitigated by exemption, for example, of food and other necessities, the cost of medical services and medicines, from indirect taxation, or the imposition of lower than average rates of tax on such goods and services. Nowadays, under state welfare provisions it is becoming more usual to pay cash allowances to those whose incomes are below an official "poverty line". (See also NEGATIVE INCOME TAX.)

REGULATED INVESTMENT COMPANIES — These companies, also known as "Mutual Funds", formed under U.S.A. law, make diversified investments with funds provided by their investors to whom they distribute dividends and capital gains realised. Special tax rules apply so that the investor does not incur additional taxation by the interposition of another company between him and the ultimate investments. Such companies are broadly similar to UNIT TRUSTS (q.v.) when in "Open End" form, but may also be "Closed End" in which case the shares issued to the public are fixed in number and traded on the Stock Exchange.

REGULATOR — See CUSTOMS REGULATOR and REGULATOR TAX.

REGULATOR TAX — The Regulator Tax (also known as the "Wobble" Tax) was introduced in Holland early in 1971 as a mechanism for adding a surcharge to, or making a deduction from, the main revenue taxes, viz., income tax, corporation tax, petrol duty, motor car sales levy and VAT, which together produce 80 percent of tax revenue. Originally levied as a surcharge at 5 percent the regulator was reduced to (an addition of) 3 percent on 1 July 1972 and has not so far been applied to VAT.

RE-INVESTMENT PERIOD — In granting ROLL-OVER RELIEF (q.v.) it is normally stipulated that the replacement asset or investment must be acquired within a limited period before or after disposal of the asset which gives rise to the potential capital gains tax liability. In the U.S.A., for example, on sale of a residence the new home must be acquired within 18 months of the disposal, or in case of a newly-constructed home, within 24 months.

RE-INVESTMENT RELIEF — Roll-over relief in respect of the purchase of a new investment after realising a capital gain on disposal of a previous investment, allowed in Belgium.

RELIEF OF DISTRESS, POVERTY, ETC. — The classic definition of a charity (see CHARITIES, DONATIONS; CHARITIES EXEMPTION) is that it has as its main purpose one or more of certain objects. These objects have been defined as the advancement of education, of religion, the relief of distress, poverty, etc., and the serving of purposes beneficial to the community.

RELIEFS — In personal income tax systems it is usual to make various deductions, based on the personal circumstances of the individual, before applying graduated tax rates to the rest of his income. (See CHILD, EARNED INCOME RELIEF, HOUSEKEEPER, SMALL INCOME RELIEF, SPOUSE.)

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RELIGIOUS TAXES — Certain types of tax, the proceeds of which are used for religious purposes, are occasionally encountered even in secular states. In countries where, for example, Islam is the official religion, there may be a liability to pay FITRAH and ZAKAT (q.v.), and in Britain at one time TITHES (q.v.) were payable to the Church. In Federal Germany there are currently statutory liabilities to subscribe to one or other of various recognised religions, these payments being deductible for income tax purposes. Income tax relief is given in some other countries for voluntary or contractual contributions to approved religious bodies or to their social service activities.

REMISSION ON REVENUE ERROR — A system, recently inaugurated in the U.K., where tax has been undercharged through no fault of the taxpayer and because of a departmental error. The relief is only given where the taxpayer's income is below certain limits, and only where the tax arrears resulting from the error have not been notified to the taxpayer in the year following that in which the under assessment took place. (See also ERROR, DEPARTMENTAL, and ERROR OR MISTAKE.)

REMITTANCE BASIS — Where a person lives in one country but derives income from others, the foreign income may be taxed either on the amount actually arising, or the amount remitted to the country of residence. The latter method — the remittance basis — relates the person's tax more nearly to the amount of income actually available for him to spend in the country of residence and may be administratively easier to manage since the Tax Department is not then concerned with unremitted foreign income. Where foreign income is remitted, the tax liability normally takes account of foreign tax paid thereon (see FOREIGN TAX RELIEF, (CREDIT)). In some countries the remittance basis applies to persons resident there but not domiciled, or not ORDINARILY RESIDENT (q.v.), in the taxing country.

REMOVAL EXPENSES — In some countries the expenses incurred by an employee, after ceasing one employment, in moving his residence to another part of the country to obtain another job are not deductible because they are not regarded as incurred in connection with one particular employment (see WHOLLY, EXCLUSIVELY, and NECESSARILY). In Canada and the U.S.A. such expenses are deductible in computing employment income, and in the U.S.A. the relief is also granted to a businessman or professional who changes his place of business.

RENEWAL OF ASSETS — Although DEPRECIATION ALLOWANCES (q.v.) are generally granted in tax code for assets which depreciate in use while employed in producing profits, smaller items, such as hand tools, are sometimes dealt with on a renewals basis, i.e. purchases are deducted, sales credited and the value of the stock of such items at beginning and end of the accounting period is also brought into the calculation.

Where renewal (replacement) of an asset involves realisation of a capital gain on the old asset, ROLL-OVER RELIEF (q.v.) may be due.

RENTS, MINERAL — The rent paid for the right to exploit mineral resources, which may be in the form of a royalty, or charge on the *volume* or *weight* of mineral-bearing material extracted (see MINERAL ROYALTIES), or as a rent for an *area* of mineral-bearing land (or sea-bed) exploited. Such rents are normally deductible in computing profits from mineral production. (See also WASTING ASSETS.)

REPLACEMENT-COST DEPRECIATION — In circumstances of monetary inflation, depreciation allowances based on the historic cost of an asset may be regarded as inadequate where the cost of replacing the asset has increased sharply in money terms. If, for example, replacement cost has doubled in a particular tax year, and the value of money halved, it would be necessary to double the depreciation allowance in order to give effect to the appropriate allowance in real terms. There are obvious administrative difficulties in trying to introduce a replacement-cost depreciation system, since replacement cost may vary for technological reasons as well as because of monetary inflation. If such a system is adopted, however, rough justice may be done by using a general price index as a factor to convert "historic" allowances to take account of the degree of inflation.

REPLACEMENT OF ASSETS — See RENEWAL OF ASSETS.

REPORT DEFICITAIRE — (France) Carry forward of losses.

REPRESENTATIONAL OCCUPATION — See OCCUPATION, REPRESENTATIONAL.

RESALE PRICE MAINTENANCE (R.P.M.) — The system whereby manufacturers fix retail prices for their products, traders being discouraged or even prohibited from selling goods at less than the fixed price. This practice deprives the consumer of the full advantage of competition, as a result of which certain businesses (such as supermarkets, chain stores or discount houses) may be prepared to sell goods at less than the recommended price. Where prices are effectively controlled by manufacturers, or some other authority, there may be some slight advantage to the tax department concerned with administering income tax, since if the profit margin is fixed, the gross profit on selling the commodity will also be precisely ascertainable.

RESEARCH — Expenditure on research and development is normally allowed for tax purposes, either as a current deduction where it relates to existing products and processes, or as depreciation or amortisation allowances where it results in the creation of a new product or process. In Italy, for example, if research is abandoned without producing results the balance of expenditure may be written off in the year research was terminated. If successful, the expenditure may be written off over five years. (See PATENTS.)

RESERVES RELIEF — On general income tax principles, deductions for amounts placed to reserve are restricted mainly to specific bad debts reserves where trading debts owed to the trader, which are regarded as likely to prove wholly or partially irrecoverable, are individually valued on the accounting date. Some countries, however, provide special reliefs such as deferral of tax by way of incentive, in respect of amounts placed to reserve against some future commitment such as the incurring of capital expenditure on new premises, plant and machinery. (See BAD DEBTS, BUSINESS CYCLE EQUALISATION RESERVES.)

RESIDENCE, CHANGE OF — See REMOVAL EXPENSES.

RESIDENCE, FISCAL — The concept of residence is important for income taxes in that a resident is usually accorded RELIEFS (q.v.) from income in computing his tax, but may also be taxed on his world income instead of merely the income arising in the country of residence. A non-resident would only pay on the income arising in the country, but would probably be denied reliefs except any provided by a DOUBLE TAXATION (q.v.) treaty.

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RESIDENT ALIEN — A concept in U.S.A. tax law — U.S. passport-holders are subject to U.S. tax on world income, wherever resident, and the treatment of those resident in the U.S.A. varies according to whether they are or are not U.S. citizens. Elsewhere the criteria of domicile and ORDINARILY RESIDENCE (q.v.), etc. are used instead.

RESIDENTIAL ENERGY CREDIT — To encourage economy in the use of fuel in the U.S.A., tax relief is granted to taxpayers who install energy-saving components in their homes or who instal equipment to produce solar, geothermal, or wind energy. The relief is for expenditure incurred after 19 April 1977 and will expire on 31 December 1985.

RESIDENTIAL PURCHASE INCENTIVE — A tax incentive granted in the U.S.A. for newly-constructed residences, bought between March and December 1975. The relief was 5 percent of the purchase price, subject to a maximum tax credit of $2,000. The credit was subject to RECAPTURE (q.v.) if the residence was sold within 36 months and there were other restrictions. In the U.K. an incentive to home purchase consists in the deduction from other income for tax purposes of interest paid on mortgages entered into to finance home purchase without any tax being payable on the notional annual value of the home to its owner.

RESIDENTS TAX — In countries which have SCHEDULAR TAX SYSTEMS (q.v.) whereby income is charged at a flat rate of tax, supplementing the basic levy with additional graduated tax on total income, such extra liability may be known as a "supplementary" or "residents" tax. The latter term is particularly appropriate where the country seeks to apply graduated tax only to those residing within its borders, charging merely a flat rate of tax on income accruing to non-residents.

RESOURCE RENT (TAX) — A concept formulated by economists to the effect that taxation on the exploitation of natural resources should be related to the comparative richness of particular resources, rather than at a flat rate on the resources as a whole. The concept is difficult to put into practice, though it has been broadly adopted, e.g. in MALAYSIA'S TIMBER PROFITS TAX and TIN PROFITS TAX (q.v.).

RESTAURANT TAX — A tax sometimes levied specifically on restaurants, usually as a percentage of gross sales, but sometimes — particularly where entertainment is provided — on a per capita basis on the customers served in the restaurant. Under some types of sales tax regime, e.g. V.A.T., services provided by restaurants are taxed in common with the services, provided by other businesses as a feature of the taxation of services in general. (See also CABARET TAX.)

RETAIL EXPORTS SCHEME — A scheme operated in connection with Value Added Taxes whereby retailers may arrange for the sale of goods to tourists free of tax and customs duty, the goods being delivered to the tourist on leaving the country. Another such scheme allows the tourist to purchase goods in department stores or other shops at a tax-inclusive price but reclaim the V.A.T. (only) at a customs or tax office on leaving the country.

RETAIL SALES DRIVE — An organised physical check by Customs, V.A.T., or Sales Tax administration staff, of goods on sale in retail shops to confirm that the goods have duly borne any customs duty, sales tax, etc. which is supposed to apply to them.

RETAIL SALES TAX — An ad valorem tax on sales of goods to consumers, whether by retailers or other traders. Retail sales taxes have been levied in a number of countries, notably the individual states of the U.S.A. and the provinces of Canada, and more recently (the "turnover tax") in Eire, where it has, however, been superseded by V.A.T.

RETENUE A LA SOURCE — (France) Withholding of tax at source.

RETIREMENT — The term has two meanings relevant to taxation: (a) regarding individuals, the cessation of employment at the age of 60, 65 or whatever is the customary retirement age in the relevant country, usually followed by receiving a pension; (b) in the U.S.A. the term is used to refer to the taking out of usage items of plant, machinery, etc.

RETIREMENT ACCOUNTS, INDIVIDUAL — Individual Retirement Accounts (IRAs) were authorised in the U.S.A. by the Employee Retirement Security Act of 1974 as qualifying for favourable tax treatment. Taxpayers not covered by private pension schemes could set up their own retirement provisions and could deduct payments therefor up to 15 percent of income, subject to a maximum deduction of $1,500, and the accumulating funds would be tax-free. Subsequent legislation has liberalised the original terms in various ways, e.g. ROLL-OVER RELIEF (q.v.) is given when an employee leaves one employment but puts the IRA funds accumulated into the new provision in his subsequent occupation.

RETIREMENT ANNUITY — Most tax administrations allow deductions from current income in respect of annual contributions under contracts to provide pensions or annuities on retirement. The net effect of paying out such moneys so as to receive income during retirement is a deferment of part of the taxpayer's income. The tax treatment of allowing deductions and then taxing annuities or pensions in due course is the logical one of taxing the taxpayer at all times on his actual net income.

RETIREMENT GRATUITIES — Some "approved" pension schemes provide not only for a pension, but also for a lump sum payment at the end of active employment, which may or may not involve commutation of part of the gross pension payable. The object is usually to help the ex-employee to set up a new home or meet other expenses which may be incurred in the transition from employment to retirement. In general such "contractual" payments do not incur tax. (See also GOLDEN BOWLER, GOLDEN HANDSHAKE, REDUNDANCY PAYMENTS.)

RETIREMENT RELIEF — In the U.K. system of CAPITAL GAINS TAX (q.v.), exemption is given of the first £20,000 of gains resulting from disposal of assets by a taxpayer on retirement from business at age 65 or more. There is also relief to a smaller degree for those retiring at age 60 upwards.

[to be continued]

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By Klaus Esser. Cologne, Verlag Dr. Otto Schmidt, 1978. Rechtsfragen der Handelsgesellschaften, Heft 37. 248 pp., 32 DM.
Monograph discussing the income tax treatment of partners in a limited partnership and a silent partnership under German law. (B. 102.195)

REALSTEUERN

Ein Leitfaden für die kommunale Steuerverwaltung. By Max Troll. Stuttgart, Forkel Verlag, 1979. 254 pp.
Practical guide explaining the most important aspects of taxes which may be levied by municipalities in Germany, e.g. the multiple to the trade tax and real property tax. (B. 102.192)

STEUER-FORMULAR-HANDBUCH

Formulare — Muster — Erläuterungen für die Steuerpraxis. By Helmar Fichtelmann, Rolf Mittelbach, Rolf Petzoldt and Dieter Schulze zur Wiesche. Cologne, Peter Deubner Verlag, 1979. 550 pp., 128 DM.
Handbook reproducing and explaining forms used in tax matters, particularly concerning procedures to be followed by taxpayers requesting special treatment in payment of tax due, or appealing to the Courts in the case of complaints on decisions by the tax authorities, or forms used for the establishment of legal forms of enterprises. The book also discusses the practical impact of these forms. (B. 102.294)

DIE STEUERHINTERZIEHUNG (PAR. 370 AO 1977)

Eine strafrechtliche, kriminologische und kriminalistische Untersuchung unter besonderer Berücksichtigung von Vermögens- und Einnahmesteuerhinterziehungen. 2. unveränderte Auflage. By Carola Seckel. Lübeck, Verlag Max Schmidt-Römhild, 1979. Kriminalwissenschaftliche Abhandlungen, Band 10. 324 pp., 78 DM.
Study examining the criminal law and criminological aspects of tax avoidance and tax evasion, with emphasis on the avoidance and evasion of individual and corporate income tax and net worth tax. The author also discusses the existing provisions in the Fiscal Code 1977 concerning fiscal punishments and fines and takes a position against these provisions. (B. 102.290)

STEUERRECHT

Ein systematischer Grundriss. 7., überarbeitete und erweiterte Auflage. By Klaus Tipke. Cologne, Verlag Dr. Otto Schmidt, 1979. 620 pp., 64 DM.
This book provides a comprehensive description of the tax law of the Federal Republic of Germany. The concepts are systematically presented in theory and the practical application is also demonstrated. (B. 102.292)

UNTERNEHMUNGSBEWERTUNG UND STEUERN

3., neubearbeitete Auflage. By Carl Helbling. Düsseldorf, IdW-Verlag, 1979. 487 pp., 78 DM.
Study on the various concepts of valuation of business assets for purposes of taxation with special attention to the problems of this matter in German-Swiss business relations. (B. 102.196)

ZIVILPROZESSORDNUNG

12. Auflage. By Richard Zöller. Cologne, Verlag Dr. Otto Schmidt, 1979. 2356 pp.
Twelfth revised edition of commentary on German civil procedure. Due to the author's practical experience, the book follows a practical approach. The following new legislation is worked in: "Vereinfachungsnovelle", e.g. law simplifying civil procedure; marriage and family law reform, changes in foreclosure proceedings. (B. 102.081)

GREECE

OECD ECONOMIC SURVEYS: GREECE

Paris, Organisation for Economic Co-operation and Development, 1979. 72 pp., 12 Fr.Frs. (B. 102.172)

ICELAND

TAXES IN ICELAND 1979

Short description of the taxation of individuals and companies in Iceland 1979 (Assessment year 1979: Tax year (income year) 1978). Prepared by S. Thorbjörnsson, Director of Internal Revenue, September 1979. Reykjavik, Government Printer, 1979. 17 pp. (B. 102.221)

INDONESIA

PAKET 20 APRIL 1979

Tarif baru. Pajak Penjualan, Bea Masuk & PPn-Impor. Jakarta, Yayasan Bina Pajak, 1979. 55 pp.
The April 20, 1979 package concerning the reform of the sales tax on domestic sales, import duties and sales tax on importation of goods. (B. 51.447)

INTERNATIONAL

ADVANCED INTERNATIONAL TAX PLANNING

The 11th Multi-choice Symposium held in Amsterdam from 24 to 26 October 1979 convened by Seminar Services International. Volume I and Volume II. Lausanne, Seminar Services, 1979. 650 pp.
Text of contributions on various subjects. Volume I includes: "The use of double taxation agreements" by Terry M. Browne Acca; "Doppelbesteuerungsabkommen und Betriebstättenbegriff des OECD-Musterabkommens" by B. Heider; "Taxation of plant constructions and other constructions abroad" by J. van Hoorn Jr. Volume II includes: "Tax treaties and tax planning: a comparative study of recent cases and rulings" by M. Edwardes-Ker; "International leasing operations, holding and finance companies" by K.J. McLachlan. (B. 102.264)

ANNUAL REPORT ON EXCHANGE ARRANGEMENTS AND EXCHANGE RESTRICTIONS 1979

Washington, International Monetary Fund, 1979. 470 pp.
The material is updated as of December 31, 1978. (B. 102.235)

BASIC PROBLEMS IN INTERNATIONAL FISCAL LAW

Translated from the German by W.E. Weisflog. By Arnold A. Knechtle. London, HFL (Publisher) Ltd., 1979. 264 pp., £13.50. (hardcover).
Updated version of a doctoral thesis translated into English from the German original, "Grundfragen des internationalen Steuerrechts". Study dealing with obstacles to economic integration, including fiscal obstacles, the concept of international fiscal law, the elimination of international double taxation and the legal sources of international law. (B. 102.094)

HANDBOOK ON EXPORT FREE ZONES

By Thomas Kelleher. Vienna, United Nations, 1976. United Nations Industrial Development Organization, UNIDO/IOD.31, July 22, 1976. 117 pp.
Study of the development of export free zones in the world. (B. 102.122)

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INTERNATIONAL CONTRACTS CONFERENCE

The 3rd Multi-choice conference held by Seminar Services International, Amsterdam, November 22 and 23, 1979. In two volumes. Lausanne, Seminar Services, 1979. 171 + 273 pp.
Printed working papers distributed for participants in the International Contracts Conference held in Amsterdam, November, 1979. Subjects dealt with are: international adhesion contracts, joint ventures and other forms of doing business in the USSR, protection of crediting, interest in commercial contracts with U.S. firms, international mergers, possible tax liabilities of the seller in the country of the buyer, etc. (B. 102.309)

INTERNATIONAL CORPORATE PLANNING

By Michael Z. Brooke and Mark van Beusekom. London, Pitman Publishing, Ltd., 1979. 323 pp.
Study on the specific issues involved in international corporate planning covering the nature of international corporate planning, the environment in which it is conducted, the major techniques available to planners and the role of planning departments.
(B. 102.229)

INTERNATIONAL ECONOMIC DEVELOPMENT AND RESOURCE TRANSFER

Workshop 1978. Edited by Herbert Giersch. Tübingen, J.C.B. Mohr (Paul Siebeck), 1979. 620 pp.
Printed texts of the papers prepared by various contributors for a workshop held in June 1978. The following subjects are included: the relationship between the domestic and international sectors in economic development; problems of measuring the production and absorbtion of technologies in developing countries.
(B. 102.249)

INTERNATIONAL ENTERPRISES AND TAXATION

Some preliminary results of an empirical study concerning international enterprises. By Sven-Olof Lodin. Stockholm, The Nordic Council for Tax Research, 1979. 26 pp. (B. 102.222)

INTERNATIONAL TAXATION AND LIVING COSTS 1979

London, Inbucon/AIC Salary Research Unit, 1979. 52 pp.
Information on the personal taxation rates and social security contributions in various countries and the exchange rates, necessary for administration of employees working in those countries.
(B. 102.230)

INSTITUTE ON MULTINATIONAL TAXATION

Course materials. June 27-29, 1979, Washington. Co-sponsored by the Chamber of Commerce of the United States in cooperation with Marchmont Conferences (London) and The American Tax Institute in Europe (Paris). Washington, Georgetown University Law Center, Continuing Legal Education and the Chamber of Commerce of the United States, 1979.
Loose-leaf publication containing topics contributed by various speakers on multinational tax issues. (B. 102.140)

INTERNATIONALER TECHNOLOGIETRANSFER UND STEUERRECHT

By Karl-Ludwig Busse. Frankfurt, Verlag Peter Lang, 1978. Studien zum Finanz- und Steuerrecht, Band 2. 331 pp.
This book surveys the influence of taxation on the development of the international transfer of technology between independent and combined enterprises. Taking the tax systems of the German Federal Republic, the United States, France, Austria, Canada, Spain, Brazil and Mexico as examples, the influence of national tax laws and of double taxation treaties on the tax burden of the transfer of technology is illustrated and their impact on business decisions of enterprises is analyzed. (B. 102.084)

INTERNATIONAL TAX AVOIDANCE

A study by the Rotterdam Institute for Fiscal Studies. Volume A: general and conceptual material. Project leader: Dr. J.C.L. Huiskamp. Principal authors: Dr. Barry Bracewell-Milnes, Mr. M.A. Wisselink. Deventer, Kluwer, 1979. 368 pp., 90 Dfl.
Volume A contains the general and conceptual material and discusses the concept of international tax avoidance, what causes it and how it is achieved, especially through the use of tax havens. Dealt with are attempts to prevent international tax avoidance by various legal measures and their administration, and the international dimension of collaboration between governments.
(B. 102.162)

MANAGERIAL FINANCE

6th Edition. By J. Fred Weston and Eugene F. Brigham. Eastbourne, Holt-Saunders, Ltd., 1978. 1030 pp.
Revised sixth edition of textbook on managerial finance. Questions and problems are appended for each topic discussed.
(B. 102.226)

THE MEASUREMENT AND REFORM OF BUDGETARY POLICY

By T.S. Ward and R.R. Neild. London, Heinemann Educational Books, 1978. 118 pp.
Study on measurement and reform of budgetary policy.
(B. 102.261)

PROCEEDINGS OF A CONFERENCE ON LOCAL GOVERNMENT FINANCE

London, Institute for Fiscal Studies, 1973. Publication No. 10, December 1973. 141 pp., £ 2.
Printed texts of the following talks are included: "The reform of local government finance" by C.D. Foster; "The rising cost of local government services" by Peter M. Jackson and discussions.
(B. 102.262)

THE STRATEGY OF MULTINATIONAL ENTERPRISE

Organization and finance. Second edition. By Michael Z. Brooke and H. Lee Remmers. London, Pitman Publishing, Ltd., 1978. 277 pp.
Interdisciplinary study on the strategy of the operations of multinational enterprises with emphasis on the structure and control of such companies. Topics such as company-government relationships and strategic considerations on moving abroad are also discussed. (B. 102.228)

TRANSFER PRICING AND MULTINATIONAL CORPORATIONS: AN OVERVIEW OF CONCEPTS, MECHANISMS AND REGULATIONS

By Sylvain R.F. Plasschaert. Hants, Saxon House, Teakfield Ltd., 1979. 120 pp.
Study on the concept of transfer pricing and guidelines for constructive solutions. (B. 102.130)

TAX INCENTIVES FOR PRIVATE INVESTMENT IN DEVELOPING COUNTRIES

Editor: Robert Anthoine. Deventer, Kluwer, 1979. 272 pp.
Comparative analysis of the tax laws of developed countries which have a bearing upon direct private investment in developing countries, including tax reports on 19 developed countries prepared by national authors, and eight tax reports on developing countries. (B. 102.161)

TWENTY-NINTH ANNUAL REPORT ON EXCHANGE RESTRICTIONS 1978

Washington, International Monetary Fund, 1978. 476 pp.
Annual report on global exchange restrictions as well as other measures and intergovernmental arrangements that may have balance of payments implications. The period covered is 1977 and the early part of 1978. (B. 102.176)

UNITED NATIONS DRAFT MODEL DOUBLE TAXATION CONVENTION BETWEEN DEVELOPED AND DEVELOPING COUNTRIES

(Unofficial Draft to be considered at its Eighth Meeting in December 1979 by the Group of Experts on Tax Treaties between Developed and Developing Countries). IFA Seminar Paper (Wednesday, September 5, 1979). Deventer, Kluwer, 1979. 30 pp.
Text of the Draft Model Double Taxation Convention between Developed and Developing Countries. (B. 102.173)

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YEARBOOK OF NATIONAL ACCOUNTS STATISTICS 1978

2 Volumes. New York, United Nations, 1979. 1494 + 645 pp.
Twenty-second issue of the Yearbook of National Accounts Statistics prepared by the Statistical Office of the United Nations. Volume I, "Individual country data", shows detailed national accounts estimates for 151 countries and areas. Volume II, "International tables", contains other information, estimates of total and per capita gross domestic product, national income, and national disposable income expressed in U.S. dollars for 155 countries and areas. (B. 102.281)

IRELAND

FIFTY—FIFTH ANNUAL REPORT OF THE REVENUE COMMISSIONERS

Year ended 31st December 1977. Dublin, Stationery Office, 1978. 163 pp. (B. 102.214)

OECD ECONOMIC SURVEYS: IRELAND

Paris, Organisation for Economic Co-operation and Development, 1979. 56 pp., 12 Fr.Frs. (B. 102.133)

ITALY

CODICE TRIBUTARIO

Seconda edizione. Milan, Dott. A. Giuffrè Editore, 1978. 2698 pp.
Compilation of Italian tax laws and decrees. (B. 102.286)

CODICE TRIBUTARIO

Seconda edizione. Appendice. Milan, Dott. A. Giuffrè Editore, 1979. 648 pp.
Appendix to the compilation of tax laws, which updates the basic volume to January 31, 1979, and with respect to the VAT, to April 1, 1979. (B. 102.287)

COMPANY INCOME TAX IN ITALY

With taxation on dividends, interest, royalties and other forms of income. Rome, Banco di Roma, 1979. 92 pp. (B. 102.101)

LA DETERMINAZIONE DEL REDDITO IMPONIBILE NEI RAPPORTI FRA SOCIETA ITALIANE E COLLEGATE ALL'ESTERO

Società per lo studio dei problemi fiscali, Convegno di Rapallo, 29-30 giugno 1979. By Augusto Fantozzi. Genova, Diritto e Practica Tributaria, 1979. 20 pp.
Paper on the determination of profits of Italian companies and related foreign companies. (B. 102.184/189)

MANUALE DELLE IMPOSTE DIRETTE

3 Volumes. By Giuseppe Giuliani. Milan, Casa Editrice Giuffrè, 1979. 3781 pp.
Handbook of direct taxes, compilation of tax laws and degrees, administrative rulings and letters and case laws. This three-volume book is up to date as of June 30, 1979. (B. 102.288)

IL NUOVISSIMO CODICE TRIBUTARIO FISCALE

Annotato per articolo. Edited by Giovanni de Riso, Mario Spina and Francesco Dibari. Piacenza, Casa Editrice La Tribuna, 1979. 1436 pp.
1979 Edition of compilation of tax laws, decrees and annotations. (B. 102.102)

DAS SCHWEIZERISCH-ITALIENISCHE DOPPEL-BESTEUERUNGSABKOMMEN

La Convenzione tra Svizzera e Italia sulle doppie imposizioni. The Swiss-Italian double taxation convention. By Silvio Bianchi and Siegfried Mayr. Bern, Editions Cosmos, 1979. 82 pp.
Handbook published in German, Italian and English, explaining the comprehensive double taxation treaty between Italy and Switzerland signed April 28, 1978 as viewed from the Swiss and Italian points of view. (B. 102.129)

JAPAN

OECD ECONOMIC SURVEYS: JAPAN

Paris, Organisation for Economic Co-operation and Development, 1979. 63 pp., 12 Fr.Frs. (B. 102.134)

AN OUTLINE OF JAPANESE TAX ADMINISTRATION 1979

Tokyo, National Tax Administration, 1979. 89 pp. Guide providing an outline of the tax administration in Japan. Activities of the National Tax Administration are described. (B. 51.441)

AN OUTLINE OF JAPANESE TAXES 1979

Tokyo, Tax Bureau, Ministry of Finance, 1979. 295 pp.
Annual guide explaining the taxes in Japan updated to include the 1979 tax changes. (B. 51.440)

LUXEMBOURG

LES SOCIETES HOLDING AU GRAND-DUCHE DE LUXEMBOURG

Aspects juridique, fiscal et comptable. Luxembourg, Institut Universitaire International Luxembourg, 1979. 150 pp.
Study on the concept of holding companies under Luxembourg tax law and its future developments in the light of the European Communities policy. Relevant text of statutes is appended. (B. 102.095)

MALAYSIA

THE 1980 BUDGET SPEECH

By the Minister of Finance in the House of Representatives on October 18, 1979. Kuala Lumpur, Government Printer, 1979. 53 pp. (L. 52.186)

MEXICO

CONSIDERACIONES ACERCA DE LA DOBLE TRIBUTACION INTERNACIONAL

By Victor Manuel Armando Urquieta Jimenez. Mexico, Universidad Nacional Autonoma de Mexico, Facultad de Derecho, 1977. 165 pp.
Doctoral thesis on international double taxation. (B. 15.927)

EFICACIA DE LOS CONVENIOS DE COORDINACION FISCAL

By Pablo Ruiz Herrera. Mexico, Universidad Nacional Autonoma de Mexico, Facultad de Derecho, 1976. 176 pp.
Doctoral thesis on taxation by various tax authorities, and the manner to avoid double taxation. (B. 15.925)

EL IMPUESTO SOBRE LA RENTA Y LA DISTRIBUCION DE LA RIQUEZA

By José de Villa. Mexico, José de Villa, 1979. 50 pp.
Study of the income tax and distribution of wealth in Mexico. (B. 15.930)

LEY DEL IMPUESTO SOBRE LA RENTA

Reglamento y disposiciones complementarias. Mexico, Editorial Porrúa, 1979. 543 pp.
Income Tax Law of Mexico and complementary rules. (B. 15.926)

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MANUAL DE RESOLUCIONES INTERPRETATIVAS DE LEY FEDERAL DEL IMPUESTO SOBRE INGRESOS MERCANTILES 1977

Mexico, Secretaria de Hacienda y Credito Público, 1977. 308 pp.
Handbook containing the rulings relating to the federal sales tax. (B. 15.924)

NEPAL

INVESTORS' GUIDE TO NEPAL 1975

Kathmandu, Industrial Services Centre, 1975. 123 pp.
General relevant information including tax incentives for investors in Nepal. The company law of Nepal, industrial licensing and registration regulations are dealt with. (B. 15.450)

THE NETHERLANDS

ASPECTEN VAN VERZEKERING BIJ EXPORT

By D. Koole. Deventer, Kluwer; The Hague, Fenedex, 1979. 99 pp., 32.50 Dfl.
Monograph discussing insurance aspects arising from exportation of goods. (B. 102.068)

ATTENTIEPUNTEN VOOR HET INTERNATIONAAL COMMERCIEEL OPEREREN

By P. Schmidt. Deventer, Kluwer, 1979. 148 pp.
Important points to reckon with when an enterprise is to operate internationally, prepared as a ready reference guide. (B. 102.199)

BASIC PROBLEMS IN INTERNATIONAL FISCAL LAW

Translated from the German by W.E. Weisflog. By Arnold A. Knechtle. Deventer, Kluwer, 1979. 264 pp., 52 Dfl.
Updated version of a doctoral thesis translated into English from the German original, "Grundfragen des internationalen Steuerrechts". Study dealing with obstacles to economic integration, including fiscal obstacles, the concept of international fiscal law, the elimination of international double taxation and the legal sources of international law. (B. 102.077)

COMMERCE AND INDUSTRY IN THE NETHERLANDS

Ninth edition. Amsterdam, AMRO Bank, 1979. 63 pp.
Guide providing information to businessmen contemplating the formation of a company in the Netherlands and other possibilities for cooperation or trade with local companies in the Netherlands. (B. 102.248)

COMPENDIUM VAN DE OMZETBELASTING

Tweede herziene druk. By J.M.F. Finkensieper. Deventer, Kluwer, 1979. 143 pp., 28.50 Dfl.
Second revised edition of compendium on the turnover tax on value added explained as amended as of January 1, 1979. Relevant texts of statutes are appended. (B. 102.099)

FISCAAL MEMO

Juli 1979. Deventer, Kluwer, 1979. 78 pp., 14.50 Dfl.
Revised edition providing practical information in a nutshell concerning tax provisions and such related subjects as social security contributions as of July 1, 1979. (B. 102.141)

FISCAAL WINSTBEGRIP EN FINANCIERINGS-FACILITEITEN VOOR ZELFSTANDIGEN (II)

The Hague, Raad voor het Midden- en Kleinbedrijf, 1979. 74 pp.
Revised report by a special committee concerning the taxation of income and the financial incentives for entrepreneurs in medium and small-scale businesses in connection with the Hofstra Report on a neutral tax system. Relevant documents are appended. (B. 102.076)

DE FISCALE AANSPRAKELIJKHEID VAN DE WERKGEVER

By J.C.K.W. Bartel. Deventer, FED. 1979. Serie Belastingconsulentendag, No. 24. 64 pp., 13.50 Dfl.
Text of speech and ensuing discussion on the responsibility of employers to withhold and transfer taxes and social security levies to the Treasury, held on April 20, 1979 and convened by the Dutch Federation of Tax Consultants. (B. 102.100)

INVESTMENT GUIDE: THE NETHERLANDS

The Hague, Ministry of Economic Affairs, 1959. 151 pp.
A set of brochures providing facts about doing business in the Netherlands covering the following subject: How Duch tax law affects the U.S. investor; Business entities and company law in the Netherlands; Labor relations in the Netherlands; Trading in the Netherlands; Banking, finance and government incentives in the Netherlands; Taxation, accounting and auditing in the Netherlands; The Netherlands (introduction). (B. 102.263)

SCHEMATISCH OVERZICHT VAN DE SOCIALE WERKVERZEKERINGSWETTEN

37e druk, juli 1979. By T. Boersma and G.F. Fortanier. Deventer, Kluwer, 1979. 12 pp.
Revised and updated 37th edition of survey concerning national insurance laws effective as of July 1, 1979. (B. 102.142)

TERUGWERKENDE KRACHT OP HET GEBIED VAN BELASTINGWETGEVING (2)

Bespreking van het preadvies van Mr. H. Prast. Deventer, Kluwer, 1979. Geschriften van de Vereniging voor Belastingwetenschap, No. 151. 39 pp., 17.50 Dfl.
Second part of a report by H. Prast on the retroactive application of tax law in the Netherlands, containing a printed text of the discussion. (B. 102.200)

WAT DES KEIZERS IS

Bundel opstellen, uitgegeven ter gelegenheid van het 25-jarig bestaan van de Nederlandse Orde van Belastingadviseurs. Deventer, Kluwer, 1979. 162 pp., 45 Dfl.
Compilation of essays published on the occasion of the 25th anniversary of the Netherlands Tax Advisors' Association. The contributions prepared by various persons concentrate on the position of the tax advisor in the past, present and future. (B. 102.302)

NEW CALEDONIA

LA FISCALITE DES SOCIETES EN NOUVELLE-CALEDONIE

By Elisabeth Peguilhan. Noumea, Centre de Productivité et d'Etudes Economiques, 1979. Document No. 71, August 1979. 88 pp.
Explanation of the taxation of companies in New Caledonia. In addition it treats business tax, tax on financial activities and other related taxes levied on the establishment of a company. Text of statutes is appended. (B. 51.425)

NEW ZEALAND

INVESTMENT AND TAXATION: NEW ZEALAND

London, Touche Ross International, 1979. 27 pp.
Booklet on New Zealand in the series of Investment Incentives and Taxation, prepared by Touche Ross International, dealing with general investment law and taxation. (B. 51.397)

NORDIC COUNTRIES

INTERNATIONELLA FÖRETAGS BESKATTNING

Nordisk rapport vid Nordiska skattevetenskapliga forskningsrådets seminarium på Hanaholmen i oktober 1978. By Sven-Olof Lodin. Vällingby, LiberFörlag, 1979. Nordiska skattevetenskapliga forskningsrådets skriftserie, Nr. 6. 86 pp.

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Research report prepared by the Nordic Research Council of Tax Science with respect to taxation of international enterprises with emphasis on the performance by Nordic countries. Researchers from Denmark, Norway, Sweden and Finland participated in the study headed by Prof. Sven-Olof Lodin. (B. 102.222)

NORWAY

THE NORWEGIAN MARKET

Oslo, Den Norske Creditbank; Aftenposten, 1979. 31 pp. (B. 102.245)

O.E.C.D.

THE CASE FOR POSITIVE ADJUSTMENT POLICIES

A compendium of OECD documents 1978/79. Paris, Organisation for Economic Co-operation and Development, 1979. 140 pp., 16 Fr.Frs.
Compendium containing OECD documents in their final form relating to work on some agreed general orientations for policies in member countries to facilitate structural adjustments in their economies needed to sustain faster economic growth. (B. 102.096)

OECD ECONOMIC OUTLOOK

No. 25, July 1979. Paris, Organisation for Economic Co-operation and Development, 1979. 163 pp., 32 Fr.Frs. (B. 102.066)

STATISTIQUES DE RECETTES PUBLIQUES DES PAYS MEMBRES DE L'OCDE

Revenue statistics of OECD member countries 1965-1978. Paris, Organisation for Economic Co-operation and Development, 1979. 235 pp.
Eighth annual publication in a series providing data in respect of general government tax revenues, including compulsory social security contributions for member countries of the OECD during the years 1965-1978. (B. 102.206)

TRANSFER PRICING AND MULTINATIONAL ENTERPRISES

Report of the OECD Committee on Fiscal Affairs 1979. Paris, Organisation for Economic Co-operation and Development, 1979. 100 pp., 36 Fr.Frs. (B. 102.067)

PACIFIC

FISCAL POLICY AND TAX STRUCTURE IN THE PACIFIC REGION

Proceedings of a Seminar held in Sydney in 1978 during the 32nd Congress of the International Fiscal Association. Deventer, Kluwer, 1979. 57 pp.
Offprint from the 1978 IFA Yearbook containing the texts of six panel papers and a summary of the discussion in the seminar. (B. 102.098)

PARAGUAY

LEGISLACION FISCAL DEL PARAGUAY

Cuarta edición. Tome I. By Carlos A. Mersán. Asunción, Carlos A. Mersán, 1976. 385 pp.
Compilation of fiscal laws as well as the Paraguayan constitution and customs laws and regulations. (B. 15.917)

PORTUGAL

OECD ECONOMIC SURVEYS: PORTUGAL

Paris, Organisation for Economic Co-operation and Development, 1979. 68 pp., 12 Fr.Frs. (B. 102.132)

SCANDINAVIA

TRENDS IN SCANDINAVIAN TAXATION

By Gustaf Lindencrona. Deventer, Kluwer, 1979. 46 pp., 20 Dfl.
Special features of the Scandinavian taxation development discussed by contributors from Denmark, Finland, Norway and Sweden. (B. 102.165)

SINGAPORE

LEGAL FRAMEWORK OF BUSINESS ORGANISATIONS

By Philip N. Pillai. Singapore, Malaya Law Review, 1978. Singapore Law Series, No. 6. 178 pp.
Introductory survey of the legal organization of business entities in Singapore. (B. 51.428)

SPAIN

MEMORIA DE LA ASOCIACION ESPANOLA DE DERECHO FINANCIERO 1976

Tomos I, II y III. Madrid, Editorial de Derecho Financiero, 1976. 741 + 704 + 1055 pp.
Three-volume publication on the activities of the Asociación Española de Derecho Financiero in 1976, containing papers and discussions from the IFA Congress of 1975 and the VII Jornadas Hispano-Luso-Americanas de Estudios Tributarios (Subjects: taxation of groups of enterprises, and procedure in tax cases) and a survey of the development of the Spanish tax system from 1964 to 1977 by J. Banacloche. (B. 102.177)

MEMORIA DE LA ASOCIACION ESPANOLA DE DERECHO FINANCIERO 1977

Madrid, Editorial de Derecho Financiero, 1979. 620 pp.
Report of the 1977 activities (national as well as international) by the Spanish Association of Tax Law. (B. 102.078)

VESTIGING ALS BEDRIJF IN SPANJE

(Uitgave augustus 1979), opgesteld door Klynveld Kraayenhof & Co. The Hague, Fenedex, 1979. 59 pp.
Description of important legal, financial and taxation aspects arising from a business establishment in Spain. (B. 102.215)

SWEDEN

INVESTMENT AND TAXATION: SWEDEN

London, Touche Ross International, 1979. 32 pp.
Investment and taxation guide for Sweden in a series of publications prepared by Touche Ross International for internal use. (B. 102.275)

SWITZERLAND

DOPPELBESTEUERUNGSABKOMMEN DER SCHWEIZ MIT NORWEGEN, SCHWEDEN UND DÄNEMARK

Unter Einbezug des Aussensteuerrechts Norwegens, Schwedens und Dänemarks. By Urs. Kammermann-Ohlsson. Zürich, Schulthess Polygraphischer Verlag, 1978. Schweizer Schriften zum Handels- und Wirtschaftsrecht, Band 32. 188 pp.
Thesis on the comprehensive double taxation treaties concluded by Switzerland with Norway, Sweden and Denmark and the inclusion of the international tax laws adopted by Norway, Sweden and Denmark. (B. 102.198)

ÖFFENTLICHE FINANZEN DER SCHWEIZ

Finances publiques en Suisse 1977. Bearbeitet von der Eidgenössischen Finanzverwaltung; Elaboré par l'Administration fédérale des finances. Bern, Bundesamt für Statistik; Office Fédéral de la Statistique, 1979. Statistische Quellenwerke der Schweiz, Heft 630. 153 pp.
Statistical data on revenue and expenditures of the Confederation, the cantons and the municipalities for 1977. (B. 102.135)

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UNITED KINGDOM

THE BANKING ACT 1979

By F.R. Ryder. London, Sweet & Maxwell, 1979. 98 pp.
(B. 102.276)

BUTTERWORTHS ORANGE TAX HANDBOOK 1979-80

Capital transfer tax, development land tax, stamp duties, VAT (including VAT Statutory Instruments) as operative on August 6, 1979. Fourth edition. London, Butterworths, 1979. 1195 pp., £ 9.50.
Consolidated plain text of the legislation on capital transfer tax, development land tax, stamp duty and value added tax.
(B. 102.282)

BUTTERWORTHS YELLOW TAX HANDBOOK 1979-80

Income tax, corporation tax, capital gains tax. Eighteenth edition. London, Butterworths, 1979. 1203 pp., £ 11.50.
Consolidated plain text of the legislation on income tax, corporation tax and capital gains tax as operative for 1979-80.
(B. 102.283)

CAPITAL TRANSFER TAX

By John Coombes, Abingdon, Professional Books, Ltd., 1977. 259 pp.
Monograph on capital transfer tax. Text of statutes is appended.
(B. 102.269)

CAPITAL TRANSFER TAX

Second edition. By David J. Hayton and John Tiley. London, Butterworths, 1978. 501 pp., £ 14.90.
Second revised edition of guide intended to be a comprehensive exposition of capital transfer tax law for practitioners as well as students. The law is stated as of November 1, 1977.
(B. 102.071)

COMPANY LAW

Fourth edition. By Robert R. Pennington. London, Butterworths, 1979. 874 pp., £ 16.
Fourth revised edition, giving an exposition of the law as of August 1, 1978. (B. 102.072)

DISCLOSURE TO UNIONS -- HOW THE LAW IS WORKING

A study of the implementation of ss. 17-21 of the Employment Protection Act 1975. By Arthur Marsh and Roger Hussey. London, Touche Ross & Co., 1979. 94 pp. (B. 102.137)

DISTRIBUTION OF PERSONAL WEALTH IN BRITAIN

By A.B. Atkinson and A.J. Harrison. Cambridge, Cambridge University Press, 1978. 330 pp.
Study examining the distribution of personal wealth in Britain and analysing the underlying social and economic forces. Statistical and economic background information to current debates on justice and the taxation of wealth is provided. (B. 102.090)

DOUBLE TAXATION RELIEF

London, Her Majesty's Stationery Office, 1979. 33 pp.
Booklet explaining the main features of the law and practice relating to double taxation relief for taxes on income and capital gains, including the double taxation agreements which the U.K. has made with other countries. (B. 102.074)

THE FINANCE (NO. 2) ACT 1979

Part I: the Finance Act, customs and excise duties, income tax and corporation tax, petroleum revenue tax, capital taxation; Part II: exchange control, appendices. London, Touche Ross & Co., 1979. 28 pp. (B. 102.211)

THE HAMBRO TAX GUIDE 1979-80

By A.S. Silke and W.I. Sinclair. London, MacDonald and Jane's Publishers, Ltd., 1979. 257 pp., £ 5.95.
This eighth edition updates the general tax guide incorporating the material as of August 1, 1979 including the Finance Act 1979 and Finance (No. 2) Act 1979. (B. 102.202)

KEY TO INCOME TAX

Finance (No. 2) Act 1979 edition. By J.M. Cooper. London, Taxation Publishing Company, 1979. 256 pp., £ 5.50.
Annual reference guide providing information on the income tax as amended by Finance (No. 2) Act 1979 of September 1, 1979.
(B. 102.304)

LAW FOR THE RETAILER AND DISTRIBUTOR

Third edition. By J.R. Lewis. Bristol, Jordan & Sons, Ltd., 1979. 220 pp., £ 6.50.
Considerations on the laws affecting the retailer and distributor. Relevant texts of statutes are appended. (B. 102.259)

PROFIT SHARING AND OTHER SHARE ACQUISITION SCHEMES

By Francis G. Sandison. Croydon, Tolley Publishing Company, Ltd., 1979. 231 pp., £ 8.95.
Monograph on profit sharing schemes. The law is stated as of April 2, 1979. (B. 102.070)

PROFIT SHARING SCHEMES

London, Her Majesty's Stationery Office, 1979. 48 pp.
Booklet describing the provisions in the Finance Act 1978 relating to profit sharing schemes. (B. 102.075)

ROWLAND'S TAX GUIDE 1978-79

Second edition. Editor: Nigel Eastaway with David Trill. London, Butterworths, 1979. 576 pp.
This guide is published in conjunction with Butterworth's Yellow and Orange Tax Handbooks which reproduce the actual legislation currently in force. This book has been prepared by practitioners for practitioners. (B. 102.073)

SIMON'S TAXES

Finance Bill 1979. The provisions relating to income tax, capital gains and corporation tax. The text from the Bill as first presented to Parliament and published on 21 June 1979, followed by explanatory notes. London, Butterworths, 1979. 30 pp.
(B. 102.208)

TAXATION OF COMPANIES

Second edition. By Richard Bramwell and John Dick. London, Sweet & Maxwell, 1979. 236 pp., £ 17.
Monograph on the taxation of companies describing the provisions of the tax law as of March 31, 1979. (B. 102.253)

TAX AVOIDANCE SCHEMES FOR U.K. MANAGEMENT

London, Institute for International Research, 1978. 28 pp.
(B. 102.063)

TAX EXPENDITURES IN THE UNITED KINGDOM

By J.R.M. Willis and P.J.W. Hardwick. London, Heinemann Educational Books, 1978. 107 pp.
The book deals with various exemptions and reliefs from income tax in the U.K. which reduce the tax base and in effect discriminate in favour of particular personal circumstances and particular kinds of income and expenditure. (B. 102.260)

THE TAX PRACTITIONER'S DIARY 1979-80

London, Butterworths, 1979. 71 pp., £ 4.25. (B. 102.277)

WHEATCROFT AND WHITEMAN ON CAPITAL GAINS TAX

Third cumulative supplement. Up to date to March 1, 1979. By Terence Mowschenson. London, Sweet & Maxwell; Edinburgh, W. Green & Son, 1979. 116 pp.
Supplement to update the basic volume on capital gains tax.
(B. 102.136)

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COMPREHENSIVE INCOME TAXATION

Joseph A. Pechman, editor. Washington, The Brookings Institution, 1977. 311 pp.
Publication of the papers of a conference held by scholars and government officials on the fundamentals of comprehensive income taxation. The authors cover such issues as the economic definitions of income, personal deductions, employee benefits and transfer payments, capital gains and losses, the tax treatment of the family and taxable business income. (B. 102.089)

1979 DEPRECIATION GUIDE

Including ADR system; system for pre-1971 assets. Chicago, Commerce Clearing House, Inc., 1979. 263 pp., $ 7. (B. 102.124)

FACTS AND FIGURES ON GOVERNMENT FINANCE

20th Biennial edition, 1979. Washington, Tax Foundation, Inc., 1979. 288 pp., $ 10.
Compendium of data about government financial operations. (B. 102.170)

FEDERAL ESTATE AND GIFT TAXATION

Second edition. By John K. McNulty. St. Paul, Minn. West Publishing, Co., 1979. 488 pp.
Introduction to the law of federal estate and gift taxation. (B. 102.125)

FEDERAL INCOME TAXATION

Volume one: taxation of individuals. Third edition. By Adrian A. Kragen and John K. McNulty. St. Paul, Minn., West Publishing Co., 1979. 1283 pp.
Completely revised third edition of the Kragen & McNulty income tax casebook which contains only material dealing with the income taxation of individuals. A second volume will contain the material on the taxation of corporations and partnerships. (B. 102.204)

FEDERAL INCOME TAXATION/CASES AND MATERIALS

Volume I. By Stanley S. Surrey, William C. Warren, Paul R. McDaniel and Hugh J. Ault. Mineola, N.Y., The Foundation Press, Inc., 1972. 1419 pp.
Volume I contains provisions affecting both individuals and corporate taxpayers with emphasis on taxation of individuals. Volume II will cover the taxation of business organizations. This volume is a companion volume to Warren & Surrey, "Federal Estate and Gift Taxes, Cases and Materials". (B. 102.254)

FEDERAL INCOME TAXATION/CASES AND MATERIALS

Volume I. 1979 Supplement. By Stanley S. Surrey, William C. Warren, Paul R. McDaniel and High J. Ault. Mineola, N.Y., The Foundation Press, Inc., 1979. 487 pp.
This 1979 Supplement to Volume I of Federal Income Taxation covers the principal developments in federal income taxation since January 1, 1972. (B. 102.256)

FEDERAL INCOME TAXATION

A law student's guide to the leading cases and concepts. Second edition. By Marvin A. Chirelstein. Mineola, N.Y., The Foundation Press, Ltd., 1979. 346 pp.
Textbook explaining the federal income taxation of individuals. (B. 102.255)

FEDERAL TAX GUIDE 1980

Chicago, Commerce Clearing House, Inc., 1979.
Volume I of 1980 Federal Tax Guide in loose-leaf is entirely devoted to an explanation and new developments in the federal income tax. The other three volumes constitute the regular edition of the Guide series and contain official texts of income, estate, gift, and withholding tax regulations. The material is updated weekly. (B. 102.220)

FOREIGN TRADE TAX HANDBOOK FOR MANUFACTURERS

How to use a DISC and other forms of corporations to export and to operate abroad more profitably. By Paul D. Seghers. New York, International Tax Institute, Inc., 1979. 171 pp.
(B. 102.223)

GUIDEBOOK TO PENSION PLANNING

Chicago, Commerce Clearing House, Inc., 1979. 450 pp., $ 7.
Reprint from the Commerce Clearing House Pension Plan Guide dealing with the rules and authorities on pensions, profit sharing and employee benefits. (B. 102.285)

HAWAII INCOME PATTERNS 1976: INDIVIDUALS

Honolulu, Tax Research and Planning Office, Department of Taxation, 1979. 79 pp.
This nineteeth annual report summarizes individual income tax statistics from a sample of 1976 Hawaii individual income tax returns. (B. 102.183)

INCOME TAX REGULATIONS AS OF JULY 9, 1979

"Final" and "Proposed" under Internal Revenue Code. Three volumes. Chicago, Commerce Clearing House, Inc., 1979.
Annual three-volume compilation of "final" and "proposed" income tax regulations issued by the Treasury Department, explaining in detail the meaning and application of each section of the Internal Revenue Code. This publication is compiled from CCH 1979 Federal Tax Guide Reporter and 1979 Standard Federal Tax Reporter as of July 1979. (B. 102.123)

THE INDIRECT CREDIT

A study of various foreign tax credits granted to domestic shareholders under U.S. income tax law. Volume II. By Elisabeth A. Owens and Gerald T. Ball. Cambridge, International Tax Program, Harvard Law School, 1979. 386 pp.
Second volume of study describing and analysing the U.S. law governing the credit granted to domestic corporations for foreign income taxes paid by foreign corporations. The law and case law is stated as of November 1, 1978. (B. 102.303)

INHERITANCE AND THE INEQUALITY OF MATERIAL WEALTH

By John A. Brittain. Washington, The Brookings Institution, 1978. 102 pp.
Study which draws attention to the inequality in the distribution of wealth rather than to the inequality in the distribution of income. The role of material inheritance in the perpetuation of inequality of wealth is evaluated. (B. 102.093)

INTERNAL REVENUE CUMULATIVE BULLETIN 1978-2 JULY-DECEMBER

Washington, Department of the Treasury, Internal Revenue Service, 1979. 588 pp.
Consolidation of all official rulings, decisions, executive orders, tax treaties and other items of a permanent nature, published in the weekly Bulletin in the second half of 1978. (B. 102.232)

INVESTERINGEN IN ONROEREND GOED IN DE VERENIGDE STATEN; FISCALE ASPECTEN

By M.L.B. van de Lande and L.S. Ullman. Deventer, Kluwer; The Hague, Fenedex, 1979. Fiscale en juridische documentatie voor internationaal zakendoen, No. 6. 114 pp., 34.50 Dfl.
Monograph describing the tax aspects arising from investment in real estate in the U.S.A. by individuals and by companies resident in the Netherlands. Relevant statutes are appended. (B. 102.224)

INVESTMENT GUIDE TO THE UNITED STATES

New York, Citibank, 1979. 72 pp. (B. 102.247)

OECD ECONOMIC SURVEYS: U.S.A.

Organisation for Economic Co-operation and Development, 1979. 91 pp. (B. 102.295)

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PROCEEDINGS OF THE NATIONAL TRAINING WORKSHOP ON THE USE OF PHONE POWER IN STATE TAX ADMINISTRATION

Sponsored by National Association of Tax Administrators. Washington, Federation of Tax Administrators, 1979. National Workshop, No. 1, April 1979. 133 pp. (B. 102.246)

STATE TAX HANDBOOK

As of October 1, 1979. Chicago, Commerce Clearing House, Inc., 1979. 672 pp., $ 8.50.
Brief description of the tax system of each state and the District of Columbia as of October 1, 1979. (B. 102.284)

STUDIES IN TAXATION, PUBLIC FINANCE AND RELATED SUBJECTS; A COMPENDIUM

Volume I. Washington, Fund for Public Policy Research, 1977. 550 pp.
A compendium of studies prepared for the U.S. Congress by the Congressional Research Service, Library of Congress. The articles include: "Tax fraud: distinguishing civil and criminal tax frauds" by Howard Zaritsky; "Outline of major changes in the social security cash benefits program under Title II of the Social Security Act" by Joel Greenberg. (B. 102.091)

U.S. TAXATION OF AMERICAN BUSINESS ABROAD

By G.C. Hufbauer, Wilson E. Schmidt, Norman B. Ture, Oswald H. Brownlee and Dan Throop Smith. Washington, American Enterprise Institute for Public Policy Research, 1975. 101 pp.
Studies on U.S. taxation of foreign source income followed by exchange of views. (B. 102.088)

1980 TAX ANGLES FOR SPECIAL TAXPAYERS

Chicago, Commerce Clearing House, Inc., 1979. 388 pp.
The book gives information for the following groups of taxpayers: corporate executives, professional persons and sales persons. It contains individual tables of contents and topical indexes for each special taxpayer classification. (B. 102.240)

TAX PLANNING 1980

Chicago, Commerce Clearing House, Inc., 1979. 176 pp.
(B. 102.241)

WEALTH REDISTRIBUTION AND THE INCOME TAX

Principal paper by Norman B. Ture. Edited by Arleen A. Leibowitz. Toronto, Lexington Books, 1978. 130 pp.
Compilation of papers which reevaluate the ethical basis of redistributive taxation and the effect of such taxation on savings and investment. (B. 102.169)

Loose-Leaf Services

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AUSTRALIAN INCOME TAX — LAW AND PRACTICE:

— Bulletin
releases 26-29, 32-36, 38 and 39
— Cases
releases 25-30, 33-38 and 40
— Replacement pages
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Butterworths, Pty., Ltd., Chatswood.

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DIE EINKOMMENSTEUER:

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— Kommentar
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Wirtschaftsverlag Dr. Anton Orac, Vienna.

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CCH Canadian, Ltd., Don Mills.

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Richard de Boo, Ltd., Toronto.

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Richard de Boo, Ltd., Toronto.

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Butterworths, Pty., Ltd., Scarborough.

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Richard de Boo, Ltd., Toronto.

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Kluwer, Deventer.

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Walter Diamond
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DAS STEUERSYSTEM SINGAPURS – GESTERN UND HEUTE

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Le Directeur d'Autorité Monétaire de Singapour a décrit les caractéristiques du système fiscal de Singapour, les avantages fiscaux offerts aux investisseurs étrangers, son évolution vers un centre financier international, mais a fait remarquer que Singapour n'était pas un paradis fiscal.

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Extraits de la présentation du Budget 1980 prononcé par le Ministre du Commerce et de l'Industrie M. Goh Chok Tong le 5 mars 1980. Le budget est caracterisé par sa prudence à maintenir les dépenses régulières du Gouvernement aussi modérées que possible et à favoriser les objectifs de développement.

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NOVEMBER 1980

Confédération Fiscale Européenne (C.F.E.): Second Congress of European Tax Consultants (subject: "La pratique de la Fiscalité en Europe"), Rome (Italy), November 6 and 7 (English, French, German).

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CIAT: P.O. Box 2129, Panamá 9A (Panama).

Confédération Fiscale Européenne, Secrétariat Général (C.F.E.), D-5300 Bonn 1, Dechenstrasse 14, German Federal Republic or Siège Social F-75009 Paris, 9 rue Richepanse (France).

Institute for International Research, 70 Warren Street, London, W1P 5PA (United Kingdom).

Investment and Property Studies Ltd., Norwich House, Norwich Street, London EC4A 1AB, United Kingdom (Registration for the Cannes Tax Conference should apply to this address).

International Association of Assessing Officers, 60th Street, 60637 Chicago 1313 East, U.S.A.

International Fiscal Association (I.F.A.): General Secretariat, Woudenstein, Burgemeester Oudlaan 50, P.O. Box 1738, 300 DR Rotterdam (Netherlands).

Nederlandse Federatie van Belastingconsulenten, Wassenaarseweg 20, 2596 CH Den Haag (Netherlands).

Management Centre Europe, Avenue des Arts 4, B-1040 Brussels (Belgium).

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Georgetown University Law Center, Office of Continuing Legal Education, 600 New Jersey Ave., N.W., Washington D.C. 20001 (U.S.A.).

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Singapore's Tax System

Past and Present*

by GOH CHOK TONG

We are indeed honoured that you have chosen to hold your 6th International Tax Conference in Singapore for a second time. Your Third Conference was held here in 1974 and to those of you who have been here before, I hope you will find the changes and development in Singapore interesting enough to justify your coming back. May I welcome you back as well as all other participants and guests who are here for the first time.

I am, however, constrained by your eminent presence to sally forth on a subject in which you are clearly superior. There is another constraint. With the Singapore Government Budget Statement due to be delivered only a month from now, any provocative statement on taxes will unwisely take the wind out of the Budget sail. Thus, I find it prudent on my part to limit myself this morning to a brief historical description of Singapore's tax system, concluding with some remarks on the lessons that can be abstracted from our experience.

Traditionally, Singapore's economy has been dependent on entrepot trade. Industries were limited to those which could take advantage of Singapore's geographical location, such as processing industries of commodities produced in the region. The dependence on entrepot trade required the pursuit of a free port policy. This greatly narrowed the scope for raising public revenue. Unlike many countries, Singapore could not depend on extensive import and export duties. Income tax was considered undesirable and impractical because of the certainty of evasion, but the Colonial Government probably also had little incentive to tax their own wealthier and more influential expatriate population. Thus, before World War II, the main source of revenue was a tax on the consumption of liquors, pork and fish, gaming tables and pawnbrokers' shops, and a bizarre tax on opium consumption. Opium farms were created and the widespread addiction of the local population to opium provided the British Administration with an easy source of revenue. Today, the tax on all these items has been removed except for liquors on which there is a customs revenue duty. Opium consumption, of course, is illegal, and drug addiction is a tax on our resources and not the other way round.

War tax, which was a form of tax on income, was introduced for the first time in 1917 as a temporary expedience to provide funds for the war effort. An attempt was made to make it a permanent tax after the war, but it failed because of strong opposition. During the last year of the operation of the tax in 1922, $3.9 million was collected constituting about 10 percent of the total Government revenue. In 1941, tax on income was reintroduced to meet the war commitments but before much revenue could be collected, Singapore fell to the invading Japanese forces.



Goh Chok Tong

Minister for Trade and Industry

Born in Singapore in 1941. Educated at Raffles Institution and graduated in 1964 from the University of Singapore with a B.A. (Hons.) Class I in Economics. In 1966, was awarded a Fellowship to Williams College, U.S.A., where he obtained his Master of Arts in Development Economics.

Joined the Singapore Administrative Service in 1964. Worked as economic planner and research economist. In August 1969, was seconded to the newly-incorporated Neptune Orient Lines Ltd. (NOL), Singapore's national shipping line, as its Planning and Projects Manager. Resigned from the Civil Service to become a permanent staff of NOL about a year later. Appointed as Financial Controller and later Financial Director on Board of NOL. Became the Company's Managing Director in November 1973. Left in 1977 to take up appointment as Senior Minister of State.

Has served as Chairman of the National Statistical Commission and NTUC INCOME, and Board Member of Port of Singapore Authority, Post Office Savings Bank, Sembawang Shipyard Ltd., Container Warehousing & Transportation (Pte) Ltd., and various subsidiary and associate companies of NOL.

Is Deputy Chairman of Singapore Labour Foundation and Board Member of People's Association. Governor of Asian Development Bank.

Elected Member of Parliament for the Marine Parade constituency in the 1976 General Elections. Appointed Senior Minister of State for Finance in September 1977, and Minister for Trade and Industry in March 1979.

* Speech at the opening of the 6th International Tax Conference in Singapore on 4 February 1980.

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After the Second World War, huge sums were required to reconstruct Singapore. The need to explore new sources of revenue became even more acute when the smoking of opium was prohibited following public and social pressures. It was not without vocal resistance that tax on income was legislated in 1947. Since then, income tax has assumed prominence, and, today, it is the mainstay of Government revenue contributing $1.28 billion, or 35 percent of Government revenue.

Other taxes, although introduced earlier, were not that eventful or as bizarre as the opium tax. Estate duty was introduced in 1885, and stamp duty, levied on various kinds of commercial and local documents, in 1896. Property tax, which is a tax on the annual value of real property, was levied only in 1960. Prior to that, the City Council and the Rural Board levied local assessments on rates.

During the 1960s, Singapore embarked on planned industrialization to solve the main economic problems of the day — slow economic growth and high unemployment. Industrialization was spearheaded by import-substitution industries, and protective duties were introduced. But it did not take long for Singapore to realise that its future lay in export-oriented industries and not inward-looking domestic industries. Protective duties ceased to be introduced for new industries, and, today, the question is when and not whether to remove the vestiges of protective duties introduced in the early days to induce industries to be set up.

In the 1970s, Singapore strove to be a financial centre. Tax measures were used to facilitate this. In 1969, legislation was passed to exempt from tax interest derived by non-residents on deposits with banks. In 1973, the tax for certain offshore income derived by Asian Currency Units of financial institutions was reduced to 10 percent. The concession was subsequently extended to cover other offshore income such as income derived from financing or re-financing of offshore trade transactions and foreign exchange transactions in currencies other than Singapore dollars with persons outside Singapore.

Singapore's Income Tax Act is basically simple. This simplicity has been maintained over the years despite amendments made from time to time. The amendments were necessitated by economic and social considerations.

Tax concessions, however, are contained in separate legislation. The Pioneer Industries (Relief from Income Tax) Ordinance was introduced in 1959 to provide tax holidays of up to five years to pioneer enterprises and tax concessions to firms for income attributable to expansion in capital investments. In 1967, the Economic Expansion Incentives (Relief from Income Tax) Act was passed to replace the earlier legislation and to consolidate the laws. The Act will continue to be the framework upon which new tax incentives will be considered.

In the field of property tax, incentive was also employed to stimulate and assist private participation in the redevelopment of the urban area. There was a multiplicity of property tax rates, but the base rate from which reductions are given was 36 percent. For approved projects in the urban area, the rate was reduced from 36 percent to 12 percent for a period of 20 years. This incentive was also extended to developments in Sentosa Island, our tourist resort island. The present multiplicity of rates, however, will be standardized at a single rate of 23 percent by 1983. The objective of a lower standard rate is to achieve a steady growth of the property sector and an improvement in the built-up environment, particularly in the urban area.

The development of Singapore's tax system has been closely tied to the economic and social policies of Singapore. In the last two decades especially, the tax system has been used to promote economic growth, in particular, the growth of the manufacturing and financial sectors. This, in turn, has led to a larger base for income tax and taxes on property and payroll. Consequently, these taxes registered substantial increases and they have now supplanted import and excise duties as the more important revenue items. This leads us to the first theorem on taxes and that is "Less is More". The mathematical expression of this is that 40 percent of zero is zero, 40 percent being the Singapore income tax rate on

During the first week of February 1980 Singapore hosted the Sixth International Tax Conference. This Conference is the most recent in a series of conferences which started in 1970 at the initiative of Professor G.S.A. Wheatcroft and which have been held every two years (1970 — Nassau, Bahamas; 1972 — Kingston, Jamaica; 1974 — Singapore; 1976 — Nairobi, Kenya; 1978 — Honolulu, Hawaii, U.S.A). A large percentage of the speakers and the participants attended several if not all of the conferences, a feature which creates an almost ideal framework for discussing new developments in international taxation, particularly in regard to the countries and territories of the British Commonwealth. At each conference, ample attention is given to taxation in the region where it is held.

The opening address of the Sixth International Tax Conference was given by the Minister for Trade and Industry, Mr. Goh Chok Tong, whose statements are likely to surprise those who are used to the almost general call for higher income taxes in other parts of the world.

Minister Goh's address was followed by a talk by Mr. Wong Pakshong, managing director of the Monetary Authority of Singapore.

It is with much pleasure that we publish the text of both addresses with the permission of the two speakers. In addition, an extract from the Budget Speech 1980 is included in this issue.

Further details of the tax system of Singapore (as well as of the other countries in South East Asia) are contained in the 6-volume loose-leaf work Taxes and Investment in Asia and the Pacific, *prepared and published by the Bureau.*

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corporation profits. Thus, conditions must be created for investments to take place, and for these investments to succeed.

As Singapore now enters its second stage of industrial development with emphasis on higher technology industries, tax incentives will play an important role in attracting investment and transfer of technological know-how. But more important than the tax system is the political and economic climate for investment. There must be political stability to ensure the security of investments. There must be discipline amongst workers and management and affable industrial relations. The private sector must be given maximum leeway to exercise its ingenuity, innovativeness and risk-taking capability. If these basic political and economic parameters are present, less tax in an expanding economy will lead to more revenue.

Work and investments are ingredients vital to Singapore's continued growth and prosperity. The income tax structure must never discourage this.

Thus, taxes must descend to the minimum level of Government expenditure consistent with good administration and not expenditure rising to the maximum taxes possible. This I offer as the second principle of taxation. There must therefore be periodical reviews of the entire gamut of taxes. Taxes which have outlived their original objectives should be scrapped even though they are convenient sources of revenue. Personal income tax rates must be periodically revised to take into account the pernicious effect of inflation. An overtaxed society which consistently yields more revenue than the expenditure required could lead to inefficient uses of public funds.

Taxes are never popular, particularly, personal income tax. In levying them, it is worth our remembering the third dictum: The more heavily a person is supposed to be taxed, the greater his incentive to escape being taxed. And if he thinks he can cheat safely, he probably will. There must, therefore, be adequate anti-avoidance and anti-evasion provisions in the Tax Act, and an effective machinery to back up these provisions. It is accepted that tax avoidance is within the law. However, artificial ways of transacting business such as the creation of "shell" companies to avoid paying tax altogether must be discouraged. Sometimes such tax avoidance manipulations slip into the area of tax evasion. Thus, the process of preventing serious loss of revenue will continue and be intensified, if necessary. But, of course, we should not tax a person too heavily.

As a government must spread the benefits of its expenditure amongst the population, the tax net must cover as many people as possible, but consistent with their ability to pay. The more taxpayers there are, the lower the tax per capita. Our fourth principle of taxation is: spread benefits and taxes amongst the population. Equity requires taxes to be levied for the benefit of the taxed.

And lastly, let me quote you the eternity law: Nothing is certain except death and taxes.

The Future Position of Singapore in International Taxation*

by Michael Wong Pakshong **

It was with some diffidence and apprehension that I agreed to speak at this conference. I would be the first to admit that I am not a tax expert. What little tax I learned as an articled clerk in London over 20 years ago has long since been forgotten. Another reason is the sneaking suspicion that the title of the address was foisted on me in the expectation that there might be a preview of tax changes to come. Alas, I fear I shall disappoint you.

My only exposure to tax — apart from the common affliction we all suffer as taxpayers — are the frequent pleas and representations why additional areas of banking and financial activities should be either exempted from tax completely or the rates reduced even further. Of course there are those who do not make a frontal assault by calling for the abolition of a tax — but rather deviously try to advocate a zero rate of tax. I

* Address given at the opening session of the Sixth International Tax Conference held from 4th to 8th February 1980 in Singapore.

** Managing Director of the Monetary Authority of Singapore.



Michael Wong Pakshong

Mr. Michael Wong Pakshong currently holds the post of Managing Director of the Monetary Authority of Singapore.

He was born June 2, 1931 in Durban, South Africa where he graduated from High School in 1949. He further acquired a B.A. (Hons) at the University of Bristol (United Kingdom) and became a Fellow of the Institute of Chartered Accountants in England and Wales in 1959.

Other appointments held by Mr. Wong are: Chairman of the Neptune Orient Lines Limited, Chairman of the Securities Industry Council, Deputy Chairman of the Board of Commissioners of Currency of Singapore and Governor of the International Monetary Fund.

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suppose there is a fine distinction between the abolition of a tax as opposed to a zero rate of tax, but I suppose it is best to leave this philosophical point for further discussion by all the experts we have assembled here today.

SINGAPORE IS NOT A TAX HAVEN

It has never been said of Singapore that it is a tax haven. The standard rate of tax on corporate profits is 40 percent, while the highest marginal rate of personal tax is 55 percent. For an individual resident in Singapore the income tax rates are as follows:

Chargeable income	*$*	*Rate of tax (%)*
first	2,500	5
next	2,500	8
next	2,500	10
next	2,500	12
next	5,000	15
next	5,000	20
next	5,000	25
next	10,000	30
next	15,000	35
next	50,000	40
next	100,000	45
next	200,000	50
income exceeding	400,000	55

Furthermore, we have as diligent and conscientious an Anti-Evasion Unit of the Inland Revenue as can be found anywhere in the world.

While there are sections of the population who escape the tax net, those of us who are privileged to pay tax can vouch for the efficacy of the collection system.

This leads me to make on prediction about the future position of Singapore in international taxation. Perhaps it is the only prediction that I feel confident of making. It is only a matter of time before the system is improved to bring within the tax net the many self-employed persons who have hitherto avoided paying tax.

Although Singapore is not a tax haven certain transactions do not attract tax. Perhaps the most obvious is that we do not have a capital gains tax. As long as anyone does not make a trade or profession in dealing, profits from buying and selling securities, for example, it can be freely carried out.

Most observers agree that there are no signs that a capital gains tax is likely to be introduced. This of course means that a number of investment companies have tried to find ways to buy and sell shares and yet escape tax — especially when there is an increasing frequency of profitable transactions. It is perfectly understandable why portfolio managers would like clearcut definitions/guidelines laid down so that they can then tailor all transactions to fall neatly as capital gains. I very much doubt if we can achieve such definitions or guidelines which the Inland Revenue authorities will readily accept.

A few years ago, when world interest rates were much lower, there existed a perfectly legal way for individuals to earn a very reasonable rate of return by opening a savings account with the Post Office Savings Bank. What was remarkable was that the interest earned from a Post Office Savings Account was not subject to tax and there was no ceiling to the amount of interest which any individual could derive from this source. The limitation was set only by the wealth of individuals.

During the period 1968 to 1978 the Post Office paid an interest rate of 5 percent p.a. — which meant that anyone with a marginal rate of 55 percent enjoyed an equivalent grossed up rate of 11 percent. But alas, all good things come to an end. Nowadays only the interest earned on a maximum deposit of $100,000 is exempt from tax — (which when grossed up at a marginal rate of 55 percent and an interest rate of 6 percent gives a grossed up rate of 13.3 percent). Deposits in excess of $100,000 are exempt from tax — but the Post Office Savings Bank only pays 4¼ percent — which gives a grossed up rate of 9.4 percent — which is hardly attractive these days.

For the non-resident of Singapore there are other attractions in making deposits with banks in Singapore. A non-resident does not have to pay tax on interest from deposits made with banks in Singapore. He also has the additional exemption from estate duty which is conferred on Asian dollar accounts.

STAMP DUTIES

Apart from income tax, we have in Singapore — as do many countries who are members of the Commonwealth — a comprehensive range of stamp duties. This is an arcane area of revenue law where many fear to tread. There were stamp duties in Singapore long before anyone thought of bringing in income tax. Like a good member of the Commonwealth, Singapore has preserved intact the stamp duties which have remained practically unchanged since 1929. Such amendments as were made were mainly concerned with increasing revenue from stamp duties.

In the 1970's, as the nature of banking became more sophisticated, it became apparent that stamp duties — especially those levied on an ad valorem basis — would inhibit the development and growth of banking and financial activities. The banking lobby was most pursuasive in getting the many stamp duty amendments which were made from 1972 onwards. They rightly pointed out that the yields from the offending stamp duties were minimal, whereas the exemption from duty at least creates a market and results in transactions whose profits would be subject to Singapore tax. This coincided at the time with the government's objective to promote the Asia Dollar Market. The market in Asian dollar bonds, negotiable certificates of deposits, promissory notes, bills of exchange and loan syndicates could not have been established if the stamp duty exemptions had not been given.

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THE CHARACTER OF TAX INCENTIVES IN SINGAPORE

The study of Singapore's tax incentives in the past 20 years will be a fruitful area of study for the economic historian. Any study will show how the introduction of these incentives has been used to shape and influence not only the rate of growth — but also the direction in which economic activity was positively directed.

In the 1960's, there was unemployment and an over-reliance on entrepot trade and related activities. The policy then was to diversify the economy and to promote labour-intensive industries. It was also aimed at import substitution. To achieve this an effort was made to attract foreign investments. Thus from 1959 onwards a range of tax incentives was introduced which basically gave investors tax holidays — or pioneer status as they are called in Singapore.

As foreign investors set up plants, so the incentives were widened to encourage non-pioneer industries to invest in up-to-date capital equipment. They were allowed the benefit of accelerated depreciation (Income Tax (Amendment) Act 1965).

Incentives have evolved over the years and there is no longer the emphasis on import substitution or the promotion of labour intensive industries.

However, it is the Economic Expansion Incentives (Amendment) Acts of 1975 and 1979 which are interesting. Even without any minimum capital investment pioneer status was extended to any enterprise which places a premium on skill and craftsmanship as well as producing a product where the value added was high. It also allowed local and foreign companies to expand their operations into services. Thus we now promote the use of Singapore as a regional warehousing and service centre. Reduced rates of taxation are given to technical and consultancy services performed overseas as well as trading in non-traditional commodities in offshore markets. [1]

The change in direction now recognises the necessity to introduce higher technological levels in manufacturing and the production of more sophisticated manufactured goods — as well as the realisation that greater productivity must be achieved by all sectors of the economy. It is with anticipation that we await the next budget to see if further incentives or disincentives are in store for us.

I must not omit to mention that with the establishment of the Singapore Registry of Shipping tax exemption is given to ships which fly the Singapore flag.

BANKING AND FINANCE

In modifying stamp duty and income tax, the fiscal climate improved to such an extent that banks and financial institutions found Singapore was a strategic place to have a branch. The recognition of Singapore as a financial centre is evidence of the success of these incentives — though it would be wrong to attribute this success to tax alone.

It is my impression that we now have a system which does not require much more tinkering around with, certainly as far as fiscal incentives are concerned. Of course, there are eternal optimists who continue to advocate a zero tax rate for all offshore activity.

It seems to me that the economic growth that we have had over the last ten years in the region has not gone unnoticed. For many of the institutions, it is the desire to participate in what they perceive to be the potential opportunities for profit which draws the banks here rather than for reasons of tax. By our willingness to allow reputable financial institutions to establish offices here, we continue to receive applications and enquiries.

This is not to say that we can afford to be complacent. Far from it. There are still areas in our income tax and revenue laws which can do with some streamlining and rationalisation. Such changes as may occur will be relatively minor, certainly as far as banking is concerned. I expect that it is not so much tax changes that banks would like to see — but rather changes in the ground rules we have established for their operations. This, of course, is a controversial area which should be discussed — but in another forum.

As far as I am aware there is no measure we can take which could lead to a quantum leap similar to that which occurred when withholding tax on bank interest was abolished over 10 years ago. No measure, that is, apart from the total abolition of income tax or a drastic reduction in tax rates.

So far I have tried to describe the features of our tax system — how it has made Singapore what it is today in terms of economic strategy and development.

1. There is an effective system of taxation so that there is no question of Singapore qualifying as a tax haven.
2. Despite not being a tax haven there are a limited number of ways of conducting transactions which are not subject to tax — outside of outright tax evasion.
3. *Stamp duties*
   I described modifications and amendments which were necessary to give us an even chance of promoting banking and finance.
4. *Tax incentives*
   How incentives have evolved over the years and the growing refinement in changing the character of industrialisation.
5. *Banking and finance*
   I expressed the view that we have probably made most of the changes necessary for this sector.

All this has been enumerated to provide a perspective of where we are — and in view of what we have done — where we are likely to go.

Some guideposts of the highways and byeways we are likely to traverse may be gleaned from government statements.

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1. *Editor's note:* See for privileged treatment accorded with respect to warehousing and servicing incentives and consultancy services Lee Fook Hong, *Singapore's new tax incentives* in 33 BULLETIN FOR INTERNATIONAL FISCAL DOCUMENTATION 386, 388 (1979).

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POSITIVE FISCAL POLICY

In the 1978 Budget, taxpayers in Singapore were given a pleasant surprise when taxes were reduced by raising the ceilings before the top marginal rate of 55 percent became effective. [2] I would like to quote what was said by the Minister of Finance when he introduced the change:

"Aggravating the problem of equity or fairness in sharing the tax burden is the ability of many self-employed and professionals to incorporate themselves into companies in order to sell their personal services, and thereby quite legally avoid paying tax at more than 40 percent, the company rate. Professionals and executives working for the public sector on salaries are unable to take advantage of this loophole in the law. Nor do they enjoy the perks of tax-free 'expenses'.

I have therefore decided, from Year of Assessment 1978, to make income tax less inequitable by broadening the steps over which the tax rate goes up".

In the same budget, the Minister also stated that it was the policy to shift gradually the impact of taxation from income to consumption taxes. In order to make up for the loss in revenue from personal taxes, taxes on public utility and telephone bills were increased, as were the fees levied on the registration of cars, driving licences, entertainment duty and colour TV licences.

The implications and the import of these statements are pretty obvious. What is not obvious is to *what degree* these policies will be implemented, and *how* — as well as *when*.

WHAT IS THE FUTURE OF SINGAPORE IN INTERNATIONAL TAXATION?

One approach is to consider the business which many present at this conference specialise in. In tax planning you must keep abreast of all developments which can be exploited to minimise the tax liability of your clients.

It would be futile for me to predict what may or may not come about in terms of specific changes and where Singapore will stand in the international tax league especially as far as loopholes and concessions are concerned.

Taxation as one of the most important components of fiscal policy will undoubtedly be used in the management of aggregate demand. The fight against world inflation will be with us for some time yet.

Of possibly far greater interest to a wider audience will be the use of taxation in shaping what Singapore will be in the decades to come. Taxation will become one of the elements that will most likely be used in a package of measures.

Taxes have already been used to reduce energy consumption. It is very likely that novel and imaginative taxes can be devised to meet the problems which may befall us. The use of tax to influence demographic trends is but a simple example.

The success or otherwise of taxes ultimately rests on the reasonableness of the burden which people have to bear. Government has shown an acute awareness that effort and achievement should be adequately rewarded. As long as this is practised, I see no reason why taxes cannot be used positively and creatively for improving on what we have so far achieved in Singapore.

In other words, if you must tax — tax wisely and intelligently.

2. *Editor's note:* See for a discussion of the Budget 1978: Lee Fook Hong, *1978 Budget and tax changes* in 32 BULLETIN FOR INTERNATIONAL FISCAL DOCUMENTATION 122 (1978).

INDIA: Interim Budget 1980

Extract from the Budget Speech 1980 pronounced by the Finance Minister, Mr. R. Venkataraman, on February 29, 1980. The recently elected Indira Ghandi Government has had too little time to present a full-fledged budget which will now be submitted in May or June of this year.

36. I propose to introduce today a Finance Bill which seeks to continue the existing rates of income-tax for the financial year 1980-81. However, I have also three proposals of a non-controversial nature for the amendment of the Income-tax Act. I shall now briefly explain these proposals.

37. Some state governments have set up statutory corporations for the promotion of socio-economic interests of members of the scheduled castes and the scheduled tribes. I propose to exempt from income-tax the income of all statutory corporations or bodies, associations or institutions wholly financed by the Central or a state government, established for promoting the interests of the members of the scheduled tribes.

38. As the Hon'ble members are aware residents of Ladakh were exempted from payment of income-tax up to and including the assessment year 1979-80 in respect of income accruing or arising to them from any source in that district or outside India. I propose to continue the tax exemption for a further period of three years.

39. Under an existing provision, awards for literary, scientific and artistic work or attainment, instituted by the Central government or by any state government or approved by the Central government, are exempt from income-tax. I propose to extend this tax concession to approved awards for outstanding work in alleviation of the distress of the poor, the weak and the ailing. Hon'ble members will be glad to know that this provision will set at rest doubts about the taxability of the Nobel Prize awarded to Mother Teresa in recognition of her service to suffering humanity.

40. There is no change in the rates of customs and Central excise duties. However, provision has been made in the Finance Bill for the continuance of the auxiliary duties of customers and special duties of excise at the existing rates for the year 1980-81.

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Singapore: BUDGET 1980

A GO-GETTER BUDGET

Extracts from the Budget Speech pronounced by the Minister for Trade and Industry, Mr. Goh Chok Tong, on March 5, 1980.

The FY 1980 Budget has been formulated on the basis of the following guidelines:

(a) *Financial prudence:* We shall continue with the prudent policy of keeping Government recurrent expenditure down to the minimum and within the revenue expected to be collected within the fiscal year, but consistent with a high standard of administration.

(b) *Development objectives:* The Budget should reflect the thrust and objectives of our policy to restructure the economy and of our development strategies for the Eighties. It should balance economic growth with social objectives. Investment in infrastructural development should be matched by investment in people and improvements in housing and other social amenities.

The FY 1980 Budget provides $4,019 million in the "Main estimates". This recurrent expenditure is fully covered by the expected revenue of $4,118 million. It is 19 percent higher than that for the last fiscal year and in my view is the minimum required to maintain the public services at a high standard. The need to exercise effective control over the utilisation of manpower, given our policy to encourage economy in the use of labour, is reflected in a net total increase of only 957 posts, including those created by Establishment Warrant in the course of this current financial year. This is an increase of only 1.4 percent over the FY 1979 establishment. Of these new posts, 533 are for the Ministry of Education in connection with their revised primary education system, the computerisation of education data and establishment of new schools. With the conversion of Radio and Television Singapore into a statutory corporation, 1,422 posts are taken out of the Budget. The FY 1980 establishment will, therefore, be reduced by 465 posts to 69,226 posts compared to the FY 1979 establishment of 69,691.

The Budget, however, recognises that as steps are taken to minimise staff increases, Ministries and Departments have to mechanise, automate and computerise. They must also upgrade or retrain the skills of officers. The Budget therefore provides funds for new and better machines and for computerisation as well as for training of civil servants.

The importance of infrastructural development is again emphasised in the Budget. Forty-seven percent of the FY 1980 Budget, or $3,617 million, is for development. Expenditure on economic services will amount to $1,755 million, or 49 percent of total development expenditure. This includes a sum of $1,047 million for industrial and commercial development (largely as loans to the Jurong Town Corporation and to industrial and commercial enterprises) and $430 million for the development of Changi Airport and roads in the Republic.

Our economic restructuring programme and the long term economic health of our country require that we harness our workers to produce higher value-added and skilled manufactures and services. We must maximise the talents of our people. Human resource development is therefore one of our top development priorities and is reflected in our Budget. More and better education and training of both teachers and students are necessary to upgrade the quality of our workforce. The Budget provides for higher expenditure for our schools, training institutions and universities.

Economic development must bring about a material improvement in social services. A sum of $1,133 million is provided for public housing, accounting for 31 percent of the Development Budget. The provision for economic services and public housing together accounts for 80 percent of the total Development Budget.

REVENUE: CHEERS AND TEARS

I now move on to tax changes and revenue estimates for the new fiscal year. It is not possible to bring cheers for all. There will be cheers and there will be tears, but our compass must be the overall good of Singapore.

The total revenue estimated for FY 1980 is $4,113 million. This represents a fall in collections of $167 million or 3.9 percent compared with the revised estimates for FY 1979. The drop is due to the exceptionally high revenue receipts in FY 1979 which came from land sales and back payments of land premia and also property tax arrears from statutory boards.

Income tax remains the largest single source of revenue and it is expected to show an increase of 7 percent or $93 million over the revised estimates for FY 1979. For FY 1980, income tax is expected to yield $1,423 million. Property tax collections, however, are expected to fall by some $30 million mainly because of the phased reduction of property tax rates to a level of 23 percent in 1983.

The total budgeted expenditure for FY 1980 is $7,636 million, comprising a recurrent expenditure of $4,019 million and a development expenditure of $3,617 million. The expected revenue of $4,113 million for FY 1980, therefore, falls short of the total Budget by $3,523 million. Of course, we cannot expect to finance the entire development expenditure with Government revenue. The question is how much of this should be financed from public borrowings and how much from additional taxes. I, therefore, come now to the moment of anxiety.

TAX CHANGES: WITHDRAWAL OF PROTECTION FOR CIGARETTES AND TOBACCO

I have earlier announced that we will not protect local industries against competition from imports. This applies also to the manufacture of cigarettes.

At present, the manufacture of cigarettes is protected through the imposition of an import duty higher than excise duty. Withdrawal of protection is in keeping with the development strategy to expose to competition those industries which should have grown out of the fledgling stage. I have, therefore, decided to remove this protection for cigarette manufacture by harmonizing excise duty with import duty. Excise duty on cigarette manufacture will therefore be raised from $4 per kilogram to $9 per kilogram. The import duty of cut rag will also be increased from $35 per kilogram to $36 per kilogram.

This approach in removing protection is in line with our policy of discouraging smoking.

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The revision of duty which is expected to yield an additional $21 million per year will come into effect today.

There is a loss in revenue of $50 million, however, from the general removal of protective duties. The net revenue loss arising from trade liberalization is, therefore, $29 million.

TAX CONCESSIONS

(i) Research and development

I have earlier dwelt on the plan to promote research and development in the 1980s. The purpose is to encourage manufacturers to develop new products and processes and to modify existing ones. I am pleased to declare that specific tax incentives will be given to promote R & D activities in Singapore.

For manufacturing enterprises conducting R & D and R & D institutions servicing them, the following tax incentives will be given:

(a) Double deduction of R & D expenditure, other than on buildings and equipment, on a case-by-case basis;
(b) Accelerated depreciation over three years for all plant and machinery for R & D;
(c) Investment allowance of up to 50 percent of the capital investment in R & D, excluding building costs, on a case-by-case basis;
(d) Extension of the initial allowance of 25 percent and annual allowance of 3 percent, presently available only to industrial buildings and structures, to R & D buildings; and
(e) Capitalisation and writing-off of lump sum payments for manufacturing licensings for a period of 5 years.

These concessions will take effect from Year of Assessment 1981.

(ii) Capital allowances for plant and machinery

Also, in line with our policy to develop high technology and to assist our enterprises to mechanise, computerise, and upgrade their operations, I have decided to liberalise the tax treatment of capital allowances for plant and machinery as follows:

(a) Accelerated depreciation allowance of 33 1/3 percent over three years will be extended to investment in computers and R & D equipment;
(b) The method of granting annual allowances will be converted from the reducing balance to the straight line method; and
(c) The existing depreciation schedule will be replaced by another with more realistic rates for write-offs. (This schedule is attached as Appendix I to my Budget Statement).

The rates in the new schedule take cognizance of the fact that certain assets promote mechanisation and automation. Hence, these are given increased rates of allowances. To give an example, under the existing scheme, it takes ten years to write off about 70 percent of the cost of machinery not used by "industrial enterprises". Under the new schedule, the machinery will be allowed to be written off completely in six years. The new method applies to both existing and new assets with effect from 1 January 1980. For a depreciable asset bought before the date, the straight line deduction will be computed by dividing the written down value of the asset by the remaining number of years of its estimated life in accordance with the new schedule.

The new method of depreciation together with the new rates for write-off provides for faster depreciation deductions on capital investment. Business firms will have more after tax earnings which they can use to channel into spending on depreciable assets for the purpose of mechanisation and automation.

The loss in revenue in the first year from this tax concession is estimated to be at least $78 million.

(iii) Stamp duties

In previous years, many incentives have been given to promote the development of Singapore as a financial centre. This year, I intend to remove the inconveniences experienced by financial enterprises by removing certain duties altogether and rationalising others at a single rate:

(a) Mortgages and debentures
The existing rates of duty on mortgages and debentures will apply but the maximum amount payable is now fixed at $500.

(b) Marketable securities
Asian Dollar and Singapore Dollar Bonds are presently granted stamp duty remission on a case-by-case basis. The exemption will now be given across the board.

Stamp duty on contract notes for the trading of marketable securities will also be abolished.

(c) ACU offshore loan agreements
The present 1/2 percent ad valorem stamp duty, subject to a maximum of $500 on ACU offshore loan agreements, will be abolished.

In addition, stamp duties on all other documents relating to ACU offshore loans will be abolished.

(d) Share certificates
The 0.1 percent ad valorem duty on share certificates will be removed.

(e) Share transfer deeds
The 0.2 percent and 0.3 percent duty on share transfer deeds will be standardised at 0.2 percent.

(f) Insurance policies
The existing multifarious duties will be standardised at a single rate of $1 per document.

(g) Partnership agreements
The existing manifold rates will be standardised at a single rate of $10.

(h) Promissory notes
The duty will be revised to $1 per note.

Stamp duties on the following instruments in the First Schedule of the Stamp Act will also be removed completely:

Article 3 — Agreement or memorandum of agreement
Article 7 — Appraisement
Article 8 — Apprenticeship deed
Article 12 — Average bond
Article 13 — Award
Article 25 — Contract
Article 28 — Copy or extract
Article 33 — Deed of any kind not described in this Schedule
Article 37 — Extract
Article 43 — Letter of allotment and letter of renunciation
Article 48 — Note of protest by the master of a ship
Article 54 — Protest of bill or note
Article 55 — Protest by the master of a ship
Article 67 — Valuation
Article 68 — Warrant for goods

The concessions on stamp duties will take effect from 1 April 1980. The loss in revenue is estimated at $10 million in the first year.

(iv) Concession for off-shore gold transactions

I have received representations that the tax rate of 40 percent on income derived from off-shore gold transactions inhibits the development of the market. I have studied the matter and am prepared to remove this disincentive. With effect from Year of Assessment 1981, the 10 percent concessionary tax rate will apply to the following income derived from gold transactions with non-residents:

1) Profits arising from the transactions of Asian Currency Units (ACUs) with non-residents, other ACUs, and broker and dealer members of the Gold Exchange of Singapore (GES) in the Singapore and overseas gold markets. This is an extension of the concession so far given to ACUs on income derived from off-shore transactions with non-residents.
2) Fees, commissions and profits of

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approved broker and dealer members of the GES, that is, those approved by the Monetary Authority of Singapore, arising from their transactions with non-residents, other members of the GES, and ACUs, in both the Singapore and overseas gold markets. Associate members of the GES will not be eligible for the concession.

It is hoped that the loss in revenue, estimated at $1.5 million, will be compensated later by the growth of the gold market.

PERSONAL INCOME TAX

(1) Tax rates

In my Budget Statement last year, I stated that taxes should never be so high as to become a disincentive to hard work or to stifle talents and skill. But "high" is a relative term as different individuals have different thresholds of pain. We know, however, that the wider the tax base the lower the tax burden per capita will be. These are two guiding principles behind this year's tax changes.

As at 31 December 1979, there were 389,387 individual taxpayers, representing an increase during the year of 30,459 taxpayers. The Inland Revenue Department should be able to bring more taxpayers into the net when its computerisation programme is completed. Meantime, steps will be taken to ferret tax evaders.

There have been several representations in the past, including some from my colleagues in the House, to increase the tax reliefs for earned income, dependents and other deductible tax items. I decided against an increase in earned reliefs last year and I am deciding against an increase in any of these reliefs this year. The rationale for this decision is the need to spread income tax to cover as many individuals as possible.

Across-the-board reduction

At present less than 38 percent of our work force pay any income tax. The more citizens we have paying income tax, the more voters there are who understand that welfare programmes which sound such attractive giveaways from some magic cornucopia conjured up at election time, must mean an increase in their income tax. Several advanced countries, like Britain, have been hypnotised by this "soak the rich" slogan, only to discover that they have, by heavy taxes on personal incomes, stifled the drive to excel and to succeed of their enterprising and talented, of their professional and even of their skilled workers. We want our skilled workers to increase their earnings as against the unskilled and to pay income tax, but not such that he finds it not worth the time, effort and investment to learn to be a skilled worker. Paying income tax will imprint in the minds of Singaporeans the importance of prudent fiscal and welfare policies since many will have a direct responsibility to pay taxes for Government social expenditure from their own incomes.

Between increasing the level of deductible reliefs and lowering tax rates across the board to afford reliefs from inflation, I have opted for the latter. My decision is based on sound principle and on precedent, first established by the Deputy Prime Minister as Minister of Finance, and upheld by the present Minister for Finance since 1970. This general reduction in personal tax rates gives relief to all without shrinking our taxpaying population.

Details of the existing and new tax rates are being distributed to Honourable Members and they are attached as Appendix II to my Budget Statement.

Every taxpayer will be given a reduction in tax ranging from 6.8 percent to 19.9 percent, depending on his tax bracket. The average reduction in tax is 16.1 percent. This I consider generous as our Consumer Price Index rose by only 4 percent last year. The substantial reduction is evidence of our intention not to stymie the application of time, talents and effort in earning income which generates economic growth.

The highest marginal rate remains at 55 percent, but the lowest marginal rate is now reduced to 4 percent. Taxpayers in the first and second tax brackets, therefore, enjoy the largest reductions in relative terms. Those in the first taxable bracket will, on average, pay only one percent of their incomes in tax. The others are given tax reductions commensurate with their bigger tax liabilities.

The new rates will take effect from Year of Assessment 1980. The loss in revenue is estimated at $45.5 million out of a total estimated personal income tax collection of $476 million.

Combatting tax avoidance through rate reduction

The aim of the Government is to reduce the levels of personal income tax in the next 2-3 years until the maximum effective rate is no more than the company rate of income tax, i.e. 40 percent. Then there will be no advantage for people to set up companies from which they draw low salaries for income tax purposes, whilst the bulk of their needs are paid by the company whose profits carry only 40 percent company tax. Such a reduction will be fairer on those wage earners who cannot hide their incomes, and on those professionals who cannot incorporate themselves into private limited companies because their professions disallow it. Also, income tax falls unfairly. Wage earners like those in the Civil Service, who cannot put aside part of their incomes as perks carry a heavier tax burden than those in the private sector who can. There are also some professionals, like doctors, who have a natural advantage in tax evasion over lawyers or accountants because of the nature of the payments, made by patients in cash to doctors, as against cheques by clients, often corporations, to lawyers and accountants.

The Inland Revenue Department will vigorously bring more evaders into the tax net. But we shall be deceiving ourselves if we believe that we can get all successful hawkers, restauranteurs, property brokers and freelancing commercial intermediaries to keep and render proper accounts. It will be many years before we can insist on proper book-keeping and accounting which the developed societies have evolved. Even in these societies, new forms of tax evasion such as barter, or exchange of services, have defeated the tax collector.

Reward for hard work and high performance

For the next stage of our economic development to succeed, we must make it worthwhile for our young to spend time and effort to acquire skills and knowledge that will enable them to earn and to keep more of their incomes for their efforts. At present those who earn between $20,000 and $100,000 a year, the technicians, engineers, managers and professionals, are carrying the greatest burden of income tax. The Government proposes to spread these tax rates more equitably.

We shall be wise to take note of the results on those societies where personal income tax has been used to equalise spendable incomes in the name of progressive taxation. It has blunted the incentive to outperform one's peers; it has levelled the gifted and the industrious down to the mediocre and the indolent. It has narrowed the difference between what the highly skilled takes home as against the unskilled. The results have been ruinous for economies like Britain. Overemphasis on dividing up the national cake equally has ended up in smaller pieces of a non-growing cake. On the other hand, the Japanese and Germans have concentrated on making the national cake bigger and have achieved it by rewarding hard work and high performance, giving a thicker slice to those who have contributed more. The result, even for the unskilled who are entitled to the thinnest slice, has been a piece of cake larger than a thicker slice of a smaller cake. The moral for us is to concentrate on creating a bigger cake through giving full rewards for effort, skills, hard work and enterprise.

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(ii) Relief for handicapped persons

I have one more tax concession in my bag. Some years ago, the Minister for Finance extended the allowance for handicapped children to include those over 16 years of age. This year, I intend to make a modification to this relief. If a tax-payer maintains a brother or sister who is incapacitated by physical or mental infirmity and who does not earn any income and continues to depend on the taxpayer, he will be entitled to claim a deduction of $750. The allowance is presently given only to parents of handicapped persons.

This relief is given only to taxpayers who maintain such a member of the family in the same household. The deduction may also be apportioned if more than one taxpayer maintain the same handicapped brother or sister. It will take effect from Year of Assessment 1980.

CONCLUSION

The tax changes this year will result in a net revenue loss of $164 million in the coming fiscal year. But if they have the desired effect of stimulating effort and economic activities, this loss will be made good by an expanding economy in subsequent years. In case the signals of tax reductions, in particular, in personal income tax rates, are read wrongly, I want to emphasize that these reductions are given not because we are elated over our good economic performance, or because the Treasury coffers are overflowing, but because we anticipate some very difficult years ahead, including this year. The primary objective of the tax liberalization this year is to create maximum room for Singaporeans to exercise their enterprise to the utmost so that they are better prepared to cross the treacherous waters ahead. Tax is a cost item, and in some instances, an empediment to efficiency and effort. We are reducing this cost and impediment. This is, therefore, a go-better Budget. Individuals, partnerships and corporations must go for the opportunities. They must not delay. They must catch up on skills, technology, modern management and exports. They must not be trapped in indolence and lowskilled, low-valued industries and services.

We face the uncertainty of superpower conflicts in the political and military arena. We face the certainty of higher fuel prices. We face the grim prospect of the region being destabilized by external forces, and the oil life-line being cut.

We are unsure of the outcome of the Presidential Elections in the U.S. this year, and hence the global impact of its policy changes. On the other hand, we are sure of sluggish world economic growth cohabiting with inflation.

We, therefore, have the perfect recipe for trouble. We have spelt out our strategy to deal with the difficult times ahead. If we stiffen our resolve, remain robust, we stand a good chance of pulling through the next few years as planned. But we must dare to achieve, and think ahead.

Saving is essential to the growth of our economy. This year's revenue is estimated to exceed recurrent expenditure by only $94 million. We shall draw down $2,482 million from the Development Fund to finance development expenditure. This still leaves a deficit of $1,041 million in the Development Budget which has to be borrowed from private savings, primarily from the Central Provident Fund. Without this generation of savings in the past, we would have to raise taxes, or curtail our development expenditure, to the long term detriment of our economy. Our economic prosperity today is achieved through a partnership of government and individual effort, public and private savings. Present-day Singaporeans must, therefore, save a part of their earnings to secure their own future, and their children's.

They must at all times avoid waste. They must not squander their tax rebates.

APPENDIX I: NEW SCHEDULE

		Period for which annual allowances are given (Years)	Rate assuming initial allowance is claimed (Percent)
1	Manufacturing and industrial processing plant and machinery	6	13 1/3
2	Office equipment:		
	Furniture and fixtures (Includes furniture and fixtures which are not a structural component of a building.)	10	8
	Data handling equipment (Includes typewriters, calculators, adding and accounting machines, copiers, and duplicating equipment.)	8	10
	Telecommunication equipment	10	8
3	Transport equipment:		
	Buses	6	13 1/3
	Business service passenger vehicles	6	13 1/3
	Taxis	5	16
	Trucks, lorries, trailers and vans	6	13 1/3
	Motorcycles and bicycles	8	10
4	Electrical equipment (Includes assets such as electrical and industrial apparatus, domestic and commercial appliances, airconditioning and ventilating equipment.)	8	10
5	Electronic equipment (Includes assets such as electronic detection, guidance, control, radiation, computation, test and navigation equipment.)	8	10
6	Materials and passenger handling equipment (Includes assets such as lifts, escalators, weighing machines, conveyor belts, forklifts, lifting gears, trolleys and cranes.)	6	13 1/3
7	Building & construction equipment (Includes assets such as rollers, mixers, piling and drilling plants, loaders, dumpers, excavators, bulldozers and support structure.)	6	13 1/3
8	Fire safety device	10	8
9	Electric, gas, water and steam, utility plant (Includes tanks and generators.)	16	5
10	Wholesale and retail trade service assets (Also includes assets used in such activities as the operation of restaurants and cafes.)	8	10

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		Period for which annual allowances are given (Years)	Rate assuming initial allowance is claimed (Percent)
11	Plant for recreation and amusement purposes (Includes assets used in the provision of entertainment services on payment of a fee or admission charge, as in the operation of bowling alleys, billiard and pool establishments, theatres, cinemas, concert halls, amusement parks, and miniature golf courses.)	10	8
12	Equipment used in personal and professional services (Includes assets used in the provision of personal and professional services which are not elsewhere classified.)	10	8
	Special assets		
13	Aircraft	5	16
14	Bank vaults	16	5
15	Cable cars and equipment	12	6 2/3
16	Containers	10	8
17	Farming equipment	8	10
18	Floating and dry docks	16	5
19	Gas cylinders	16	5
20	Motion picture films	5	16
21	Musical instruments and other related assets	10	8
22	Railway wagons, lines and related equipment	16	5
23	Cables and related assets	16	5
24	Vessels, barges, tugs and similar water transportation equipment	16	5

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APPENDIX II: PROPOSED REDUCTION IN INDIVIDUAL INCOME TAX

Chargeable income group	Existing rates %	Proposed rates %	Average tax paid $	Average reduction in tax $	Average reduction in tax %	Effective tax rate at end points %	Effective tax rate at end points %
1 - 2,500	5	4	63.30	12.60	19.9	5.0	4.0
2,501 - 5,000	8	7	216.40	36.20	16.8	6.5	5.5
5,001 - 7,500	10	9	443.40	61.30	13.8	7.7	6.7
7,501 - 10,000	12	11	723.60	86.50	12.0	8.8	7.8
10,001 - 15,000	15	14	1,220.70	121.80	10.0	10.8	9.8
15,001 - 20,000	20	17	2,107.90	219.80	10.4	13.1	11.6
20,001 - 25,000	25	21	3,253.90	395.10	12.1	15.5	13.5
25,001 - 35,000	30	26	5,183.70	674.80	13.0	19.6	17.1
35,001 - 50,000	35	32	9,189,00	1,096.30	11.9	24.3	21.6
50,001 - 75,000	40	34	16,218.40	1,964.00	12.1	29.5	25.7
75,001 - 100,000	40	36	26,372.40	3,266.00	12.4	32.1	28.3
100,001 - 200,000	45	40	45,625.00	5,469.50	12.0	38.6	34.1
200,001 - 400,000	50	45	109,703.90	12,107.90	11.0	44.3	39.6
400,001 - 600,000	55	50	219,938.70	22,759.30	10.3	47.9	43.0
> 600,000	55	55	423,798.20	28,850.00	6.8	–	–

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From other parts of the Budget Speech

DEVELOPMENT OF FOREIGN TRADE

The Trade Development Section in the Department of Trade will continue to carry out the task of trade development effectively. We will expand and revitalise the Commercial Secretary Service. We will set up two new trade offices, in the E.E.C., in addition to the existing four. We have signed a trade agreement with China at the end of last year, and are discussing the setting up of trade offices in China. We will consider the setting up of a computerised trade information system to provide trade and commercial data. We will continue our support, including fiscal incentives for local manufacturers to participate in overseas trade fairs and missions. The double tax deduction scheme will be extended to cover overseas marketing campaigns. Through the tax incentives for international trading companies, we will encourage the formation of multi-activity international trading companies to push the export of Singapore manufactured products in overseas markets. The Trade Development Committee with private sector representation has been meeting to discuss trade problems and prospects. It should continue to do so and perform an effective role as an advisory committee to the Department of Trade.

ECONOMIC POLICY: CONCLUDING REMARKS

In the Budget Statement last year, I remarked that the world in 1979 looked like becoming a more difficult place to make a living in. I was not wrong in my assessment. But, happily, Singaporeans responded with an extra spurt. We ended 1979 with a performance better than 1978's. The world in the 1980s, including 1980, does not look like a bed of roses either. But there is a streak in the Singaporeans that gives us confidence, and that is, they dare to achieve. Our job as a government is to set out our objectives, direction and modus operandi clearly and unequivocally, and lead. The rest is up to Singaporeans to achieve and excel.

It is this quality in Singaporeans, to compete and excel, that gives confidence of success in further liberalization of the economy as we restructure.

In the latter part of the Sixties, we began to shift away from import-substitution industries. We recognised that a policy of import-substitution behind tariff walls will at best give us short-term gains but will stifle our growth in the longer term. Protected industries, sheltered from competitive pressures, will become inefficient and stunted in their growth potential. Moreover, as we depend on the world markets for large scale expansion of manufacturing activities, our products must be internationally competitive. This cannot be achieved with tariff protection.

We therefore stopped introducing new protective duties around 1968. In 1973 and 1977 we removed a wide range of protective duties. Last year, we announced that the protection of locally assembled motor vehicles will cease from 1st August 1980. Nevertheless, there are still a number of protective tariffs remaining. These duties have been in existence for more than a decade. The protected industries should have grown into adulthood by now. If not, they will never mature.

Singpore practises what it preaches. We preach free trade and open competition. We shall, therefore, remove all protective duties other than those included in the ASEAN Preferential Trading Arrangement (PTA), most immediately, some in phases. Details of these tariff removals or reductions will be gazetted by the Ministry of Finance separately.

We have offered our ASEAN partners preferential tariffs on a number of items under the ASEAN Preferential Trading Arrangement. These duties will have to remain as we have to fulfil our commitments. The level of these duties, however, will be reduced as we progress in the ASEAN PTA exercise.

Mr. Speaker, Sir, I have included the discussion of protective duties in my Concluding Remarks instead of in the main body on Development Strategies because our action to remove tariff protection has an impact wider than the direct effect on the industries concerned. Our action removes the last vestiges of protectionism in the pursuit of an open, competitive economy wedded to the world's fortunes. It is an act of confidence.

IFA NEWS

British Branch

On January 8, 1980 the British Branch of IFA held a "Tax Workshop" whose main theme was "The limits of tax avoidance". Speakers were Mr. Alun G. Davies and Dr. Barry Bracewell-Milnes who were so kind as to submit their papers for publication by the International Bureau of Fiscal Documentation. These papers appeared in the January 1980 issue of EUROPEAN TAXATION.

The next "Tax Workshop" was held on March 6, 1980 and dealt with "Exchanges of information and extra-territorial claims by the Revenue Authorities". Speakers were Mr. Arthur Johnstone and Mr. John Reynolds.

The newly formed Manchester Branch of the British IFA met on March 20, 1980 where Mr. Joel Barnett spoke on "Treasury Ministers and the Inland Revenue — decision making".

Anglo-U.S. Seminar, New York

On May 8-9, 1980 a joint British-U.S. international tax seminar will be held in New York. The draft program shows that subjects to be discussed are, inter alia, the British Advance Corporation Tax and withholding taxes under the new U.K.-U.S. tax treaty; unitary taxation in the United States; employee problems; investments in the United Kingdom and the United States and interpretation of statutes and ruling procedures.

35th IFA Congress in West Berlin: New dates

Due to unforeseen circumstances the organisers of the 1981 IFA Congress in West Berlin had to change the earlier announced dates. The Congress will now be held from September 21 through 25, 1981.

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TAXATION AND ECONOMIC BEHAVIOR:

A Review of Recent Literature

By Nizar Jetha *

Empirical research, including econometric, is indispensable for assessing economic effects of taxation. Theory is frequently inconclusive, and at best, can only identify the relevant factors, whose relative strengths must then be determined by other methods. Empirical research has formed an integral part of recent developments in public finance. This paper reviews some recent research on the effects of taxation on labor supply, saving and risk taking. The emphasis will be on the kind of questions that are being asked and the tentative conclusions that have emerged rather than on theoretical underpinnings of hypotheses and problems of statistical methodology. [1] *All evidence considered here relates to the United States.*

SUPPLY OF LABOR

Theory provides a clear-cut framework for studying the effect of a change in wage rate on labor supply. Consider a reduction in the wage rate. This would make leisure more attractive in relation to work, thereby inducing an individual to increase his consumption of leisure (or equivalently, to reduce his supply of labor). On the other hand, the loss of income due to lower wages would induce the individual to reduce the consumption of leisure (or equivalently, to increase his supply of labor). These effects are known as *substitution* and *income effects*, respectively. The former captures, in the present context, the response of labor supply to a change in relative prices (wage rate) with utility (or income) held constant, while the latter captures the response to a change in income with relative prices held constant. The total effect of a change in wage rate on labor supply will be given by the sum of substitution and income effects. The former will be positive since a change in wage rate (with income constant) will induce a change in labor supply in the same direction; the latter will normally be negative since a change in income (with wage rate constant) will tend to induce a change in labor supply in the opposite direction. The total effect would, therefore, depend on the relative strengths of a positive substitution effect and a negative income effect.

Empirical studies express total and substitution effects in the form of elasticities. The total (uncompensated) elasticity is derived from the total effect while the substitution (compensated) elasticity is derived from the substitution effect. [2] Assessment of the supply responses of factors to changes in their rewards, which is the subject of this paper, requires knowledge of uncompensated elasticities. However, in other problems in public finance, such as those concerned with the welfare implications of distortions in resource allocation, the relevant elasticity is the compensated elasticity since economic efficiency is a function solely of relative prices.

In practice, it has proved difficult to disentangle income and substitution effects. One of the first studies that tried to do this is by Kosters. [3] The study included an analysis of the effects of wage rates on the labor supplied by married males aged 50-64 years. The labor supply was defined alternately as the number of hours worked per week and year. An equation that gave right signs for all coefficients implied an uncompensated wage rate elasticity of -0.09 and a compensated wage rate elasticity of +0.04. The total elasticity is relatively low, but its negative sign suggests a backward sloping supply curve of labor (that is, hours of work vary inversely with the wage rate). This finding has been frequently confirmed for males. It should be stressed, however, that the study did not explicity allow for the effects of taxation.

Since married women often work primarily to supplement family income and since the marginal tax rates applied to their earnings depend on their husbands' earnings, tax considerations can be expected to be an important determinant of the labor supplied by married women. To test whether the number of hours worked

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1. Two excellent surveys on the economic effects of taxation, but of a different kind from the present one, will be found in George F. Break, "The Incidence and Economic Effects of Taxation" in A. Blinder *et al.*, *The Economics of Public Finance* (The Brookings Institution, 1974), and Michael J. Boskin, "On Some Recent Econometric Research in Public Finance," *American Economic Review*, May 1976.

2. The effect of a change in wage rate on labor supply can be represented mathematically as follows:

$$\frac{\partial L}{\partial W} = \left(\frac{\partial L}{\partial W}\right)_{\text{utility = constant}} + L\,\frac{\partial L}{\partial Y}$$

where L = labor supply, W = wage rate and Y = income. The expression on the left is the total effect, and the first and second terms on the right represent substitution and income effects, respectively. Multiplying both sides of the above equation by W/L gives

$$\frac{W}{L}\frac{\partial L}{\partial W} = \frac{W}{L}\left(\frac{\partial L}{\partial W}\right)_{\text{utility = constant}} + \frac{W}{\partial Y}\frac{\partial L}{\partial Y}$$

where the expression on the left represents the uncompensated elasticity of labor supply and the first term on the right the compensated elasticity of labor supply. For a general derivation of income and substitution effects and their interpretation, see James M. Henderson and Richard E. Quandt, *Microeconomic Theory: A Mathematical Approach* (Second Edition, McGraw-Hill, 1971).

3. Marvin Kosters, "Effects of an Income Tax on Labor Supply," in A. Harberger and M. Bailey (eds.), *The Taxation of Income from Capital* (The Brookings Institution, 1969).

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by women depend on gross or net of tax wages, Rosen [4] estimated the following model:

$$HOURSj = A_1 (1 - ptj) WAGEj + \sum_{i=1}^{n} BiXij$$

where HOURSj = the jth married woman's hours of work, WAGEj = her gross wage, tj = her marginal tax rate, Xij = all other relevant factors (e.g. number of young children, other family income, etc.) and p = a parameter of tax perception. It is clear that p = 0 would imply that individuals react to gross wages, whereas p = 1 would imply that they react to net wages. An estimate of p of close to 1 was found, suggesting that the tax structure does indeed have an effect on the labor supply of married women. The results of the study imply an elasticity of supply for married women (working half time) of between 1.3 and 1.9. [5]

Evidence of a different kind concerning the impact of taxation on work effort has come from negative income tax experiments. One of the first such experiments was carried out in New Jersey. [6] The experiment involved payments of income subsidies (ranging from 50-125 percent of poverty line) to low-income families, and the imposition of tax rates of 30-70 percent on the other income of those families. Since the working poor simultaneously faced higher marginal tax rates (lower net wages) and an income subsidy, both substitution and income effects could be expected to reduce the amount of work supplied. A substantial decline in the labor supply of the participants was, therefore, expected. The evidence, however, did not bear this out; there was only a small (five to six percent) reduction in average hours worked by the male heads of families who received negative income tax payments.

Thus, contrary to popular notions which attribute to taxation substantial disincentives to work, empirical evidence is often inconclusive or reveals only modest disincentive effects (for males). While taxpayers will tend to exaggerate the impact of taxation, part of the discrepancy between the taxpayers' perceptions and empirical evidence may be due to the difficulties of capturing the complexity of the process of work decisions within a family in a model, and of measuring the supply of labor. The latter needs some elaboration. Measuring labor supply by the number of hours worked, either weekly or annually, may not reveal much about the disincentive effects of taxation where institutional factors preclude the variation in work hours by a large proportion of the labor force. In such a situation, the disincentive effects are likely to be reflected in reduced intensity of work, lesser willingness to change jobs and other kinds of work behavior. Empirical studies may have, therefore, seriously underestimated the effects of taxation on work effort by concentrating on the hours worked. Quantification of the other ways in which disincentives may manifest themselves is, however, easier said than done.

SUPPLY OF SAVING

Theory cannot tell us even the sign of the substitution effect where the response of saving to a change in the rate of interest is concerned. All that the theory predicts is that an increase in the rate of interest (that is, a decline in the price of future consumption in terms of the present consumption forgone) would induce an individual to demand a higher *quantity* of future consumption. But current saving is the *expenditure* on future consumption. This need not necessarily increase when the price at which future consumption may be purchased declines, since a higher quantity of future consumption may now be purchased with the previous level of saving. [7]

The view that interest rates have little, if any, effect on private (personal plus corporate) saving is widely held. The historical stability of the gross private saving rate (GPSR), [8] defined as gross private saving as a proportion of GNP, [9] and the failure of most studies to find a significant interest elasticity of saving are responsible for this view. The absence of a trend in the GPSR has become known as "Denison's Law" and has been given various behavioral interpretations.

Among the first studies to find a substantial interest elasticity of private saving is the one by Wright. [10] Working with consumption, rather than directly with saving, the study estimated a consumption function of the form:

$$C = a + bY + cW + dr$$

where C = consumption, Y = expected income [11] W = net worth and r = net of tax return on corporate bonds. [12] The consumption, income and net worth variables are defined in per capita terms to allow for the effect of population growth. The study found interest elasticities of saving [13] ranging from 0.18 to 0.27. [14]

4. H. Rosen, "Tax Illusion and the Labor Supply of Married Women, " *The Review of Economics and Statistics*, May 1976.
5. The study is based on a sample in which a large proportion of women were not part of the labor force. Furthermore, the particular statistical specification used implies that the number of hours worked does not affect the hourly wage rate. These considerations need to be borne in mind in interpreting the results.
6. Joseph A. Pechman and P. Michael Timpane (eds.), *Work Incentives and Income Guarantees, The New Jersey Negative Income Tax Experiment* (The Brookings Institution, 1975).
7. Martin Feldstein, "The Rate of Return, Taxation and Personal Savings," *The Economic Journal*, September 1978.
8. Paul David and John L. Scadding, "Private Saving: Ultrarationality, Aggregation and 'Denison's Law'", *Journal of Political Economy*, March/April 1974.
9. In this connection, saving is defined as gross private saving plus consumer expenditure on durables; and GNP correspondingly includes imputed annual income from consumer durables.
10. Colin Wright, "Saving and the Rate of Interest," in A. Harberger and M. Bailey (eds.), *Taxation of Income from Capital* (The Brookings Institution, 1969).
11. Expected income is normally derived as a function of past incomes.
12. Difficulties associated with the choice of an appropriate rate of return on capital will not be considered here.
13. The national accounting identity, C = Y—S, where C = consumption, Y = income and S = saving, implies that $\frac{\partial C}{\partial r} = -\frac{\partial S}{\partial r}$

The interest elasticity of saving, $\frac{r}{S}\frac{\partial S}{\partial r}$, can, therefore, be derived from $\frac{\partial C}{\partial r}$, the estimated coefficient of r in the consumption function.
14. These appear to be compensated elasticities.

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In an important recent contribution, Boskin has criticized behavioral interpretations of Denison's law and has extended Wright's research. [15] Expressing GPSR as:

$$GSPR = \frac{GPS}{GNP} = \frac{GPS}{DPI} \times \frac{DPI}{GNP}$$

where GPS = gross private saving and DPI = disposable private income, he notes that since DPI/GNP has fallen substantially due to growth of taxation, the constancy in GPSR must be due to a substantial increase in gross private saving out of disposable private income. Taking account of this observation, his direct test of the responsiveness of saving to the rate of interest consists of estimation of functions of the form:

$$\ln Ct = a + b \ln DPIt + c \ln DPIt - 1 + d \ln Wt - 1 + e \ln Ut + f Rt$$

where Ct = per capita private consumption, DPIt = per capita private disposable income, Wt = per capita wealth at the end of period t, Ut = the rate of unemployment, Rt = the real after-tax return on capital, and ln represents natural logarithms. This study finds an elasticity (uncompensated) of private saving with respect to the real net of tax rate of interest of 0.4, which is much higher than previous estimates. An elasticity of this magnitude is significant for policy purposes since it implies, for instance, that an increase in the real after-tax return from 4 percent to 5 percent could be expected to raise the gross private saving rate from 20 percent to 22 percent.

Although Boskin's work deals with taxation and inflation more carefully than previous studies, criticism of his work has centered on his derivation of the expected real after-tax rate of return. [16] This is not altogether surprising in view of the difficulties of specifying expectations concerning interest rates and inflation in a completely satisfactory way. While Boskin's results remain controversial, his work has prompted further research on the relationship between private saving and rate of interest.

A sizable proportion of private saving takes the form of corporate retained earnings, contributions to pension schemes and private housing. The high degree of aggregation involved in studies of total private saving results in a neglect of institutional factors affecting the composition of saving. The aggregative consumption and saving functions also mask the interrelationship between different forms of private saving. The relationship between corporate and private savings is particularly important because the tax structure provides substantial encouragement to the retention of corporate earnings. Does the higher corporate saving induced by tax incentives raise the rate of private saving or is it offset by lower personal saving? A similar question may be asked concerning social security. Do social security contributions raise overall saving or are they treated as a substitute for personal saving? Questions of this kind have received growing attention, but no unambiguous conclusions have so far emerged.

Feldstein has examined the relationship between corporate and personal saving by postulating that real accrued capital gains due to retained earnings are likely to be of a more permanent nature and consequently could be expected to exercise a stronger effect on consumption than those arising from a revaluation of existing assets. [17] However, lacking separate data on these two components of real accrued gains, he estimated models of the following form:

$$Ct = a + bYt + cWt - 1 + dGt + eREt$$

where Ct = consumption expenditure, Yt = disposable income, Wt = the stock of wealth at the end of period t, Gt = accrued capital gains and REt = retained earnings, all defined in per capita terms. With this specification, the coefficient of retained earnings represents the excess effect of retained earnings over capital gains in general. The coefficient of accrued gains was found to be small, but the marginal propensity to consume retained earnings (e) amounted to about two-thirds of the long-term marginal propensity to consume disposable income, implying that higher corporate saving will tend to be largely offset by lower personal saving, leaving private saving unchanged.

This conclusion has been questioned in a recent paper by Bhatia. [18] Bhatia contends that Feldstein's aggregative method of calculating accrued gains — that of deducting personal saving from changes in household wealth — gives unreliable figures. Instead, he derives accrued gains more directly by aggregating accrued gains on major household assets (corporate stock, nonfarm real estate and some farm assets). Using the series on accrued gains thus computed did not give significant coefficients either for accrued gains or retained earnings. This suggests that corporate saving has no effect on personal saving, except through expected capital gains which are treated as additions to their wealth by households. The effect of wealth on consumption tends to be relatively weak, however.

Social security will have two countervailing effects on personal saving. The availability of benefits during retirement will tend to reduce private saving in the working years. At the same time, by encouraging early retirement, social security will induce greater private saving since provision must be made for a longer retirement period. To determine the net effect of these tendencies on personal saving, Feldstein has employed a model similar to that used for assessing the relationship between corporate and personal saving. [19] The model is of the form:

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15. Micheal J. Boskin, "Taxation, Saving and the Rate of Interest," *Journal of Political Economy*, April 1979 (Part 2).
16. E. Philip Howrey and Saul H. Hymans, "The Measurement and Determination of Loanable Funds Saving," *Brookings Papers on Economic Activity*, 3:1978.
17. Martin Feldstein, "Tax Incentives, Corporate Saving, and Capital Accumulation in the United States," *Journal of Public Economics*, April 1973.
18. Kul B. Bhatia, "Corporate Taxation, Retained Earnings and Capital Formation," *Journal of Public Economics*, February 1979.
19. Martin Feldstein. "Social Security, Induced Retirement, and Aggregate Capital Accumulation," *Journal of Political Economy*, September/October 1974, and "Social Security and Saving: The Extended Life Cycle Theory," *American Economic Review*, May 1976.

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$$Ct = a + bYt + cWt—1 + dSSWt$$

where Ct = consumption expenditure, Yt = disposable personal income, Wt = net worth at the end of period t, and SSWt = gross social security wealth ("the present value in year t of the retirement benefits which could eventually be claimed by all those who are either in the labor force or already retired in year t"). All variables are in per capita terms. The main conclusion of the study is that social security reduces private saving by at least 30 percent. Feldstein has found further support for his conclusion from research based on cross-section data. [20] Other studies have, however, found the effect of social security on personal saving to be much lower [21] or indeterminate. [22]

Should further research confirm Feldstein's findings, its implications for the present social security arrangements would require careful consideration. Reduced private saving due to social security would be of no consequence if it were offset by increased public saving. In a funded social security scheme with an accumulated reserve fund, a decline in private saving would be at least partially offset by an increase in public saving. However, in the pay-as-you-go social security system of the United States, where contributions are almost wholly paid out as benefits, lower private saving would not be compensated by higher public saving. A decline in private saving would, therefore, reduce overall national savings. This possible effect is viewed with concern by those who believe that a higher rate of capital accumulation would be desirable.

PORTFOLIO COMPOSITION

The effect of taxation on risk taking is also theoretically inconclusive. A pioneering study of this subject showed that a proportional income tax on total income (including capital gains) would encourage greater risk taking (that is, a shift to a portfolio that is characterized by a higher expected yield as well as greater uncertainty concerning the realization of that yield) provided that capital losses could be fully offset against other income. [23] This conclusion was confirmed in a more modern theoretical framework based on expected utility. [24] The reason for this counter-intuitive result is that a proportional income tax reduces both yield and risk in the same proportion. In this situation, an individual will wish to obtain the same combination of yield and risk as in the pre-tax situation but, to obtain that combination in the presence of the tax, the proportion of assets held in the risky asset would have to be increased. This analysis depends critically on the existence of a riskless asset with no yield, a requirement that will not be fulfilled in a world of uncertain inflation rates. Later work has shown, however, that no statement concerning the impact of taxation on risk taking can be made in a completely general framework. [25] To discover the effect of taxation on portfolio composition, one must, therefore, turn to empirical analyses.

The first econometric study on the effect of taxation on portfolio composition was undertaken by Feldstein. [26] The study examined the influence of the tax structure on the holdings of financial assets such as common stock, preferred stock, municipal bonds, savings bonds, other bonds and bank accounts. Utilizing household data, Feldstein estimated functions of the form:

$$Pji = f \text{ (tax class, wealth class, age, sex, human capital/nonhuman capital)}$$

where Pji = proportion of the ith individual's portfolio held in assets of type j. The study's most striking conclusion is that the proportion of portfolio held in common stock increases substantially with marginal tax rates (and income). The share of common stock in the portfolio was found to increase by over 30 percent from the lowest tax bracket to the highest.

The effect of taxation on relative net yields realized on different assets by each individual provides the main explanation for this result. While all individuals will receive identical gross yields, the relative net yields received by different individuals will vary due to differences in marginal tax rates and special features of the tax system. The main stimulus to the demand for equities comes from the fact that, largely due to the preferential treatment of capital gains, relative net yields on common stock increase with income. Thus, the strong positive association between high tax rates and holdings of common stock, while suggestive, does not imply that high marginal rates of tax *per se* encourage investment in common stock and other risky assets. Further research to clarify the relationship between taxation and risk taking is clearly needed.

In another article, Feldstein and Yitzhaki have examined the effect of capital gains tax on sales of common stock. [27] Two types of transactions are distinguished: "switching", where sales of common stock are followed

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20. Martin Feldstein, "Social Security and Private Savings: International Evidence in an Extended Life-Cycle Model," in Martin Feldstein and Robert P. Inman (eds.), *The Economics of Public Services* (Macmillan, 1977), and Martin Feldstein and Anthony Pellechio, "Social Security and Household Wealth Accumulation: New Macroeconometric Evidence," *Review of Economics and Statistics*, August 1979.
21. Alicia H. Munnell, *The Future of Social Security* (The Brookings Institution, 1977).
22. Robert J. Barro, *The Impact of Social Security on Private Saving* (American Enterprise Institute, Washington, D.C., 1978); Robert J. Barro and Glenn M. MacDonald, "Social Security and Consumer Spending in an International Cross Section," *Journal of Public Economics*, June 1979; and Louis Esposito, "Effect of Social Security on Saving: Review of Studies Using U.S. Time Series Data," *Social Security Buletin*, May 1978.
23. Evsey D. Domar and Richard A. Musgrave, "Proportional Income Taxation and Risk Taking", *Quarterly Journal of Economics*, May 1944.
24. J. Tobin, "Liquidity Preference as Behaviour Towards Risk," *Review of Economic Studies*, February 1958.
25. Martin Feldstein, "The Effects of Taxation on Risk Taking," *Journal of Political Economy*, September 1969.
26. Martin Feldstein, "Personal Taxation and Portfolio Composition: An Econometric Analysis," *Econometrica*, July 1976.
27. Martin Feldstein and Shlomo Yitzhaki, 'The Effects of the Capital Gains Tax on the Selling and Switching of Common Stock," *Journal of Public Economics*, February 1978.

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by purchases of different stock, and "net sales", where proceeds from sales of common stock are not reinvested. Household data are utilized to explain the ratio of "switches" to the value of common stock holding, as follows:

$$\frac{\text{Value of switches of common stock}}{\text{Value of common stockholding}} = f\,(\text{capital gains tax rate, age, value of stock holdings, income class})$$

The results, based on a marginal rate of capital gains tax of 15 percent, suggest that "switches" would have been over three times larger (than they were) in the absence of the capital gains tax. The evidence, thus, supports the conjecture that the taxation of capital gains on a realization basis, by permitting the postponement of the tax until assets are sold, significantly discourages stock sales for the purpose of portfolio reallocation. As is to be expected, tax considerations were not found to be important in decisions concerning "net sales".

CONCLUDING REMARKS

The inconclusiveness of many studies and the simplicity of statistical specifications stand out. As more data become available, hypotheses and econometric techniques of greater sophistication can be expected to be utilized. Nonetheless, the recent studies, with their careful examination of the old questions and formulation of new ones, are bound to influence the direction of future empirical research on the impact of taxation on economic behavior.

United States ~ Netherlands Antilles

Revenue Ruling 80-4: Foreign tax credit

A payment to the Netherlands Antilles pursuant to the election described in Rev. Rul. 65-16 is a payment made pursuant to a legal liability for purposes of Sec. 901(b) of the Code; Rev. Rul. 65-16 amplified.

Issue. Is a payment to the Netherlands Antilles pursuant to the election described in Rev. Rul. 65-16, 1965-1 C.B. 626, a payment made pursuant to a legal liability for purposes of the foreign tax credit provided in section 901(b) of the Internal Revenue Code?

Law. Rev. Rul. 65-16 holds that a Netherlands Antilles corporation electing to be taxed under Article 8A of the National Ordinance on Profit Tax of 1940 of the Netherlands Antilles, as added by the National Ordinance of December 30, 1963, may be entitled to the tax benefits that are accorded by Articles VII, VIII, and IX of the United States-Netherlands Income Tax Convention, 1950-1 C.B. 92, as extended to the Netherlands Antilles, 1956-2 C.B. 1116.

Section 901(b) of the Code generally allows qualifying United States taxpayers to claim a foreign tax credit for the amount of any income taxes paid or accrued during the taxable year to any foreign country subject to certain limitations.

Section 902(a) of the Code provides generally that domestic corporations owning at least 10 percent of the stock of a foreign corporation from which it receives dividends paid out of accumulated profits shall be deemed to have paid a certain portion of any creditable foreign income tax paid or deemed to have been paid by such foreign corporation on or with respect to such accumulated profits.

For purposes of claiming a credit under section 901(b) of the Code for the payment or accrual of an amount to a foreign government, such payment or accrual must constitute a tax liability to the foreign government. *See* Rev. Rul. 76-215, 1976-1 C.B. 194. Only the taxpayer liable for the tax may claim a credit under section 901 and only in the amount for which the taxpayer is liable. *See* Rev. Ruls. 72-370, 1972-2 C.B. 437 and 59-101, 1959-1 C.B. 189. When a credit is being claimed pursuant to section 902(a) by a domestic parent corporation for amounts paid or accrued to a foreign government by its foreign subsidiary, such amounts must also constitute a tax liability to the foreign government. A payment of an amount to a foreign government that is not made pursuant to a legal tax liability could be a contribution to such government rather than a payment of a tax. *See* Rev. Rul. 76-508, 1976-2 C.B. 225.

Holding. A payment to the Netherlands Antilles pursuant to the election described in Rev. Rul. 65-16 will be considered a payment made pursuant to a legal liability for purposes of the foreign tax credit provided in section 901(b) of the Code under the United States-Netherlands Income Tax Convention as extended to the Netherlands Antilles.

Effect on Other Revenue Rulings. Rev. Rul. 65-16 is amplified.

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UNITED KINGDOM BUDGET 1980

New Medium-term Strategy

Extracts from the Budget Speech which was pronounced on March 26, 1980 by the Chancellor of the Exchequer, Sir Geoffrey Howe.

The tax measures relate to: high pay settlements — high oil prices — high exchange rate.

The tax measures which I am about to announce are consistent with the medium-term strategy and the overall budgetary framework. They also take account of the changes in the balance of the economy which have come about over the last year.

Many are made necessary only by the impact of inflation upon the tax system. One of the many reasons why we need to master inflation — though not perhaps the most important — is that it would enable Chancellors to make much shorter Budget speeches.

Three developments in particular have influenced me: high pay settlements, high oil prices, and the high exchange rate.

Together, these developments have swung the balance strongly in favour of consumers and against companies, in particular against those companies facing competition from overseas, whether in home or overseas markets.

Consumers have lost something as a result of the increase in oil prices. But the great majority have more than made up for this by big pay increases and the benefit they have received from income tax cuts, the high exchange rate and lower prices for imported manufactures.

In 1979, average personal after-tax incomes increased by 20 percent, while the profits of companies not engaged in North Sea operations fell by over 5 percent in money terms, and of course by much more in real terms.

In deciding the balance of my tax changes, I see a stronger case for reducing the real burdens on companies and small businesses than on private individuals.

Of course, not all companies have lost out. The oil companies are making large windfall profits. The banks are gaining from high interest rates. Some of these are in a position to contribute more by ways of taxation.

The financial position of most sections of business will be eased as interest rates come down.

So far as tax changes are concerned, I shall concentrate the limited funds available to me on encouraging enterprise and on relieving specific pressures which are particularly damaging or unfair.

PETROLEUM REVENUE TAX UP

The Government's objective in taxing North Sea oil operations must be to strike a balance between the nation's claim to a share in the profits from this national resource, and the right of those engaged in the risky business of oil exploration and development to a fair return on their efforts.

Since my last Budget, world oil prices have increased dramatically. North Sea oil prices, which follow world prices, have risen by more than half from about $20.70 to some $33.75 a barrel.

This substantial change has greatly favoured the oil companies. I propose, therefore, for chargeable periods ending on 30th June next and subsequent periods, to increase the rate of Petroleum Revenue Tax from 60 percent to 70 percent.

At the same time, I propose to rectify some anomalies in the PRT rules concerning transfers of North Sea interests between oil companies, and the taxation of gas. These are changes which the industry has requested.

I also propose to introduce special PRT provisions for fields which span the median line between the UK and the Norwegian Continental Shelves.

I have one further proposal on Petroleum Revenue Tax. It relates to the collection of tax. The PRT structure gives companies very early relief for capital expenditure. This means that PRT is not collected until some considerable time after a field has come on stream.

The increases in oil prices have greatly strengthened the industry's cash position. I am satisfied that PRT payments can in future be made somewhat earlier. The Petroleum Revenue Tax Act, 1980, went some way in this direction. I now propose to go slightly further. We shall require companies which are liable to PRT for the chargeable period to June 30, 1981, to make at the beginning of March 1981 an advance payment for that chargeable period at a rate of 15 percent based on 1980 liabilities.

Advance payments for later chargeable periods will be made in the same way but not necessarily at the same rate. These advance payments will be offsettable against normal payments of PRT.

In total the changes in oil company taxation are expected to bring in an extra £535m, making a total of Petroleum Revenue Tax, Corporation Tax and royalties for 1980-81 of rather over £4bn. We are thus ensuring that the nation as a whole secures a proper share of North Sea profits this year.

North Sea oil adds to national income mainly through increased Government revenues and oil company profits. Though the sums of money are large, we must not exaggerate them.

Even in the years of peak production later this decade, no more than 6 percent of GNP is expected to come from the North Sea,equivalent to perhaps two years of the kind of economic growth we achieved in the 1950s and 1960s.

This makes it all the more important that we should use the oil wisely, with an eye to our long-term economic interests.

In particular, we should take the opportunity offered by the growth of oil revenues to bring the level of public sector borrowing steadily down, and this is what our medium-term strategy envisages.

BANKS: WINDFALL PROFITS

In recent weeks there has been a good deal

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of comment about the profits declared by the clearing banks. Some represent a "windfall" to the banks, which arises from the combination of high interest rates and the fact that interest is not paid on current accounts.

The windfall element is not a sign of enterprise or efficiency, as the banks themselves recognise. But it is equally irrational to attribute these profits to some wickedness on the part of the banks.

They need the major part to strengthen their capital base, which would otherwise have been eroded by inflation.

There could, of course, be a case in principle for a special tax related to the windfall element in these profits, and I shall be considering this further. However, it has not yet been established that such a tax is either practical or entirely desirable in today's conditions.

Leasing, in which the banks have been heavily involved, has grown rapidly in the past few years. Underlying this growth has been the 100 percent capital allowance, which leasing companies can claim on assets bought for leasing.

The present rules apply to equipment leased to UK industrial and commercial companies, which would qualify in their own right for these tax incentives if they were to purchase the equipment for themselves.

I do not propose any changes in transactions of this kind. Leasing finance of this sort has become an important — in many cases an essential — source of finance for investment in manufacturing industry. Under the present tax rules, however, these 100 percent allowances apply to all leased equipment.

Thus leasing effectively extends the benefits of tax incentives to certain users — such as overseas companies, certain public bodies in the U.K., and consumers — who would not qualify for tax incentives if they had purchased the equipment themselves. I propose to end these anomalies.

As from June 1 expenditure on leasing involving these users will normally qualify only for 25 percent tax allowances.

There will be transitional provisions for leased television sets. Though the extra revenue in 1980-81 will be negligible, the saving in a full year will be over £200m.

These provisions will replace, from June 1, the stopgap provision for foreign leasing which I proposed on October 23, when announcing the abolition of exchange control. They will also include measures to end the growing abuse of leasing by individuals for tax avoidance purposes.

However the Motability Scheme for leasing cars to disabled people will continue to benefit from the existing provisions.

COMPANY LIQUIDITY

I have already referred to the difficult problems that many companies will be facing in the coming year, with great pressure on their liquidity. I have considered how far it would make sense for the Government to help them by major tax reductions.

Such help could only be provided at the expense of much higher personal taxation or higher borrowing and thus higher interest rates.

I believe that the greatest service which I can perform for business is to reduce the burden of financing the public sector and thus to get interest rates down. I have, therefore, given precedence to this objective.

However, there is, as I observed last June, a clear need to re-examine the corporate tax structure. I have already undertaken that there will be full consultations before changes are made. I understand that the accountancy profession will be publishing their new standard on current cost accounting later this month. We will, therefore, publish a Green Paper later this year, reporting the results of our general review of the present corporation tax provisions.

Meanwhile, I do not think that it would be right to change the rate of corporation tax or to make major changes in its structure. But I do propose one important concession to help companies which face a particular difficulty.

A number of businesses in manufacturing, and certain areas of distribution, are concerned about the recovery charges which they will face as a result of reductions in stock levels likely to arise either because of the general pressure on liquidity, or in some cases as a result of the steel strike.

I propose, therefore, to allow a substantial part of the stock relief recovery charge consequent on a reduction of stocks to be deferred for one year.

This change will be subject to certain conditions dependent on the extent to which stocks are financed on trade credit.

The new relief will be given for business accounts ending after 1979-80. The cost is estimated at £210m in 1980-81 and a further £125m in 1981-82.

While further relief is justified in the cases to which I have referred, there is criticism that the present stock relief may confer an unjustifiable advantage in certain circumstances.

This is a complex matter on which detailed consultation will be needed, but my intention is to legislate next year in respect of the tax payable generally on January 1, 1982. This will give enough time for consultation.

I propose another modest measure affecting business taxation. I intend to provide relief for redundancy payments in excess of the statutory minimum paid when a business stops trading.

VAT, MINOR CHANGES ONLY

I turn now from companies to my other proposals for finding extra revenue. I begin with the indirect taxes.

Last June, I took an important step in implementing a change in the tax structure that everyone knew to be necessary. I carried out a substantial switch in the balance of taxation from direct to indirect taxes.

I do not intend to go further in that direction this year. But I do intend to ensure that the real yield of indirect taxation is not eroded. Inflation can all too easily have that effect.

First, I shall deal with Value Added Tax. Without the extra revenue from last June's Budget changes it would have been quite impossible this year for any Government to avoid either much larger cuts in public spending or big increases in income tax.

This is the first year in which the full yield of the 15 percent rate will be available. The yield will be some £12,450m in 1980-81.

I propose no change in the 15 percent standard rate of VAT. I am, however, making a number of technical changes, to ease the administrative burdens borne by small businesses — about which I shall have more to say later.

There have been signs that some large companies may have been delaying their VAT payments to the Exchequer. This must be corrected at the earliest opportunity. Customs and Excise are already taking steps, with my approval and within the existing law, to reduce the attractions of delay.

But more needs to be done. I shall, therefore, be asking the House to raise the maximum penalty for late payment. My proposal is that it should be expressed as a proportion of the tax at stake.

In practice, this will raise the penalty for only the larger companies. For them the

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existing maximum penalty, of £100 plus £10 a day is clearly inadequate.

I also propose to remedy an anomaly in the coverage of VAT. Lubricating and certain oils are currently zero-rated, without any real justification. We shall be laying an Order to charge them at the full rate from Thursday, May 1. This will yield an additional £12m in 1980-81 and £17m in a full year.

I want also to inform the House today of my decision on one of the options for staff savings in the Customs and Excise. Concern has been expressed by a number of my Hon. Friends and by representative business organisations at the possibility that we might withdraw the facility of monthly returns for those VAT traders who are entitled to claim repayments.

I have carefully considered representations about the effect on business cash flow, and I do not intend to pursue this option further.

EXCISE DUTIES UP

This year most of the additional revenue I need from the indirect taxes must come from excise duties. Because they are applied to a physical quantity, the real value of their yield declines in times of inflation. A number of them have not been increased since early 1977 and many have been declining in real value over a much longer period.

Accordingly, taking the duties as a whole, I am proposing increases which will reflect the impact of the last year's inflation and keep the real yield roughly constant.

I start with the duties on alcoholic drinks and tobacco, which were last increased three years ago. I propose from midnight tonight to increase the duties on drinks by amounts which, including VAT, represent about 2p on the price of a typical pint of draught beer, 8p on a bottle of table wine and 50p on a bottle of whisky.

The tobacco duty will be raised with effect from midnight on Friday. Including VAT, the increase will represent 5p on the price of a typical packet of 20 king-size cigarettes.

There will be consequential increases for most other alcoholic drinks and tobacco products, but rather less than the full amount on pipe tobacco.

The increases on alcoholic drinks will yield £273m in 1980-81 and £288m in a full year. The tobacco increases will yield £180m in 1980-81 and £195m in a full year.

Next, betting and gaming. I do not propose any changes in the general betting duty or the pool betting duty. But the Government has been persuaded by some of the criticisms of the present duty on casinos made by the Royal Commission on Gambling.

This duty depends heavily on rateable value. It is not an equitable tax, and the more profitable casinos are seriously undertaxed.

From October 1, therefore, the present duty will be replaced by one related more closely to the profitability of casinos, and designed to produce about two-and-a-half times as much revenue in a full year.

At about the same time, the duty on bingo will be increased from 5 percent to 7.5 percent. Provision will also be made in the Finance Bill for restructuring the duty on gaming machines.

We intend to remove the duty on penny machines, and propose to increase the revenue from the very profitable jackpot machines usually found in clubs. These changes will yield £5m in 1980-81 and £20m in a full year.

NO ABOLITION OF MOTOR VEHICLES TAXATION

I turn now to Vehicle Excise Duty. Our

HIGHLIGHTS OF THE BUDGET PROPOSALS 1980/81

This year's Budget announced by the Chancellor of the Exchequer on March 26, 1980 includes many proposals relating to all fields of taxation. The major proposals are summarised below.

DIRECT TAXES:

Personal income tax

Abolition of the 25 percent rate of tax and raising of thresholds for higher bands of tax.

Raising of the main allowances by around 18 percent.

Corporation tax

The small company rate will fall from 42 to 40 percent.

Petroleum revenue tax

Rise in the rate of PRT from 60 to 70 percent.

An advance payment of the tax will be required for the chargeable period to June 30, 1981 in March 1981 at the rate of 15 percent of the previous year's liability.

Capital taxes

The review of capital taxes promised in last year's Budget has been made but no drastic structural changes were proposed.

Capital transfer tax

The threshold for CTT will be doubled to £50,000.

Capital gains tax

The present £1000 exemption, progressively withdrawn above a certain amount, will be replaced by a straightforward £3000 allowance.

The first £1500 of gains by trusts will be exempt.

Relief will be provided on gains from the sale of a private residence used for residential letting.

The double charge to tax on gifts — CTT and CGT — which may arise on the transfer of such gifts will be removed by allowing the CTT paid to be set off against any subsequent gain on the transfer.

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predecessors announced their intention to abolish the duty on cars and other petrol-driven vehicles. They proposed to make good the revenue loss by increasing the tax on petrol.

As the House will recollect, after carefully reviewing the arguments, we decided that this was not a sensible change to make.

Even if the tax had gone, the need for a vehicle register would have remained. This is essential to the police and for vehicle control. So much of the form-filling would have continued unabated.

We decided it was much better to keep the Vehicle Excise Duty, but to achieve staff savings by streamlining its administration, along the lines which my rt. hon. friend the Minister of Transport has already proposed.

As part of this, he is announcing today that from October, four-monthly licences will be replaced by six-monthly licences. From August a stamp-saving scheme will be introduced to help motorists to budget for payment of this tax.

If the duty is to remain, we would be wrong to allow inflation to go on eroding its real value. Because of doubts about its future, the rates of this duty have remained unchanged since 1977.

I therefore make no apology for proposing increases in the duty on most vehicles of about 20 percent, and on the heaviest lorries of about 30 percent this year. As a result, the annual duty on cars will increase by £10 to £60.

The larger increase on the heaviest lorries will reflect the high road costs which they impose on the community. These changes will produce an estimated additional yield of £240m a year, but will still leave the Vehicle Excise Duty lower in real terms than after the last increase in 1977.

INCENTIVE FOR ELECTRIC VEHICLES

I have one further small change to announce in Vehicle Excise Duty. Electric vehicles at present play only a small part in road transport. But they are much cleaner and quieter than vehicles powered by internal combustion engines, and they could bring big future energy savings.

Because I want to encourage their further development, I propose to abolish Vehicle Excise Duty on them. The cost in 1980-81 will be less than £2m.

In my Budget last June, I stated that there was a continuing case for measures that would help us to conserve oil.

PETROL AND OTHER MOTOR FUELS

The price of petrol in the U.K. remains well below that in any other EEC country. If we are to ensure that our oil resources are not wasted, a duty increase is justified this year.

If we had decided, as the last Government had in mind, to replace VED progressively by higher petrol taxation, I should have been obliged to consider increasing the price of petrol by at least 20p a gallon. That would have been necessary simply to replace the revenue formerly provided by VED.

To match the VED increase I have announced would have taken the figure to 24p a gallon — and higher still, if the present petrol duty were itself maintained in real terms.

Since we are retaining the VED, such large increases are not needed. Instead, I shall be increasing the duty on petrol, from 6 pm tonight by the equivalent, including VAT, of 10p a gallon.

For the last three years the rate of duty on derv has been higher than that on petrol. I have decided that we can no longer justify this differential, which has borne heavily on commercial and industrial users.

Taking account of VAT, the increase in the duty on derv will be about 4p a gallon. This will mean that once again the duties on petrol and derv are the same.

These increases will yield an additional £450m from petrol and £55m from derv in 1980-81, and in a full year.

I also propose to raise the duty on heavy oil, other than derv, by about 0.5p a gallon from 6 pm tonight. This will yield an additional £50m in 1980-81 and in a full year.

I have decided not to increase the duty on burning oil and on domestic paraffin, which are the oils most commonly used in the home.

These VAT and excise duty changes will raise additional revenue of £1,260m in 1980-81 and £1,305m in a full year. They do not imply any real increase in indirect taxes as compared with 1979-80.

The immediate impact effect on the RPI will be just over 1 percent, but in the longer run these excise duty changes, by contributing to the reduction of the budget deficit, will help to ensure that inflation is brought down and stays down.

As I have explained, I do not believe I should be justified in allowing the real costs of motoring and road transport to fall, simply as a result of inflation.

But if it is right in principle for road users to face a constant fiscal burden, it would not be fair to disregard the increasing unreality of the income tax charge levied on those who are partly sheltered from rising costs because they have a company car available for private use.

The scales of benefit charged to income tax have been allowed to fall well behind any reasonable measure of true values. The present figures barely cover the current cost of tax, insurance and maintenance.

This is unfair to individuals who have to bear the full cost of car ownership, not to mention those who cannot afford to run a car at all.

I propose, therefore, to increase by some 20 percent the scale figures which are used for measuring the benefit of a company car for tax purposes. This change will be effective from April 1981.

At the same time, there will be one modest relief. The qualifying annual mileage of business use above which a reduced rate of tax is charged should be reduced from 25,000 to 18,000 miles a year. In the light of our widespread consultations last year, I believe these changes will generally be recognised as fair.

I have also been considering whether I ought to take action to charge tax on the value of petrol provided by employers for private use by their employees. This would present severe administrative problems, both for employers and for the Inland Revenue.

Even so, I shall feel bound to contemplate action next year if the provision of free petrol continues to spread at anything like its present rate.

BENEFITS IN KIND

As the burden of income tax is reduced, I would hope to see a decline in the provision of benefits in kind. It is consistent with that view for me to impose a reasonable charge to income tax on benefits which do remain.

In that spirit, I approach one area this year which has so far escaped the eye of my predecessors. I refer to the provision for employees of items such as suits of clothing and television sets. I propose to double, from 10 percent to 20 percent, the proportion of the value of such objects taken as a measure of the annual taxable benefit.

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And I shall impose an effective charge where the items concerned are subsequently acquired by the employee for less than true value. I am also taking steps to increase from 9 percent to 15 percent the rate of interest used to measure the value of beneficial loans to employees and to raise to £200 the limit below which the benefit of such loans is not charged to tax.

Fringe benefits are charged to tax only if the employee earns more than a certain amount, now £8,500. The case for abolishing this threshold has been pressed upon us. I have asked the Inland Revenue to consult employers and others about the administrative problems that might be involved in such a change.

INCOME TAX

I now turn to my main proposals for income tax. The cuts I made last year were an important start on reducing the oppressive burden of direct taxation. At every income level, taxpayers now retain a significantly larger share of their incomes, which they are free to spend or save as they choose.

I intend to do more in the future. But at a time when output is falling and we are making further heavy cuts in public expenditure, I cannot afford to protect income-taxpayers fully from the effects of inflation. This then must be a year of consolidation.

At first sight that would suggest increases in the personal allowances which fall some way short of the rise in prices during 1979. But this would have a number of undesirable effects.

It would lower the starting point of income tax in real terms compared with a year ago. It would increase the number of taxpayers. It would narrow the gap between tax thresholds and the main social security benefits. And it would impose particularly heavy burdens on those with the smallest incomes. All those effects would be most undesirable.

INCREASE OF DEDUCTIONS COMPENSATED BY ABOLITION OF 25 PERCENT RATE BAND

Given the limited scope available, I have considered how to avoid these consequences, I mean to do so by adopting an alternative approach. I propose to increase the main income tax allowances by 18 percent or so, which is in line with the rise in prices and in conformity with the indexation requirement of the 1977 Finance Act.

This will bring substantial relief to all taxpayers. But in order to afford this, I intend to remove the lower rate band of taxation, levied at 25 percent on the first £750 of taxable income.

This combination will protect the position of the very poorest taxpayers, whilst ensuring that basic rate taxpayers receive some, though not complete, protection from the rise in prices.

The single allowance will thus be increased by £210 to £1,375 and the married allowance by £330 to £2,145. The corresponding allowances for people over 65 will go up by £280 to £1,820, and by £440 to £2,895.

The income limit for the age allowance will go up to £5,900. Also, the additional personal allowance, available mainly to single parents, will go up by £120 to £770. The revenue cost of these increases in 1980-81 will be some £1,800m, offset by a saving of £750m from ending the lower rate band.

I cannot this year make any further reductions in the income tax rates. So the basic rate will remain at 30 percent and the higher rates will also remain unchanged.

The case for the lower rate band was never at all clear. The 25 percent rate was not the effective marginal rate for more than a small number of fulltime adult workers.

For those on lower incomes an increase in the personal allowances would always have been more valuable than the lower rate band. And the existence of this lower rate band added significantly to the complexity of the tax system.

Its disappearance will simplify and shorten the PAYE tables, and reduce the administrative burden on employers and on the Inland Revenue, where there will be a valuable staff saving of 1,300 posts.

I am in no doubt that it is right, in a year when difficult choices have to be made, to concentrate on raising the tax thresholds for everybody, as I have proposed, by about 18 percent.

I am also in no doubt that it is necessary to abate the tax reductions which follow from that change by the abolition of the lower rate band.

Taken together, these changes are equivalent to an effective increase in tax reliefs of 11 percent for a married couple and rather less than that for single taxpayers.

The 18.75 percent rise in child benefit implies a broadly comparable annual rate of increase — about 11 percent — over its April, 1979, level.

Next, higher-rate taxpayers. Given the substatial improvements last year it would not be appropriate to give major relief to higher-rate taxpayers this year.

However, our progressive income tax system operates in such a way that those who pay tax at higher rates experience sharply increasing tax burdens in times of inflation.

In the ordinary course it would be right to increase the higher rate threshold and bands by the same proportion as the increase in personal allowances. That would imply 18 percent this year.

But this year the improvements in personal allowances are partially offset by abolition of the lower rate band. That change will have only limited significance for those on higher incomes. So I have decided not to raise the higher rate thresholds fully in line with inflation, as I have done for the main personal allowances, but to put them up by only about 11 percent.

That is, as I have explained, broadly equivalent to the total net increase in tax reliefs which I have proposed for married couples paying tax at the basic rate.

In money terms the threshold for the higher rates will be raised to £11,250 and the threshold to the top rate of 60 percent to £27,750. There will be corresponding increases at the intervening points.

So far from making the rich richer, these restricted improvements will result in an increase in the real burden of income tax for the higher rate taxpayer.

The cost of increasing the higher rate thresholds is £100m in 1980-81 compared with a cost of £140m if they had been fully indexed.

I am also limiting this year's increase in the threshold to the investment income surcharge to 10 percent, that is to £5,500. However, with a view to consistent treatment in future years, I shall include provisions in the Finance Bill which should ensure, with effect from next year, that the higher rate threshold and bands, together with the investment income surcharge threshold, are covered by indexing legislation in the same way as the main personal allowances.

For the typical married couple with two children the net effect of my Budget changes will be to increase their weekly income by £2.68 per week from November. For a single man with the same earnings the increase will be 49p per week.

The income tax changes I am proposing will be given effect when new tax tables have been printed and distributed. They

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will be made together and will produce a net increase in take-home pay on the first pay day after May 31.

AWARDS

I am proposing two other small income tax changes which have long merited action.

I propose to exempt from tax the payments made to holders of certain gallantry awards, such as the Distinguished Conduct Medal and the Conspicuous Gallantry Medal. These will in future be treated in the same way as annuities payable to holders of the Victoria Cross and George Cross.

I went also to do something more for widows in the difficult time immediately following bereavement. I therefore propose to increase the present single allowance which widows receive for the tax year in which they are bereaved.

The addition for that year will, at its maximum, bring the single allowance for widows up to the level of the married allowance.

We have also been reviewing the treatment for tax purposes of husband and wife. This is a complex and important subject. I am grateful in particular to the Equal Opportunities Commission for the light which their publications have shed on this aspect of sex discrimination.

It is easier to define the problems than to find the answers. Certainly, radical changes should not be made in haste. I propose, therefore, to issue later this year a Green Paper on this subject. I hope that it will stimulate further constructive debate, leading us ultimately to acceptable solutions.

Although, as I have just explained, this is not a year in which sweeping reductions of income tax are possible, that need not prevent us making sensible reforms in the tax system wherever the opportunity offers.

I have frequently drawn attention to the extent to which the tax system has woven itself deeply into the fabric of national life. Tax has been piled upon tax, often with little regard for their interaction. The accidental effects of this tax onslaught have often been as damaging as the direct consequences.

HOUSING

My first proposal is designed to help first-time buyers in particular.

I have received representations from many quarters about the burden of stamp duty on house purchasers. Difficulty in acquiring a new home restricts the mobility of labour. Those at the lower end of the market — mainly young couples — particularly deserve help.

I do not think these considerations justify us in making, this year, an increase in the mortgage interest relief ceiling, which I propose to maintain at £25,000. But I do think it would be right to raise the starting point for stamp duty on transfers of property by £5,000 to £20,000.

The limits for reduced rate bands will be similarly increased, by £5,000, so that the full 2 percent rate will now be reached at £35,000. This will cost £75m in 1980-81, and £85m in a full year.

Too many homes are underoccupied, or even standing empty. This is often a direct, even if unintended, result of rent control: sometimes it is a consequence of planning policies, which my rt. hon. friend the Secretary of State for the Environment is improving.

There are also fiscal obstacles to the economic use of the available stock of property. One of those I intend to deal with this year. I propose a new and additional relief from capital gains tax to help people who let part of their homes.

At present these house-owners, when they come to sell, can find themselves unexpectedly faced with a capital gains tax charge. This change will encourage letting, and contribute to the better use of the housing stock.

Next, the national heritage. The House has already passed a Bill to set up the National Heritage Fund. The Finance Bill will include a provision to treat if for tax purposes as if it were a charity.

The Fund will be set up with an initial amount of around £12m at its disposal. The Government will in future make an annual contribution to the Fund, including the amount needed for the continuation of the acceptance in lieu system.

But we should also do more to make it possible, both today and in the future, for owners of historic houses to look after their properties on behalf of the nation as a whole.

The last Government took a similar view and introduced provisions to assist owners to set up maintenance funds for the support of their houses. But that scheme proved to be so restrictive that it has hardly been used.

I intend therefore, to recast substantially the maintenance fund provisions. If we are going to adopt this method of encouraging the preservation of our heritage — and I believe it is the right one — then it is only sensible to make it work.

Our fresh proposals will apply to the maintenance of buildings, historically associated contents, gardens, and land of historic, scenic and scientific interest.

The overriding condition will, of course, be that the public should have reasonable access. These measures are intended to cement a bargain between those who have to bear the cost of maintaining the National Heritage, and the people as a whole.

CHARITIES

The third way in which we aim to assist private action this year is by providing tangible Government support for the widespread and often unsung voluntary effort that goes on at every level of our national life.

It is important to do all we can to help charities and to stimulate private benefactors and helpers. A partnership between Government and voluntary effort can be the best way of meeting many pressing social needs, particularly when State spending is having to be cut back. With this in mind, I have given careful consideration to the fiscal recommendations of the Goodman Committee and of the National Council of Social Service.

I propose to double — to £200,000 — the capital transfer tax exemption for bequests to charities; and to exempt wholly from development land tax all future disposals of land by charities. Income tax relief for payments to charities made under Deeds of Covenant, which has hitherto been limited to the basic rate of income tax, will be extended to the higher rates subject to a ceiling of £3,000 a year.

A minor stamp duty easement on Deeds will be made. And in response to representations I am reducing the period for tax relief on Deeds of Covenant from seven years to four years.

These measures, which will cost £30m in a full year, are designed to provide the right conditions for substantial growth in the important partnership between voluntary service and the community.

EQUITY INVESTMENT

Now I turn to an area where the tax system can be used to involve the individual more closely in the working of the econo-

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my. I refer to proposals which will encourage direct personal investment in the stocks and shares of British industry.

In the last 20 years the proportion of the equity of British companies held in direct individual ownership has been almost halved. This is a trend I should like to reverse.

It is generally agreed that share-ownership and profit-sharing can help in developing employees' understanding of, and commitment to, business and industry. I believe that share-ownership can also spread a wider understanding of the role for risk-taking and initiative in the economic system.

I have two sets of proposals to make.

First, I propose to make more generous the provisions which the last Government introduced two years ago to encourage profit-sharing.

In passing, I would note that those provisions were based upon proposals originally put forward by my rt. hon. friend, the Secretary of State for Energy. They attracted all-party support.

I propose to raise from £500 to £1,000 a year the value of shares allocated to any one employee which can qualify for tax relief; to reduce from five years to two the period after which employees can sell their shares; and to cut from 10 years to seven the period after which they can draw them out free of income tax.

Second, I propose to reintroduce legislation similar to that which Lord Barber introduced in 1973 enabling employees to be given options to buy shares in their companies without incurring liability to income tax.

This scheme will have links, as in 1973, to a scheme for contractual savings. These measures will help to fulfil our promise to encourage employee share-ownership and provide the incentive to save and build up capital.

There is one anomaly in the field of life insurance, which I propose to put right.

The rate of life insurance relief used to be equivalent to half the basic rate of income tax. It has recently got out of line and I propose to restore the relationship by reducing it to 15 percent.

Because of the practical problems posed for the life insurance industry, the change will not take effect until April 6 next year.

Steps will also be taken to deny life assurance premium relief to certain short-term bonds. This change will take effect from today.

Before I leave discussion of the capital markets I should add that I propose that traded options, which at present are anomalously treated as wasting assets for Capital Gains Tax purposes, should in future be treated on the same basis as share warrants.

I hope these measures will help to encourage the wider direct ownership of shares, by altering the relative attractions of investment through the institutions and through more direct means.

I come now to a series of measures which are intended to increase the wealth-creating vitality of our economy. That means giving greater encouragement to the processes of economic change, and improving incentives to the enterprise sector. For the mainspring of economic vitality it is now widely agreed that we must look to private initiative, widely dispersed and properly rewarded. Enterprise means jobs.

TAXATION OF CAPITAL

I start with capital taxation, which is widely regarded, and rightly so, as a severe discouragement to those seeking to build up a business and pass it on to the next generation. We have, as I promised last year, subjected capital taxation to a thorough review.

Representations from a large number of bodies have confirmed that the damage done by these taxes in their present form is out of all proportion to their yield. There is, of course, a place for capital taxation, including in particular a charge on death. But change is needed.

What I can do this year must be constrained by our financial position. I am, therefore, proposing changes which will be of particular help to smaller businesses. This is an earnest [proof] of our determination to make further progress when economic conditions permit.

First, the march of inflation over the years has brought far too many estates into charge to the capital transfer tax. This is a particular burden on the small business, when it passes from one generation to another, whether on death or by lifetime transfer.

I propose therefore that the threshold for the capital transfer tax should be increased to £50,000. This will exempt from the tax at least two-thirds of the estates which would otherwise have been liable; and up to 400 fewer staff will be needed than if we had left the threshold unchanged.

A reduction in the scale of rates above the new threshold, however much it is needed, is not possible at the moment; nor are other changes I should like to have made. I am, however, making one or two minor changes designed to reduce administration.

In the case of the capital gains tax, I am fully conscious of the impact inflation has had. It can rightly be argued that the tax often falls on what are no more than paper gains. Proposals for indexation or tapering as a means of meeting this problem have been put forward on many occasions in the past.

I have had both proposals re-examined but the conclusion to which I have come is that both would result in an unwelcome increase in the cost of administration — for taxpayers as well as the revenue — while reducing the yield of the tax to negligible proportions.

I cannot, however, leave matters as they are, I propose, therefore, to replace the present £1,000 exemption — which is progressively withdrawn above £5,000 — by a straight forward allowance of £3,000.

This change, which will operate from April 6, will remove from tax half the cases at present liable; and at a reasonable revenue cost, it will reduce staff requirements by 300.

As a corollary of this new proposal, there will be an exemption for the first £1,500 of gains for trusts: and investment and unit trusts will now be exempted from the tax, although investors in such trusts will remain liable if their own gains in the year exceed the new exemption limit.

Finally, I propose to remove the present double charge on gifts, which arises from the overlap between Capital Transfer Tax and Capital Gains Tax, by providing roll-over relief for the latter. This has been a particular source of grievance and one on which representations have been received from a large number of people.

The cost of these changes in the Capital Transfer Tax will be £60m this coming year and twice as much in 1981-82.

In the case of Capital Gains Tax, there will be no cost this coming year and a cost of £25m in 1981-82. These figures need to be judged against the already rising yield of the capital taxes as a result of inflation.

I realise that these necessarily limited changes will fall short of what many people had hoped for. But I must ask for patience in present circumstances. Meanwhile the benefit the present changes give to the small business should not be under-estimated.

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Because of the 50 percent relief — which will remain, as will the comparable relief for agriculture — a person transferring a business worth £100,000 will pay no Capital Transfer Tax, if there are no other assets.

We would, of course, have liked to bring similar help to businesses of all sizes. My proposals do give some measure of relief to everybody, but this year most assistance goes to small businesses. As I have already indicated there have been extensive consultations on Capital Taxation before the Budget. We propose to continue this process. There are in particular certain specialised areas such as settled property which require every detailed consideration.

I now turn to another tax which can inhibit development, the Development Land Tax. In my last Budget I reduced the rate of this tax to 60 percent and increased the exempt slice to £50,000. I then said there would be no further reduction in the rate and no early increase in the exempt slice. This remains the position.

Representations have, however, been made to me from many quarters that the tax inhibits development because of uncertainty about the amount of tax chargeable which can normally only be ascertained once development starts.

It is important to remove obstacles of this kind if we are to make the best use of our resources. I propose to deal with this point and the necessary legislation will be added to the Finance Bill at an appropriate stage. There will also be a number of other detailed improvements. All these changes are designed to free the market and encourage development.

Taxes are stifling independent enterprise in other ways too.

SMALL BUSINESSES

For many years the fashion both in Government and in industry was to favour mergers and amalgamations. No doubt mergers have brought advantages in some cases. But it is now clear that the fashion for industrial elephantism was greatly exaggerated.

I believe that there are cases where businesses are grouped together inefficiently under a single company umbrella. They could, in practice, be run more dynamically and effectively if they could be "demerged" and allowed to pursue their own separate ways under independent management.

The present tax rules can in practice effectively discourage demergers of this kind, by charging the assets of the "demerged" company to advance corporation tax and income tax as distributions.

I propose to bring forward, during the passage of the Finance Bill, measures to ease the tax charge on distributions of this kind, subject to certain safeguards and where they are concerned solely with the genuine splitting off of independent trades within the corporate sector.

My colleagues and I would welcome any views those outside Government might have on these proposals. It may be that further measures will turn out to be justified.

I now turn to measures specifically designed to improve the tax environment in which the small business lives and works.

Any business, but particularly the new small business just starting up, needs somewhere to operate.

An imaginative and helpful new venture in recent years has been the development of estates of small industrial workshops for separate letting to small businesses.

I propose to bring in a Small Workshops Scheme which will enable industrial buildings allowances at the rate of 100 percent to be claimed on the construction of small industrial buildings. The scheme will run for three years, and will simplify the present administrative arrangements.

I shall also make provision for industrial buildings allowance to be given on the construction of industrial buildings rather than on their first lettings.

In addition to my own proposals, my right honourable friend the Secretary of State for the Environment intends to consult on relaxation of planning controls over changes of use as between light industry and warehousing for small units.

My right honourable friend the Secretary of State for Industry intends to make £5m available to build 1,000 new nursery factory units in assisted areas in co-operation with the private sector.

New businesses and particularly new small businesses also need capital. Many people with capital to invest might be ready to back enterprising ventures if they knew that losses could be offset against taxed income, instead of only against capital gains.

I propose that, through a new Venture Capital Scheme, losses on equity investment in unquoted trading companies, incurred after April 5, 1980, may be set off against income.

Next, I propose to relax the conditions for tax relief for interest paid on money borrowed for investment in, or lending to, a close company. The present rules require an investor to have worked for the greater part of his time in the company's business. I propose to abolish that condition, and thus provide added incentive for outside investment in small firms.

Just as important as attracting new capital from the outside is the generation of new capital from the inside, in the form of profits which are retained in the business.

The tax system has now contained for over 50 years a series of provisions under which a "close" company may be required to justify the amount of profits which it wished to retain in the business, undistributed.

Following last year's reduction in the rate of income tax, I now propose important changes including the abolition of the apportionment of trading income both of close trading companies and of members of trading groups.

These changes will cut out a thicket of complex tax provisions, which are time-consuming for the small trading business, and a real impediment to growth.

But if small companies are to generate the funds to finance their expansion, they must first earn profits and then they must be left with sufficient of those profits after payment of tax.

Better profits must come through improved efficiency and greater productivity. That is a matter for industry itself and not for Government. But Government can help by reducing the burden of tax.

I propose therefore to cut the small companies' rate of corporation tax to 40 percent — that is no less than 12 points below the full rate of 52 percent — and at the same time to raise the qualifying limits to £70,000 for the full relief and £130,000 for the marginal relief.

My next proposal is designed to help the unincorporated small business. It is important that the self-employed should be able, with tax assistance, to make adequate provision for their retirement.

PENSIONS

I am therefore raising the limits on retirement annuity relief. The normal percentage of earnings qualifying for tax relief will go up from 15 percent to 17.5 percent, and the ceiling on the premiums qualifying for relief will be abolished.

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BUSINESS LOANS

I also propose some minor measures affecting business taxation. Following consultations with industry I propose that the costs of raising business loan finance should be allowed for tax purposes; relief will also be given for pre-trading expenses of a business provided these expenses would have been allowable if the business had been trading when they were incurred.

Certain changes will also be made in the tax deduction scheme for the construction industry — the 714 scheme — which will lighten the administrative burden of the scheme and change certain features which operate harshly.

As the last element in my package to help small businesses, I am making certain changes in the arrangements for VAT, in order to ease the administrative burden.

I propose that from midnight the registration threshold for VAT should be increased from £10,000 to £13,500. The de-registration limit will also be increased from June 1. At the same time I shall be increasing from £50 to £250 the relief from payment of tax on stocks and assets when a person de-registers.

ENTERPRISE ZONES

Despite the severe financial restrictions we are thus giving help to smaller businesses at many, many points where the system bears too hardly. Individually relatively few of the measures could be described as of major importance; but taken together they represent a significant step forward in making this country one in which enterprise will be properly rewarded and thus flourish again. Together they will cost about £160m in a full year.

Finally, I come to an idea that is intended to pioneer a new and more adventurous approach to the whole question of industrial and commercial renewal.

There are some parts of our economy, most notably in the older urban areas, where more and more public authority involvement seems to have led to less and less fruitful activity.

The planning process has all to often allowed, even caused, whole areas at the heart of some of our most populous cities to be laid to waste for years, even decades.

Even when plans do finally come to be made, the public purse is often unable to provide the funds, or the enterprise, to match the planners' aspirations. And when private initiative might have been ready to stir, it has generally been stifled by rules and regulations — and by a tax system which pays no regard to these special problems.

Some hon. Members may recall that, in a speech made on the Isle of Dogs, a little less than two years ago, I put forward a proposal for trying to bring new life back to these areas of urban dereliction.

The idea was not politically partisan. For my thinking had taken place in parallel with that of the distinguished Fabian, Professor Peter Hall. Quite independently, we had concluded that there was much to be said for the establishment in these man-made wildernesses of what I have called "Enterprise Zones".

I am, therefore, pleased to be able to announce today action by the Government which will transform into reality the idea which I then put forward.

We are proposing to establish, in the first instance, about half a dozen Enterprise Zones — with the intention that each of them should be developed with as much freedom as possible for those who work there to make profits and to create jobs.

Each will cover perhaps 500 acres. Within these Zones two major tax incentives will be available; first, 100 percent capital allowances for both industrial and commercial buildings; and, second, complete relief from development land tax.

But fiscal concessions are only part of what is needed.

These Zones will, therefore, enjoy the following additional benefits: 100 percent derating of industrial and commercial property; a drastically simplified planning scheme; exemption from the scope of industrial training boards (with consequent exemption from industrial training levies); accelerated handling of applications for warehousing free of customs duty; minimal

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requests from Government for statistical information; and abolition of the remaining industrial development certificate procedures.

I hope and believe that an imaginative experiment along these lines may succeed where conventional policies have proved inadequate. No one can doubt the need for change from present arrangements.

In far too many of our towns and cities today, and for far too many businesses, particularly small and new ones, the gap between a productive idea and a foreseeable profit has widened into a chasm of red tape. And the same red tape all too often stands between a young school leaver and the prospect of a job.

Even before this proposal had any official status at all, there has been no lack of interest in the idea. The Government will be consulting local authorities and other interests before decisions on individual areas are made. Fuller details will be found in the policy document, which is being issued this evening. There could not be a better time for making a fresh start of this kind.

For in the decade that lies ahead. Britain has the opportunity of following a more hopeful path. We have ended the 1970s with a society that is becoming less tolerant, because we live with an economy that has been growing no richer. The 1980s can be very different.

The disappointments of the last decate spring from illusions that have persisted too long; the illusion that we can pay ourselves what we have not earned; the illusion that governments may go on borrowing when they dare not tax; and, most foolish of all, the illusion that we can somehow strike our way to higher living standards.

Married couples — income all earned

	Charge for 1979/80		Proposed charge for 1980/81		
Income	*Income tax*	*Percentage of total income taken in tax*	*Income tax*	*Percentage of total income taken in tax*	*Reduction in tax after proposed changes*
2,000	46	2.3	0	0	46
2,500	171	6.8	106	4.3	65
3,000	317	10.6	256	8.5	61
3,500	467	13.4	406	11.6	61
4,000	617	15.4	556	13.9	61
4,500	767	17.1	706	15.7	61
5,000	917	18.4	856	17.1	61
6,000	1,217	20.3	1,156	19.3	61
7,000	1,517	21.7	1,456	20.8	61
8,000	1,817	22.7	1,756	22.0	61
9,000	2,117	23.5	2,056	22.8	61
10,000	2,417	24.2	2,356	23.6	61
12,000	3,036	25.3	2,956	24.6	80
15,000	4,296	28.5	4,017	26.8	279
20,000	6,704	33.5	6,302	31.5	402
25,000	9,364	37.5	8,833	35.3	531
30,000	12,273	40.9	11,588	38.6	685

Nothing will be easy in the years immediately ahead. But beyond that the strategy offers hope of real success.

It is a strategy for the defeat of inflation, by the re-establishment of monetary control. It is a strategy for the restoration of prosperity, by the encouragement of enterprise.

Politics is not only the art of the possible, it is also the art of the necessary. The strategy outlined in this Budget is designed to do what is necessary — and so lay foundations for the success which is well within the grasp of the British people.

RESTORATION OF PROSPERITY BY THE ENCOURAGEMENT OF ENTERPRISE

The essential condition for success in the 1980s is that we should turn our backs on those illusions that we should have the courage, over a period of years, to carry through the realistic policies to which there is no alternative.

In this Budget I have tried to set those policies in a strategy for the medium term.

ERRATUM

In the box accompanying Mr. Paulo Kantor's article "The Supplementary Income Tax (Imposto Suplementar de Renda) on Dividend Distributions" it was erroneously stated that corporations opting for consolidated returns are subject to a 32 percent rate of corporate income tax. This 32 percent rate was abolished by the Decree Law No. 1,648 of December 18, 1978. We wish to emphasize that the mistake was made by the Editors and that Mr. Kantor is not responsible for the contents of the box.

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FIRST INDUSTRIAL ZONE IN CHINA ESTABLISHED*

Development of an area in Shekou district (SKIZ)

The State Council of the People's Republic of China recently authorized the China Merchants Steam Navigation Co., Ltd. of Hong Kong (hereinafter "CMSN") to develop the Shekou district into an industrial zone. In the initial stage, the area comprises some 10,000 sq.ft.; the administrative supervision lies in the hands of Shenzhen City of Guandong Province.

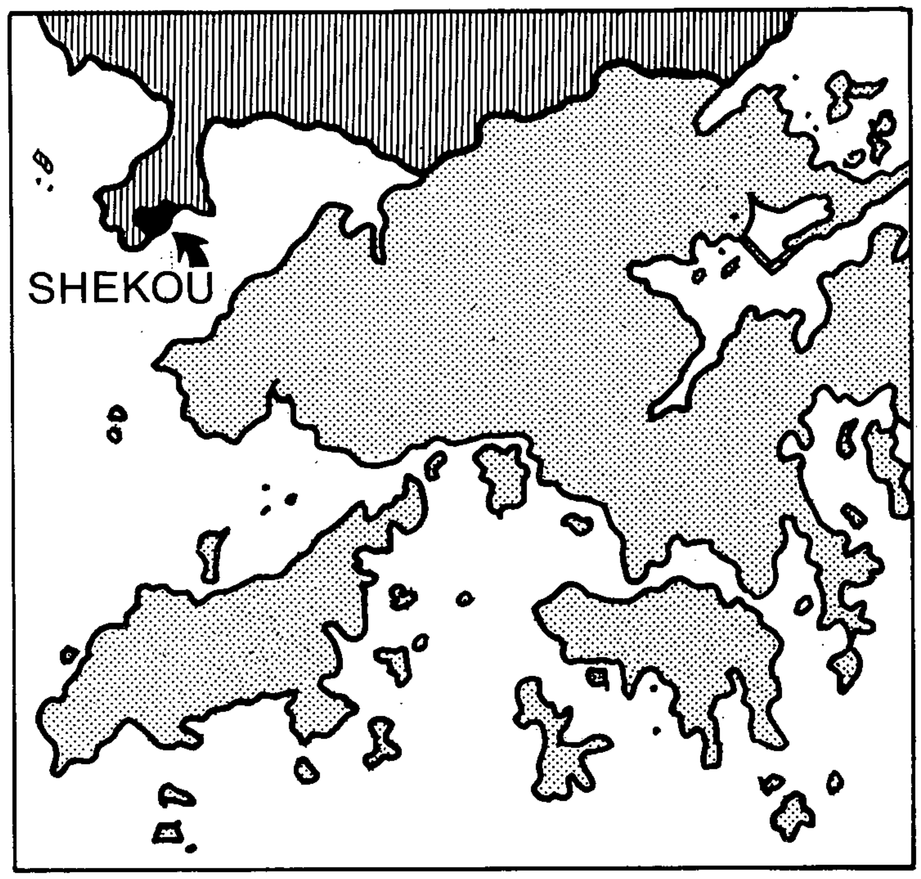
The major role to be played by CMSN is to attract foreign entrepreneurs, overseas Chinese as well as residents of Hong Kong and Macao to participate in joint ventures in the Shekou Industrial Zone. The main field of activity in that zone is to engage in manufacturing and processing commodities, the bulk of which is to be exported. The Joint Venture Law of the People's Republic of China [1] will govern these joint ventures. Also they must be incorporated and registered with the Administration Bureau of Industry and Commerce in Shenzhen, notwithstanding the fact that negotiations usually occur in Hong Kong.

The CMSN has published an Investor's Handbook entitled *The Shekou Industrial Zone in Shenzhen.* It deals with questions including geographical location, weather and climate, earth conditions, construction work and the particulars of joint ventures in SKIZ. Reproduced below are those sections which relate to questions of location, investment and taxation.

The sections dealing with taxation refer specifically to:
(a) *import tax;*
(b) *export tax*; and
(c) *Corporation Profit Tax.*

Apparently, the term *import tax* is used to combine the Industrial and Commercial Consolidated Tax and import duties. The Industrial and Commercial Consolidated Tax is basically a sales (turnover) tax which has, in certain respects, the features of an excise duty. The rates vary from 1.5 to 69 percent. The amount generally reflects the degree of necessity of a particular item to the economy and/or to the average consumer. No credit is given for tax previously paid, a sharp contrast with the value added tax found throughout European countries. [2] The tariff for import duties is classified into 17 categories which consist of 1864 items. The rates vary considerably and may approach 400 percent (e.g. tobacco). [3]

Export tax apparently also refers to the Industrial and Consolidated Tax but further includes export duties. Significantly, export duties are levied on a very limited number of items. [4]



In any case, the International Bureau of Fiscal Documentation was informed by the competent authority that "all supplies furnished to SKIZ ranging from equipment, construction materials, raw materials to daily necessities *shall be imported free of tax* and finished and semi-finished export products manufactured in SKIZ *shall be exported free of tax*".

Corporation Profit Tax will be levied on a joint venture's income after a 3-5 year tax holiday. No details are yet known explaining whether provisions concerning the computation of profits, etc. will generally correspond with those applied for purposes of the Industrial and Commercial Income Tax, or whether new legislation will be promulgated in this field. [5] Readers are kindly advised to follow developments as revealed in our publication TAX NEWS SERVICE.

* The editors would like to express their sincere thanks to China Merchants Steam Navigation Co. Ltd. of Hong Kong (CMSN) for the permission to reproduce parts of its Investor's Handbook *The Shekou Industrial Zone in Shenzhen.*

1. For a detailed discussion of the Joint Venture Law of the People's Republic of China and a reprint of the full text of that law in English, French and German, see the loose-leaf publication: TAXES AND INVESTMENT IN ASIA AND THE PACIFIC, Chapter on the People's Republic of China, published by: International Bureau of Fiscal Documentation, Amsterdam.
2. For a detailed discussion of the Industrial and Commercial Consolidated Tax including a complete list of tax rates, see the publication mentioned supra.
3. For more details, see the publication mentioned supra. Furthermore, the *Deutsche Handelsarchiv* has published a complete list (in German) in its publication: DHA 1973 Heft 9 at 1103 ff.
4. Id. at 3.
5. For a detailed discussion of the Industrial and Commercial Income Tax, see supra, note 1.

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Geographical location

"The Shekou Industrial Zone" (SKIZ) is located on the east coast of the Pearl River estuary, just to the west of the city of Shenzhen and embraced by the Deep Bay. SKIZ is in an advantageous location where sea and land transportations are convenient — separated only by the water of the bay from Yuen Long and Lau Fau Shan of the New Territories; about 30 kilometres from Shenzhen and about 150 kilometres from Guangzhou by road; around 20 nautical miles from the Central of Hong Kong and around 80 nautical miles from Guangzhou by sea.

The superiority of SKIZ in geographical location makes it an ideal place for foreign businessmen, overseas Chinese and compatriots from Hong Kong and Macao to make industrial investment.

Particulars of joint ventures in SKIZ:

1. *Equity ratio:*
The partners of a joint venture shall make investments in cash according to their respective percentage of share-holding in the venture. Each partner's investment shall in general not be less than 25 percent of the total investment. The exact proportion of share-holdings in a joint venture may be agreed upon between the parties according to the particular line of business of the venture. Technological patents and equipment may be converted into cash as investment.

2. *Organization:*
A joint venture shall have a Board of Directors, a president and various department managers. The Chairman of the Board of Directors shall be appointed by CMSN; the Vice-Chairman, the President, the Vice-President as well as department managers shall be appointed through consultation by the participants.
With regard to the Memorandum & Articles of Association of a joint venture, reference may be made to both Hong Kong and international conventional practices.

3. *Contract period:*
The contract period of a joint venture shall be determined by the particular line of business of the venture. The average term is around 25 years. The period may be extended upon expiration through agreement between the parties. Any application for such extension shall be made six months before the expiration of the contract.

4. *Land and land utility cost:*
The Real Estate Company of the Shekou Industrial Zone, a subsidiary of CMSN, has been authorized to plan and control the use of the land of the district.
Joint ventures shall apply to the Real Estate Company of SKIZ for the use of land there and pay its utility in compliance with the rules concerned.
The land utility cost is HK$2 to HK$4 per sq.ft. per year.

5. *Taxes:*
All supplies furnished to SKIZ ranging from equipment, construction materials, raw materials to daily necessities shall be exempted from import tax.
Finished and semi-finished export products shall be exempted from export tax. But taxes shall be levied on products for the domestic market in accordance with Customs' regulations of the PRC.
A joint venture shall qualify for a 3-5 year tax holiday from the date of its commissioning. From the 4th or 6th year on, a 10 percent Corporation Profit Tax shall apply.

6. *Visa application:*
Foreign residents, overseas Chinese and compatriots from Hong Kong and Macao entering SKIZ by sea may have their passports or travel documents visaed at the wharf of the Zone.
Compatriots from Hong Kong and Macao entering SKIZ by road via Shenzhen shall go through visa formalities in accordance with the usual practice.
Foreign nationals, foreign nationals of Chinese descent and overseas Chinese entering SKIZ by road via Shenzhen may present their passports or travel documents two days in advance to the Planning and Development Division of CMSN, which will obtain the required visas for them.
Those who wish to make a one day trip to the place shall be granted entry-exit visas valid for one day; technical and management personnel who have to frequent the Zone to perform their duties shall be granted 3 or 6 month multiple entry-exit visas.

7. *Staff and workers:*
A joint venture shall present a list of manpower requirement covering the numbers and qualifications of workers, technicians and administration personnel needed in the venture to the Labour Services Company of the Shekou Industrial Zone, which shall in turn recommend to the joint venture suitable candidates they could possibly find.
The joint venture has the right to scrutinize the candidates. If the candidates prove to be satisfactory, employment contracts shall be concluded between the joint venture and the Labour Services Company of the Shekou Industrial Zone.
The joint venture also has the right to dismiss any workers or staff members who seriously violate the rules and regulations of the venture during the execution of the employment contracts.

8. *Salaries, wages and welfare funds:*
A joint venture shall pay the workers in Hong Kong dollars which shall be converted into Renminbi. The average wages for ordinary workers of a joint venture shall be higher than those for workers working in the same kind of enterprise of China and lower than those for workers working in the same kind of enterprise of Hong Kong. A joint venture shall appropriate a certain sum of money equivalent to 10 percent of the total amount of wages as welfare funds and medical benefits for the workers. A bonus shall be given to workers and staff members who have fulfilled or overfulfilled their production quotas with products up to the standard both in quality and in quantity.
The staff and workers of a joint venture in SKIZ shall enjoy the statute holidays, festivals and leave days with full pay in line with the laws of the People's Republic of China. Staff and workers on sick leave shall get

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their pay in accordance with the pertinent regulations of the PRC.
Labour insurance for workers and staff members shall be effected with the insurance company in SKIZ by the joint venture.
Salaries and benefits for senior technicians and management personnel shall be fixed separately.
Salaries for technicians and management personnel from abroad as well as from Hong Kong shall also be fixed separately. The foreign and Hong Kong staff shall pay a certain sum of personal income tax.

9. *Foreign exchange control:*
Foreign currency shall be used in book-keeping/accounts of the joint ventures in SKIZ. Every joint venture should submit to the General Administration of the Shekou Industrial Zone its quarterly balance sheets. Foreign exchange transactions shall be conducted at the banks in SKIZ. Foreign currencies can be freely remitted both inwards and outwards but through the banks in SKIZ only.

10. *Power and water supply:*
Power consumption in SKIZ shall be charged at the same rates as applied in Hong Kong for industrial electricity. Water consumption shall be charged by the unit (1,000 gallons of water is calculated as one unit.) and at a rate 20 percent lower than that applied in Hong Kong.

11. *Arbitration:*
In case of economic or legal disputes, the parties involved shall endeavour to settle them through friendly consultation. Should consultation be exhausted, the disputes may be settled through conciliation or arbitration by an artbitral body of China or through arbitration by an arbitral body agreed upon by the parties.

For further information, please contact

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Along with the development of China's foreign economic and trade relations, inquiries from industrialists, businessmen as well as lawyers and practitioners abroad about the relevant legal matters are pouring in. At the same time, requests of the parties concerned for consultation or for the recommendation of legal agent to act on their behalf in negotiation, conciliation, arbitration or legal proceedings in respect of their economic, commercial and maritime disputes with their respective foreign or Chinese counterparts are growing in number. In these circumstances, the China Council for the Promotion of International Trade has decided to set up a Legal Counsel Office which can deal with the following matters:

1. *To act as agent in litigation and arbitration cases having to do with economic, commercial and maritime disputes between foreign and Chinese counterparts, as entrusted by clients at home and abroad;*

2. *To assist in resolving economic, commercial and maritime disputes between foreign or Chinese counterparts, as entrusted by clients at home and abroad;*

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The Legal Counsel Office will charge reasonable fees for services in accordance with work done, efforts made and actual costs to be borne by the clients.

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CORRIGENDUM

The country bordering the North and Mid-East of Ethiopia shown in the map on page 4 of the January issue of the Bulletin should read the Republic of Djibouti. Moreover, the administrative region of Ethiopia bordering Shoa, Hararge, Bale and Sidamo is Arsi.

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The GATT Multilateral Trade Negotiations – Principal Results

Information Note prepared by the Commission of the European Communities (November 1979) on the occasion of the agreement given by the Council of Ministers on 20 November 1979 to the results of the Multilateral Trade Negotiations undertaken in the framework of the GATT.

Contents

I. Results which exceed appearances
II. Protectionism and the "world crisis" held in check
III. Protracted and sometimes difficult negotiations
IV. Lowered customs tariffs
V. Freer and more stable agricultural exchanges
VI. Improved discipline and more balanced development of international exchanges

I. RESULTS WHICH EXCEED APPEARANCES

The multilateral trade negotiations (MTN) — known as the "Tokyo Round" because the decision to initiate them had been taken in the Japanese capital in September 1973 by 103 nations of the world — ended on April 1979 with a general agreement on the essential points. Their goal was to reduce obstacles to trade in the world, and the most spectacular element is, to all appearances, the lowering of customs duties which will go into force at the beginning of 1980.

Nevertheless, without wishing to minimize the importance of this aspect, the results of the MTN far exceed the simple fact that in the future, duties will be lowered; basically speaking:

— *a new discipline in international exchanges has been instituted*

Between industrialized countries, customs duties — with the exception of "peaks" remaining in a few customs tariffs — had as obstacles to trade become almost secondary as compared to the regulations and restrictions of customs valuations, of technical standards, subsidies, compensation rights, and protectionism in national markets. The MTN have helped to define (with one exception, the safeguard clause) new codes and other legal texts on these various aspects which should if not eliminate, at least reduce abuses and disguised protectionism and pave the way for a freer and more harmonious development in international exchanges.

— *International trade for agricultural products will be considerably improved and facilitated*, by taking into consideration the special aspects of this sector. Prior to the Tokyo Round two major gaps (among several others) existed in the organization of worldwide agricultural exchanges: the United States benefited from a dispensation which allowed it not to respect all the GATT rules and for example to apply a surcharge on imports of subsidized products without taking into account GATT's clear-cut regulations in this sector; the common agricultural policy (CAP) of the European Community was in certain of its aspects, the object of recurring disputes aimed at challenging its legitimacy.

This situation has been modified by negotiation: the United States will, at present, accept greater international discipline; and the specific mechanisms of the CAP will no longer be contested as to their basic principle, their application being — as in the past — subject to GATT regulations.

In addition, systems for permanent consultation have been introduced into the agricultural sector, in order to supervise the stabilization of world markets in view of the special responsibility of this sector in the solution to such problems as hunger in the world and the chronic malnutrition of entire populations.

II. PROTECTIONISM AND THE "WORLD CRISIS" HELD IN CHECK

The results of the Tokyo Round are all the more significant that they were achieved in a period of international economic recession. In periods of expansion, it is relatively easy to reduce obstacles to exchanges as imports do not contribute to fear of unemployment or the failure of local business enterprises. The situation is quite different in times of recession when the "protectionist reflex" comes into play with the illusion that it is possible to solve problems by transferring them to others and by closing one's borders. The multilateral trade negotiations largely contributed to reducing this danger: conscious of their interdependence and their responsibilities, the leading countries or world trade-groups — headed by the Community — turned their backs on protectionism which could easily have taken hold and which, in case of failure of the negotiations, would have plunged them into a situation more severe than that of the 30's. The Vice-President of the European Commission, Mr. *Haferkamp*, had declared that in the event of a world trade war, the number of unemployed in the Community could have exceeded 10 million: social and political tensions would have become such that the structures of European society would undoubtedly not have resisted.

Naturally, to hold protectionism in check it would not be sufficient to suppress the barriers to exchanges without criteria, guidelines or precautions. The guidelines constitute the "rules of the game". They are the codes and procedures already mentioned. The criteria concern, for example, the special advantages granted the weaker nations, that is to say, the developing nations, from whom the industrialized nations expect only partial reciprocity and in some cases none at all. Precautions

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refer essentially to the balancing of reciprocal concessions. After several years of efforts, the European Commission, which conducted negotiations on behalf of the Community, on the advice of the Council of Ministers and in permanent contact with the Committee of Representatives of the Member States (Committee known as the Article 113 Committee), has considered that the overall results are "reasonable, well-balanced and acceptable". From the European Community's point of view, the results are far from negligeable: goals have not all been achieved, but in a few fields they have even been exceeded; in return for certain concessions, the European Community has improved its access to the American market, and, to a lesser degree, to the Japanese market and to those of other developed countries. The Community Ministers have also shared this view, on the condition, of course, that the commitments subscribed to would be respected and that the decisions taken would be completely and correctly implemented by all countries.

III. PROTRACTED AND SOMETIMES DIFFICULT NEGOTIATIONS

The multilateral trade negotiations (MTN) were formally opened upon the adoption of the "Tokyo declaration" by the Ministers of 103 countries, gathered together in September 1973 in the Japanese capital within the context of the General Agreement on Tariffs and Trade (GATT). The Tokyo meeting was the result of an initiative on the part of the United States, the European Community and Japan who, early in 1972, had agreed upon two joint declarations dealing with the timeliness of seeking ways to reduce obstacles to international trade. These declarations gave the basic political impetus to the project. Following the Tokyo meeting, negotiation structures were rapidly put into place, in Geneva. However, the leading partners still had to define their goals and acquire the necessary instruments of negotiation.

For the Community, this was done in June 1973, when the Council adopted a "global concept" specifying the goals to be attained and the conditions for reciprocity. The government of the United States had to wait until January 1975 that Congress in its "Trade Act" grant it the necessary powers to negotiate. The following month, the Community established the details of its negotiation stand.

After a long period of preparation, the actual discussions began towards the middle of 1977, when a certain number of basic divergences (concerning in particular the scope and conditions of negotiations relative to agriculture) between the Community and the United States were smoothed out. The criteria for the lowering of customs duties, with, as requested by the European Community, the acceptance of the principle according to which the highest duties were to be reduced to a greater degree so as to harmonize the tariff "profiles", were defined on the basis of a formula proposed by the Swiss. The basic agreements reached in the middle of 1977 made it possible to establish a precise schedule for the presentation of the demand and offers of the various participants with regard to "tariffs", "agriculture" and "non tariff measures" (for recurring problems), and also to achieve substantial progress in the elaboration of codes concerning the non-tariff measures liable to find multilateral solutions.

Towards the middle of 1978, an agreement in principle was achieved between the leading participants, on the content of the "final negotiation package", following a few difficult phases and several interventions at a political level. Technical difficulties were surmounted and the political will to succeed on the part of the Nine as well as of the United States, Japan and the other developed countries was confirmed. A "joint agreement memorandum" was published in July 1978, summing up the situation and mentioning the goals still to be achieved. By the end of 1978, the tariff negotiations, both in the field of industry and agriculture, as well as the elaboration of the codes had been fully completed. Several months were then necessary to iron out the last divergences and to determine the particular conditions of reciprocal concessions. In April 1979, the negotiators were able to initial the minutes recording the results of the negotiations, in view of submitting them to the respective governments and authorities. The Congress of the United States accepted these results in July 1979. Confronted with a Commission report on the October negotiations, the Council of the European Community deliberated on it at its session on October 29. In the meantime, contacts and conversations were being pursued with the developing countries and with a few developed countries, among which Australia, with a view to completing the negotiations on specific points.

A tariff protocol finalizing details of the tariff negotiations between industrialized countries was signed in July and an additional tariff protocol was established in November to enable other countries, principally the developing countries, to include their concessions.

It was not possible to conclude negotiations on one point alone, the new procedures and guidelines concerning the safeguard clause to be included in the GATT. Discussions on this subject will continue outside the Tokyo Round, and in the meantime the GATT's existing "clause" remains valid.

IV. LOWERED CUSTOMS TARIFFS

Customs duties throughout the world had already been reduced in the past in preceding negotiations. There remained nevertheless, certain particularly high customs duties, specially within certain "irregular" tariffs which were composed of very high duties next to others which were very low. The Tokyo Round provides for a new *generalized lowering of tariff rates by close to one third* by the leading trade partners (European Community, United States and Japan in particular) and the total suppression of duties in a significant sector, *aeronautics*. Reductions will not be "linear", that is to say that they will not be identical in their percentage: the duties which at present are the highest and which are to be reduced according to the so-called Swiss formula, will be subject to greater reductions than others. This will decrease the

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difference between the customs tariffs of the leading partners in international trade.

The customs duty rates of the European Community will, for the greatest part be of 5 percent to 10 percent; as few as 180 duties out of several thousand included in the Community's customs tariff will exceed 10 percent and only one (the rate applied to lorry imports) will exceed 20 percent. This homogeneous tariff will continue to constitute an important element of cohesion for the Community and will enable it to maintain reasonable protection with regard to outside pressures. For sectors with special economic and social conditions, the present reduction of duties will be small or non-existent: automobiles, lorries, shoes, fertilizers, and certain plastic and chemical products. In "sensitive" sectors such as the textile sector, protection is not provided by customs duties alone, but by quantitative agreements ("multifibre" international agreement).

The United States will reduce its tariff by close to a third. Thus, most of its imports will be subject to customs duties inferior to 5 percent; a few duties superior to 20 percent and even 30 percent will nevertheless still remain. In its final list, the United States thus tends to eliminate restrictions and to suppress the "American Selling Price".

Japan will reduce its tariff by almost one half if one takes into consideration the legal tariff (which, in fact, was not applied for several years), and by one quarter if the duties actually applied are taken into account. The profile of the Japanese tariff will be quite similar to that of the European Community (most duties will be inferior to 5 percent) but more 15 percent to 20 percent "peaks" will remain. The incidence of the Tokyo Round tariff reduction on the other industrialized countries will be less important particularly in view of the fact that the European Community already applies reciprocal exemptions in its exchanges with most of the Western European nations such as Switzerland, Austria, Sweden, Norway, Finland and Iceland.

Among the results, the following should also be mentioned: the total suppression among the leading industrial countries as a whole, of customs duties in the civil aeronautics sector, beginning in 1980. The Community had, in practice, already suspended the application of duties on its aircraft import: it finally has obtained total reciprocity, particularly significant for the Airbus sales to the United States and Japan, in addition to an extended application to exchanges of other products of this sector as well as to spare parts.

In general, the *customs reductions will be spread out over a period of eight years*, from 1980 to 1987, accelerated in certain cases such as in the field of aeronautics, as already mentioned. After the first five stages of reduction, the European Community will examine the situation to decide on proceeding to the final three stages, if disarming is pursued. The reductions as a whole should be in force by the beginning of 1987 at the latest.

V. FREER AND MORE STABLE AGRICULTURAL EXCHANGES

The specific character of the agricultural sector, which the European Community has asserted from the start, and which has finally come to be recognized by all, has led to special solutions taking into account the fact that duties do not constitute in themselves the essential element regulating exchanges. For a few basic products -- cereals, dairy products, beef — the goal was to set up special international arrangements and in two out of the three cases (with the exception of cereals) this goal was achieved. The principles and mechanisms of the Common Agricultural Policy (CAP) of the European Community were not called into question even in the aspects which had been challenged in the past (namely export refunds).

Only one important setback was noted: the failure to obtain in due time an international arrangement for cereals. The negotiations on this subject will continue outside the Tokyo Round. The arrangement on dairy products includes information and cooperation procedures for the sector as a whole, and price guidelines for powdered milk, butter, butteroil and cheese products. The beef arrangement is based on a mutual information mechanism and on a system of multilateral consultations in case of problems in the world market. In addition, it set up an "advisory organism on agricultural problems".

These arrangements and procedures are completed by specific nation-to-nation concessions. The European Community has in particular, obtained freer access to the American market for cheese products, alcohols, spirits and beef in exchange for certain concessions on poultry and on a special variety of table grapes and for a few arrangements concerning the importing of tobacco, rice and prime quality beef.

Among other positive results for Europe, the improved access obtained for cheese products (Canada, Australia, Japan), for alcoholic drinks (Canada, New Zealand, Japan) and for products of the agro-alimentary industry should be mentioned. In exchange, the European Community will stabilize the regulation of its own imports of beef and of certain dairy products coming from various countries.

VI. IMPROVED DISCIPLINE AND MORE BALANCED DEVELOPMENT OF INTERNATIONAL EXCHANGES

The reduction, and even suppression, of customs duties would not be very significant were the possibility of introducing other obstacles to trade, of applying discriminatory measures on foreign products originating in certain areas, of applying, whenever one chooses, compensation duties, of excluding certain sectors from international competition, not contained and disciplined. It is for this reason that the defining of new, more clear-cut and more equitable rules for international exchanges constitutes one of the most important results of the Tokyo Round, without which the customs

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reductions would have led to advantages that were simply illusory or at the least uncertain and short-lived.

At the same time, however, it would have been unthinkable — for the European Community as for the other nations — to grant partners excessive "inspection rights" over domestic legislation and conduct, which are dictated at times by legitimate and urgent demands (for example, when public health is involved). A balance has, in general, been achieved after long and complicated negotiations. The "codes" elaborated as a result, improve and update the rules and procedures governing world trade, by facilitating the suppression or reduction of a number of non-tariff barriers to exchanges and by improving supervision.

The new rules cover the following fields:

(i) *Code on the technical obstacles to trade*, concerning obstacles resulting from the fact that the compulsory technical standards for a large number of industrial products (cars, electrical machinery, household appliances, etc.) are not the same from one country to another. The new agreement introduces procedures which, while respecting the right to establish the standards which protect the health and safety of consumers and utilizers, aim at avoiding discriminations and "disguised protectionism" (the possibility to protect national production by imposing standards which create problems that are often insurmountable for foreign producers).

(ii) *Code on Government purchases.* This code aims to eliminate legislation or administrative practices which channel government purchases to national suppliers or which provide price preferences for these purchases. The goal has only been partially achieved; but the code nevertheless opens exceptionally important markets to European industries while naturally guaranteeing a certain reciprocity. This presents two advantages: for the firms, which will benefit from a widening of their markets, and the governments which will benefit from broadened competition.

(iii) *Code on subsidies and compensation rights*. The goal of this code is to put an end to the arbitrary introduction of compensation rights on importing by guaranteeing a uniform application of the GATT provisions. The imbalance between rights and obligations which previously existed has been eleminated. On the other hand, new procedures for the discussion of domestic subsidies which could adversely affect international trade, have been established.

(iv) *Anti-dumping code* which aims at prohibiting practices which consist of penetrating foreign markets by selling at prices below the normal price. In this case, the goal has also been to eliminate the discrepancies between the various countries in their application of GATT rules. Procedures have been more clearly defined.

(v) *Code on import licences and code on customs valuations* (namely, the manner in which the value on imported products is calculated in view of applying an ad valorem customs duty to these). These codes cover technical fields, which, however, are of considerable importance to importers and exporters and to the legal basis for stability of exchanges. The same can be said of the agreement which aims at discouraging the exchange of spurious merchanidse.

An agreement on a new *safeguard clause* was not reached. At the present time, should a country note that imports of a given product provoke serious perturbations on its market, it can adopt measures of protection, which, however, according to a certain interpretation of existing rules, must be applied to all exporting countries. The new clause under consideration would establish criteria for the application of "selective" measures exclusively to products from certain sources having caused the serious prejudice observed. Certain of the developing countries opposed the clause, fearing that, in practice, the "selective clause" would be more often directed against their products. Nevertheless, the problem remains extremely urgent for a large number of GATT countries and the European Community will continue to explore the possibilities of an agreement after the Tokyo Round.

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By Joachim Fronia. Tübingen, J.C.B. Mohr (Paul Siebeck), 1979. Institut für Angewandte Wirtschaftsforschung, Schriftenreihe Band 33. 332 pp., 75 DM.
Study containing a short-term economic model on the interrelationship between production and prices in the various sectors of industry in Germany and possibilities to come to a conjunctural analysis.
(B. 102.359)

STEUERBEGÜNSTIGTE KAPITALANLAGEN 1979/80

Herausgegeben von der Fachredaktion des Spezialdienstes Steuer-Telex. Cologne, Peter Deubner Verlag, 1979. 68 pp.
Documentation on legislation, case law and publications concerning tax favored capital investments in Germany.
(B. 102.389)

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Annual Tax Advisors' Congress Report of 1979, containing the texts of the proceedings, lectures and debates on such topics as current problems of financial policy, selected problems in corporate income tax, fiscal problems related to usufruct, special problems related to the new turnover tax law 1979, etc.
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DIE ÜBERNAHME FREMDER URTEILE BEI PRÜFUNGEN

By Harald Neitemeier. Düsseldorf, IdW Verlag, 1979. Schriftenreihe des Instituts für Revisionswesen der Westfälischen Wilhelms-Universität Münster, Band 13. 212 pp., 38 DM.
Study on the theoretical and practical importance of the utilization by German tax auditors of decisions made by foreign auditors.
(B. 102.360)

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Düsseldorf, IdW Verlag, 1979. 413 pp., 39.50 DM.
Text of the new German 1980 Turnover Tax Law together with the Government's substantiation, as well as the texts of the 1980 Regulatory Ordinance to the new Turnover Tax Law and the texts of EEC Directives.
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INDIA

COMMENTARIES ON THE CUSTOMS ACT, 1962

(Act No. 52 of 1962) (as amended up-to-date) along with various rules, interconnected provisions and useful appendices and notifications. Revised by R.B. Sethi, V. Gauri Shanker. 2nd Edition. By T.P. Mukerjee, T.P. Allahabad, Law Publishers, 1979. 1045 pp.
Comprehensive commentary on the customs law. Texts of statutes and by-laws are appended. Reference to case law illustrates the explanation per provision of the law.
(B. 51.456)

COMMENTARIES ON THE LAW OF INCOME TAX IN INDIA

Golden jubilee - eleventh edition. By V.S. Sundaram. Revising associates: B. Malik, S.C. Manchanda and K.R. Ramamani.
In 4 Volumes. Vol. I Sections 1-34, 1978-79. Allahabad, Law Publishers, 1979. 1140 pp.
Volume I of a 4-volume commentary on the income tax law in India consists of an explanation of sections 1 to 34 of the income tax law of 1961 as revised up to October 1978.
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The Wealth Tax Act, 1957 (as amended up to 15 September 1977). By Ved Prakash Verma. Calcutta, Eastern Law House, 1978. 1558 pp.
Comprehensive commentary on the wealth tax in India arranged by section per provision of the law is contained in Part I. Part II contains exemptions at a glance from 1957 to 1977. In addition, it includes valuation of assets. Texts of notes on finance bills and amended bills and relevant circulars are appended to Part II.
(B. 51.455)

R.B. SETHI'S COMMENTARIES ON CENTRAL EXCISE ACT AND RULES

With allied laws. 2nd Edition. Revised by B. Malik, C.L. Gupta and Jagdish Lal. Allahabad, Delhi Law House, 1978. 961 pp.
Comprehensive commentary on the central excise law. Text of statutes including related laws are included. Reference to case law illustrates the explanation per provision of the law.
(B. 51.457)

INDONESIA

WIRTSCHAFTSPARTNER INDONESIEN

Daten - Kommentare - Wirtschaftspraxis. Editors: Rudolf O.G. Roeder and Jörg Willecke. Hamburg, Institut für Asienkunde, 1979. 232 pp.
"Business Partner Indonesia" is a compilation of studies by various authors on important features prevailing in Indonesia in connection with business or investment in Indonesia (including business law, company law and taxation).
(B. 51.460)

INTERNATIONAL

INTERNATIONAL ACCOUNTING, AUDITING AND TAX ISSUES

Changing rules and corporate responses. New York, Business International Corporation, 1979. 311 pp.
Study designed to set out the requirements for drafting a consolidated balance sheet as adopted in various individual countries and the changing international rules with respect to accounting, auditing as well as tax issues encountered by multinational companies in international business operations with emphasis on U.S. companies and statutes. Texts of relevant documents are appended such as the EEC Commission's Fourth Council Directive on the Annual Accounts of Corporations and Limited Liability Companies, Report of the AICPA Special Advisory Committee on Internal Accounting Control - The Minahan Report, EEC Proposal for a Seventh Council Directive concerning group accounts.
(B. 102.344)

LABOR RELATIONS LAW: CANADA, MEXICO AND WESTERN EUROPE

By Gary E. Murg and John C. Fox. New York, Practising Law Institute, 810 Seventh Avenue, New York, N.Y. 10019., 1978. 1433 pp.
Labour systems explained in two volumes on the following countries: Canada, Mexico, the United Kingdom, Belgium, France, Italy, the Netherlands and the German Federal Republic.
(B. 102.362)

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MANUAL FOR THE NEGOTIATION OF BILATERAL TAX TREATIES BETWEEN DEVELOPED AND DEVELOPING COUNTRIES

New York, United Nations, 1979. 190 pp., $10.
Three-part manual consolidating the findings on the guidelines for the conclusion of tax treaties between developed and developing countries as developed by the Group of Experts set up by the United Nations. Part One contains an analytical and historical review of international double taxation and tax evasion and avoidance. Part Two contains, in consolidated form, the guidelines formulated by the Group of Experts. Part Three contains suggestions relating to procedural aspects of tax treaty negotiations and to the application of the guidelines. Appended to the manual are texts of model tax treaties, both bilateral and multilateral.
(B. 102.318)

1978 STATISTICAL YEARBOOK/ANNUAIRE STATISTIQUE 1978

Thirtieth issue. New York, United Nations, 1979. 966 pp.
This edition of the Statistical Yearbook 1978 contains annual data received up to the end of 1978 and in most cases covers the last ten years.
(B. 102.322)

IRELAND

TOLLEY'S TAXATION IN THE REPUBLIC OF IRELAND 1979-80

By Nigel A.D. Lambert and Eric L. Harvey. Croydon, Tolley Publishing, Ltd., 1979. 160 pp., £5.50.
A detailed guide to taxation in the Republic of Ireland covering income tax, capital gains tax, capital acquisition tax, wealth tax, corporation tax and value added tax, and including the provisions of the Finance Act 1979.
(B. 102.415)

ISLE OF MAN

ANATOMY OF A TAX HAVEN

The Isle of Man. By Mark Solly. Douglas, Shearwater Press, Ltd., 1975. 132 pp.
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Volume 2. Manx income tax. By Mark Solly. Douglas, Shearwater Press, Ltd., 1979. 256 pp.
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(B. 102.414)

ITALY

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MALTA

INTO THE EIGHTIES: OPTIONS FOR THE ECONOMY

Valletta, Chamber of Commerce, 1979. 35 pp.
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COMPILACION DE IMPUESTOS ESPECIALES

Mexico, Secretaría de Hacienda y Crédito Público, 1979. 180 pp.
Texts of laws and implementary decrees on excise duties (liquor, fermented products and beer).
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FISCALITE EUROPEENNE: MONACO

2 Volumes. By Pierre Fontaneau. Nice, Les Cahiers Fiscaux Européens, 1979.
Loose-leaf publication in two volumes on the tax system in Monaco, one of a series of loose-leaf volumes describing the taxes in EEC member countries and other European countries in a uniform way for purposes of comparison.
(B. 102.316)

THE NETHERLANDS

HET ABC VAN HET BELASTINGRECHT

By W.J. de Langen. 8e druk, bewerkt door D. Brüll, A. Hartman, R. Oorthuizen en J. van Soest. Alphen a.d. Rijn, Samsom, 1979. 114 pp.
Introductory textbook dealing with the corporate income tax, individual income tax, net wealth tax and related by-laws in the Netherlands.
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DE BELASTING-ALMANAK 1980 VAN ELSEVIERS WEEKBLAD

25ste editie. By J. Viersen and E.N. Jonker. Amsterdam, Annoventura, 1980. 320 pp., 15.50 Dfl.
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Seventh edition. By S.W. van der Meer. Zwolle, W.E.J. Tjeenk Willink, 1979. 128 pp.
English translation of the statutory texts of company law in the Netherlands and in the Netherlands Antilles.
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By C.A. Boukema. Zwolle, Tjeenk Willink, 1979. Studiepockets Bedrijfsrecht, No. 2. 139 pp., 22 Dfl.
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Achtergronden & verklaringen. By C.A. Hazeu. Rotterdam, Erasmus University, 1979. Brochure Fiscaal Economisch Instituut, No. 14. 155 pp.
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Handbook providing schedules describing, from different points of view, the financial regulations (subsidies, guarantees and tax facilities) granted to medium and small enterprises.
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Second printing of monograph explaining the provisions for allowable personal deductions of expenses by individual taxpayers.
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Tweede druk 1979. By H. Bakker. Deventer, Fed, 1979. Fed's Fiscale Brochures, IB: 3.55. 60 pp.
Monograph on the problem in Netherlands income tax law which arises where an entrepreneur liquidates his business in exchange for annuities.
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Annual guide for filing 1979 individual income tax return and 1980 net wealth tax return, including a summary on inheritance tax and gift tax, municipal real property tax and school contributions.
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Compilation of contributions and commentary at a congress convened by the University of Rotterdam on the subject of the imputation system with reference to the developments and existing systems in the EEC member countries and the situation in the Netherlands.
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OVERSEAS INVESTMENT IN NEW ZEALAND

Wellington, The National Bank of New Zealand, Ltd., 1978. 34 pp.
Brochure providing information for foreign investors on business conditions and laws affecting investments in New Zealand, including taxation, company law, foreign exchange regulations.
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COMPANY TAX LAW IN NIGERIA

By J. Ola Orojo. London, Sweet & Maxwell, 1979. 300 pp., £ 14.
Monograph explaining the corporate income tax contained in the Company Income Tax Act 1961, the petroleum profits tax and the capital gains tax in Nigeria. The consolidated text of the Company Income Tax Act 1961 as amended up to July 1978 is included. (B. 13.048)

RECURRENT AND CAPITAL ESTIMATES OF THE GOVERNMENT OF THE FEDERAL REPUBLIC OF NIGERIA 1979-80

Lagos, Federal Ministry of Information, 1979. 618 pp.
Text of Budget Speech for 1979/80, press statement on the 1979/80 Budget, consolidated financial statement 1979/80 and summaries of revenue and expenditure estimates for 1979/80.
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O.E.C.D

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Rapport du Comité des Affaires Fiscales de l'OCDE 1979. Paris, Organisation for Economic Co-operation and Development, 1979. 106 pp., 36 Ffr.
French version of a report also available in English, entitled "Transfer pricing and multinational enterprises".
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EL DERECHO LABORAL EN CENTROAMERICA Y PANAMA

3 Volumes. By Fernando E. García Rodríguez. Tegucigalpa, Banco Centroamericano de Integración Económica (BCIE), 1977. 70 + 333 + 228 pp.
Three-volume handbook on labour legislation in Panama and Central America.
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PAPUA NEW GUINEA

FOREIGN INVESTMENT POLICY

Port Moresby, Institute of National Affairs, 1977. Institute of National Affairs, Discussion Paper No. 1, August 1977. 155 pp.
This document contains the findings of the first research project undertaken by the Institute of National Affairs. The purpose of the project is to improve the dialogue between the Government and the private sector, particularly in policy areas of mutual interest. Contributions include the following: "Papua New Guinea's foreign investment policy" by John Wylie; "A general outline of the government's economic policies with specific reference to overseas investors" by the Hon. J. Chan; "Present government thinking on investment policy for extractive industries" by N. Agonia.
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PARAGUAY

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Quinta edición, Tomo II. By Carlos A. Mersán. Asunción, Carlos A. Mersán, 1979. 818 pp.
Compilation of fiscal legislation up-dated for 1979.
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PHILIPPINE TAX SYSTEM UNDER THE NEW SOCIETY

By Angel Q. Yoingco and Vicente G. Quintos. Manila, Angel Q. Yoingco and Vicente G. Quintos, 1979. 617 pp.
Study of the tax reforms during the period 1972-1978. It discusses the 338 presidential decrees, letters of instruction and memorandum circulars issued during the period up to June 11, 1978. Complete listing of tax legislation is appended.
(B. 51.368)

A SHORT GUIDE TO PHILIPPINE TAXES

Revised edition. Manila, National Economic and Development Authority, National Tax Research Center, 1979. 69 pp.
Introductory guide describing the tax system of the Philippines as of December 1978.
(B. 51.453)

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INVESTOR'S GUIDE TO THE ECONOMIC CLIMATE OF SINGAPORE

Seventh edition. Singapore, Singapore International Chamber of Commerce, 1979. 100 pp.
Guide describing the investment climate and the facilities, requirements and opportunities for investors in Singapore.
(B. 51.452)

SOUTH AFRICA

1979/80 SUPPLEMENT TO SILKE ON SOUTH AFRICAN INCOME TAX

By Costa Divaris and Michael L. Stein. Ninth edition. Consulting editor: Aubrey S. Silke. Cape Town, Juta & Company, Ltd., 1979. 528 pp.
Supplement to be used in conjunction with the ninth edition of Silke on South African Income Tax bringing the material up to date as of the 1980 tax assessment year.
(B. 13.047)

SPAIN

CURSO DE SISTEMA FISCAL ESPANOL

Madrid, Ministerio de Hacienda, 1977. 918 pp.
Handbook on the Spanish tax system as it was before the 1979 tax reform.
(B. 102.422)

ESTUDIOS DE DERECHO TRIBUTARIO

2 Volumes. Madrid, Ministerio de Hacienda, 1979. 1755 pp.
Two-volume handbook containing 37 articles by various authors on general principles of tax law.
(B. 102.442)

EEN HUIS KOPEN IN SPANJE

By C.E. van der Lande. Alphen a.d. Rijn, Samsom, 1979. 120 pp.
Introductory guide for those who intend to buy real estate in Spain. Legal, administrative and taxation aspects are dealt with.
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SWEDEN

THE SWEDISH BUDGET 1980/81

A summary published by the Ministry of Economic Affairs and the Ministry of the Budget, Stockholm, 1980. 167 pp.
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SWITZERLAND

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Eine entscheidungs- und problemorientierte Darstellung. By Lucius Jenal. Basel, Lucius Jenal, 1979. 320 pp.
Doctoral thesis on income treaties for the avoidance of double taxation concluded by Switzerland with developing countries.
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BYLES ON BILLS OF EXCHANGE

The Law of Bills of Exchange, Promissory Notes, Bank Notes and Cheques. 24th Edition. By Maurice Megrah and Frank R. Ryder. London, Sweet & Maxwell, 1979. 509 pp., £35.
Monograph on the Law of Bills, Cheques and Promissory Notes.
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CORPORATION TAX

Fourth edition. By B.S. Topple. Plymouth, Macdonald and Evans, 1979. 186 pp., £2.75.
Fourth edition of textbook explaining the corporation tax based on the law updated to take account of the Finance (No. 2) Act 1979.
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DOUBLE TAXATION RELIEF

A detailed explanation of the law and practice of double taxation relief. By Deloitte Haskins & Sells. Croydon, Tolley Publishing Company, Ltd., 1979. 175 pp., £7.95.
Study on the double taxation relief in United Kingdom law and practice on income and capital gains as well as gift and inheritance taxes. The law and agreements are stated as of August 1, 1979.
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KEY TO CAPITAL GAINS TAX

Capital Gains Tax Act, 1979 Edition. By K.R. Tingley. London, Taxation Publishing Company, Ltd., 1979. Taxation Master Key Series. 391 pp., £6.25.
Annual guide presenting explanation of the capital gains tax law and practice as stated as of September 1, 1979.
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Revised edition of guide to corporation tax describing the law as amended by Finance (No. 2) Act, 1979.
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PINSON ON REVENUE LAW

First supplement to the twelfth edition. Up to date to August 1, 1979. By Barry Pinson. London, Sweet & Maxwell, 1979. 30 pp., £1.
Supplementary text to the basic work.
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SUPPLY ESTIMATES 1979-80 FOR THE YEAR ENDING 31ST MARCH 1980

Supplementary estimates (classes II-XVII: CIVIL). London, Her Majesty's Stationery Office, 1979. 387 pp.
Presentation of the Supplementary Estimates 1979-80 necessary to secure additional money and Parliamentary authority in connection with the cost of services.
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TAKE-OVERS AND MERGERS

Fourth edition. By M.A. Weinberg, A.L. Greystoke and M.V. Blank. London, Sweet & Maxwell, 1979. 854 pp., £45.
Fourth edition of revised systematic reference work on the law and the practice relating to take-overs and mergers with reference to law and regulations in force as of April 1, 1979.
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TOLLEY'S CAPITAL GAINS TAX 1979-80

A comprehensive detailed guide to capital gains tax including the legislation and relevant case law to 30 September 1979.
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U.S.A.

BITTKER AND EUSTICE'S FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS

Fourth edition. 1979 Supplement. By James S. Eustice. Boston, Warren, Gorham & Lamont, 1979. 186 pp.
Supplement to basic work with extensive tables of contents.
(B. 102.329)

CORPORATION — PARTNERSHIP — FIDUCIARY FILLED-IN TAX RETURN FORMS

1979 Edition. Chicago, Commerce Clearing House, Inc., 1979. 128 pp., $3.50.
Guide for filing in 1979 the 1978 income tax returns of corporations, partnerships, estates and trusts.
(B. 102.340)

EMPLOYEE STOCK OWNERSHIP PLANS

Edited by Joseph E. Bachelder III. New York, Practising Law Institute, 810 Seventh Avenue, New York, N.Y. 10019. 1979. 788 pp., $40.
Articles by various authors on the development and provisions of the Employee Retirement Income Security Act of 1974 and amendments.
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1980 GUIDEBOOK TO LABOR RELATIONS

Chicago, Commerce Clearing House, Inc., 1979. 392 pp., $8.50.
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A GUIDE TO CORPORATE TAX PLANNING

Third edition. By Sidney Kess. Chicago, Commerce Clearing House, Inc., 1979.
Two cassette tapes dealing with planning as part of audit work and planning at year-end. Two booklets are appended entitled: "Quizzer" and "Checklists".
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INCOME TAX TREATIES

Edited by Jon E. Bischel. New York, Practising Law Institute, 810 Seventh Avenue, New York, N.Y. 10019. 1978. 959 pp.
Compilation of studies in the field of international taxation, particularly United States bilateral tax treaties with other countries (the United Kingdom, France, The German Federal Republic and Japan), as well as a description of the structure and operation of tax treaties in general. Contributions include: "The historical development of income tax treaties" by Mitchell B. Carroll; "Permanent establishments in the United States" by Robert L. Williams; "The effect of tax treaties on transfer of technology" by Jon E. Bischel; "The United States-German tax convention" by Henry J. Gumpel; "Working with the Japanese treaty" by John Huston. An extensive bibliography and the text of the 1977 OECD Model Tax Treaty are appended.
(B. 102.361)

INDIVIDUALS' FILLED-IN TAX RETURN FORMS

1980 Edition. Including: sample filled-in forms, rate tables, work sheets, check lists. Chicago, Commerce Clearing House, Inc., 1979. 136 pp., $3.
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Introduction identifying possible investment opportunities for profit and methods for reducing or deferring income taxes.
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Three-volume loose-leaf set containing compilation of Uruguayan tax laws, decrees and rulings prepared by the tax administration of Uruguay.
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SINGAPOUR: MODIFICATIONS FISCALES

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L'auteur étudie les nouvelles mesures d'encouragement pour favoriser le développement de l'économie et les différentes modifications introduites par le "Income Tax (Amendment) Act" de 1980.

II. *Résumé du Budget 1980*
L'auteur analyse le Budget 1980 présenté par M. Goh Chok Tong et bien accueilli par la plupart des habitants de Singapour qui le qualifie de Budget "réduction d'impôt".

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Der Verfasser bespricht die Anreize, durch die ein weiteres Wachstum der Wirtschaft bewerkstelligt werden soll, sowie die sonstigen Veränderungen, die durch das Einkommensteueränderungsgesetz 1980 bewirkt werden.

II. *Zusammenfassung zum 1980-Haushalt Singapurs*
Der Verfasser untersucht den vom Herrn Goh Chok Tong vorgelegten Haushalt 1980, der von den meisten Bürgern begrüsst und als "Steuersenkungs-Haushalt" bezeichnet wurde.

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DIE STEUERAENDERUNGEN FUER 1980 IN DER REPUBLIK SUEDAFRIKA

Der Verfasser untersucht die neuesten Entwicklungen im Steuersystem Südafrikas. Durch den Haushalt 1980 werden verschiedene Vorschriften dergestalt angepasst, dass der progressive Steuertarif durch die inflationäre Entwicklung nicht zu einer höheren Steuerbelastung führt und damit das volkswirtschaftliche Wachstum beeinträchtigt.

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IRLANDE: BUDGET 1980

Extrait du Budget présenté le 27 février 1980 par le Ministre de Finances, M. O'Kennedy. Le niveau d'impôt relativement bas en Irlande a été rendu possible par les emprunts à grande échelle et les impôts sur le revenu ainsi que la sécurité sociale ont de nouveau aménagé. Toutefois les impôts indirects ont été considérablement augmentés, par example la TVA passe de 20 à 25 pour cent.

IRLAND: DER HAUSHALT 1980

Auszüge aus der Haushaltsrede, die der Finanzminister, Herr O'Kennedy, am 27. Februar 1980 gehalten hat. Die verhältnismässig geringe globale Steuerbelastung in Irland wurde durch eine umfangreiche Kreditaufnahme ermöglicht. Der Haushalt sieht Verbesserungen bei der Einkommensteuer sowie bei der Sozialversicherung vor. Andererseits werden die indirekten Steuern beträchtlich erhöht; der Umsatzsteuersatz steigt z.B. von 20 auf 25 v.H.

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ZAMBIE: BUDGET 1980

Extraits de la présentation du Budget 1980 prononcée par le Ministre de Finances M. Musokotwane d'obtenir des revenus supplémentaires. La consommation de produits de luxe serait dissuadé et l'utilisation de matériaux chers importés serait faite avec discernement.

SAMBIA: HAUSHALTSREDE 1980

Auszüge aus der vom Finanzminister, Herrn Musokotwane gehaltenen Haushaltsrede. Die Regierung will in erster Linie die Staatseinnahmen erhöhen. Ferner soll der Konsum von Luxuswaren verteuert und eine bessere Unterhaltung von teuren Importgütern gefördert werden.

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Tax Developments in Singapore

BY LEE FOOK HONG, FCIS, FAIA

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II. SUMMARY OF THE 1980 BUDGET

A. THE ECONOMIC EXPANSION INCENTIVES (RELIEF FROM INCOME TAX) (AMENDMENT NO. 2) ACT, 1979

The Economic Expansion Incentives (Relief from Income Tax) (Amendment No. 2) Act, 1979 was passed by Parliament on December 11, 1979 and assented to by the President on December 18, 1979. It was published in the Singapore Government Gazette Act Supplement No. 31 dated December 28, 1979.

This Act amends the Economic Expansion Incentives (Relief from Income Tax) Act to ensure that in computing the export profit of an export enterprise which qualifies for tax relief under Section 32 of the Act, such part of the capital allowance as may be attributable to the export profit qualifying for the tax relief must be deducted.

The Amendment will take effect from the Year of Assessment (Y/A) 1980.

B. INCOME TAX (AMENDMENT) ACT, 1980

The Income Tax (Amendment) Act, 1980 was passed by Parliament on March 17, 1980 and assented to by the President on March 26, 1980.

It was published in the Government Gazette Act Supplement No. 12 dated April 3, 1980. [1]

The Income Tax (Amendment) Act, 1980 seeks to implement some of the tax changes announced in the Government's 1979 Budget proposals and also to make other amendments to the Income Tax Act.

The major tax changes effected by the Amendment Act are summarised in the Appendix hereto. Below are some brief notes on the amendments to the various sections and the respective dates on which such amendments will be effective.

1. The Act Supplement is obtainable from the Singapore National Printers (Pte.) Ltd., 303 Upper Serangoon Road, Singapore 1334 and S.N.P. Publications Sales Division, Fullerton Building, Ground Floor, Singapore 0104. The price is S$ 1.50 per copy.

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Section 10(1A) — **Effective from Y/A 1980**

1. Net annual value of owner-occupied properties

The proviso to Section 10(1A) has been amended to include "..... any property owned by a married woman living with her husband shall be deemed to be owned by the husband."

Before the amendment, the Act allows a husband and a wife to claim exemption from income tax on one property each.

After the amendment, only one property for each couple will be exempt from income tax with effect from the Year of Assessment 1980.

Section 10(8) — **Effective from Y/A 1979**

2. Maintenance payment received by a child

This new Section 10(8) provides that any maintenance payment made to a child under a court order or a deed of separation is not deemed to be income and therefore will not be subject to tax.

Section 10(6A)
Section 13(1)(x) — **Effective Y/A 1979**

3. Exemption for pensions

Since the Year of Assessment 1977 only 50 percent of the pension derived by a Singapore resident has been subject to tax. This Section has now been deleted and the following new paragraph (x) has been added to Section 13(1):

> "(x) the income derived by a person resident in Singapore from any pension granted under any written law relating to pensions in Singapore or under such other pensions scheme as may be approved by the Minister by notification in the Gazette."

Accordingly any pension granted under any written law in Singapore as well as under any approved private pension scheme designated by the Minister will be exempt from tax with effect from the Year of Assessment 1979.

Section 14(3A) — **Effective 1.4.79**

4. Deduction from car expenses

A new Sub-section (3A) has been added to Section 14 to increase the limitation on the amount of allowable expenses from $15,000 to $25,000 in respect of a motor car acquired on or after April 1, 1979. The effect of this amendment is that the deduction for expenses incurred by any business service passenger vehicle with "Q" registration costing more than $25,000 purchased on or after April 1, 1979 shall be limited to the amount which bears to such outgoings and expenses the same proportion as $25,000 (previously $15,000) bears to the capital expenditure incurred by the owner in respect of the motor car. For example:

1) Total running expenses incurred is $5,000
2) QEL 1234 costing $30,000 was purchased in November 1979
3) The amount to be allowed against taxpayer's income will be $\frac{25,000}{30,000}$ x $5,000 = $4,166.70

Section 14B (3)(c) — **Effective 1.4.79**

5. Double deduction not allowed

This amendment precludes any company which is enjoying tax relief under the Economic Expansion Incentives (Relief from Income Tax) Act from being given double deduction of expenses under that Section.

Section 14C — **Effective 1.4.79**

6. Double deduction for export market development expenditure

The new Section 14C provides for double deduction of the following expenses incurred on or after April 1, 1979 by a company resident in Singapore principally for promoting the export of goods manufactured in Singapore:

a) Export market development expenditure incurred in carrying out a marketing project overseas approved by the Minister; or
b) Advertising expenses in respect of advertisements placed in any approved Singapore publication designed for publicity overseas.

Section 14D — **Effective 1.4.79**

7. Expenditure on scientific research projects

A new Section 14D has been inserted to provide for deduction of expenditure on scientific research incurred on or after April 1, 1979 by a manufacturing company where the deduction would not be allowable as revenue expenses under Section 14 of the Act. The expenditure must be incurred on scientific research carried out in Singapore and related to the trade or business of the taxpayer or consist of payments to an approved research institute for scientific research related to the taxpayer's trade or business.

Expenditure of a capital nature e.g. capital expenditure incurred on plant, machinery, land or buildings will qualify for deduction.

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Section 15(1)(j) — **Effective Y/A 1980**

8. Motor cars registered and used outside Singapore

Section 15(1)(j) has been amended to allow deductions for expenses incurred in respect of motor vehicles registered outside Singapore and used exclusively outside Singapore provided such vehicles are used for the purposes of producing income subject to Singapore income tax.

Section 19(2A) — **Effective Y/A 1980**

9. Capital allowances on cars limited to $25,000

A new proviso to Section 19(2A) has been introduced to increase the limitation on capital allowances from $15,000 to $25,000 in respect of a motor car acquired on or after April 1, 1979.

When a business service passenger vehicle costing more than $25,000 was purchased on or after April 1, 1979 the respective amounts of initial and annual allowances claimed shall be limited to 20 percent each of $25,000.

For example, if a business passenger car (QEL 1234) was purchased in November 1979, costing $30,000, the initial and annual allowances to be allowed for Year of Assessment 1980 will be restricted to $5,000 and $5,000 respectively.

(Note: There are proposals in the 1980 budget for new depreciation rates and change from reducing balance method to straight line method).

Section 19(2D) — **Effective**

10. Capital allowances for cars registered and used outside Singapore

This sub-section has been amended to enable capital allowances to be granted in respect of motor vehicles which are registered outside Singapore and used exclusively outside Singapore provided such cars are used for the purposes of producing income liable to Singapore income tax.

Section 20(5)(c) — **Effective 1.4.79**

11. Sale price of cars purchased on or after 1.4.79

Consequent upon the increase in the limitation of capital allowances from $15,000 to $25,000 the sale price of a business service passenger vehicle purchased on or after April 1, 1979 costing more than $25,000 will be computed according to the following formula:

$$\frac{25{,}000}{\text{purchase price of the car}} \times \text{selling price}$$

Section 20(5A) — **Effective Y/A 1981**

12. Balancing allowances for business service passenger vehicles only

This new Sub-section has been introduced to assure that

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no balancing allowances will be granted on the sale of a motor car which is not, for any basis period after the basis period for the Year of Assessment 1981, registered as a business service passenger vehicle.

Section 39(2)(e)(ii) **Effective Y/A 1980**

13. Central Provident Fund (CPF) contributions

The maximum amount of compulsory contributions made to the CPF Board allowable as relief has been increased from $4,000 to $5,000.

For example, if Mr. A's CPF contribution for the year 1979 is $5,080 the maximum amount of CPF to be allowed against his assessable income will be $5,000 (maximum) for the Year of Assessment 1980.

This amendment also applies to compulsory contributions made to other pension or provident fund schemes approved by the Minister for Finance.

Section 26
Section 43C **Effective Y/A 1980**

14. Concessionary rate of tax for income from insuring of offshore risks

The scope of the concessionary rate of tax for insurance companies under Section 43C of the Act has now been extended by the amendment act from income derived from the *reinsuring* of offshore risks to income derived from the *insuring* of offshore risks.

Republic of Singapore

Personal income tax
Old and new rates compared

Chargeable Income	Old		New		Savings
	Old Rate %	Tax Payable	New Rate %	Tax Payable	
On the first 2,500	5	125	4	100	25
On the next 2,500	8	200	7	175	25
On the first 5,000		325		275	50
On the next 2,500	10	250	9	225	25
On the first 7,500		575		500	75
On the next 2,500	12	300	11	275	25
On the first 10,000		875		775	100
On the next 5,000	15	750	14	700	50
On the first 15,000		1,625		1475	150
On the next 5,000	20	1,000	17	850	150
On the first 20,000		2,625		2,325	300
On the next 5,000	25	1,250	21	1,050	200
On the first 25,000		3,875		3,375	500
On the next 10,000	30	3,000	26	2,600	400
On the first 35,000		6,875		5,975	900
On the next 15,000	35	5,250	32	4,800	450
On the first 50,000		12,125		10,755	1350
On the next 25,000	40	10,000	34	8,500	1500
On the first 75,000		22,125		19,275	2850
On the next 25,000	40	10,000	36	9,000	1000
On the first 100,000		32,125		28,275	3850
On the next 100,000	45	45,000	40	40,000	5000
On the first 200,000		77,125		68,275	8850
On the next 200,000	50	100,000	45	90,000	10,000
On the first 400,000		177,125		158,275	18,850
On the next 200,000	55	110,000	50	100,000	10,000
On the first 600,000		287,125		258,275	28,250
Over 600,000	55		55		

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II. SUMMARY OF THE 1980 BUDGET*

On March 5, 1980, the Minister for Trade and Industry, Mr. Goh Chok Tong, presented his 1980 Budget to the Parliament of the Republic of Singapore. Before outlining the financial policy for the coming year, he summarised the salient points of the "Economic Survey of Singapore 1979" and spelt out the economic objectives for the future and the strategies for the Eighties.

Singapore's economic performance in the seventies

In his summary of Singapore's economic performance in the 1970s Mr. Goh revealed that Singapore's economy grew at an average annual rate of 6.8 percent in 1974 and 4.0 percent in 1975. For the decade as a whole, real GDP grew at an average rate of 9.4 percent per annum, better than the 8.7 percent achieved in the Sixties.

Singapore's economy in 1979

On Singapore's economy in 1979 Mr. Goh said that in 1979 world economic performance remained sluggish for the third successive year. The industrialised economies averaged a growth of 3 1/4 percent, slower than the already poor growth rates of 3.7 and 3.9 percent in 1977 and 1978 respectively. World trade grew by 7 percent, slightly faster than the previous year. Inflation, however, worsened. Consumer prices climbed up to 10 percent, from 8 percent in the previous two years.

Singapore's economic performance in 1979 was encouraging, and better than the previous years. Real GDP rose by 9.3 percent, as against 8.6 percent for 1978. The higher rate of growth was achieved with relative price stability. Despite the higher oil prices and the larger wage increase recommended by the National Wages Council (NWC), consumer prices rose by only 4 percent, lower than the 4.8 percent in 1978. Unemployment was reduced to 3.3 percent from 3.6 percent in the previous year.

All sectors of Singapore's economy expanded. Manufacturing grew by 14 percent, the highest rate of expansion since the recession. The value of external trade rose substantially by 32 percent, but this was due mainly to oil price increases.

Mr. Goh said that overall he would have rated last year's economic performance as excellent had it not been marred by one black spot — declining productivity growth. Economic expansion was achieved more through a quantitative input of workers than through productivity increases. Employment increased by 6.6 percent, 2.1 percentage points higher than the previous year, while productivity growth fell to 2.6 percent, from 4 percent in 1978.

Economic objectives and development strategies for the Eighties

Outlining his development strategies for the 1980s, Mr. Goh set clearly defined targets for 1990. Singapore's development strategies for the 1980s aimed at attaining the standard of living achieved by Japan in 1978. This means that the target is an 8-10 percent annual growth in the 1980s.

"*If we succeed, we shall attain in 1990, a per capita income of S$15,000 to S$18,000 (at 1979 prices) which Japan has already achieved in 1978*", said Mr. Goh. He then proceeded to elaborate on the objectives in specific areas.

On industrial development Mr. Goh said that in the 1980s, he would like the manufacturing sector to become even more dynamic, increasing its share of GDP from the present 22 percent to 31 percent by 1990, and leading the economy through consistent high productivity increases.

The Singapore Government will provide better jobs with higher wages for a better educated and trained population as well as opportunities for local entrepreneurs to participate in industries either on their own or in joint ventures with foreign investors.

On trade development the Minister forecasts that by 1990 manufactured goods will comprise 60 percent of exports if Singapore succeeds in achieving its industrial goals in the 1980s.

Through the tax incentives for international trading companies, the Government will encourage the formation of multi-activity international trading companies to push the export of Singapore manufactured products in overseas markets. The double tax deduction scheme will be extended to cover overseas marketing campaigns.

On services development Mr. Goh said that in the 1980s Singapore would be developed into a financial supermarket offering a wide and sophisticated range of financial services. The Government aims to develop Singapore into an international funds management centre. Bankers would be encouraged to improve efficiency and productivity through greater computerisation and other forms of automation.

Transport and communication were the leading growth sectors in the 1970s. These sectors will remain an important pillar of the economy while computer services will be more actively promoted in Singapore and overseas.

The export of consultancy and technical expertise will become more important in the 1980s. The conces-

* See for an excerpt of the Budget Speech 1980 page 150 of the April 1980 issue of the BULLETIN.

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sionary tax on income and the 5 percent preferential margin to local contractors should help in the aim of exporting consultancy services.

Computer services are a crucial area to concentrate on and Singapore should also plan to export its computer software and services.

To stimulate utilisation, computers and peripheral equipment will be allowed to be written off in three years for tax purposes. In addition to the incentives given to International Consultancy Services, the Government is studying the feasibility of granting pioneer status for highly sophisticated computer software activities which are export-oriented as well as providing a concessionary tax rate of 10 percent, for a period of five to ten years for certain computer-related specialised companies.

On ASEAN economic cooperation the Minister stressed that in the 1980s, Singapore would continue to seek and foster closer economic cooperation within ASEAN for Singapore has a stake in the stability and prosperity of the ASEAN region.

On manpower development Mr. Goh said that the pressing need throughout the restructuring of manufacturing industry would be for an abundant supply of skilled, technical and professional manpower. Exact needs are still being worked out and the universities and technical institutions will be asked to expand rapidly. Singapore will be short of engineers in the 1980s at the current rate of output from the University. The University of Singapore will be asked to expand and re-constitute its Engineering Faculty to produce more and better-suited engineers to service and manage Singapore's expanding economy.

Professionals need experience to measure up to international standards of professional competence. It is, therefore, necessary to ensure that there are no closed shop practices of professional cartels. Registration for professionals like architects, doctors, engineers, accountants and lawyers would be further liberalised.

The Minister added, *"To help overcome shortages of labour, policies would be reviewed to attract more females to take up employment and to encourage older people who are still fit to remain in employment."*

On the Budget for the coming fiscal year, the Minister said that it has been formulated on the basis of the following guidelines:

(a) *Financial prudence:* We shall continue with the prudent policy of keeping Government recurrent expenditure down to the minimum and within the revenue expected to be collected within the fiscal year, But consistent with a high standard of administration.

(b) *Development objectives:* The Budget should reflect the thrust and objectives of our policy to restructure the economy and of our development strategies for the Eighties. It should balance economic growth with social objectives. Investment in infrastructural development should be matched by investment in people and improvements in housing and other social amenities.

After quoting figures for the total estimated expenditure and revenue for the financial year 1980, the Minister proposed the following:

(a) Tax changes
(b) Tax concessions
(c) Personal income tax
    (i) Reduction in tax rates, and
    (ii) Relief for handicapped persons.

Tax changes

Withdrawal of protection for cigarettes and tobacco

At present, the manufacture of cigarettes is protected through the imposition of an import duty higher than excise duty. Withdrawal of protection is in keeping with the development strategy to expose to competition those industries which should have grown out of the fledgling stage. The Singapore Government has, therefore, decided to remove this protection for cigarette manufacture by harmonizing excise duty with import duty. Excise duty on cigarette manufacture will therefore be raised from $4 per kilogram to $9 per kilogram. The import duty of cut rag will also be increased from $35 per kilogram to $36 per kilogram.

Tax concessions

(i) Research and development

To encourage manufacturers to develop new products and processes, and to modify existing ones, specific tax incentives will be given to promote R & D activities in Singapore.

For manufacturing enterprises conducting R & D and R & D institutions servicing them, the following tax incentives will be given:

(a) Double deduction of R & D expenditure, other than on buildings and equipment, on a case-by-case basis;
(b) Accelerated depreciation over three years for all plant and machinery for R & D;
(c) Investment allowance of up to 50 percent of the capital investment in R & D, excluding building costs, on a case-by-case basis;
(d) Extension of the initial allowance of 25 percent and annual allowance of 3 percent, presently available only to industrial buildings and structures, to R & D buildings; and
(e) Capitalisation and writing-off of lump sum payments for manufacturing licensings for a period of 5 years.

These concessions will take effect from Year of Assessment 1981.

(ii) Capital allowances for plant and machinery

In line with Singapore's policy to develop high technology and to assist enterprises to mechanise, computerise, and upgrade their operations, the tax treatment of capital allowances for plant and machinery will be liberalised as follows:

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(a) Accelerated depreciation allowance of 33 1/3 percent over three years will be extended to investment in computers and R & D equipment;
(b) The method of granting annual allowances will be converted from the reducing balance to the straight line method; and
(c) The existing depreciation schedule will be replaced by another with more realistic rates for write-offs. See Appendix I to the Budget speech on page 153.

(iii) Stamp duties

In previous years, many incentives have been given to promote the development of Singapore as a financial centre. This year, the Government intends to remove the inconveniences experienced by financial enterprises by removing certain duties altogether and rationalising others at a single rate:

(a) *Mortgages and debentures*
The existing rates of duty on mortgages and debentures will apply but the maximum amount payable is now fixed at $500.

(b) *Marketable securities*
Asian Dollar and Singapore Dollar Bonds are presently granted stamp duty remission on a case-by-case basis. The exemption will now be given across the board.

Stamp duty on contract notes for the trading of marketable securities will also be abolished.

(c) *ACU offshore loan agreements*
The present 1/2 percent ad valorem stamp duty, subject to a maximum of $500 on ACU offshore loan agreements, will be abolished.

In addition, stamp duties on all other documents relating to ACU offshore loans will be abolished.

(d) *Share certificates*
The 0.1 percent ad valorem duty on share certificates will be removed.

(e) *Share transfer deeds*
The 0.2 percent and 0.3 percent duty on share transfer deeds will be standardised at 0.2 percent.

(f) *Insurance plicies*
The existing multifarious duties will be standardised at a single rate of $1 per document.

(g) *Partnership agreements*
The existing manifold rates will be standardised at a single rate of $10.

(h) *Promissory notes*
The duty will be revised to $1 per note.

Stamp duties on the following instruments in the First Schedule of the Stamp Act will also be removed completely:

Article 3 — Agreement or Memorandum of Agreement
Article 7 — Appraisement
Article 8 — Apprenticeship Deed
Article 12 — Average Bond
Article 13 — Award
Article 25 — Contract
Article 28 — Copy or Extract
Article 33 — Deed of any kind not described in this Schedule
Article 37 — Extract
Article 43 — Letter of Allotment and Letter of Renunciation
Article 48 — Note of Protest by the Master of a Ship
Article 54 — Protest of Bill or Note
Article 55 — Protest by the Master of a Ship
Article 67 — Valuation
Article 68 — Warrant for Goods

The concessions on stamp duties will take effect from 1 April 1980.

(iv) Concession for off-shore gold transactions

The Singapore Government has received representations that the tax rate of 40 percent on income derived from off-shore gold transactions inhibits the development of the market. The matter has been studied and Government has decided to remove this disincentive. With effect from the year of assessment 1981, the 10 percent concessionary tax rate will apply to the following income derived from gold transactions with non-residents:

1) Profits arising from the transactions of Asian Currency Units (ACUs) with non-residents, other ACUs, and broker and dealer members of the Gold Exchange of Singapore (GES) in the Singapore and overseas gold markets. This is an extension of the concession so far given to ACUs on income derived from off-shore transactions with non-residents.
2) Fees, commissions and profits of approved broker and dealer members of the GES, that is, those approved by the Monetary Authority of Singapore, arising from their transactions with non-residents, other members of the GES, and ACUs, in both the Singapore and overseas gold markets. Associate members of the GES will not be eligible for the concession.

Personal income tax

(i) Tax rates

Between increasing the level of deductible reliefs and lowering tax rates across the board to afford reliefs from inflation, the Government has opted for the latter. This decision is based on sound principle and on precedent, first established by the Deputy Prime Minister as Minister of Finance, and upheld by the present Minister for Finance since 1970. This general reduction in personal tax rates gives relief to all without shrinking the tax-paying population.

Details of proposed reduction in individual income tax are shown in Appendix II to the Budget speech on page 154.

Every taxpayer will be given a reduction in tax ranging from 6.8 percent, depending on his tax bracket. The average reduction in tax is 16.1 percent.

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The highest marginal rate remains at 55 percent, but the lowest marginal rate is now reduced to 4 percent. Taxpayers in the first and second tax brackets, therefore, enjoy the largest reductions in relative terms. Those in the first taxable bracket will, on average, pay only one percent of their incomes in tax. The others are given tax reductions commensurate with their bigger tax liabilities.

The new rates will take effect from Year of Assessment 1980.

The aim of the Government is to reduce the levels of personal income tax in the next 2-3 years until the maximum effective rate is no more than the company rate of income tax, i.e. 40 percent.

(ii) Relief for handicapped persons

If a taxpayer maintains a brother or sister who is incapacitated by physical or mental infirmity and who does not earn any income and continues to depend on the taxpayer, he will be entitled to claim a deduction of $750. The allowance is presently given only to parents of handicapped persons.

This relief is given only to taxpayers who maintain such a member of the family in the same household. The deduction may also be apportioned if more than one taxpayer maintain the same handicapped brother or sister. It will take effect from Year of Assessment 1980.

Reaction to the Budget

The 1980 Budget has been well received by most Singaporeans who describe it as a Tax Cut Budget or a Joy Budget. Because of the across-the-board tax cuts in personal income tax most people welcome the budget as a give-away budget as every taxpayer at all levels is given a reduction in personal income tax payment for the Year of Assessment 1980. (See old & new rates compared in Appendix I.) There are more "cheers" than "tears" as cigarette manufacturers are perhaps the only group to spill tears over the Budget.

A summary of the tax changes and tax concessions appears as Appendix II.

APPENDIX I

Personal income tax
Old and new rates compared

Chargeable Income		Old Old rate%	Old Tax payable	New New rate%	New Tax payable	savings
On the first	2,500	5	125	4	100	25
On the next	2,500	8	200	7	175	25
On the first	5,000		325		275	50
On the next	2,500	10	250	9	225	25
On the first	7,500		575		500	75
On the next	2,500	12	300	11	275	25
On the first	10,000		875		775	100
On the next	5,000	15	750	14	700	50
On the first	15,000		1,625		1,475	150
On the next	5,000	20	1,000	17	850	150
On the first	20,000		2,625		2,325	300
On the next	5,000	25	1,250	21	1,050	200
On the first	25,000		3,875		3,375	500
On the next	10,000	30	3,000	26	2,600	400
On the first	35,000		6,875		5,975	900
On the next	15,000	35	5,250	32	4,800	450
On the first	50,000		12,125		10,775	1,350
On the next	25,000	40	10,000	34	8,500	1,500
On the first	75,000		22,125		19,275	2,850
On the next	25,000	40	10,000	36	9,000	1,000
On the first	100,000		32,125		28,275	3,850
On the next	100,000	45	45,000	40	40,000	5,000
On the first	200,000		77,125		68,275	8,850
On the next	200,000	50	100,000	45	90,000	10,000
On the first	400,000		177,125		158,275	18,850
On the next	200,000	55	110,000	50	100,000	10,000
On the first	600,000		287,125		258,275	28,850
over	600,000	55		55		

APPENDIX II

Summary of tax changes and tax concessions

Tax changes

Withdrawal of protection for cigarettes and tobacco

Excise duty on cigarette manufacture is raised from $4 to $9 per kilogram and import duty on cut rag is increased from $35 to $36 per kilogram.

Tax concessions

1. Tax concessions for research and development

Tax incentives for research and development to encourage manufacturers to develop new products and processes and to modify existing ones. (Double deduction for R & D expenditure, accelerated depreciation and investment allowance of the capital investment.)

2. Capital allowances for plant and machinery

Higher capital allowances for plant and machinery to encourage development of higher technology and greater automation. (An accelerated depreciation allowance for plant and machinery including computers and R & D equipment, and a more favourable accounting method for writing off equipment, i.e. changes from reducing balance method to straight line method.)

3. Stamp duties

Removal of certain duties and rationalising others at a single rate aimed at promoting the Republic's development as a financial centre. (Removal of stamp duties for Asian dollar and Singapore dollar loans, Asian currency unit off-shore loans, share certificates and standardisation of the duty on share transfer deeds to 0.2 percent.)

4. Concession for offshore gold transactions

To encourage the growth of the market the Minister removed the 40 percent tax on income derived from goal transactions with non-residents and replaced it with a 10 percent concessionary rate.

5. Personal income tax

(i) Tax rates
An across the board reduction in personal tax rates ranging from 6.8 percent to 19.9 percent.

(ii) Relief for handicapped person
A relief of $750 if the taxpayer maintains an incapacitated brother or sister.

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The 1980 Income Tax Changes in the Republic of South Africa

BY DR. ERWIN SPIRO

While pursuing a policy of more growth from greater strength, Senator O.P.F. Horwood, the Minister of Finance, when delivering his Budget speech, emphasized that tax concessions had to be adjusted to prevent the combination of inflation and a progressive tax system, the so-called "fiscal drag", from increasing the real tax burden on the community and thereby actually retarding economic growth. Adverting to the expectations of the taxpayer, however, the Minister of Finance asked him to heed Halifax's warning: "*Men should do with their hopes as they do with their tame fowl: cut their wings that they may not fly over the wall.*"

I. FURTHER CONCESSIONS

Initial and investment allowances. The existing initial and investment allowances, which are two of the principal incentive devices, will be extended for a further period of three years till June 30, 1982.

Building costs of dwellings for employees. To encourage participation by employers in the provision of housing for their employees, the presently existing ceiling on the deduction, for tax purposes, of the building costs of any one dwelling for a farmer's employee will be increased from R4,000 to R5,000. For other employers, the existing allowance of 25 percent of the expenditure incurred will be increased to 50 percent, with a maximum of R4,000 instead of the present R3,000. The revised allowances will apply to the cost of buildings, the erection of which commences on or after April 1, 1980.

Lump sum distributions. The maximum tax-free lump sum benefit paid out of a pension, provident or retirement annuity fund on or after March 1, 1980, will be increased from R45,000 to R60,000. A number of other allied adjustments will also be effected.

Expenses incurred by the physically disabled. The maximum deduction for tax purposes in respect of expenses incurred by the physically disabled will be increased from R600 to R1,200, and all other limitations will be removed.

Married working women. As rising costs prejudice the net income of the two-breadwinner family more than that of the single-breadwinner family, the tax-free portion of married women's income will be increased from R900 to R1,200.

II. STRUCTURAL CHANGES

Subscription shares. The interest on subscription shares of building societies is currently tax-free on a maximum share investment of R150,000 per person (whether such person is the taxpayer or not). This concession appears to the Minister of Finance to be out of line with the far more modest amounts which may be invested tax-free in the Post Office, the Treasury and also in the form of tax-free indefinite period building shares and will now be restricted — to the obvious dismay of the building societies — to a maximum tax-free subscription share investment of R50,000 per taxpayer. To minimize inconveniences, the restriction will be phased in equal amounts over a period of three years.

Loan levy. There being no reason for the continuation of compulsory loans to the State as the necessary funds can be substituted for on a voluntary basis in the form of Government stock issues in the domestic market, all loan levies on individuals and companies will be abolished as from April 1, 1980.

Fringe benefits. Taxation of fringe benefits really means taxation of income in kind. Certain fringe benefits have always been subject to tax, and a new source of revenue is not envisaged. Differences of opinion relate mainly to the method of taxation and the date the tax should be instituted. There are now revised draft proposals, aiming at taxing all housing loans, entertainment allowances, private use of business cars, share participation schemes and low interest or interest free loans and the elimination of discrimination between the private and public sectors. The Minister of Finance intends to bring them into force from March 1, 1981.

Single basic income tax rate for married and unmarried persons. In future, the differentiation between unmarried and married persons will now be achieved, firstly, by allowing a smaller primary rebate to unmarried persons (see the examples under Tax Rebates) and, secondly, by increasing their tax by means of a 20 percent surcharge. The progression of the basic marginal rates of the normal income tax will be adjusted so that the maximum rate in respect of married persons is only reached at R40,000 and in respect of single persons, inclusive of the surcharge, at R28,000. In addition the maximum basic marginal rate will be decreased from the present 55 percent to 50 percent. Reference is made to Annexure — Table II.

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Tax rebates. There will be a return to a system of tax rebates as was in force prior to 1972, in contrast to the system of diminishing income abatements applicable at present. The latter are deducted from the taxable income, reduced, however, as income increases whereas rebates are deducted from the tax regardless of the size of the taxable income (see *Bulletin* 328 (1971)). The existing combined abatement for medical expenses and insurance premiums will be separated. Insurance premiums will continue to qualify for rebate purposes, but as far as medical expenses are concerned, from the 1980/81 tax year, actual medical expenses up to a maximum amount of R1,000 will qualify as a deduction (in the case of persons over the age of 60 years up to a maximum amount of R2,000). As a result a person will only become liable to tax if his taxable income, after deduction of actual medical expenses, exceeds the following amounts:

Persons over the age of 60 years

unmarried	R3,000
married	R4,000

Persons under the age of 60 years

unmarried	R1,500
married	R2,500
married with 1 child	R3,750
married with 2 children	R5,000
married with 3 children	R6,200
married with 4 children	R7,166

III. TAXATION OF BLACK PEOPLE

Last year the Minister of Finance pointed out that the equalization of the tax liability of whites, coloureds and Indians, on the one hand, and blacks, on the other, would extend over a period of three years. As in the case of other population groups, it is necessary also to grant relief in respect of black taxpayers. The threshold of liability for tax will, therefore, be increased from R1,200 to R1,800 per taxpayer, and the tax rate thereafter will be reduced by 20 percent. Reference is made to Annexure — Table I.

IV. FUTURE LAW

Initial and investment allowances. There are certain controversies, but the Minister of Finance felt that the status quo should not lightly be changed and, therefore, directed the Standing Commission on Taxation to investigate the whole issue and to submit recommendations to him.

Fringe benefits. In view of the fact that the proposed measure is to apply only from March 1, 1981 (see II above), employers and employees have, according to the Minister of Finance, been afforded sufficient time to determine the effect of the proposals on their take-home earnings and to adapt to the new approach.

Separate taxation of (working) wives. Referring to fresh representations for the separate taxation of (working) wives, the Minister of Finance still did not see his way clear, both for reasons advanced by the Standing Commission on Taxation Policy and for practical and logistical reasons, to change over now to a system of separate assessments and, one may add, to a separate incidence of tax.

V. RATES OF INCOME TAX (NORMAL TAX)

Persons other than companies. Persons other than companies are, in respect of the taxable income derived in the year of assessment ending on February 28, 1981, or June 30, 1981, whichever is applicable, subject to normal income tax at the rates contained in Annexure — Table II with a maximum basic marginal rate of 50 per cent and with the addition, in the case of unmarried persons, of a 20 percent surcharge on the tax. As mentioned earlier (sub II), the maximum rate will thus be reached where the taxable income exceeds R40,000 in the case of married persons and R28,000 in the case of unmarried persons.

Companies. The rates for companies in respect of taxable income derived in the Republic of South Africa in the year of assessment, that is the financial year ending during the twelve-month period from April 1, 1980 to March 31, 1981, are as follows:

(i) *taxable income derived otherwise than from mining:* 40 cents per R1. A surcharge of 5 percent of such tax is to be added to such tax. The effective rate is thus 42 cents per R1.

(ii) *taxable income derived from gold mining:*
(a) on any mine other than a post-1966 gold mine an amount determined in accordance with one of the formulae laid down plus a surcharge which is not payable in respect of certain assisted gold mines equal to 5 percent of the said amount;
(b) on post-1966 gold mines an amount determined in accordance with one of the formulae laid down plus a surcharge of 5 percent of the said amount;
(c) in the form of excess recoupments over capital expenditure accruing to companies which are or have been gold mining companies the average rate of tax as determined in accordance with the Act or 35 cents per R1, whichever is higher.

(iii) *taxable income derived from mining for diamonds:* 45 cents per R1 plus a surcharge of 5 percent of such amount;

(iv) *taxable income derived from mining operations other than mining for gold or diamonds (or natural oil):* the position is the same as in the case of a non-mining company (see (i) above);

(v) *taxable income derived from mining for natural oil:* in respect of taxable income derived from mining for natural oil (excluding gas) normal tax at the rate applying to non-mining income plus an amount equal to 40 percent of the balance remaining after deducting the normal tax and in respect of taxable income derived from mining for natural oil in the

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form of gas normal tax at the rate applying to non-mining income, the normal and additional taxes chargeable being subject to such a reduction as the Minister of Mines, in consultation with the Minister of Finance, may determine. Where sulphur, salt or any other mineral is won in the course of mining for natural oil, the income derived from the mining of sulphur, salt or other mineral is deemed to be derived from mining for natural oil.

Summary of reductions. The reductions may be summarized as follows:

(i) in the case of all persons; the disappearance of the loan levy, that is 10 percent;
(ii) in the case only of persons other than companies: the reduction of the maximum rate from 55 to 50 per cent, such maximum rate being reached now at R40,000 (instead of before R30,000) in the case of married persons and at R28,000 (instead of before R22,000) in the case of unmarried persons.

VI. RATE OF OTHER TAXES CONTAINED IN THE INCOME TAX ACT

Non-resident shareholders' tax. The non-resident shareholders' tax is 15 percent of the amount of the dividend or interim dividend in question.

Undistributed profits tax. The undistributed profits tax is 33 1/3 cents on every R1 by which the 'distributable income' as defined exceeds the amount of dividends distributed during the 'specified period' as defined.

Non-residents' tax on interest. The non-residents' tax on interest is 10 percent on the amount of the interest in question.

Donations tax. The donations tax is at progressive block rates, the block exceeding R90,000 being taxable at the rate of 25 percent.

ANNEXURE – TABLE I (BLACK TAXATION)

Taxable income	Rates of tax
Where the taxable income—	
does not exceed R1,800	Nil
exceeds R 1,800 but does not exceed R 2,100	R0.00 plus R0.24 for each completed amount of R30 by which the taxable income exceeds R1,800;
exceeds R 2,100 but does not exceed R 3,120	R2.40 plus R0.72 for each completed amount of R30 by which the taxable income exceeds R2,100;
exceeds R 3,120 but does not exceed R 4,140	R26.88 plus R1.68 for each completed amount of R30 by which the taxable income exceeds R3,120;
exceeds R 4,140 but does not exceed R 5,160	R84.00 plus R2.40 for each completed amount of R30 by which the taxable income exceeds R4,140;
exceeds R 5,160 but does not exceed R 6,180	R165.60 plus R3.12 for each completed amount of R30 by which the taxable income exceeds R5,160;
exceeds R 6,180 but does not exceed R 7,200	R271.68 plus R3.36 for each completed amount of R30 by which the taxable income exceeds R6,180;
exceeds R 7,200 but does not exceed R 8,220	R385.92 plus R3.84 for each completed amount of R30 by which the taxable income exceeds R7,200;
exceeds R 8,220 but does not exceed R 9,240	R516.48 plus R4.80 for each completed amount of R30 by which the taxable income exceeds R8,220;
exceeds R 9,240 but does not exceed R10,260	R679.68 plus R5.28 for each completed amount of R30 by which the taxable income exceeds R9,240;
exceeds R10,260 but does not exceed R11,280	R859.20 plus R6.24 for each completed amount of R30 by which the taxable income exceeds R10,260;
exceeds R11,280 but does not exceed R12,300	R1,071.36 plus R6.72 for each completed amount of R30 by which the taxable income exceeds R11,280;
exceeds R12,300 but does not exceed R13,320	R1,299.84 plus R7.68 for each completed amount of R30 by which the taxable income exceeds R12,300;
exceeds R13,320 but does not exceed R14,340	R1,560.96 plus R8.16 for each completed amount of R30 by which the taxable income exceeds R13,320;
exceeds R14,340 but does not exceed R15,360	R1,838.40 plus R8.88 for each completed amount of R30 by which the taxable income exceeds R14,340;
exceeds R15,360 but does not exceed R16,380	R2,140.32 plus R9.60 for each completed amount of R30 by which the taxable income exceeds R15,360;
exceeds R16,380 but does not exceed R17,400	R2,466.72 plus R10.32 for each completed amount of R30 by which the taxable income exceeds R16,380;

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Taxable income	Rates of tax
Where the taxable income—	
exceeds R17,400 but does not exceed R18,420	R2,817.60 plus R10.80 for each completed amount of R30 by which the taxable income exceeds R17,400;
exceeds R18,420 but does not exceed R19,440	R3,184.80 plus R10.80 for each completed amount of R30 by which the taxable income exceeds R18,420;
exceeds R19,440 but does not exceed R20,460	R3,552.00 plus R10.80 for each completed amount of R30 by which the taxable income exceeds R19,440;
exceeds R20,460 but does not exceed R21,480	R3,919.20 plus R11.04 for each completed amount of R30 by which the taxable income exceeds R20,460;
exceeds R21,480 but does not exceed R22,500	R4,294.56 plus R11.04 for each completed amount of R30 by which the taxable income exceeds R21,480;
exceeds R22,500 but does not exceed R23,520	R4,669.92 plus R12.00 for each completed amount of R30 by which the taxable income exceeds R22,500;
exceeds R23,520 but does not exceed R24,540	R5,077.92 plus R12.00 for each completed amount of R30 by which the taxable income exceeds R23,520;
exceeds R24,540 but does not exceed R25,560	R5,485.92 plus R12.72 for each completed amount of R30 by which the taxable income exceeds R24,540;
exceeds R25,560 but does not exceed R26,580	R5,918.40 plus R13.20 for each completed amount of R30 by which the taxable income exceeds R25,560;
exceeds R26,580 but does not exceed R27,600	R6,367.20 plus R13.68 for each completed amount of R30 by which the taxable income exceeds R26,580;
exceeds R27,600 but does not exceed R28,020	R6,832.32 plus R13.92 for each completed amount of R30 by which the taxable income exceeds R27,600;
exceeds R28,020	R7,027.20 plus R14.40 for each completed amount of R30 by which the taxable income exceeds R28,020.

ANNEXURE – TABLE II
(WHITES, COLOUREDS AND INDIANS)

Taxable income	Rates of tax
Where the taxable income—	
does not exceed R6,000	.8 percent of each R1 of the taxable income;
exceeds R 6,000 but does not exceed R 7,000	R480 plus 10 percent of the amount by which the taxable income exceeds R6,000;
exceeds R 7,000 but does not exceed R 8,000	R580 plus 12 percent of the amount by which the taxable income exceeds R7,000;
exceeds R 8,000 but does not exceed R 9,000	R700 plus 14 percent of the amount by which the taxable income exceeds R8,000;
exceeds R 9,000 but does not exceed R10,000	R840 plus 16 percent of the amount by which the taxable income exceeds R9,000;
exceeds R10,000 but does not exceed R11,000	R1,000 plus 18 percent of the amount by which the taxable income exceeds R10,000;
exceeds R11,000 but does not exceed R12,000	R1,180 plus 20 percent of the amount by which the taxable income exceeds R11,000;
exceeds R12,000 but does not exceed R13,000	R1,380 plus 22 percent of the amount by which the taxable income exceeds R12,000;
exceeds R13,000 but does not exceed R14,000	R1,600 plus 24 percent of the amount by which the taxable income exceeds R13,000;
exceeds R14,000 but does not exceed R15,000	R1,840 plus 26 percent of the amount by which the taxable income exceeds R14,000;
exceeds R15,000 but does not exceed R16,000	R2,100 plus 28 percent of the amount by which the taxable income exceeds R15,000;
exceeds R16,000 but does not exceed R18,000	R2,380 plus 30 percent of the amount by which the taxable income exceeds R16,000;
exceeds R18,000 but does not exceed R20,000	R2,980 plus 32 percent of the amount by which the taxable income exceeds R18,000;

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Where the taxable income—

exceeds R20,000 but does not exceed R22,000	R3,620 plus 34 percent of the amount by which the taxable income exceeds R20,000;
exceeds R22,000 but does not exceed R24,000	R4,300 plus 36 percent of the amount by which the taxable income exceeds R22,000;
exceeds R24,000 but does not exceed R26,000	R5,020 plus 38 percent of the amount by which the taxable income exceeds R24,000;
exceeds R26,000 but does not exceed R28,000	R5,780 plus 40 percent of the amount by which the taxable income exceeds R26,000;
exceeds R28,000 but does not exceed R30,000	R6,580 plus 42 percent of the amount by which the taxable income exceeds R28,000;
exceeds R30,000 but does not exceed R32,000	R7,420 plus 44 percent of the amount by which the taxable income exceeds R30,000;
exceeds R32,000 but does not exceed R34,000	R8,300 plus 46 percent of the amount by which the taxable income exceeds R32,000;
exceeds R34,000 but does not exceed R36,000	R9,220 plus 47 percent of the amount by which the taxable income exceeds R34,000;
exceeds R36,000 but does not exceed R38,000	R10,160 plus 48 percent of the amount by which the taxable income exceeds R36,000;
exceeds R38,000 but does not exceed R40,000	R11,120 plus 49 percent of the amount by which the taxable income exceeds R38,000;
exceeds R40,000	R12,100 plus 50 percent of the amount by which the taxable income exceeds R40,000;

AFRICAN TAX SYSTEMS

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- Country Surveys
  - Taxation of Individuals
  - Taxation of Companies
- Revenue Sources
- Fiscal Aspects of Economic Integration in Africa
- Tax Treaties (full texts in English)
- Documentation • Bibliography

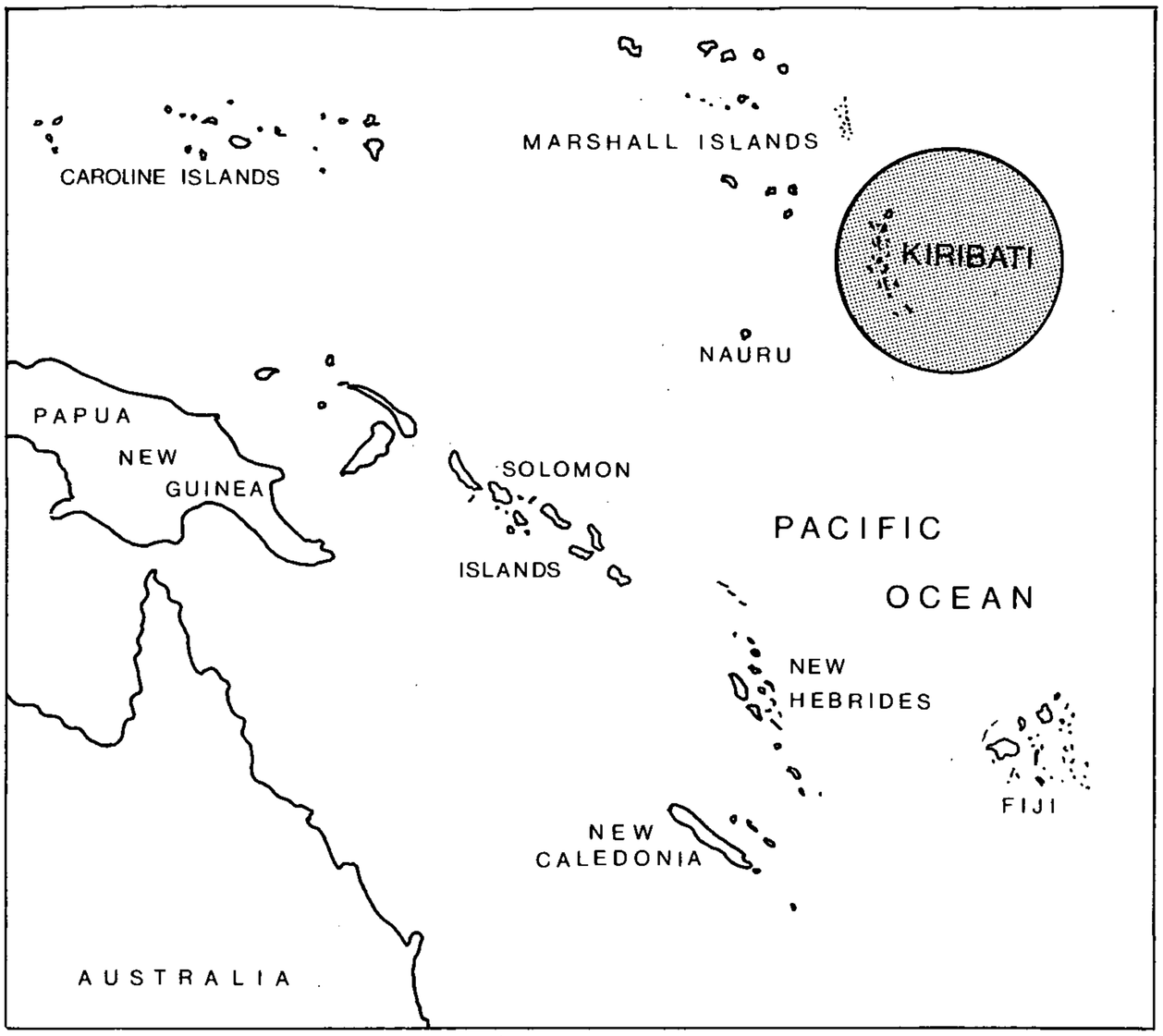
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The Tax System of Kiribati[1]



I. INTRODUCTION

On July 12, 1979 the Gilbert Islands, which until that date had been a colony of the United Kingdom, became independent under the name of the Republic of Kiribati. Its total surface is no more than 655 square kilometres (approximately one quarter of the size of Luxembourg) although its islands are spread over a part of the Pacific which measures more than 4,000,000 square kilometres (about twice the surface of Greenland). [2] Its capital city is Bairiki on the island of Tarawa.

The Republic of Kiribati consists of three groups of islands:

The Gilberts Group:
Makin, Butaritari, Marakei, Abaiang, Tarawa (centre of government administration), Maiana, Abemama, Kuria, Aranuka, Nonouti, Tabiteuea (North and South), Beru, Nikunau, Onotoa, Tamana, Arorae, Banaba.

The Line Group:
Tabuaeran (Washington), Teraina (Fanning), Christmas (Northern Line Group), Malden, Starbuck (Central Line Group), Vostock, Caroline, Flint (Southern Line Group).

The Phoenix Group:
Canton, Orona (Hull), Nikumaroro (Gardner), Moara (Sydney), Phoenix, Birnie, Mckean, Enderbury.

II. POLICY OBJECTIVES

A. Tariff policy

Import tariffs are of particular importance in an economy in which imports constitute a large proportion of local consumption and investment. They influence consumption patterns, the viability of local businesses and the distribution of real incomes. The revenue from import tariffs accounts for 40 percent of locally raised revenue.

The level of tariffs may thus have a considerable effect on the achievement of objectives.

The following principles have been established for guidance in setting tariffs at levels which will assist in establishing a sound long term economic structure and in achieving the objectives of the "National Plan".

(a) Duties should promote the most beneficial economic structure in the long term.
(b) Where compatible with (a), local production should be encouraged by tariff measures.
(c) Where compatible with (b), basic consumer necessities should be subject to minimal duties.
(d) Luxury consumer goods should be subject to high rates of duty for revenue purposes.

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1. We are indebted to Mr. P. Jackson of the Kiribati Ministry of Finance for most of the information published in this note.
2. Wereldmarkt, July 10, 1979 at 8.

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(e) Where compatible with (d), goods which are important in the consumption of rural people should be subject to minimal duties.
(f) Taking into account (a), raw and semi-processed goods should generally be subject to lower duties than processed goods.
(g) Goods conducive to education and health should be subject to minimal duties.

In the Budget of 1978, amongst other measures, the duties on bicycles, sewing machines and lamp oil were eliminated, duties on cotton fabrics reduced and on poultry and eggs increased.

B. Recurrent revenue and investment

The recurrent budget has been financed entirely from local revenue, with a substantial surplus in most years which has been used to build the Revenue Equalisation Reserve Fund. With the expiry of phosphate during this year, the position changes radically, which can be seen from Table 1. Local revenue will be substantially below present expenditure.

Arrangements for funding the deficit have been made with the United Kingdom under the "Independence Financial Settlement", but this settlement allows for the utilisation of part of the Reserve Fund interest per year. It is intended to manage the Reserve Fund so as to slow down, as far as possible, the depreciation of its capital value in real terms. The Agreement provides for a review of financial arrangements in 1982.

C. Foreign investment

The British Phosphate Commissioners (BPC), a partnership of the British, Australian and New Zealand Governments, have played a dominant role in the economy of Kiribati for most of this century through their phosphate mining operation on Banaba.

The BPC has been the main source of overseas earnings, the main source of government revenue and a substantial employer. The consequences of the termination of phosphate mining on Banaba were realised some time ago when it was decided to build up the Revenue Equalisation Reserve Fund with the income derived from phosphate mining.

Besides the BPC, the only significant foreign investment has been in copra plantations, banking and fuel supplies. Fanning Island Plantations owns the islands of Fanning and Washington and operates copra plantations employing about 135 people. Total employment by foreign owned companies, excluding BPC, amounts to about 175 people.

The main constraints on the growth of foreign investment have been the remoteness of the country from major markets, the shortage of land and the lack of skilled manpower. Little effort has been made to promote foreign investment.

With the loss of phosphate revenue the Government is now concerned to build up economic activity in the country and is taking a more active role in the promotion of foreign investment. A number of sectors have been identified as suitable for foreign investment, the most important being fisheries, tourism and mineral exploration.

Foreign investment is specifically to be encouraged in order to develop the economic strength of the nation after the end of phosphate mining. Some of the objectives of this foreign investment will be to promote the development of new and existing industries based on marine and other resources, and to encourage foreign business investment in Kiribati.

Foreign investment will particularly be sought for the development of the country's natural resources and in the commercial and manufacturing sectors. The most suitable projects for foreign investment are likely to be those that:

(a) provide employment for local people;
(b) expand exports or reduce imports;
(c) require large capital sums in joint ventures, where the government contribution can be in the form of the resource to be exploited;
(d) require foreign technology or management to ensure success (e.g. in mineral exploration);
(e) require foreign participation to ensure access to markets.

Further aims regarding foreign investment are:

(a) to ensure local participation in significant ventures involving foreign capital;
(b) to ensure maximum local benefit in employment, overseas earnings and government revenue from ventures involving foreign capital;
(c) to minimise any adverse social effects arising from foreign investment.

III. THE TAX SYSTEM

There are no provisions for such taxes as Wealth tax, Gift tax or Corporation tax, neither is there a levy for Estate duty.

A. Income tax

Income tax is charged on the income earned by a resident, which accrues in, is derived from or is received in Kiribati, and, in the case of a non-resident, that income which accrues in or is derived from Kiribati.

Income tax is charged on all of the following:

(a) gains or profits from:
  (i) any business, for whatever period of time carried on (provided that a husband and wife carrying on a business together shall not be treated as partners in relation to each other for any purpose of this Ordinance);
  (ii) any employment or services rendered;
  (iii) any right granted to any other person for the use or possession of any property;
(b) dividends, interest and discounts;
(c) any pension, charge, annuity or alimony;

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(d) any amount deemed to be his income under this Ordinance.

Note

Any income directly derived from the sale of copra shall be exempt from Income tax, but instead a charge of 25 percent in respect of "Copra tax" shall be levied.

The rates of tax are as follows:

	Australian $		%
First	500	—	9
next	500	—	12
next	1,000	—	21
next	1,000	—	30
next	1,500	—	39
next	1,500	—	45
exceeding	6,000	—	50

The following outgoings and expenses are allowable when ascertaining income in respect of individuals, partnerships or companies:

(a) Interest paid upon borrowed money, where the said money is employed in the production of income chargeable to tax (providing the loan was not for acquiring a source of income outside Kiribati).
(b) Rent paid by any tenant of land or buildings occupied for the purpose of acquiring the income.
(c) Sums expended on the necessary repair of premises, plant, machinery, etc.
(d) Bad debts incurred (in the course of a business).
(e) Contributions to approved pension schemes.
(f) Certain expenditure of a capital nature for the purposes of a business.
(g) Any amount paid by way of alimony or allowance under a decree of divorce.
(h) Any loss incurred, and where it cannot be wholly "set-off" against income from other sources for that year, the remainder shall be carried forward and deducted in ascertaining total income for subsequent years in succession.

In addition to Income tax there are one or two specific taxes, i.e.:

Phosphate taxation (as per the government ordinance as follows): Of the net proceeds per ton of phosphate minerals exported from the Republic, the British Phosphate Commissioners shall in any phosphate year (ending 30/6) pay a phosphate tax. Phosphate tax per ton shall be calculated in with the Table contained in the Schedule, ranging from $3.9045 tax on $4.40 proceeds per ton to $5.6039 tax on $6.40 proceeds per ton.

Landowners taxation: This is a land tax assessed, levied and collected by the Council within whose area of authority the land is situated. The amount of tax to be imposed is determined by the amount of Revenue required to be raised from this source for the Council Fund.

B. Customs duties

Customs duties are levied on both goods imported into and exported out of Kiribati. The rates are either ad valorem or specific and are indicated in the Customs Tariff.

IV. REVENUE

The Government's internal revenue for the years 1973 through 1979 and the forecasted figures for 1980 through 1982 are set out in Table 1.

Table 1

	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
Direct taxes	301	353	592	700	885	880	1,060	820	880	935
Indirect taxes	1,545	2,312	1,889	2,520	2,818	2,510	2,553	2,370	2,410	2,520
Phosphate taxes	2,910	10,603	22,783	9,500	8,301	8,082	6,544	—	—	—
PWD overheads	—	—	—	—	—	450	300	320	340	360
Tuna licences	—	—	—	—	—	259	1,000	1,360	1,430	1,500
Other income	741	1,172	1,091	1,152	1,947	2,807	3,140	3,390	3,630	3,850
Total revenue	5,497	14,440	26,355	13,872	13,951	14,988	14,597	8,260	8,690	9,165

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Ireland: BUDGET 1980

"It's good news for non-drinking, non-smoking, non-driving taxpayers" (Irish Times, February 28, 1980 at 15)

The following is an extract of the text of the Budget statement by the Minister for Finance, Mr. O'Kennedy, pronounced on February 27, 1980.

Prudent management of the public finances and improving the climate for economic development are normal priorities for a Minister for Finance when drawing up his Budget. This obligation takes on a special significance at a time of international economic recession, such as we now experience.

Because the international recession has had a particularly damaging impact on our energy dependent open economy, there is a new burden to be carried today. We must all ensure that this new burden, unwelcome though it may be, will be shouldered evenly by all who can bear it. A progressive economic policy can only be implemented through the collective commitment and action of all sections of the community. It must be built on the firm foundation of a caring and sharing society, so that in overcoming the immediate problems, we emerge more determined to achieve a healthy social and economic order which we can all respect.

My proposals today, and Government policy throughout the year, will be firmly directed towards those ends.

The experience of last year indicates that we have found it difficult as a nation, in a period of growing prosperity, to adjust to the new reality of international economic recession.

But adjust we must, and my Budget proposals today are intended to encourage that adjustment in our individual and national interest. The pursuit of social justice in a basically healthy economy, beset as it may be by serious difficulties, has been a guiding principle for the Government in adopting the proposals which I will outline. I hope that they will evoke a positive and helpful response at this critical time in our national development. Our renewed determination, following the dramatic upsets of the past year, to achieve the objectives of equity and a proper balance in our national finances will not yield immediate results in the year ahead, but it will make a major contribution towards positive progress in that direction.

There is an urgent need to reduce the balance of payments deficit and the level of Exchequer borrowing. In seeking to reduce the level of borrowing, the Government have concentrated on curbing the growth of public expenditure, so as to ensure that taxpayers will be called upon to contribute only to absolutely essential services. We must see to it that the taxpayer's money is used effectively and in a manner that he or she will fully endorse. This will also ensure that the general burden of taxation is kept to the minimum consistent with economic and social priorities.

I will return to both of these themes later, but first I wish to review the economic developments in 1979. These comments will be brief because Deputies have already received a copy of the paper "Economic Background to the Budget, 1980".

●●●

TAXATION

I turn now to the subject of taxation. The over-all level of taxation in Ireland, at 34 percent of GNP in 1978, compared with an average of 40 percent for the other EEC countries. This relatively low level of taxation in Ireland has been made possible only by large-scale borrowing over the past five years to finance current services.

The Government is fully committed to devising an equitable tax system, as between each taxpayer and each section of the community. It is not possible to allow each section the tax system of its choice, nor can a complex tax system be changed all at once. The Government will endeavour to ensure that taxpayers will recognize that no one is being disproportionately burdened and, particularly, that no one, by evasion, passes on his burden to another.

Steps have already been taken in the last two Budgets to improve the position of low income taxpayers, in particular by means of large increases in the personal allowances. The proposals in this Budget will advance the Government's objectives significantly.

The Government-ICTU Working Party on Taxation has devoted considerable time to devising acceptable and factual bases of comparison of the distribution of the tax burden. These are but the initial steps in tackling the complexities of the matter.

In order to assist the Government to assess the problem, objectively, and to design an equitable tax system, the Taoiseach has proposed a full-scale Commission on Taxation. The Government envisages that the Commission would discharge its task with all possible speed and might, by arrangement, provide interim reports on specific tax areas. Significant changes need not await the conclusions of the Commission, as today's Budget measures will show.

Within the obvious constraints that apply this year, my tax proposals should demonstrate the Government's commitment to equity in the tax system in a manner consistent with the economic and social priorities we must pursue.

PERSONAL INCOME TAX

I will deal first with personal income tax. Of all taxes, personal income tax has most notably become a cause of widespread public unrest and dissatisfaction. I cannot in my Budget

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resolve all the problems associated with income tax but, when I have finished, I hope it will be clear that I have gone a long way towards an acceptable tax system — indeed, probably further than most people would reasonably expect, in the present circumstances. I am satisfied that the need to give justice and fair-play to income taxpayers requires that substantial measures be taken now rather than later.

In principle, income tax is a fundamentally fair tax system. Its essence is that each taxpayer pays, according to his means, on a common basis with everybody else in the same position, and that those who are better off pay more by an appropriate amount. The tax code also has a wide range of allowances and reliefs to cater for a varying range of social and family circumstances.

It is when the tax system is allowed to drift away from the basic principle I have outlined that the public's notion of fairness and equity is offended and disquiet about the tax system begins to mount. This is an issue which must be faced and resolved.

There are four main problems to which my proposals must address themselves:

- First of all, in the light of the recent Supreme Court decision, I have to deal with the taxation of married couples, particularly those where both husband and wife are earning.
- Next, I have to tackle the higher tax burden imposed on an increasing number of taxpayers in recent years, because income increases have attracted higher rates of tax.
- Thirdly, I think there is a need to give further reliefs to the less privileged taxpayers — those with low incomes, and, particularly, those with social and physical handicaps.
- Finally, there has been increasing unrest caused by the difference between the basis of assessment applied to wage and salary earners on PAYE and that applied to other taxpayers such as self-employed. These, as a general rule, pay tax based on profits of the accounting period ending in the preceding income tax year.

Married taxpayers

With regard to the taxation of married couples, the Government is satisfied, in the light of recent developments, that nothing less than substantial changes in income taxation will now suffice. We intend, therefore, to implement our undertaking to alleviate the taxation of married couples.

A narrow approach towards effecting the minimum changes to meet the Supreme Court's decision would lead to unjustifiable discrimination against the one income family particularly where a married woman elects to care for the family on a full time basis at home rather than take up work outside the home.

Even in cases where both spouses are working, their tax liability, if nothing were done, would vary depending on how incomes were divided between them. There would also be considerable scope for tax avoidance by self-employed and better-off taxpayers, who could now attempt to take advantage of the Court's decision and arrange for both spouses to have an income designed to minimise liability for tax.

To implement the basic principle that taxpayers, with the same income and the same family and social circumstances should pay the same amount of tax, the Government has decided to implement now in full our longer-term plans for income-splitting.

This means, in effect, that all married couples, whether with one, or two, incomes, will have the benefit of double the personal allowance and rate bands applicable to single persons.

The Government is reinforced in its view that this represents a major and much needed social advance in the tax system by the views expressed by such representative bodies as the Irish Congress of Trade Unions. The Government believes that the introduction of this principle accords with the general needs and wishes of the community, notwithstanding the cost and the inevitable measure of tax redistribution involved.

The main personal allowances have been increased, substantially, in each of the past two years and, even if unchanged, would still be higher in real terms than they were in 1977.

Employees

However, I am providing a special Schedule E employee allowance of £400 for each PAYE taxpayer in order to improve the tax progression for these taxpayers, and also to take account of the fact that the self-employed, generally, have at present the advantage of paying tax on a previous year basis.

I intend to exclude from this provision those Schedule E taxpayers in a position to control their own remuneration or that of their spouses, for example directors of proprietary companies. This Schedule E employee allowance is also intended to take account of the case made by ICTU that the present general scheme of allowances discriminates against employees and in favour of other taxpayers. Where an eligible husband and wife are both earning, this allowance will apply to each income. On the other hand, as a consequence of the introduction of income-splitting, the working wife allowance is being abolished.

Adjustment to inflation

The higher rates of tax — or tax bands — now apply at unduly low rates of pay. This has occurred largely because, over the years, the value of the tax bands has not kept pace with inflation. Income taxation has become too progressive. Relatively high marginal tax rates clearly contribute to inflation and affect the attitude to work and attendance at work.

I have decided to tackle this problem as effectively and as fundamentally as I can. I propose, therefore, to raise the income levels at which the tax rates from 35 percent upwards apply.

The new rate structure will be as follows:
The first £1,000 of taxable income

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for single persons and £2,000 for married persons will be at a rate of 25 percent; the next £4,000 for single persons and £8,000 for married persons will be at 35 percent; the next £2,000 for single persons and £4,000 for married persons will be at 45 percent; the next £2,000 for single persons and £4,000 for married persons will be at a new rate of 55 percent; and the balance of taxable income, that is above £9,000 for single persons and £18,000 for married persons, will be taxed at a rate of 60 percent.

The special allowance for PAYE taxpayers will have the effect of raising the point of application of the 25 percent and higher tax bands by a further £400, or by a further £800 where an eligible married couple are both earning.

A male industrial worker on, say, just over £100 a week will get relief of about £150 if he is single and £230 if he is married. If his wife also works and earns the average industrial female wage, the total relief for the couple will be about £500 or over 20 percent of their tax bill.

At present a married PAYE earner whose wife does not work may move from the standard, or 35 percent rate, to 45 percent at £122 per week. As a result of may proposals, this will not now happen until his earnings reach not less than £243 per week. The corresponding figure for single persons is raised from £100 to £125 a week.

The new structure, at one stroke, will bring over 180,000 taxpayers, or nearly two-thirds of those at present liable at higher rates, down to the lower standard rate band.

Tables which are circulated with my Financial Statement will show the relief which is granted to different categories of taxpayers.

It may appear that the distribution of tax relief unduly favours married couples with higher incomes, but this is an unavoidable consequence of observing the Supreme Court decision and of implementing income-splitting in full.

In broad terms, a relief given to a single person is doubled for married couples. Consequently, unless single persons on relatively modest incomes were to have their income tax burden increased, married couples with high incomes had to obtain substantial tax relief. The Government were faced with a situation in which the income of the average single male industrial worker had in many cases brought him into the 45 percent tax band. To remedy this situation, it was necessary to widen the standard rate tax band for single people — with a resultant double benefit for married couples.

The following is an example of the effect of my proposals on a married couple where the husband is earning £8,000 and his wife, who also works, is earning £4,000. Between them, because both are working, they have an income of about twice the average income for single workers. In 1979/80 they paid much more than twice the average tax of single persons and the top rate of 60 percent applied to part of their incomes. Their top rate of tax will now be reduced to 35 percent and the amount of tax they pay will be twice that of two single persons each earning half their combined income of £12,000 — their tax will be reduced by over £1,300. Under my proposals, much the same

HIGHLIGHTS OF THE IRISH BUDGET 1980

- The 20 percent VAT rate is increased to 25 percent from May 1, 1980.
- Following a recent court case declaring certain tax provisions unconstitutional, married couples may be assessed separately as single persons. There is an option for joint assessment whereby double the single allowance and double the tax bands for single persons is applicable. The single allowance is £1,115 and the tax rates for 1980/81 are:

Single persons	*Married couple-joint assessment*
25 percent on first £1,000	on first £ 2,000
35 percent on next £4,000	on next £ 8,000
45 percent on next £2,000	on next £ 4,000
55 percent on next £2,000	on next £ 4,000
60 percent above £9,000	above £18,000

- New special allowance of £400 for each PAYE employee except proprietory directors.
- Allowance for a child reduced by £23 to £195; allowances for one-parent families and blind persons doubled to £500 and £330 respectively.
- Exempt compensation for loss of employment increased from £3,000 to £6,000.
- The burden of taxation on farmers is increased. A resource tax of £3.50 for every £1 of rateable value in respect of holdings of £70 rateable value and over is introduced from April 6, 1980. The notional basis of assessment to income tax is abolished and replaced by the normal accounts basis. Furthermore, accelerated capital allowances for plant and machinery are restricted to 30 percent of net farm profit.
- Special rate of corporation tax of 25 percent for manufacturing companies is extended to December 31, 1980 where necessary conditions are satisfied.
- Stock relief is extended for a year — 1980/81 for income tax and accounting periods ending in the year to April 5, 1980 for corporation tax.
- Deductions for business expenses restricted to 50 percent of the taxpayer's taxable profits.
- Rises in excise duties include 20p per gallon on petrol, diesel and LPG and 40p per bottle on table wine.

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relief will now be given to a single income family.

The net result of the Budget proposals will be that the burden of income tax for nine out of ten single people on PAYE will now be less than it was in 1977/78. In the case of all married couples on PAYE, the burden will now be less than at any time since the introduction of the present unified system of income tax in 1974/75. For married couples generally, the income tax structure will be at least comparable with that in the U.K. and, for the vast majority of taxpayers on lower incomes, whether single or married, it will be significantly better.

Subsidiary deductions

I now come to deal with less privileged taxpayers. I am concerned that liability to income tax can apply to persons on very low incomes, particularly young people just starting work and casual or part-time workers. I cannot solve this problem completely but I am happy to go a long way in that direction by introducing complete tax exemption limits for people on low incomes, including those affected by sickness and unemployment. The exemption limits will be £1,700 for single and widowed persons and £3,400 for married persons. There will also be marginal relief at a rate of 60 percent for taxpayers with incomes just above the exemption limits. As a result of this proposal, 75,000 persons who would otherwise pay tax this year will now not do so.

A single person on £33 per week will be relieved of all his tax amounting to £146 per year. A married couple on £66 per week will get full relief of £300 a year.

The Government are particularly aware of the difficulties and anxieties experienced by many old persons in completing their income tax returns and complying with their tax obligations generally. In many cases this is out of all proportion to the ultimate liability involved. For this reason, I propose to raise the age exemption limits to £2,000 and £4,000 respectively for single and married persons aged 65 years and over. Special exemption limits of £2,500 and £5,000 will be introduced for persons aged 75 years and over. These limits will remove 8,000 old persons from the tax net, bringing to 83,000 the number of low-income taxpayers removed from liability. Marginal relief will benefit many more.

In 1969, an allowance was introduced to cover the case in which an individual, or his wife, is totally incapacitated throughout the year of assessment and a person is employed for the purpose of taking care of the incapacitated persons. I propose to double this allowance to £330.

I also propose to increase the allowance for incapacitated children to double the normal child allowance.

A special allowance of £250 was introduced last year for one-parent families which consist of a widowed person, a deserted spouse or an unmarried parent with a dependent child or children. This was widely welcomed. I am satisfied that this allowance fulfils a genuine social need and I propose to double it, to £500.

The allowance for blind persons has been increased since it was introduced in 1971. I propose to double this allowance also to £330. In the case of a married couple, both of whom are blind, this allowance will apply to each spouse.

Welfare benefits

The Government have been reconsidering the planned taxation of short-term social welfare benefits from April 6th next, which was provided for last year. The new tax exemption which I have proposed for those on lower incomes would reduce any revenue gain from the effects of making short-term social welfare benefits taxable and, moreover, the new tax structure will improve the incentive to work. In these circumstances the Government have come to the conclusion that the proposal should not be implemented. This change in plans will cost £8.5 million in 1980. The necessary amendment will be included in the Finance Bill.

In drawing up my proposals I had particular regard to the representations made by ICTU. In many respects the effects of my proposals on individual taxpayers are quite similar to those of the ideas they had put forward. Where there are differences, they are not, I feel, major ones.

The total cost of the changes in allowances, rate bands and exemptions is £131.5 million in 1980 and £227 million in a full year. Including the decision not to tax short-term social welfare benefits, I have now deducted £140 million in 1980 from the revenue side of the Budget.

Self-employed

The fourth major element in my income tax package this year is to devise more uniform treatment of employed and self-employed persons.

Self-employed persons are normally charged to income tax in any year on the basis of the profits of the accounting period ending in the preceding income tax year. In present circumstances, when both incomes and profits are rising rapidly in money terms each year, this results in a substantial advantage to the self-employed compared with taxpayers in the PAYE sector, where tax is charged on current earnings. It would be in the interest of greater equity if both sectors were brought to an equivalent basis of assessment as soon as possible. Where there are considerable difficulties in doing this, I am examining the matter with a view to bringing about the changes that are necessary.

I have already announced that I am giving a special PAYE allowance of £400 to compensate PAYE taxpayers for the generally more favourable basis of assessment applied to other taxpayers. I now propose also to change the dates of payment for Schedule D tax on self-employed. At present this tax is payable in two instalments on September 1st and January 1st in the year of assessment. Subject to an exception to which I shall come later, I propose to provide that all income tax other than PAYE will now be payable in one instalment on October 1st in the year of assessment.

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This change will yield £24 million in 1980.

Supreme Court judgement

As I have outlined, my tax proposals for 1980/81 take fully into account the Supreme Court decision on the taxation of married couples where both spouses are earning. I have extended this principle to all married couples and legislation in the Finance Bill will be drafted on this basis for 1980/81 onwards. I await the decision of the Supreme Court in regard to the issues recently opened before it to determine the further measures, if any, I might be required to adopt.

Home improvements

Last year a scheme was introduced, to operate for 1979/80 only, to give income tax relief, within certain limits, for the labour content of expenditure on home maintenance and improvements. As the implementation of this scheme was affected by last year's postal dispute, I propose to continue the relief for another year.

Life insurance

I have received representations that the £1,000 limit on relief in respect of life insurance premiums, which was introduced in 1974, should be raised. Due to the restriction to one-sixth of total income on the amount of premiums qualifying for relief, an increase in the limit would only benefit persons with incomes over £6,000, who are already getting substantial tax relief under my Budget proposals otherwise. However, I have decided that where a husband and wife are assessed as single persons the £1,000 limit should be applied to premiums paid by each spouse on policies on the life of either spouse. Where a couple opt for income-splitting a limit of £2,000 will apply. This will cost £0.2 million in 1980.

Compensation for loss of job

Representations have been made to me that the existing tax exemption limit of £3,000 in respect of lump sums paid as compensation for loss of employment is too low as it has not been changed since 1964. I propose to increase the limit to £6,000.

FARMING

Developments in agriculture have generally been very favourable to our farmers since we joined the EEC. Last year was, however, an exception. Between 1975 and 1978 farm incomes rose by 76 percent but in 1979 it is estimated that they fell by about 4 percent. Proposals made recently by the EEC Commission on price fixing as part of the annual review of prices and on measures to deal with surplus production would, if approved, seriously affect our farmers, particularly those engaged in the production of milk and sugar-beet. These proposals would also seriously affect workers in the related food processing industries. The Government have already made known their opposition to the proposals and they will continue to oppose them strenuously.

A strong and developing agricultural sector is basic to the economic well-being of the nation. Agriculture supports not only those directly engaged in farming but also the many thousands of others working in food processing and in services. The rapid development of agriculture since we joined the EEC reflects the energy and dynamism with which our farmers have taken advantage of the opportunities opened to them through higher prices and free access to markets provided by the Common Agricultural Policy. Investment in land improvement and in up-to-date equipment and buildings has grown enormously — traditional methods are more and more giving way to modern sophisticated techniques of farm management and production.

There is a growing realisation of the mutual interdependence between the rural and urban communities. I am anxious that understanding between farmers and workers in general be promoted and fostered. I am heartened by the recent meeting between the farming organisations and the Irish Congress of Trade Unions to develop such understanding and also by the support given by the unions to the recent rally against the proposed super-levy on milk.

Do farmers pay too little?

However, the proportion of tax paid by each sector has been unfortunately, a source of division rather than understanding between them. Since the introduction of farm taxation in 1974, taxpayers generally have felt that the amount of tax paid by farmers was less than was justified by reference to farm incomes and was not conducive to achieving equity between farmers and other sectors of the community. It is true that, in that period, farm incomes have risen substantially and the Government last year, after lengthy consultations, announced a revised system of farm taxation to be introduced this year.

Whatever differences of opinion exist on the appropriate relative share of tax paid by each sector, I believe there is universal acceptance of the principle that the amount of tax paid should reflect the income of the taxpayer. Where there is a decline in income as was experienced by the farming community in the unfavourable conditions of last year, the estimate of yield from tax must be reduced. To do otherwise would be to add a disproportionate burden of tax to the loss of income already sustained.

I do not therefore propose to insist that the yield from farm taxation in 1980 be of the same order of £100 million as was calculated before this fall in income emerged. I am not insisting on a pre-determined yield from the scheme that has been announced but I must estimate the likely yield from that scheme as with every other revenue category.

Deputies will be familiar with the scheme announced last year. How-

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ever, I feel I should outline it here again, particularly as I propose to make some adjustments to it. These adjustments should have little or no revenue implications but should facilitate the operation of the scheme and at the same time take account of the special circumstances of the farming community.

In the first instance, the threshold for liability to income tax will be lowered from £50 RV to £40 RV, making a further 9,000 full-time farmers, or 36,000 in all, liable to income tax. However, marginal relief will apply between £40 RV and £49 RV, so that a farmer with a holding of £40 RV will pay only one-tenth of his full liability, two-tenths at £41 RV and so on until the full liability becomes payable at £49 RV.

All farmers who are liable to income tax will be assessed on the basis of their profits as shown in accounts. I recognise, however, that farmers between £40 and £50 RV entering the tax system for the first time may have difficulty in preparing accounts. Accordingly I have decided that a simplified form of accounts should be used in these cases. The Revenue Commissioners, at my request, are consulting with the farming organisations to examine the form such simplified accounts should take. A new mobile advisory service which I propose to provide for taxpayers generally, and to which I will refer later, should be of special assistance for farmers in this new category.

As is normal when the income tax threshold is lowered, farmers entering the tax net for the first time will have the option of presenting current year's accounts rather than the normal previous year's accounts. This option will only apply this year as the Government have decided that the tax threshold for farmers will not be further lowered within the next three years. I think this is desirable to enable the Government to assess the operation of the scheme as it now stands. It will also enable farmers to plan ahead without the uncertainty in this area which can sometimes appear to act as a disincentive.

Lump sum assessment abolished

The notional basis of assessment will be abolished. The notional basis was introduced in 1974 and was designed to assist farmers who were not used to keeping accounts and in general to ease farmers into the tax system. It has now outlived its usefulness and can no longer be justified on equity grounds since it allows some of the highest-earning farmers to pay tax on only a fraction of their real incomes.

As announced, a restriction of capital allowances to 30 percent of net profit before deduction of capital allowances was to apply where accelerated allowances are claimed. However, as I am anxious to encourage investment for further development and increased productivity, I have decided that the restriction should be confined to plant and machinery only. This means that the restriction will not apply to farm buildings or to farm works such as land reclamation or fencing.

Over investment in plant and machinery inspired by tax avoidance is not in farmers' own best interest; nor is it in the best interest of the community as a whole since the bulk of farm machinery has to be imported to the detriment of our balance of payments. In addition, there is not a limitless pool of available credit for agriculture and wastefully soaking up an undue amount on plant and machinery which is not sufficiently employed to pay its way, deprives other more deserving and productive areas of the necessary funds. The restriction which will not affect ordinary wear and tear allowances, represents merely a deferment to later years of part of the extra capital allowances. It should not affect genuine investment which is so important to the development of agriculture.

Rates on land

As regards rates on land, which was another element of the scheme, the Minister for Environment has already announced that he will shortly introduce the necessary legislation to lower the cut-off point for rates relief under the Agricultural Grant from £60 RV to £40 RV. The cut-off point will remain at £40 RV for three years.

The scheme announced last year provided that full-time farmers would no longer pay their income tax in a single payment on January 1st, but rather in two instalments on September 1st and January 1st, in the same way as other Schedule D taxpayers. I have already announced that a single payment date of October 1st is to be introduced this year for Schedule D taxpayers generally. However, if this were applied to full-time farmers, it would mean that they would pay two years' tax in 1980 — their full 1979/80 tax under the existing single-payment date system on January 1st last, and their full 1980/81 tax under the new single-payment date for Schedule D taxpayers on October 1st. I have decided to avoid this in the interest of equity in their case. I intend instead to postpone the payment of the first instalment of 1980/81 income tax to October 1st to coincide with the single payment date of other Schedule D taxpayers.

The resource tax on all holdings of £70 RV and over at a rate of £3.50 per £ RV will be introduced from April 6th 1980. It had been intended that this tax would have been payable in one instalment on September 1st. But, in line with what I have already indicated in relation to income tax, I propose that this date should be October 1st. Marginal relief will apply to holdings between £70 TV and £79 RV.

As I have indicated, I must provide in my Budget, as in all other cases, for an estimate of the revenue yield from the farm tax scheme. Accordingly the estimated 1980 yield will now be £86 million, consisting of £33 million from income tax, £46 million from rates on land and £7 million from the resource tax. This compares with £16 million from income tax and £36 million from rates on land in 1979.

The income tax reliefs which I have announced earlier will, of course, apply also to farmers.

This scheme of farm taxation is designed to move towards equity be-

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tween taxpayers and indeed between farmers. I think that farmers themselves will recognise that it is in the interest of the farming community generally that farmers with sufficiently high incomes actually pay — and be seen to be paying — their fair share of tax from the income which they have. As I indicated to the farming organisations in my consultations with them, the operation of this revised scheme now being introduced will be kept under review in the interest of equity and in the light of experience of its operation.

Gifts and inheritances

I have received numerous representations on the question of the liability of farmers to capital acquisitions tax, i.e. gift tax and inheritance tax, on the transfer of the family farm. Many farmers have been concerned about their possible liability to the tax in view of the big increase in land prices since the tax was introduced in 1976. Because of this land price rise the market value of many farms has in recent times been substantially higher than their income-earning capacity.

Despite a tendency lately for market prices to reduce more in line with use value and thereby easing this concern I have decided to increase the upper limit of the special agricultural relief from £100,000 to £150,000 in the Finance Bill, with effect from April 1st next. This will mean that the market value of agricultural property for the purposes of the tax may be reduced by up to £150,000 for farmer beneficiaries, thereby directly relieving the problem caused by the land price rise. The cost in the current year of this change will not be significant because of the time lag between liability and payment. I firmly hope that this concession will act as a real incentive to transfers of farms to the younger generation of the farming community, and thereby promote productivity and increase the income from family farms — to the benefit of the whole economy.

ADVISORY OFFICE

It has been my experience and, I am sure, that of many Deputies that many taxpayers are bewildered about tax and find it difficult to come to grips with the complexity of the workings of the tax system. This may cause unnecessary apprehension which, in my opinion, can be overcome if the taxpayer could have access to an advisory service. Some people may not be aware that such a service is already provided in tax offices and is widely availed of. I have now arranged, in addition for the acquisition by the Revenue Commissioners of a mobile tax advisory office. This unit should be ready in a few months and will provide an advisory service for those not resident near tax offices. I stress that this service will be purely for advisory work, to enable individual taxpayers who need it to have direct access to advice, free of charge.

I will keep the operation of this service under review in the light of experience, to ensure that it is of maximum benefit to those taxpayers who require it.

Deputies will appreciate that its success will depend on the closest cooperation and understanding between the people who have access to it and the Revenue officers who are always ready to provide guidance for the public in filling in their returns form.

BUSINESS

Inventory

Stock relief was introduced as a temporary measure in 1975 in order to assist firms in certain sectors in coping with the effects of inflation on the cost of replacing stocks. Under present legislation, stock relief is available in respect of accounting periods ending before 6 April 1979.

The 1979 Budget continued the relief for a further year at a rate of three-quarters of that previously allowed. I have decided that the relief should be continued for a further year at the level obtaining in 1979. This will cost the Exchequer £3 million in 1980.

Manufacturers

The 1977 Budget introduced an incentive scheme whereby manufacturers showing certain improvements in output and employment could benefit from a special 25 percent rate of corporation tax. The scheme, whose terms were made more favourable in 1978, covered the years 1977, 1978 and 1979.

I have decided to extend the scheme to 1980 pending the introduction of the new 10 percent rate for manufacturing profits generally. As Deputies are aware, a 10 percent rate of corporation tax will come into operation as from 1 January 1981 and will run to the end of the year 2000. Provision will be included in the forthcoming Finance Bill to give effect to this scheme.

Entertainment

Considerable disquiet has been caused by the fact that many business concerns are seen to entertain on an unduly lavish scale, ostensibly for the purpose of building up the goodwill required to secure and retain customers. The stricter test for determining the admissibility of expenditure incurred for business entertainment which was introduced in 1973 does not appear to be having the desired effects. Unnecessary entertainment not only entails a subsidy from the taxpayer but also arouses a sense of inequity in the minds of those taxpayers who cannot afford to indulge in it themselves. Accordingly I propose to limit the allowance for business entertainment expenses for tax purposes to 50 percent in future.

Financial institutions

I am conscious of the vital role which the financial institutions play

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in providing for the requirements of industry and commerce as well as individuals. The question nevertheless arises as to whether the contribution to taxation by these institutions is fair and equitable having regard to the contribution being made by individuals to income taxation.

Intricate problems and interests other than those of the financial institutions themselves are involved and I am at present reviewing the matter. At the same time, I feel that this whole field might well benefit from the type of close and objective study which could be given to it by the proposed Commission on Taxation. I will consider, therefore, asking the commission, as soon as it is set up, to carry out such an investigation as a matter of urgency and, if practicable, to deal with the question by way of an interim report.

I have considered, as a general matter of tax equity, the desirability of bringing forward the time of payment of tax by companies in the light of the change now proposed in relation to individual taxpayers other than PAYE taxpayers.

This could be justified in equity, but I am also conscious of the effect which such measures could have on liquidity and investment in present circumstances. While keeping the matter under review, I have decided to defer making such a change for the present. I have also in mind that it would be useful if the proposed taxation commission were to investigate the contribution to taxation by companies at large and I would propose to ask them to include it in their programme of work.

INDIRECT TAXATION

There is of course no escaping the fact that the income tax improvements and social welfare improvements being announced today must be met from taxation and the only realistic source for the vast bulk of this is indirect taxation. There is no scope through other forms of income taxation or of direct taxation otherwise for raising the amounts involved.

Pursuing the general social orientation of my proposals, I have concentrated my indirect tax proposals on discretionary expenditure as far as possible. In this way, the impact will be minimised on the necessities of life, and therefore on households and individuals whose means and commitments are such as to allow of only limited discretionary expenditure.

There are of course limits to the extent to which the wide range of essential public services can be financed from highly selective taxation, but my purpose has been to travel this road as far as I can.

The one area where I have felt obliged to tax less discretionary expenditure has been oil products and related headings. Energy considerations, balance of payments considerations, and of course revenue considerations all arise here. The balance of payments and budgetary needs I have already explained. We simply have to reduce our dependence on highly priced imported oils. Our pattern of usage of private motor transport in particular derives from an era when our roads and streets were less congested and when the human, environmental and financial costs of our habits were of little consequence.

It is vitally important for economic, social and environmental reasons that we rationalise our consumption habits. Car-pooling, use of public transport, good driving habits and staggered arrangements for delivery of goods to congested urban and city areas can all play a major role in relieving the obvious problems and ensure that motor transport can once again be an unqualified social and economic benefit for all. Some recovery of the lost ground of latter years in petrol taxation is clearly called for, together with a greater balance in taxation of oil products generally.

Hydrocarbon oils

Excise on all of the hydrocarbon oils has not been increased since 1976, and road diesel has remained at its present level since 1969. I purpose the following increases.

First, I propose an increase of 20p per gallon for petrol, road diesel and liquid petroleum gas (LPG) used in motor vehicles. Revenue considerations demand that no undue encouragement be given to switching away from the more highly taxed petrol.

The rebate for diesel oil used in buses on services scheduled in accordance with the relevant legislation will be increased appropriately so that bus fares will not be affected.

I am particularly concerned about the special case of handicapped drivers, a concern which I believe the public share.

In order to avoid imposing additional taxation on these drivers, I am arranging that the rebate to them will be increased by the full amount of the duty. In addition, I am increasing from 450 to 600 gallons the annual quota allowed to these drivers.

Other oils

I have given very careful consideration to the effects an increase in the duty on "other oils" might have on different categories of users, to energy conservation and to the alternative tax measures which might be otherwise required. I have decided that it would be appropriate, taking all the relevant factors into account, as they affect both individuals and industrial concerns, to propose an increase of 5p per gallon on these oils. By way of extension of an existing concession, producers with glasshouses of a minimum area of one quarter of an acre and mushroom growers with not less than 3,000 square feet of cultivation area will be rebated 3p of this 5p increase.

The additional revenue in 1980 from the tax increases on hydrocarbon oils is estimated at £113 million.

Private motor vehicles

In the light of what I have already

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said, additional taxation on private motor vehicles also clearly falls to be considered. I propose that the excise duty on private motor vehicles, including motor cycles, should be increased from 35 percent to 40 percent. This can be expected to result in an increase of about 3.5 percent in the retail price. The estimated revenue yield in 1980 is £9.2 million.

The total yield in 1980 from the foregoing proposals for tax increases would be £122.2 million. This would be far short of what is required to finance the cost of the reliefs in direct taxation so I must turn at this point to what are popularly known as the "old reliables". In doing so I am encouraged by the fact that these are discretionary expenditures, and expenditures not without their social undertones in some cases.

Tobacco

I am proposing a tax increase of 10p in the retail price of the packet of 20 cigarettes in the most popular price category, with pro rata increases for cigars and other tobacco products. These increases are estimated to bring in extra revenue of £19.0 million in 1980.

Spirits

An additional 16p tax is proposed in the retail price of a glass of spirits. This will mean an extra 8p on the normal half-glass measure. This is estimated to bring in extra revenue of £14.0 million in 1980.

Beer

An increase of 6p is proposed in the tax element in the retail price of the pint of beer. This is estimated to bring in extra revenue of £30.8 million in 1980.

I also propose to increase the taxes on wine, cider and perry, and table waters.

Wines

An increase of 40p is proposed in the tax element in the retail price of a bottle of table wine. The increase will be pro rata for stronger wines, and for sparkling wines the proposed increase is 80p per bottle.

Cider

Following the restructuring of the excise duty on cider and perry in the 1979 Budget, I propose a modest increase of 10p in the tax element of the retail price of the gallon of ordinary cider. The change represents an increase of roughly 2.0p in the price of the ordinary flagon of cider. The highest strength will bear excise duty at the new rate proposed for "made wine", while cider and perry of intermediate strength will be increased by 55p a gallon.

Table waters

The existing rate of excise duty of 10p per gallon on table waters has not been altered since 1975. I propose to increase the tax element in the retail price per gallon by 30p. The new rate will be equivalent to: 6.6p on the family sized bottle (1 litre), 2.2p on the 12 oz. can and 0.7p on the 4 oz. mixer.

I am very aware of the effects this increase could have on the smaller manufacturers of mineral waters so I propose to increase the existing rebate provision pro rata. The new level of rebate will be: 12.4p on the first 20,000 gallons of output and 6.2p on the next 80,000 gallons of output.
The increases proposed for tobacco, alcoholic drinks and table waters are estimated to bring in extra revenue totalling £75.8 million in 1980.

Value-added tax

I consider in the special circumstances of this year and particularly from a balance of payments point of view that some more general constraint on expenditure is needed. The Government gave careful consideration to the question of some fundamental alterations in value-added tax. They decided, for reasons of social concern, that the present zero and 10 percent categories should remain unaltered but that an increase in the 20 percent rate to 25 percent would be justified and least likely to cause hardship. This will take effect from 1 May 1980. The additional revenue expected in 1980 from this change is £17.75 million.

I turn now to other, less general, excise and other duties where an upward adjustment of tax is necessary and appropriate.

Televisions and records

It is proposed that the specific duty of £69 on the top category of colour TV sets will be increased by £10 with pro rata increases for all other categories of colour and monochrome sets. It is also intended to increase the excise duty on gramophone records from 30 percent to 40 percent.

Cigarette lighters

I am aware that for some time now there has been a rapid growth in the sale of disposable cigarette lighters. Lighters are not subject to excise duty while matches are. Notwithstanding the fact that lighters attract VAT at a higher rate, the overall taxation favours lighters. For this reason I propose that a new excise duty of 20p per lighter be imposed on all lighters.

Stamp duty on cheques

I propose to increase in the Finance Bill the stamp duty on cheques from 1p to 3p. The 1p rate has applied since February 1971.
These three changes will yield an extra £1.6 million in 1980.

Minor excise duties

There is a large number of miscellaneous licences issued which bear an excise duty. They relate mainly to the alcoholic drinks industry and to auctioneering, betting and gaming, as well as to many other activities. I am having these examined with a view to increasing the duty, where appropri-

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ate, in order to bring them up to a realistic level in present day terms or, at least, to cover the present day costs of administering them. I would intend to make the bulk of these changes in the forthcoming Finance Bill.

I have already decided to increase the licence duty on gaming machines. The proposed new rate is £100 for a full licence for each machine and £25 for a quarter year. I am increasing the reduced rate licence to £16.50 a quarter, but at the same time extending it to cover Saturdays as well as Sundays and public holidays. I also intend to provide in the Finance Bill for an increase in the licence duty for gaming premises from £100 to £200.

I also propose to double the existing rates for firearm certificates. The new rate, for example, for a shotgun will now be £6.50 a year.

The additional revenue in this area of miscellaneous licence duties is estimated at £1.2 million in 1980.

I turn to two further revenue proposals, one affecting outdoor and the other indoor recreation. I feel I voice a commonly held view when I say that racecourse betting and dancing might be called on to make a contribution to revenue needs.

On-course betting

There is a wide differential between the 20 percent excise duty which applies to off-course betting and the 6 percent levy which operates for on-course betting with bookmakers. I am having the general role of the latter levy in the financing of the racing industry reviewed but, in the meantime, I propose to impose a stamp duty of 1.5 percent on on-course betting with bookmakers, the proceeds to accrue to the Exchequer rather than to the racing industry as in the case of the levy. The benefit to the Exchequer in 1980 is estimated at £0.5 million. Betting on the tote will be unaffected by this change.

Dances

Dances, discos, cabarets, dinner-dances and the like comprise one area which can bear an additional element of taxation. I am considering the various alternatives which may be open to me in this respect and I would intend to bring forward firm proposals at an early date.

Before I leave the area of excises, there are two subsidiary matters I would like to mention.

Small brewers

The first is the small brewers scheme which, by way of concession, I am continuing for a further year at a cost of £160,000 in 1980. The scheme, introduced in the 1978 Budget, readjusts the incidence of excise duty on beer so that the smaller producers bear a somewhat lesser rate of duty while the larger producers pay somewhat more.

Deferment of spirit duty

The second matter concerns the way manufacturers of spirits pay excise duty. The duty is paid at the end of the month following that in which spirits are released from bond, except for the month of March when the payment may not be deferred. This catch-up arrangement is a hang-over from the old April to March financial year. I propose to replace it with a similar arrangement which would operate in December.

This has the once-off advantage from the budgetary point of view of bringing forward to this year the duty which would have been deferred to end-January, 1981. The gain to the Exchequer in 1980 is estimated at £8.3 million.

Motor vehicle duties

My next proposals concern motor vehicle duties and relate back, to some extent, to the duty increases on petrol and oils; they have both conservation and revenue implications. I propose an increase in the initial and annual registration charges for cars of 16 horse power and under from £5 to £10; an increase in the charges for motor cycles from £1 to £5; an increase in the annual charge on excavators, agricultural tractors and other agricultural vehicles to £10; an increase in the driving licence fee from £2 per annum to £3 per annum.

The new rates will apply from April 1st, 1980. The extra yield in 1980 from these changes will be about £3.5 million.

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TAX EVASION

I have mentioned the matter of abuse of the social services. This brings me to the even graver matter of abuse of the tax system in various forms.

The changes I have made in the income tax structure represent a major effort to make it a just and equitable system. It is no less important that the system should be seen to be enforced fairly and equitably. The vast majority of citizens co-operate in a public spirited manner in paying their taxes but there is unfortunately a minority in the community who do not act in this way. By evading payment of taxes they pass on their share of the burden to their fellow citizen who in many cases may be less well-off and less well able to pay tax. The taxes payable by our community are imposed in the name of the community and are expended on purposes determined by the community in a democratic process. Evasion of those taxes cannot be condoned by specious argument.

The tax evader, insofar as he engages in deliberate infringement of the law through fraud, misrepresentation and false declarations, can expect the full rigour of the law to be applied against him. I wish to reassure taxpayers that in all such cases prosecutions will be brought by the Revenue Commissioners instead of their seeking discreet settlements. Over

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the past few years, there has been a significant increase in the number of cases where proceedings were initiated.

While a person engaged in tax avoidance may feel he is operating within the law, the margin between avoidance and evasion in many cases is no more than hairline. I would like it to be understood by those engaged in schemes of tax avoidance, particularly schemes which have no real economic or commercial justification, that the operation of such schemes will not be immune from changes in the law.

There are people who are avoiding paying taxes because their business activity has not come to the notice of the Revenue Commissioners. Last year the provision of additional staff enabled the Revenue Commissioners to set up special inquiry units with an emphasis on outdoor investigation, to uncover traders and landlords and providers of services and others whose business is not on record for tax purposes or whose scale of business is not fully reflected in tax returns. In recent months 6,150 such cases have been uncovered.

There is an onus on all persons engaged in business to complete tax returns. If they do not, they must realise that when discovered, the transactions of previous years will be reopened and arrears of taxes, together with any appropriate interest and penalties, will be fully recovered from them.

Very considerable changes have been made in recent years in the legal powers of the Revenue Commissioners to deal with tax evasion and omission to provide information. These powers are now being used by the Revenue Commissioners to protect the interests of the vast bulk of the community who are paying their share of taxation and, if it seems necessary to strengthen the law further, I will have no hesitation in putting forward new proposals for legislation.

If every wage earner has his tax calculated precisely on his income and deducted at source, surely justice and equity require that the self-employed and professional classes should also disclose their income fully and pay their tax accordingly. As Minister for Finance, I feel an obligation to secure that all taxpayers receive the same treatment and I will make available to the Revenue Commissioners all necessary resources to implement this principle.

See for an analysis of the Irish Budget 1980 the articles which are published in 20 EUROPEAN TAXATION (1980):

Norman E. Judge: *Ireland: Changes in personal taxation* (p. 76).

C. Salomons: *Ireland: An urban budget* (p. 82).

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ZAMBIA:
Budget Speech 1980

Extracts from the Budget Speech pronounced on January 25, 1980 by the Hon. K.S.K. Musokotwane M.P., Minister of Finance.

REVENUE MEASURES

127. Mr. Speaker, Sir, I have already referred to the size of the Budget. I have pointed out that total expenditure (including lending) will be K1,030 million, and that recurrent revenue available will be K758 million, leaving an overall deficit of K272 million. Mr. Speaker, Sir, I have already explained the financing of this deficit.

128. Sir, included in the recurrent revenue figure of K758 million is a sum of K27 million which I hope to raise through new measures. Let me now turn to the discussion of these measures.

129. Mr. Speaker, Sir, the measures I am introducing are aimed specifically at mobilising additional revenue. But some of these are introduced with the objective of discouraging consumption of luxury items and more importantly the promotion of conservation of expensive imported materials. This is primarily intended to help in strengthening our balance of payments position, a policy objective I outlined a little while ago.

(a) Excise duty

130. Mr. Speaker, Sir, I wish to commence with an outline of the measures under the category of excise duties. As Hon. Members are aware, the offtake from this source of revenue is a direct function of the volume of production or sales of goods. Government revenue thus does not change with any price increase decided on by a manufacturer. It is therefore necessary to protect our revenue offtake from inflation.

(i) Clear beer

131. Mr. Speaker, Sir, the demand of beer in Zambia continues to be relatively high. In some parts of the country the constraint seems to be insufficient supply which in many instances reflects production and distribution problems. I am therefore proposing that the price of beer should be raised by 5 ngwee per bottle. The manufacturers will receive I ngwee of this increase. Furthermore the retailers will receive 2 ngwee of the increase. This will improve the retailers' margin to the extent where it should be profitable to distribute beer to all parts of the country. Finally, 2 ngwee will accrue to the Government. I hope to raise K4.9 million in additional revenue from this measure which will take effect from midnight tonight.

(ii) Opaque beer

132. In the same vein, Mr. Speaker, Sir, there is need to adjust the price of opaque beer. I therefore propose an increase of 1 ngwee per litre with effect from 2400 hours tonight. This measure will yield K2.6 million in additional Government revenue.

(iii) Cigarettes

133. Mr. Speaker, Sir, Hon. Members will agree with me that the prices of cigarettes are still comparatively low in this country. As long as production is maintained at reasonable levels, this is a valuable source of revenue for the Government. I propose that the prices of cigarettes be increased by between 10 percent and 17 percent, with the largest percentage increase for the top luxury grades. This will mean an increase of 10 ngwee per packet of 20 cigarettes for the most expensive brands, 6 ngwee for the middle priced brands and 4 ngwee for the lowest priced brands. This measure will yield an additional K4.8 million in Government revenue and comes into effect from midnight tonight.

(iv) Soft drinks

134. Mr. Speaker, Sir, there is a general consensus in this country that the prices of various types of soft drinks are still very low. In fact some soft drinks are still cheaper than in the countries from where some of the ingredients are imported. Indeed, soft drinks are more commonly consumed by urban dwellers. I have decided, therefore, to propose an increase of 4 ngwee per 290 millilitre bottle. Out of this increase the manufacturers will get 0.5 ngwee, the retailers 0.5 ngwee and the Government will receive 3 ngwee. This measure will yield an additional K3.5 million in Government revenue and takes effect from midnight tonight.

(v) Petrol and diesel

135. Mr. Speaker, Sir, this House must now be conversant with the turbulent situation prevailing in the world oil market. Earlier this afternoon, I informed this House that the oil market is now extremely volatile with a multi-varied pricing system where availability and security of supply are the overriding considerations. I would like, Mr. Speaker, Sir, to inform Hon. Members that we as a nation will this year spend K130 million in foreign exchange on oil imports. It is imperative that we, like many other non-oil producing countries, take measures to reduce the wasteful consumption of expensive petroleum products. Since the price mechanism is one way of reducing consumption. I am proposing that the prices of various grades of petrol be adjusted upwards as follows:

Petrol — super grade to go up by 2 ngwee per litre;
Petrol — regular grade to go up by 2 ngwee per litre.

136. I also submit here that contrary to popular belief, diesel is not a cheap fuel at source. It is an expensive item commanding the same price as other fuels. To make matters worse diesel has become such a scarce commodity that suppliers may cut back on the amount they supply in our imported crude feedstock. In this situation we must take measures to prevent wasteful use. I am therefore proposing that the price of diesel should be raised by 2 ngwee per litre. As usual, the necessary tax concession has been given to the United Bus Company of Zambia (UBZ) so that its users will not face any hardship.

137. Mr. Speaker, Sir, I estimate that these measures will bring an additional K7.7 million in Government revenue and will take effect from 2400 hours tonight.

(b) Customs duty

138. Mr. Speaker, Sir, Hon. Members will recall that the rate of customs duty on capital goods was last adjusted upwards in 1978. This adjustment was from 5 percent to 7.5 percent on a specified list of items. The measure was intended to promote more labour intensive methods of production. Hon. Members will also agree with me that Zambia is one of the few countries in the world where capital goods are virtually free of duty. We must continue to encourage more use of our labour in keeping with our policy of creating more employment opportunities, a policy to which I referred earlier this afternoon.

139. I have therefore decided to adjust upwards the rate of customs duty on a selected number of capital items from 7.5 percent to 10 percent. I hope that this will further strengthen our resolve to discourage labour-saving machines. Sir,

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I have also decided to suspend the import duty on sports goods like football, hockey, cricket and other outdoor games, but excluding equipment for hunting, shooting and fishing. This is in response to the resolution of the National Council and to persistent requests and representations on the matter.

140. Sir, there are also a number of minor proposals meant to tidy up the Customs and Excise Act. Included in this exercise are adjustments in the rates of customs duty on imported items competing with locally produced goods on which excise duty has been adjusted upwards. Such increase in customs duties are meant as a countervailing measure to discourage unnecessary imports.

141. Mr. Speaker, Sir, I estimate that the measures on customs duty will yield an additional K1.7 million in Government revenue and will take effect from midnight tonight.

142. Mr. Speaker, Sir, I have proposed a small increase in the price of diesel. This will affect the agriculture industry. Many of our farmers are now using diesel in increasing amounts. As such they need some relief. Indeed farmers also need added incentives to increase their production. I am therefore proposing to amend the relevant regulations of the Customs and Excise Act to enable the Minister of Finance to give duty exemption on some imported agricultural equipment. This will be on a case by case basis and shall apply to deserving cases only. Sir, this is a very attractive incentive and I hope the response will be reflected by increased agricultural output next year.

(c) Sales tax

143. Mr. Speaker, Sir, last year, my predecessor reduced the rates of Sales Tax on a number of essential household items. I do not propose to make any adjustments to these. However, in order to raise revenue, I am proposing to raise the rates on a number of items as follows:

Sugar confectionery — from 10 percent to 15 percent
Paints, varnishes and lacquers — from 10 percent to 15 percent
Gramophone records — from 10 percent to 15 percent
Tarpaulins, tents, awnings, etc. — from 10 percent to 15 percent

144. In addition, I propose to extend the coverage of Sales Tax to aerosols, insecticides and metal holloware. The rate of Sales Tax on these items will be 10 percent.

145. Mr. Speaker, Sir, I expect these measures to yield about K1.8 million in additional Government revenue and will take effect from midnight tonight.

(d) Passenger service charges (International)

146. Mr. Speaker, Sir, Hon. Members are aware that the cost of running our airports is considerable and increasing. This House will recall that in order to assist in the proper maintenance of airports, the Government introduced a passenger services charge which is paid by passengers departing for destinations outside Zambia. This was first introduced in 1972 and was increased from K3 to K4 in 1978. In order to offset the effects of inflation on the value of revenue from this source, I propose that with effect from 1st April, 1980, all passengers on international flights departing from our airports for destinations abroad should pay a service charge of K8.00. This measure is expected to add K200,000 to Government revenue.

(e) Income tax

147. Mr. Speaker, Sir, I wish to inform this House that my Ministry has received numerous representations on income taxes from a cross-section of the population in this country. Some representations merit close attention. Others obviously are mere compliants.

148. Earlier this afternoon, in my discussion of industrial and investment policy, I informed this House that the overall strategy of the Government is one of consolidation and clarification of existing incentives to investors and manufacturers. In view of the need to encourage investment, I have given considerable thought to all the submissions by our business community. Hon. Members will agree with me that if the Government were to accede to all the requests, the loss in revenue would be staggering. However, I have made some concessions which I hope will go some way in meeting the wishes of our business community.

149. Firstly, I have decided, under capital allowances, to raise the maximum amount allowable as a deduction for the cost of a road vehicle used for business purposes from K4,000 to K6,000. This increase has become necessary in view of the rising prices of motor vehicles. This means that the ceiling on allowances for purposes of wear and tear will be much higher taking into account the effects of inflation. This comes into effect on 1st April, 1980.

150. Secondly, and in the same vein, I have decided to raise the ceiling amount allowed for purposes of initial wear and tear on low cost houses. The ceiling will rise from K4,000 to K10,000. This is an attractive concession which businessmen should utilise and help to relieve pressure on local authorities for low cost housing. This concession will come into effect on 1st April, 1980.

151. Mr. Speaker, Sir, one of the areas in which there has been an outcry concerns Undistributed Profits Tax. Last year, the relevant section of the Income Tax Act which dealt with distributions of dividends was repealed and the Undistributed Profits Tax was introduced. Sir, I wish to inform the House that I have found it impossible to completely do away with the Undistributed Profits Tax as most of the business community would want. However, I feel that certain provisions of the law are too rigid. I have therefore decided, that in order to satisfy some of the demands of the business community and to introduce some flexibility, the Act will be amended to allow for business expansion requirements, i.e. reinvestments, reasonable reserve levels and other requirements to be taken into account before the Undistributed Profits Tax is applied.

152. Sir, I am satisfied that my proposal is equitable to the business community and to the Government. It remains for me to commend the business community for the very constructive manner in which they have put forward their representations and suggestions. I hope businessmen will take advantage of the new arrangements and expand their enterprises.

153. Last year, my predecessor introduced a job credit facility as an incentive to the manufacturing sector to create new jobs. Considering the fact that we also have the Industrial Development Act which extends tax incentives to all our economic sectors, I have found it necessary to rationalise this facility. Sir, instead of allowing a flat amount as credit, I have decided to tie the facility down to the salaries or wages payable to the qualifying employees. In the first charge year of the qualifying period in which an employer has commenced qualifying business, 10 percent of the basic wages or salaries payable in respect of all qualifying employees during such charge year, will apply. In subsequent charge years of the qualifying period, 5 percent of the basic wages or salaries payable will rank as a job credit against the manufacturer's tax. The facility will also be on a once and for all basis instead of being carried forward. I have decided to introduce this amendment in view of the potential loss of Government revenue due to the loopholes I am now removing from the facility. I believe this will be fair to the Government as well as the manufacturers intending to use the facility.

154. Mr. Speaker, Sir, there are also other minor amendments to the Income Tax Act which are merely part of the continuing exercise of tidying up our legislation in the light of new developments.

155. Finally, Mr. Speaker, Sir, Hon. Members will recall that earlier this afternoon I informed this House that the

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Special Reconstruction Fund for the repair of bridges and other damaged installations now stands at just over K1 million from contributions by the people of this country. In a further expression of appreciation for this show of committment and patriotism, the Party and its Government have decided that all cash contributions to this Fund will be allowed in full for tax purposes. This will also apply to future cash contributions. Once again, I wish to publicly thank all those who have contributed so generously.

CONCLUSION

156. Mr. Speaker, Sir, I have now come to a stage where I must conclude my remarks. Before I do this, allow me the opportunity to summarise what I consider the critical issues facing the Zambian economy. The paramount objective must be to ensure that the nation spends within the limits of available resources. This will mean limiting recurrent expenditure to the most essential areas. It will also entail capital spending based on national priorities that aim at increasing employment and productivity. In addition we must not relax in our resolve to restrain inflation. We must also jealously protect the industrial peace which this country has enjoyed for a long time now.

157. Hon. Members should have noted my call on all of us to temper our optimism with caution since a number of critical factors affecting our economy are beyond our control. Indeed the world situation is so uncertain that it is difficult to confidently predict future developments. We must therefore ensure that we prudently budget the use of scarce foreign exchange resources. This country has the natural resources and ability to uplift the well-being of its people. We have a duty to leave a better country for future generations. We can only succeed if we follow the correct policies and determine the correct priorities.

158. Mr. Speaker, Sir, we have been faced with problems as a nation since Independence. We have continued to overcome all these. These problems have made our national character ever stronger. Because of the difficulties we have gone through, we have been able to demonstrate and prove to ourselves and to the world that we are a strong and determined people. Let us therefore continue building for ourselves and for posterity a Zambia that is happy and prosperous.

159. Let us avoid servitude by continuing with individual and national self reliance and discipline. Let us use our past mistakes as lessons to learn from and our past successes as a foundation to grow from. Let us all work hard. Let us all work together. Let us remain united and concentrate on working out solutions to our problems. Let us realise that the greatest asset of Zambia is the people themselves. Let each one of us in the leadership rededicate ourselves to the unity of this nation. We have in His Excellency the President Dr. K. D. Kaunda a uniting factor. Let each one of us exploit this to the full.

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IRAN

To pay or not to pay: that is the question

It has been brought to our notice that the Revolutionary High Council of the Islamic Republic of Iran passed a law on 14.9.1358 (December 5, 1979) which facilitates the settlement of outstanding tax liabilities incurred during the Iranian year 1357 (March 21, 1978 to March 20, 1979). The major points of the law are subject to dispute but the first Article caught our eye. It must be one of the few, and maybe the only one, which leaves the discretion of the amount of tax to pay to the taxpayer. The gist of the Article is that taxpayers with a basic tax liability for that period of Rls.50,000 or less need pay only what they consider justified. They are protected from further recourse by the tax authorities as the Article goes on to say that the receipt obtained for this voluntary payment will be accepted as evidence of final settlement.
How much would you pay?

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CONFERENCE DIARY

JUNE 1980

Business International Institute: The Seminar on International Finance (including: Taxation of exchange gains and losses), Port Chester, New York (U.S.A.), June 9-12 (English).

Georgetown University Law Center and *The Chamber of Commerce of the United States:* Institute on multinational taxation (treaty problems anti-avoidance measures, use of computers in international taxation, currency gains and losses, international insurance transactions, Brazilian taxation), Washington D.C. (U.S.A.), June 11-13, 1980 (English).

European Study Conferences Limited: International tax planning conference; protection of assets of companies and trusts in the face of risk (including exchange of information between tax authorities), London (United Kingdom), June 12-13 (English).

European Study Conferences Limited: Investing in United States real estate in the light of the current and proposed financial and taxation considerations, Amsterdam (the Netherlands), June 19-20 (English).

Institute for International Research: Successful trading in commodities (including the tax angle — consider it before you trade!), London (United Kingdom), June 24-25 (English).

Inter-American Center of Tax Administrators (CIAT): Fundamental tax audit considerations (including: Components of an audit program, organization of a tax audit department, EDP and tax audit, resource management support, legal aspects of tax audit), Washington (U.S.A.), June 22-27 (English, Spanish).

JULY 1980

Management Centre Europe: The China Briefing (including: Tax aspects of doing business in China), Brussels (Belgium), July 3-4 (English).

Management Centre Europe: Managing and developing foreign subsidiaries seminar (including: Tax in international operations), Brussels (Belgium), July 2-4 (English).

Management Centre Europe: International tax management seminar (including: Anti-tax haven legislation, tax treatment on technology import and technology export, handling of disputes between tax administrations), Brussels (Belgium), July 10-11 (English).

AUGUST 1980

Management Centre Europe: International cash management seminar (including: International tax aspects in cash management), Brussels (Belgium), August 20-22 (English).

SEPTEMBER 1980

34th Annual Congress of I.F.A.: I. The dialogue between the tax administration and taxpayer up to the filing of the tax return; II. The determination of the source of income. For the seminar the subject is the flight to tax havens, their use and abuse, Paris (France), September 14-19 (English, French, German, Spanish).

NOVEMBER 1980

Confédération Fiscale Européenne (C.F.E.): Second congress of European tax consultants (subject: "La pratique de la fiscalité en Europe"), Rome (Italy), November 6 and 7 (English, French, German).

SEPTEMBER 1981

35th Annual Congress of I.F.A.: I. Mutual agreement procedure and practice; II. Unilateral measures to prevent double taxation. Berlin (German Federal Republic), September 21-25 (English, French German, Spanish).

FOR FURTHER INFORMATION PLEASE WRITE TO:

Business International Institute, 12-14 chemin Rieu, 1211 Geneva 17 (Switzerland).

CIAT: P.O. Box 2129, Panamá 9A (Panama).

Confédération Fiscale Européenne, Secrétariat Général (C.F.E.), D-5300 Bonn 1, Dechenstrasse 14, German Federal Republic of Siège Social F-75009 Paris, 9 rue Richepanse (France).

European Study Conferences Limited, Kirby House, 31 High Street East, Uppingham, Rutland, Leics. LE 15 9 PY, United Kingdom.

Georgetown University Law Center, Office of Continuing Legal Education, 600 New Jersey Ave., N.W., Washington D.C. 20001 (U.S.A.).

Institute for International Research, 70 Warren Street, London, W1P 5PA (United Kingdom).

International Fiscal Association (I.F.A.): General Secretariat, Woudenstein, Burgemeester Oudlaan 50, P.O. Box 1738, 3000 DR Rotterdam (Netherlands).

Management Centre Europe, Avenue des Arts 4, B-1040 Brussels (Belgium).

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TAX GLOSSARY

by H.W.T. PEPPER *

RETROGRESSION (RETRO-ACTION), RULE AGAINST — It is a generally accepted principle of taxation that new tax laws, or Court decisions on cases brought before them, should not ordinarily seek to change the incidence of tax on transactions that had already taken place before the law was enacted or the Court decision handed down. There have been one or two exceptions to this rule in practice; for example, in Britain an income tax provision charging tax on GOLDEN HANDSHAKES (q.v.) was enacted as a part of one year's budgetary proposals after a warning had been given in the previous year that such action would be taken if the practice of making such transactions did not cease. The retrogressive effect in this particular case related only to transactions that had taken place following the warning given.

The latest development in the running battle between tax administrations and professional "avoiders" was the statement in a 1979 Budget Speech in the U.K. to the effect that any new tax avoidance schemes would be counteracted by law retrospectively.

RETURNS — Declarations of income, sales, and other details required by tax authorities, often on forms officially provided, which are to be "returned" to the authorities.

REVALUATION OF (DEPRECIABLE) ASSETS — An alternative to a system of REPLACEMENT-COST DEPRECIATION (q.v.), where inflation in a country has increased the replacement cost of assets considerably above historic cost, is to revalue the asset and then re-calculate depreciation allowances on the revised values. It is not usually administratively possible to calculate indices of revaluation for each of the many types of asset involved, so that in practice some established index of prices compared with a base year would normally be used even though the results may be anomalous between different industries.

REVENUE ERROR — See REMISSION ON REVENUE ERROR.

REVENUE-SHARING — A system introduced in the U.S.A. in 1974 whereby State and local governments were granted a share of certain Federal revenues for which, however, the Federal Government remained the collecting agent. The system is also known as PIGGY-BACKING. In Sweden, joint collection of national and local government income taxes has been in operation for many years, as has a system in the U.K. for joint collection of income tax and certain pension contributions — systems which are broadly similar to revenue "sharing".

REVENUE TAXES — Taxes which are levied to produce revenue rather than to serve any particular fiscal of economic purpose.

RECOVERABLE SETTLEMENT — Under U.K. tax law, settlements which transfer income to other persons, but which are subject to any form of revocation, are set aside for tax purposes by Sections 445 and 446 of the 1970 tax code, the income involved being regarded as the income of the settlor.

RIBICOFF AMENDMENT — See OVERSEAS EMPLOYMENT.

"RING" — In connection with a single stage sales tax where tax is payable only on sales to non-registered traders or consumers, the traders who are registered are said to form a "ring" in that purchases and sales among such traders (i.e. transactions within the "ring") are not taxable, but as soon as goods are disposed of outside the "ring", tax becomes payable.

"RING FENCE" — A term used in connection with PETROLEUM REVENUE TAX (q.v.). The profits of each field are dealt with separately — there is a "ring fence" placed around them in that external losses may not be offset, except in the case of a final loss in another terminating field.

ROAD TAX — It is common to levy various forms of taxation on vehicles using public roads, the justification being the cost of maintenance of the roads themselves, the main wear of which is caused by those using such vehicles. The tax may be based on the horsepower of a vehicle or the cubic capacity of its cylinders, or may be related to the laden weight of goods vehicles or the passenger-carrying capacity of buses and coaches. (See also ROAD TOLL.)

ROAD TOLL — During the era of turnpike roads in Britain, private entrepreneurs or land owners were authorised to build roads and charge tolls, the tolls being collected at turnpikes from those who used them. Because those entitled to collect the tolls tended to be more diligent about collecting them than maintaining the roads for which they were paid, the system fell into disrepute and was abolished. At the present time, however, a number of countries charge tolls on motor roads and bridges which are available for certain types of vehicle only, the roads and bridges, however, being provided and maintained by the government. Such charges are, for example, made in the U.S.A., Italy and France. The essential basis for such a tax must be that the road is used by a large volume of traffic, so that the cost of collection would only be a small fraction of the total tolls collected and that the payment process will not unduly slow down the flow of traffic. The term "turnpike' to denote a road on which tolls are charged is still used in the U.S.A.

ROERENDE VOORHEFFING — (Belgium) Advance payments (usually withholding tax) of tax on dividends, royalties and interest.

ROLL-OVER RELIEF — Relief from capital gains of income tax granted where assets of one class are disposed of and the proceeds of disposal are reinvested in replacement assets of the same class and where the profit on disposal would otherwise have been chargeable to tax. Such relief is provided, for example, in the U.K. (see Section 33 F.A. 1960 and Section 60 F.A. 1971). In Britain the relief is applied to business assets; in the U.S.A. it is also applied for capital gains tax purposes (in lieu of exemption) to private residences.

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ROOM TAX — A tax charged on the occupancy of rooms in a hotel, usually at a fixed rate per head per night, but sometimes on a graduated basis according to the price of the rooms. A room tax is thus a tax on hotels (and sometimes others providing accommodation for tourists at a fee) but the tax is not usually extended to the other services provided by the hotel, including the provision of meals in its dining rooms.

ROYALTIES, COPYRIGHT — The most important international flow of copyright royalties is usually that of sums paid for the hire or rental of cinematograph films. Other copyright royalties may be taxed by deduction at source, particularly where the royalties are payable to a non-resident, but double taxation treaties often mutually exempt such payments from taxation in the country of payment. (See FILM HIRE TAX, FOOTAGE TAX.)

ROYALTIES, MINERAL — See MINERAL ROYALTIES.

ROYALTIES, PATENT — As in the case of copyright royalties, tax is often deducted at source from payments of patent royalties made to non-residents (in Britain, from all such payments), subject to exemption which may be granted on a mutual basis in double taxation treaties, the country of residence taking full powers to tax.

ROYALTIES WELFARE LEVY — A levy originally concurrent with MINERAL RIGHTS DUTY (q.v.) in Britain imposed in 1910 on coal royalties and abolished when coal deposits were nationalised in 1946.

RÜCKLAGE — (Germany) Reserve for future contingencies.

RÜCKSTELLUNG — (Germany) Reserve for debts or losses existing at the balance sheet date, the amount of which is not precisely known.

RUMMAGE — The process of making a detailed search of a ship by Customs officials in a quest for contraband is known as "rummaging" the ship.

S

SAERBESKATNING — (Denmark) Separate assessment.

SAFETY EXPENDITURE — Expenditure on fire prevention, accident prevention, and so on, usually is given favourable tax treatment: either the expenditure may be deducted when incurred, or the total cost may be written off over a period of years.

SALE AND LEASE-BACK — See LEASE-BACK.

SALE OF INCOME — The device of selling present or future earnings for a capital sum in order to avoid or reduce tax liability (see, per contra, SPREADING) is countered in some countries' tax codes (U.K., U.S.A.) by making the resulting lump sum taxable as income.

SALES AND USE TAX — The scope of sales taxation in a country with a federal government, where the individual states or provinces have the power to levy sales taxation, is often expanded to a charge on "sales and use". The "use" element deals with the case where residents of the taxing state purchase taxable goods outside the taxing state from other states within the same federal jurisdiction, sometimes from "inter-state" enterprises that operate in several different states within the country. The scope of the tax is thus extended to cover sales outside the state, but within the country as a whole, which are made to residents of, in respect of goods used in, the taxing state. The "use" provision counters tax avoidance and equalises the tax position of traders within the taxing state with traders outside who sell to residents of that state.

SALES TAX — An ad valorem tax on sales of goods, and sometimes services also, usually calculated at a percentage rate, and collected at regular intervals (e.g. monthly or quarterly) from traders who are entitled to "shift" the tax to their customers by suitably adjusting the prices of the goods or services the traders provide.

SALES TAX LOTTERY — See LOTTERIES FOR CONSUMERS.

SALVAGE VALUE — The residual value (which may be merely a scrap value) of depreciable assets at the end of their service life when capital or depreciation allowances are given in respect of the cost of providing the asset. The sale proceeds or salvage value of the asset when it is taken out of service are usually credited in computing the total deduction for depreciation (see BALANCING ALLOWANCES AND CHARGES). An estimate of the ultimate salvage value of an asset may be taken into account, along with estimated service life, when computing the appropriate depreciation allowances.

SAMBESKATNING — (Denmark) Joint assessment of combined incomes of husband and wife.

SAMBESKATNING SELVANGIVELSE TIL — (Denmark) To file a joint return.

SAMTIDIGHEDSSKAT — (Denmark) Pay As You Earn (P.A.Y.E.)

SANDWICH EFFECT — The term "sandwich effect", in connection with a V.A.T., is applied to the situation when an exempt trader buys taxed goods and sells them, after processing, to a taxable trader. In the absence of special provisions, no relief would be due to the trader who finally sells to the consumer in respect of the tax originally embodied in the goods when they were purchased by the exempt trader. In fact, relief in these circumstances has in some instances been allowed to the final trader, notably in Brazil's V.A.T. (I.C.M.), and another remedy is to allow the "sandwiched" trader who buys the taxed goods to have "zero tax" treatment so that he may re-claim the tax he paid on purchase. In the latter case the goods then pass free-of-tax to the next trader, who has to account for the total tax on his sales but at least has incurred no pre-payment of tax which cannot be requited. (See also ZERO RATE.)

SATS (SKATTESATS) — (Denmark) Tax rate.

S.A.Y.E. — Save-As-You-Earn, the name given to various schemes whereby employees and others may contribute regular sums by way of savings which are refundable after five or more years with the addition of interest and/or a bonus or premium. Such schemes have relevance for taxation only where, either, some tax deduction is allowed for the contributions made, e.g. by employees who authorise deductions from their pay for the purpose, or where the bonus or interest element in the amount realised at the termination of the deduction period (i.e. the excess of the sum paid out over the amounts contributed) is exempted from tax.

SCHACHTELBETEILIGUNG — Participation of at least 25 percent by a German company in the control of another German company.

SCHACHTELVERGÜNSTIGUNG (also SCHACHTELBEFREIUNG or SCHACHTELPRIVILEG) — Exemption from corporate income tax granted to German parent companies in respect of dividends from their German subsidiary companies.

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SCHEDULAR TAXATION — Taxes on particular items of income which are applied as separate taxes, often at fixed rates, in contrast to the system of aggregating all income accruing to the same person and applying graduated rates thereto, which is the more usual form of income taxation at the present day. An example of a country which retains some elements of schedualr taxation in its income tax system is provided by Hong Kong.

SCHEDULES A TO F — Under the British income tax system tax is levied under different "schedules" or divisions according to the nature and source of the income. This compartmentalisation does not affect the incidence of the tax, which is a graduated charge upon total aggregated income. Income is classified under the various schedules, as follows:

Schedule A: Net profits from rents on leases of land, ground rents, feu-duties and other annual payments from land and other receipts arising from the ownership of, or rights over, real property.

Schedule B: Income from the occupation of certain woodlands if the occupier has not opted to be assessed under Schedule D.

Schedule C: Interest from certain securities of the British and certain overseas Governments where it is paid in Britain, the tax being paid by the paying authority and deducted from the interest paid to the investors.

Schedule D: Profits on trades, businesses, and professions, and woodlands where the owner has opted to be taxed on his commercial profits therefrom, and certain other income including interest on loans, rents and other income from real property, and certain income from abroad. This Schedule is subdivided into a number of "Cases" and the Short-Term Gains Tax (abolished April 1971) was formerly included in Case VII.

Schedule E: **Income from offices,**

Schedule E: Income from offices, employments or pensions. The schedule is subdivided into "Cases", according to the territorial source of the income.

Schedule F: Dividends and other distributions of resident companies.

SCHENKINGSRECHT — (Holland) Gift Tax.

SCHENKUNGSTEUER — (Germany) Gift Tax.

SCHIJVENTARIEF — (Holland) Tax rate computed on slices of income.

SCISSION — (France) Company splitting.

SCISSORS TRANSACTIONS — A tax avoidance device whereby a company trading in securities would buy (a controlling interest in) another company, arrange for its assets to be realised (or "stripped") then re-sell the company at a loss, deductible from its own trading profits.

SCOPE OF TAX — The "scope" of a tax, sometimes referred to as the "tax base", is its coverage, which includes the geographical area to which it is applied, the nature of the capital, income, or transactions which is to be taxed, and the persons, e.g. resident and non-resident individuals, corporate bodies and other bodies or artificial persons to whom, and in some cases the period of time (e.g. the duration of a war, emergency, or of inflation or depression) during which, the tax is to be applied.

SCRIP DIVIDEND OPTION — During the time that Governmental rules limiting dividend payments (an anti-inflation device) were in operation some companies offered shareholders an option to take scrip (stock) dividends instead of cash. Initially the move, which enhanced the anti-inflation effect of the Government's restrictions, was encouraged by the exemption of such dividends from income tax, though subsequent sale of the extra scrip would have entailed capital gains tax. After April 1975, however, such scrip dividends were made liable to income tax and options were thenceforward no longer offered.

SCUTAGE — A medieval levy in Britain under the Feudal system (the word literally means a shield tax) exigible by a feudal chief from others who owed him military service, as a cash payment in lieu of such service.

SECURITY FOR TAX — Where a taxpayer handles tax monies (PAYE deductions, V.A.T.) on behalf of a tax department, the question arises whether some security should be sought from the person involved because he is effectively in a position of trust regarding public money. In practice it is rather unusual for security to be actually sought by the tax department. Good tax administration, however, normally secures that where money is withheld at source in respect of income taxation, or in effect collected from customers by traders under a sales tax or V.A.T. regime, it should be handed over reasonably promptly after receipt.

In practice P.A.Y.E. tax is usually remitted monthly, sales tax and V.A.T. may be remitted monthly, quarterly, etc. according to the size of the amounts involved. In Brazil, where VAT (I.C.M.) is to a large extent collected by the banks on behalf of the administration, there are precise rules as to the number of days that may elapse between receipt by the bank and payment to the Treasury.

Where a taxpayer seeks to leave the country when he owes tax, and there is a genuine risk that the tax could not be collected in the event of his not returning, there is often provision in the tax law ensuring that some security be given by the departing taxpayer. See also PERIODICITY OF PAYMENTS, TAX CLEARANCE.

SECURITY TAX — In the 1970s, because of the prevalence of the hijacking of airliners by terrorists and criminals, many countries instituted body-searches and electronic surveillance of personal luggage in respect of passengers boarding aeroplanes at the main airports. Some countries have financed the cost of such security measures by a levy or tax on all passengers.

SELECTIVE EMPLOYMENT TAX (S.E.T.) — A tax which operated in the U.K. from 1966 to March 1973, in effect as a levy on the cost of services, with the stated object of encouraging the movement of employees from service industries to manufacturing industries, although some economists considered the latter already over-manned. The tax was levied at a relatively high specific amount (in a sense a "poll tax") in respect of each employee (initially £2.40 per week per man, £1.20 per woman or boy, £0.80 per girl; one-third only of the levy was made on elderly or part-time workers). The levy was payable by employers who were permitted to shift the tax to the consumer. The selective nature of the tax was in the refund system. Refunds of the total levy were granted to manufacturers, but none to service industries, while manufacturers in Development Areas were also paid a premium (see REGIONAL EMPLOYMENT PREMIUMS).

SELF-ASSESSMENT — See ASSESSMENT, SELF.

SELF-CHECKING — One of the merits claimed for V.A.T. is that because each trader pays tax on his sales and deducts the tax embodied in the purchases passed on to him by his suppliers, each trader has a vested interest in the accuracy of the certification to him of the tax paid by the traders from whom he purchases goods or services. This feature is thus claimed to be a means whereby the tax is "self-checking" or "self-enforcing".

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SELF-ENFORCEMENT — See SELF-CHECKING.

SELF SUPPLY — In V.A.T. systems, e.g. that in the U.K., there may be a charge to tax on goods produced in the taxpayer's business which he uses himself. See also HOME CONSUMPTION.

SELSKAB — (Denmark) Company (Corporation).

SELVANGIVELSE — (Denmark) Income tax return.

SEPARATE ASSESSMENT — In the U.K. a husband is assessable on the joint incomes of himself and his wife, but a wife may elect to be separately assessed on her income, from which she will then be granted a proportion of the total reliefs. Somewhat similar provisions exist in the U.S.A. (see also INCOME-SPLITTING).

SERVICE LIFE — The period during which it is estimated an asset will provide useful service to the business in which it is employed. The rate of depreciation allowed will normally depend upon the length of service an asset may be expected to give.

SERVICES TAX — A tax, usually on ad valorem lines, on various types of services, sometimes included within the scope of a general sales tax including a V.A.T., but sometimes levied separately (e.g. the former French T.P.S. (Taxe sur la Prestation des Services)) and at other times a series of individual levies on different types of service often at different rates of tax; e.g. a higher tax may be charged on entertainments, particularly those of a luxury kind, gaming or betting taxes may be levied on casinos, horserace betting, etc., and there may be special levies on the stakes in football pools. The services of artisans may be exempted or charged at lower rates in some instances, and it is fairly common to exempt from tax the services of the liberal professions, including lawyers, accountants, doctors, dentists and architects.

SEVERANCE PAYMENTS — Non-contractual gratuities payable to an employee, usually on redundancy and usually non-taxable. (See, however, GOLDEN HANDSHAKE, GOLDEN BOWLER, also LOSS OF OFFICE, REDUNDANCY.) In Italy an employer may obtain a tax deduction for provisions made for severance payments which may arise, so long as the provision is in accordance with statutory and contractual obligations concerning employment. In Japan payments on cessation of employment, including lump-sum retirement or pension allowances, and severance payments, are taxed separately from other income. Deductions are made for the period of service (¥ 250,000 p.a. up to 20 years, ¥ 500,000 for each year over 20, plus ¥ 5,000,000) and tax is applied to 50 percent of the remaining amount.

SHARE FOR SHARE ACQUISITIONS — Where the shares in a company are taken over in exchange for the shares of another company which has assumed control of the first company, the "disposal" is often disregarded for capital gains tax purposes, though a charge may arise if the shareholder subsequently realises the shares he has received in exchange for the old ones.

SHARE (STOCK) OPTIONS FOR EMPLOYEES — Some companies allow directors and key employees to have an option to buy at some future date shares or stock in the company at a price usually in keeping with current stock market value. The theory is that those benefitting will have an incentive to make the company more profitable and thus enhance the value of its shares which they are enabled to buy at specified future dates at the option price.

The tax treatment of the difference between the market value and option price of shares under such schemes varies in different countries and over a period of time. For example, in the U.K. such gains were free of tax altogether until capital gains tax was introduced in 1965. Then in 1966 the gain was made chargeable to income tax. In 1970 some tax relief was given for formal schemes for share acquisition at fixed prices and there was further liberalisation in 1972. On a change of Government in 1974, however, the benefits were made taxable to personal income tax. Most countries tax the benefits in one way or another.

SHIFTING OF TAXES — In the case of indirect taxation the tax is normally intended to fall upon consumption and be borne by consumers, so that a trader who pays the tax on his sales or deliveries in general passes on the tax, or "shifts" it "forward", to the consumer by adjusting his prices appropriately. Such taxes are said to be shifted "backwards", particularly in the case of a new or increased levy, when some traders or manufacturers are forced to absorb some of the tax if they fear or find that their products are unable to bear an increase in price of the same dimensions as the tax because the demand for their products is elastic (see also TAX PUSH INFLATION).

SHIP-MONEY — A mediaeval tax for the support of the Navy, levied in Britain on coastal towns, revived by Charles I in 1634-36, when refused financial supplies by Parliament, and declared illegal by Parliament in 1641. Refusal to pay ship-money by John Hampden and others was among the events leading up to the Civil War of 1642-45.

SHIPPING CENTRE — A country which provides (inter alia) FLAG OF CONVENIENCE facilities for ship-owners and charterers. The tax pattern is usually exemption from income (company) tax on the profits from operating shipping, but fairly substantial registration or tonnage dues are charged on an annual basis. Usually the labour laws and other relevant legislation are less onerous in the haven country than in the countries of origin of the ship-owners. The term "shipping centre" is a euphemism adopted since Flag of Convenience vessels have become unpopular in some spheres, and the haven country may develop financial and other services for the benefit of the shipping companies.

SHORTFALL ASSESSMENT — A charge made on CLOSE COMPANIES (q.v.) in Britain prior to the 1972 Finance Act where the distributions made by such companies fall short of the statutory limits.

SHORT-TERM GAINS TAX — A number of countries tax short-term capital gains, generally defined as gains accruing from the acquisition and disposal of an asset, usually within a period of six months to two years (the period is six months in the U.S., 12 months in the Philippines while France and Sweden use a two-year period). Such gains are deemed by the tax law to be income chargeable with income tax, but in some systems may be charged at rates which are lower than income tax rates but higher than the rates applicable to gains which have accrued over a longer period.

At one time Britain taxed only short-term gains, there being no charge upon longer term gains. The tax law was specially designed to tax short-term gains which were defined as gains from disposals of securities which had been acquired within 12 months of the disposal date. As regards other property, gains were taxable if the disposal took place within three years of the acquisition of the asset. This tax survived the introduction of a general capital gains tax in 1965, but was finally repealed following the Budget of April 1971. (See also SPECULATION, LAND, TAX.)

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SIEGE SOCIAL — (France) Residence of company.

SIGHT ENTRIES — The procedure whereby goods are allowed into a country by its customs officials, on an urgent basis, e.g. in the case of perishables, leaving full documentation and formalities to be completed later. (See also PERFECTION OF ENTRY.)

SINGLE STAGE SALES TAX — A sales tax which is applied at a single level of production or distribution, examples being the manufacturers' sales tax in Canada, the purchase tax in Britain and the retail sales taxes in the U.S.A. and Eire.

SINGLE TAX — A theoretical concept held by Henry George (1839-97) and his followers who advocated that all tax revenue should come from a single tax upon the increase in land values. In general, however, governments need to draw revenue from a number of different taxes, since the levying of all revenue by means of a single tax, whatever the tax base, would tend to be regarded as a rather oppressive levy. In practice, however, certain small countries, in effect, derive all their revenue from a single tax, notably the tax on minerals applied where the country has exceptional deposits of oil, phosphates or other minerals and the revenue derived from their exploitation is adequate to cover government expenditures because such revenue is large in proportion to the number of the population. In the U.S.A. over 80 percent of federal revenue is derived from the federal income tax, so that it is conceivable that the federal government could rely on a single tax if it were decided that other forms of revenue were undesirable, although present tendencies are rather in the opposite direction, adoption of a federal V.A.T. being mooted from time to time.

SITE VALUE TAXATION — A form of property taxation where the tax base is restricted to the value of the site, nothing being included for the value of the buildings or other improvements erected thereon. The tax is advocated by its proponents as a method of encouraging development, since the owner of a suitable site has no tax disincentive to deter him from developing the site to the limit of its capabilities. In practice, where site value taxation is in force it is often supplemented by an urban tax on buildings and the purity of the concept is in other cases diluted by provisions that when the total value of improvements to the site exceeds a certain percentage of the value of the site, site value tax will be payable on the value of the improvements as well as the site.
Use of the tax as an economic stimulus to development has proved of dubious value in practice. Developers tend to erect commercial or residential buildings when the time is judged right for being able to let them at a profit, rather than by reference to the degree of beneficence of the tax system. In any event PROPERTY TAX or RATES (q.v.) is normally shifted to the occupiers of buildings, not borne by developers.
In practice, also, where site value taxation has been used in developing countries it has often been found that the tax does not yield sufficient revenue to meet the budgetary needs of the taxing authority unless tax is levied at a rather high rate, which would accentuate anomalies in the tax structure.

SITUS RULE — A provision in a tax law, or in a DOUBLE TAXATION TREATY (q.v.), establishing in what place or country a source of income may be deemed to be situated for tax purposes. See also SOURCE RULE.

SITZUNTERNEHMEN — A company domiciled in Liechtenstein.

SKATTEFRI — (Denmark) Tax-free.

SKATTELEMPELSE — (Denmark) Abatement or reduction of tax.

SKATTEPLIGT — (Denmark) Tax liability.

SKATTESVIG — (Denmark) Tax fraud.

SKATTETILSVAR — (Denmark) Tax liability.

SKATTEUNDDRAGELSE, LOVLIG — (Denmark) Tax avoidance.

SKATTEUNDDRAGELSE, ULOVLIG — (Denmark) Tax evasion.

SKATTEYDER — (Denmark) Taxpayer.

SKATTEÅR — (Denmark) Year of assessment (tax year).

SLAB SYSTEM — A system of charging increasing rates of tax varying with increases in the taxable base such that the whole of the taxable sum is charged at the higher rate instead of successive slices or tranches being charged at a separate rate in the graduated scale. The slab system was used in connection with the estate duty in Britain until replaced by the slice or tranche system in 1969. Some countries still adhere to the slab system. The nomenclature is not universally adopted; some use the term "slab system" to mean what others would term the slice or tranche system. The definition of slab system given above is that adopted in the Green Book published in Britain in March 1972 on the "Taxation of Capital on Death".

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SLICE SYSTEM — See TRANCHE SYSTEM.

SMALL BUSINESS CORPORATION — Under Section 1371 of the U.S. Internal Revenue Code a small business corporation is defined as a company with not more than ten shareholders, all of whom must be individual and none a non-resident alien and the company must only have one type of equity share. Such corporations may, in effect, elect to have the corporation income taxed as if it were the personal income of the shareholders.

SMALL BUSINESS RELIEF — Various types of relief tend to be made available in tax codes for small businesses. One economic factor in favour of special relief is that small businesses seem to have a greater capacity for rapid growth than larger ones and greater need to conserve capital for re-investment. In the U.K. there are concessions in the impact of CAPITAL TRANSFER TAX (q.v.), and a lower rate of corporation tax on corporate

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income applies up to a certain level. See also SMALL TRADERS, SPECIAL TAX REGIME FOR; SMALL BUSINESS CORPORATION.

SMALL DISPOSALS RELIEF — To reduce the administrative burden of operating a capital gains tax, disposals below a certain level of value may be excluded from consideration. The growing tendency, however, is to exclude a certain level of *gains* from the scope of the tax, this being a fairer way of exempting small gains from tax.

SMALL INCOME RELIEF — Apart from the basic personal reliefs granted in computing personal income tax, some countries establish an exemption limit somewhat higher than the reliefs due to a single person, so as to eliminate many small cases from the tax field. MARGINAL RELIEF (q.v.) may also be granted where the actual income is slightly above the exemption limit. In some tax codes higher exemption limits are also set for married persons, and those above certain age limits. The U.K., which was one of the pioneers of this system, has now abolished it in favour of higher personal reliefs. (See also ZERO BRACKET AMOUNT.)

SMALL TRADERS, SPECIAL TAX REGIME FOR — It has been a feature of some sales tax systems to make special provisions for small traders, defined as those whose sales are below certain limits. For example, in Federal Germany's V.A.T. system the small trader may opt to be assessed at a small percentage rate of his total sales, instead of on the ordinary V.A.T. system of paying a higher rate on sales and receiving a deduction for tax embodied in his purchases which has been passed on to him by his suppliers. Under the V.A.T. systems generally, traders whose sales are below a certain level are exempted altogether from V.A.T., while those whose sales are above the exemption limit but below a further "abatement" limit will have their tax bill abated by a formula which provides a sliding scale of abatement giving maximum relief where the exemption limit is slightly exceeded and the minimum relief where the upper limit is almost reached. Special regimes are also sometimes applied under income tax systems, somewhat simpler forms being required of the smaller trader than are expected from the large ones.

SNAKE IN A TUNNEL — The European Monetary System (EMS) which applies to most of the members of the European Economic Community (E.E.C.). While the currencies of the EMS countries may together vary against other countries freely, the value of each member country's currency with regard to other EMS members may only vary between narrow limits, in effect between the roof and floor of the "tunnel".

SOCIAL SECURITY LEVIES — Levies for social security may take the form of a tax such as a payroll tax on the total remuneration paid by an employer to his employees, which is not related to the circumstances of individual employees (see PAYROLL TAX) or may be a contributory scheme whereby the employer and employee contribute jointly for the benefit of the employee, whose ultimate benefits are specifically related to the contributions made by and for him. The third alternative is a scheme whereby compulsory contributions are made proportionate to the salaries and wages of employees, but the benefits are related to their circumstances at the time of retirement, for example, there may be a minimum pension for the lower grades of employees, the actuarial value of whose contributions would not have produced the level of pension granted.

SOCIETÀ A RESPONSABILITÀ LIMITATA (S.R.L.) — (Italy) A company whose members are liable only up to the nominal value of their quotas.

SOCIETÀ PER AZIONI (S.P.A.) — (Italy) A company whose members (shareholders) are liable for the company only up to the nominal value of their shares.

SOCIÉTÉ CIVILE — (France) A company formed as a partnership.

SOCIÉTÉ HOLDING — A holding company, especially those in Luxembourg, which receive special tax treatment.

SONDERAUSGABEN — (Germany) Deductible personal expenses.

SOURCE RULE — In a DOUBLE TAXATION TREATY (q.v.) it is customary to indicate, either in a separate article (the "source rule") or in a clause in each relevant article dealing with a particular type of income, which of the contracting countries should be regarded as the source country for such type of income.

SØMANDSSKAT — (Denmark) Seamen's Tax.

SPECIAL CHARGE — A charge which was imposed in Britain becomes payable on 1 January 1969 on investment incomes of more than £3,000. The levy operated in the form of an additional surtax charge which was applied in conjunction with the taxpayer's normal rates of income tax and surtax. The rates adopted were such that anyone receiving an investment income of over £15,000 had to pay more than 100 percent of it in tax; the charge thus amounted to a CAPITAL LEVY (q.v.) on those with investment incomes above that figure. The tax was similar to the SPECIAL CONTRIBUTION (q.v.) levied 20 years earlier.

SPECIAL CONTRIBUTION — A tax introduced in Britain in the 1948 Budget imposing tax at graduated rates on investment income. The tax was charged for the fiscal year 1948/1949 (payable January 1949) on the investment income of 1947/1948 where that income exceeded £250. The rates of tax were graduated up to a maximum of 50 percent which, when added to ordinary income tax and surtax, involved a total tax levy exceeding 100 percent, representing a CAPITAL LEVY (q.v.) on taxpayers with higher investment incomes.

SPECIFIC DUTIES — Customs and excise duties which are levied at a certain sum per unit, or per unit of volume or weight, are known as specific duties. Current examples include the duty in the U.K. on each mechanical cigarette lighter, which is a kind of COUNTERVAILING DUTY (q.v.) to the duties on matches avoided by using a lighter, and the duties on tobacco, and on alcoholic beverages, usually quoted as so much money per unit of weight or volume, respectively.

SPECULATION, LAND, TAX — A land speculation tax has been introduced in the Isle of Man to levy tax at the standard income tax rate on land and real property which is disposed of within five years of acquisition in the case of a non-resident, and within three years in the case of residents. The tax is charged on the excess of disposal price over cost and forms a SHORT-TERM GAINS TAX (q.v.).

SPENDINGS TAX — Another term for EXPENDITURE TAX (q.v.), i.e. a tax on the total amount of expenditure incurred, or money spent, on "consumption" by the taxpayer.

SPLITTING, INCOME — See INCOME-SPLITTING.

[to be continued]

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STUDY OF TAX RATES

Made at the Eighth Hispano-Luso-Americanas Meeting

by Enrique Jorge Reig*

I. INTRODUCTION

During the Jornadas, a convention of Spanish and Portuguese speaking countries held in Buenos Aires in September 1979, discussions on the subject of tax rates took place. As an introduction to this paper we begin with a brief outline of the areas covered in the discussions on tax rates as well as the form and development of the dialogue that led to various conclusions on the subject. The objectives to be achieved by these discussions were stated in directives that were used as a basis for the analysis of the tax rates (either progressive or proportional), their structure and level (the amount of tax), but special note was taken of the type of tax — on income, capital, net worth or consumption — to be imposed and the ends to be achieved by its imposition.

In order to study the various factors that influence the rate structure of the different taxes, particularly the problems involved with public expenditures and public administration (especially the tax administration), a questionnaire and psycho-social study were prepared. This questionnaire, answered by the reporters from Argentina, Brazil and Uruguay, was a study of taxpayer attitudes that was included in the directives issued in order to form the basis of a comparative study of the tax rates in the participating countries.

Although many different factors that influence the tax rates were analyzed and their importance discussed they were not all included in the conclusions reached and recommendations made by the group. Such topics as the varying degrees of compliance and tax evasion that exist among the different countries were studied along with problems relating to public expenditure and public administration; however, no conclusions were reached on these subjects nor was a decision made on the actual effect of inflation upon the economies of the countries attending this meeting in the context of a comparative analysis of their tax systems and tax rates.

The materials used in this comparative study were the national reports. Because Argentina requested that they be submitted in advance it was possible to use them as a basis of the report. Among the ideas used in the analysis of the tax rates was Argentina's proposal that a mathematical formula be used in order to maintain continuous progressive rates, which provoked a lively and interesting discussion. However, before there could be any use of the proposed formula the whole question of whether or not taxation should be based upon a progressive scale had to be decided. In contrast to the utilitarian theory that looks at the usefulness of additional wealth or income to an individual or family group to determine the rate of taxation, the progressive tax theory rests upon a taxpayer's ability to pay the tax that is imposed upon him. The group considered a progressive tax rate therefore inherent to the general principles of equity that underlie taxation.

In order to determine clearly and precisely what is ability to pay taxes, as defined in the progressive scheme, the group devised an objective definition that was based upon the economic welfare potential of a given taxpayer. In

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(b) Taxes on consumption (sales and excise taxes)
(c) Taxes on capital and net wealth

* The author was assigned as general reporter and had the responsibility of preparing the directives used as a basis for the national reporters to produce their reports, and of presenting, as such, one paper to the congress. The meeting was held in Buenos Aires, September 1979.
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addition, in order to define the framework within which the rates were to be studied we agreed that the pattern that the progressive tax rate should take is dependent upon the current consensus and the political philosophy of the party in charge of the particular country in question at a given moment. Such is the case when, for example, a redistribution of wealth becomes an objective of the government's taxation policy; the progressive theory of taxation is then strengthened.

The recommendations proposed by the general reporter to facilitate the discussion on tax rates and to elaborate upon the conference's conclusions were made in 14 separate points, in addition to those made for each of the three tax groups (income, sales and exercise, capital and net worth) that comprise a modern system of taxation. Discussions were held based upon these points as well as the 17 conclusions that were finally approved by the Jornadas.

Because of the explicitness of the resolutions and the explanation contained in the preamble ("whereas" section) of the conclusion reached by the Jornadas it was not considered necessary to make comments on each of the individual proposals listed in the Recommendations. However, it was believed that it might prove helpful to review some of the considerations taken into account in the discussions of the different taxes.

(a) Taxation on income

Recommendation 1, which deals with the pattern of progressive income tax rates, refers to the fact that it would be desirable to reduce the spread between the marginal and average tax rates in the middle range, in such a manner that it would also result in a reduction of the average rate of tax in the corresponding tax bracket. This was viewed as an indication of the pattern to be established by a progressive tax rate. This notion was based on the premise, accepted by all the participants in these discussions, that the tax produces a less adverse effect on the productive activities undertaken by the groups of taxpayers classified in the medium income brackets (income effect) in contrast to the effect it may have on those in the high level income groups (substitution effect).

Recommendation 2 also presented interpretational problems which were clarified in discussion. The suggestion that the exemptions and exclusions from the personal tax base be kept to a minimum only refers to their number but by no means to the fixed personal minimum exemption permitting a taxpayer and the members of his family a minimum subsistence level (i.e. a so-called "non-taxable minimum" and "family allowances"). It was only intended to recommend that the number of exemptions and franchises be kept as low as possible with a view to their effect upon the erosion of the tax bases in general. Neither was the suggestion meant as a comment on the policy behind the establishment of the personal minimum exemptions which may relate to the efficient administration of a great number of lower income taxpayers, whose exemption also is often justified considering the fact that they suffer from the proportionally heavier burden that consumption taxes impose on them.

Another interesting discussion resulted from the terminology in the writing of the resolutions due to the use of the term "rate". There was some confusion on the part of some of the participants as to its meaning. In the Spanish language, "rate" (tasa) is also a certain type of revenue. Therefore, it was noted, it was best not to use "tasa" in the text when the term was employed to refer to a portion of the share of the taxable base but that such words as "aliquotes" (alicuotas), "tariffs" (tarifas), or "types" (tipos) should be used instead.

An important comment on the type of rate that should be imposed on those who derive income from personal services was made by an Argentinian participant (see Recommendation 8). Because social security payments have become such an important governmental task and social security contributions constitute a significant portion of government tax revenue, it was suggested that coordination of income and social security contributions be made. In order better to coordinate and consider these two forms of taxation when establishing a rate and in order to follow equitable tax principles, the bases upon which both social security contributions and income tax are calculated for those with earned income should be similar.

Another important recommendation — Recommendation 6 — related to the taxation of corporations or businessses is that the income from a corporation or business should be included in the tax base for the progressive personal income tax; it was pointed out at the same time, however, that corporate income tax is not applied at progressive rates but only at proportional or uniform rates.

The Preamble and Recommendations 3, 4 and 5 show that the group was aware of inflationary aspects although it generally limited the analysis to those aspects more directly related to the effectiveness of tax rates and to the fulfillment of the tax obligations by the taxpayers. The participants agreed on the need to extend the remedies formulated in the tax rate area to other spheres of tax, e.g. non-taxable minimum and family allowances, loss carry forward provisions and exemption limits. The group felt that it was understood that the meeting was to be confined to a study of the tax rates, so that the discussions did not extend to these other phases of taxation.

(b) Taxation on consumption

In the conclusions reached at the meeting, Recommendations 9 through 13 deal with consumption tax. It is interesting to note that despite the form this tax may ultimately take in the various countries, the recommendations all emphasized the need to keep the number of exemptions to a minimum. Because of the practice of allowing numerous exemptions to consumption taxes, higher rates than would otherwise result presently exist on those items subject to the tax. It was also suggested that these exemptions be limited to those that are absolutely necessary so as to reduce the burden of this

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type of tax upon taxpayers in lower income tax groups (that is, to reduce its regressivity).

In addition, after considering the importance of the type of tax, one must fix the rates (cumulative, one-stage, value added, etc.). It was decided that in the establishment of any form of consumption tax, it would be advantageous to both the tax administration and the taxpayer if only one rate were employed. Even though it was admitted that differentiated rates may be necessary to improve the distribution of the tax burden, it was also thought advantageous that their number be limited. They should be confined to two or three different rates and at the same time restrict the number of goods and services subject to another rate than the standard rate.

(c) Taxes on capital and net wealth

The four Recommendations which were adopted with respect to the taxation of capital and net wealth, 14 through 17, voice the need for a progressive rate scale, structured similarly, as in the case of income tax, applicable to net wealth and inheritance taxes; in addition, they emphasize the supplementary nature of the individual net wealth tax to the income tax. It was therefore believed advisable, when establishing the rate of this tax, to take into consideration both income and net wealth taxes and to evaluate the additional burden of the tax upon capital income.

Another important proposal which was adopted refers to the inequity that results from the use of progressive tax rates levied on certain isolated types of property. One recommendation accented the need, when fixing the tax rate, to observe the principles of non-confiscation. Another expressed the need to note that the individual net wealth tax considers as part of the taxable net wealth of an individual his investment in shares of stock companies and his interest in any business enterprise. It was therefore believed necessary to integrate individual and corporate net wealth tax when a corporate net wealth tax is imposed as a method of making collection easier, so that corporate net wealth tax is considered as an integrated part of, and not a separate revenue, from the individual net wealth tax itself.

II. THE BASIC CRITERIA USED IN THE ANALYSIS

The following discussion reproduces a substantial part of the general report, mainly from the section on the structure and level of tax rates. These were the basic criteria used in the analysis of the subject.

A. Introduction

1. Scope

The subject, "The tax rates applicable in the Spanish and Portuguese speaking countries", was analyzed from two points of view:
- the rate structure; and
- the limits or the maximum amounts that would be applicable.

The first problem encountered in the analysis is how should the tax burden be distributed among the taxpayers in keeping with the generally accepted principles of equity. This difficulty is recognized by Due and Friedlaender in their study of taxation when they remark: "What is "fair" or equitable in taxation is unavoidably a value judgement; no scientific specification of an equitable distribution pattern is possible."[1]

On the other hand, Due and Friedlaender point out: "the conflict created between equity rules and determined economic goals [such] as saving, investment and economic growth, could complicate the administration and compliance, to a point [at] which evasion could be of importance."[2]

The fundamental reason for choosing this subject for the Jornadas was to come to some conclusions about the adequacy of the structure and level of the tax rates currently in use in the countries which participated in this conference. This subject was therefore chosen in the hope that its analysis would aid in achieving compliance on the part of the taxpayers and with the expectation of reaching some conclusions and recommendations on the form and limits of the tax rates in keeping with the social and economic patterns that prevail in the interested countries.

Before analyzing the subject and the objectives to be achieved, it might prove useful to outline the current state of thought on the subject of fairness or equity in taxation.

2. The equity principle

Equity or justice in taxation, as defined by Seligman, is generally discussed in relation to the problem of progressive taxation, which from the first half of the sixteenth century was based on the "ability to pay" theory.

A vast literature has developed on the subject of the impossibility of measuring the various benefits to the individual of the aggregation of additional wealth or income to that which he already possesses. The use of the notion of sacrifice as the basic for the test of the "ability to pay" has gradually been abandoned because of substantial defects. Thus, this theory is only studied from an academic point of view and has been replaced by the "faculty theory". Thus Due and Friedlaender[3] are of the opinion that the concept of sacrifice is irrelevant and reduce their anlysis of its impact to a footnote and base the theory of equity on the "ability to pay" theory, defining this within the framework of economic welfare.

Fagan in his works on the economics and theories of

1. Due, John F. and Friedlaender, Ann F., Análisis económico de los impuestos y del sector público. El Ateneo, Buenos Aires, 1977, p. 219.
2. Due and Friendlaender, op. cit., p. 222.
3. Op. cit.

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taxation[4] is clearly of the opinion that "ability to pay" is a separate and independent doctrine from that of measuring the sacrifice on the part of the taxpayer. He attributes the broader acceptance of the "ability to pay" theory to its higher degree of objectivity, although it maintains sufficient subjectivity to keep it in line with the "sacrifice" theory.

Neumark in his study on the principles of taxation[5] refers to the problem by declaring that the "ability to pay" should permit that the loss suffered by individual taxpayers because of the effect of the imposition of taxes upon their financial situation, be an equally onerous burden in relative terms after taking into account all the important personal factors.

The well known Carter Report on Taxation[6] defines the "faculty" theory using only economic criteria. It explains the "ability to pay" as proportional to the "discretional economic potential" of the taxable units; "discretional economic potential" is the product of the total economic capability that the taxable unit can contribute to the total expenses. In short, according to the Carter Report, the "ability to pay" is equal to the real and potential economic capacity of the taxable unit to acquire goods and services to the extent it is not required to support the members of these taxable units in a comfortable standard of life measured in relation to other taxable units.

Thus, the currently accepted view of the "ability to pay" theory is based upon the concept of measuring that part of the economic potential of the taxable unit that can be disposed of without affecting an adequate standard of living for the unit members. It is evident that this concept, by making itself more objective and disassociating itself from the "sacrifice" doctrine, does not give a solution as to the manner of distribution of the required tax burden. This will depend on the income to be used to cover necessities out of the total funds available in each stratum of wealth or income.

3. The redistribution effect

The use of the "ability to pay" principle as a basis for achieving justice or equity in taxation and in conformity with its definition involves a redistribution of wealth or income by the use of progressive taxes. But according to Neumark,[7] such redistribution is not in and of itself an objective of the "ability to pay" theory. Only when redistribution is considered a socio-political and ethical aim does any levy surpassing that which is necessary to accomplish such theory become different and acquire a separate identity. As Neumark mentions, this occurs when the distribution of the fiscal levies among individuals is progressive in a higher proportion than is necessary to fulfill the "ability to pay" theory.

The adoption of redistribution as a nowadays generally accepted objective of taxation starts with the premise that the distribution of wealth and income that occurs under free market conditions in a liberal economy is not the best and has a tendency to magnify the differences between the various social classes. Thus, the effect of redistribution transforms itself into a political end that is different from that of justice or equity, this being acceptable, according to Neumark, if the results, compared with the fundamentals of the economic order based on a market economy, are considered just in the general concensus. Thus the idea of justice also becomes part of the criteria taken into consideration when discussing redistribution.

The redistribution of wealth or income, on the other hand, is not the only objective that can be accomplished through taxation; to a significant extent it can also be achieved through a public expenditure program. In countries with developing economies where education, medical and hospital services, retirement pension funds and so forth are totally or partially financed at government expense, and these programs specially benefit the lower income class, do the government's expenses fulfill an important function of redistribution. This does not mean, however, that in order to obtain an income level that is considered "just" that the tax system could not be used in order to put into action such a plan.

B. Structure and level of the rates

In analyzing the structure and level of the tax rates, recent American contributions in this area will be taken into consideration with respect to each of the following types of tax that form the fiscal system: income tax, consumption tax and taxation of capital and net wealth.

1. Structure of the rates

(a) Progressive rates

The problems involved in structuring the tax rates cannot be presented in a general manner because they are so closely related to each type of tax imposed.

The taxes on income and on capital, in the latter category particularly the taxes on inheritance and individual net wealth, demonstrate more frequently than any other type of tax the application of progressive tax rates. As a result, their imposition gives rise to the discussion on progressivity. On the other hand, consumption taxes are not consistent with the theory, and their fairness can be maintained only by the proper selection of exemptions from the tax or by the use of differentiated proportional rates of tax on groups of products that are consumed by the various income groups of the population.

There are three different methods of establishing progressivity, by groups or classes, by scales and by the

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4. Fagan, Elmer D., Recent and contemporary theories on progressive taxation, *Journal of Political Economy*, XLVI: August 1938, reproduced in *Readings in the Economics of Taxation*, selected by a Committee of The American Economic Association formed by Richard A. Musgrave and Carl S. Shoup. Richard D. Irving Inc., Homewood, Illinois, 1959, p. 12.
5. Neumark, Fritz, Principios de la imposición. Instituto de Estudios Fiscales, Madrid, 1974, p. 176.
6. The Carter Report. Spanish translation of the Report of the Royal Commission on Taxation. Kenneth L. Carter, President, Ottawa, Canada, Madrid, 1975, vol. II of the Spanish issue (3 of the Report), p. 5.
7. Neumark, Fritz, op. cit., p. 242.

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linear or continuous method (without taking into account the use of exemptions on the basis, as this method is generally not utilised as a form of progressivity because they produce an unsatisfactory distributional curve).

The use of the progressive method of taxation for groups or classes of taxpayers is inconvenient. Measuring the tax on the basis of one rate for each group or class of taxpayer in each level of the scale leads to abrupt changes in the level of taxation when going from one group or class to the next causing inequities in the transition zones. Thus, it cannot be considered to be an acceptable manner to effect progressivity.

The second alternative, namely, the so called progressivity by scales, eliminates the anomaly which occurs under the preceding method. Progressivity is accomplished by increasing the marginal tax rates that are applicable successively to the taxable sums located between the lower and higher limits (i.e. "brackets") of each step in which the base of the tax is divided. This method undoubtedly has greater merit for which reason it has been generally accepted.

The linear or continuous method makes use of a mathematical formula that permits a more rational application of the progressive principle. Once the basic parameters are chosen it is easy to fix a progressive tax rate curve. This method is criticized, however, because of the difficulty to the taxpayers in applying it.

Taking into consideration the above, it was concluded that the analysis of the structure of the rates must focus upon the use of the progressivity by scales method. The variables to be considered in this analysis include:

- the number of steps (or scales) that must be established;
- the criteria to be used to determine the limits between the different steps; and
- the pattern to be used to increase the marginal rates in each step.

As the Kaldor report[8] demonstrated and as also is said in the conclusions of the Interamerican Conference where this work was presented[9] — and in most of the other studies on the use of progression for determining tax rates — it is better to limit the number of brackets in structuring the scale.

It is more difficult to come to any conclusion about constructing the scale, when this would mean determining whether the limits of each step must be constant or variable, and, if it is to be variable, then what would be the best pattern of variation.

The Carter Report[10] proposes that the brackets within the scale used for the imposition of income tax should be increased in geometric progression. This can be accomplished by multiplying by two each step on the scale in order to reach the next one until reaching the maximum rate within the individual scale. By so doing the large number of taxpayers who are located on the bottom of the income distribution pyramid can be divided into a reasonable number of brackets. The last of these brackets would be the largest and the number of taxpayers would be smaller. The resulting curve will reveal a rapid increase in the earlier steps and then a flattening out as it progresses.

However, we believe it would be difficult to determine with sufficient precision the rules necessary to establish the limits of each tax bracket which would also take into account the distribution of the taxpayers among the proposed brackets. The distribution of the tax base in the different brackets within the scale is a problem that effects both its limits, the highest and lowest, as well as fixing the marginal rate applicable in each bracket. The Carter Report proposed that in order to fix the marginal rates, the rates should increase step by step following an arithmetical progression, as long as the limits of the brackets grow progressively in a geometical trend. This is the most difficult area in which to make decisions about how to structure a progressive tax rate because they must not only take into account the general consensus in the respective country, in conformity with what is accepted to be fair, but they also must involve definitions on the redistribution of wealth and in achieving the socio-economic objectives that are being pursued in each country.

The National Report on Argentina for the Jornadas[11] incorporated what were believed to be the goals to be achieved by the introduction of a tax scale as proposed by Carter. Under this scheme the intermediate steps of the scale would be increased gradually but would then level off at the highest point. This method would reflect the principles of equity based on both the "ability to pay" principle and the socio-economic objectives.

This method may entail the least adverse effects on the incentive to work. Because of the "income effect", taxpayers in the lower income categories may increase their efforts whereas the imposition of heavy taxes in the higher tax brackets reduces re-investment and productivity. Several factors also come into play that can define the form of the step by step curve in the marginal rate scale. These factors include the total amount of revenue to be earned from the levying of the tax without, however, exceeding the previously established maximum rate of tax and the amount of income to be generated by the various steps.

Once having fixed the exact number of brackets to be established and the criteria to be used to determine the parameters of those brackets, the final element to be taken into consideration when forming the rate structure is to what rates will the marginal rates conform at each step. This must be done in order to arrive at the total tax due from the prospective taxpayer, which can be calculated by totalling the tax due in each step,

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8. Kaldor, Nicholas, El papel de la tributación en el desarrollo económico, Reforma tributaria para América Latina, t. II, Problemas de política fiscal, Documents and Minutes of the Conference held in Santiago de Chile in December of 1962. Joint Program on Taxation OEA-BID-CEPAL, Panamerican Union 1964, p. 122.
9. Op. cit.
10. The Carter Report, vol. II, p. 10.
11. Prepared by Jorge Macon.

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taking into consideration the bracket of the scale which the taxpayer reaches.

Once again a value judgement must be made on the principles of equity to be applied and of the socio-economic objectives that are to be achieved by taxation. In order to solve this dilemma the Carter Report proposes the use of a linear progressive ascending tax rate, with geometric progression to delineate the limits of each bracket. Nothing, however, in either instance should prevent the progression (in either the higher or lower brackets) from being constant over the whole length of the rate scale or being variable in its run.

Therefore, the only rule that can be recommended is that any formula to be adopted should be reasonable in order to justify any differentations that may be introduced so that they may not be seen as arbitrary or anomalous.

García Garzón demonstrated mathematically in his work on tax rates,[12] using the Argentinian income tax rates to clarify his analysis, that a steeper progression occurs immediately after a demarcation point than before. Consequently, this situation points to the fact that the progression is subject to as many ups and downs as there are divisions in the rate scale. His observation, based on this mathematical analysis, leads him to the conclusion that the system of progression by scales contradicts the theory of uniform progression and does not conform to the theory of a uniform reduction of the marginal utility of the successive amounts of income or wealth. This would seem to be a valid observation for any system that uses a progressive scale.

(b) Proportional rates

Up to this point there has only been a study of the progressive rates of tax; hereafter will follow a discussion of proportional tax rates which is a much simpler problem.

In general — and under the fundamental principles by which progressive rates were analyzed above — progressive rates are only acceptable when applied to income or property taxes levied upon an individual or family unit as the taxable entity. However, when taxes are imposed upon profits, business operations or isolated transactions (objective or real taxes), then progressive rates are not justifiable. The rates uniformly acknowledged to be acceptable for such types of taxes and that are used in various legislation when establishing tax rates are "proportional", also called "constant" or "uniform". This term is applied to either a tax levied as a percentage of values of the taxable base (ad valorem tax) or as an amount imposed on each unit of same (kilogram, meter, liter, etc. — specific tax), the percentage and amount not varying no matter what the size of the tax base. There are two structural problems that must be resolved when a proportional tax rate is to be applied. First a choice must be made between two different tax rate systems, either a single rate, or various rates applicable to sundry goods or services or groups of goods or services which it is considered desirable to tax differentially. The second problem is upon what basis should the tax be used, an ad valorem basis or a specific one.

The first decision to be made in the choice between a single or multiple rate structure was discussed in connection with rates for a general sales tax and more specifically with regard to the value added tax. The emphasis of the analysis of this problem was placed on the administrative problems caused by using a differentiated rate system. This same difficulty was discussed in 1971 at the Buenos Aires Conference held by the Joint Program on Taxation OEA — BID — CEDAL[13] which dealt with such topics as the *administrative criteria required to establish the structure of sales and excise taxation.* At that time comment was made upon the work presented by John F. Due[14] who pointed out the administrative advantages of using a single rate of tax. Not only does this method eliminate definitional problems which are similar to those which arise if exemptions are granted but it also prevents pressure which might be placed upon the Secretary of the Treasury by various interest groups seeking to change the position of their products on the tax rating lists.

On the other hand, as a controversial point for this analysis, the advantages afforded under a differentiated tax rate scheme can be evaluated. It enables a higher rate of tax to be imposed on non-essentials or luxury articles and in this manner it also helps to influence a better use for the country's resources. This variation in the rates, provided it takes into consideration the taxpayer's ability to pay the tax imposed on the items, would thus provide a way of introducing a certain amount of progression into the tax system which would in that way balance the fact that income tax is generally relatively less important in the Latin American countries.

The simplicity or ease of administration of one rate of tax is again demonstrated when applied to the problems of tax payments and tax inspection. With just one rate there is no need to classify different taxable operations into different groups subject to different rates of tax. This problem is particularly complicated when seeking to control the amount of tax credits in cases where multiple stage taxes are imposed and credit is given for taxes paid in the previous stages such as occurs under the usual form of value added tax.

Among the tax experts writing on tax rates, Due proclaimed himself firmly in favor of uniform rates of tax. In a paper presented at the First Annual Meeting of CIAT he said: "The use of a certain number of rates for the purpose of increasing the equity of the tax and decreasing the consumption of certain luxury articles, creates the same difficulties as the exemptions, interpretative problems with regard to the rate to apply and

12. García Garzón, Juan Oscar, Paper presented to the Jornadas, entitled Alícuotas en la imposición progresiva ("Rates in progressive taxation"). Mimeographic.
13. Programa Conjunto de Tributación OEA-BID-CEPAL, Reforma Tributaria para América Latina, vol. I, Problemas de Administración de Impuestos. Documents and minutes of the conference held in Buenos Aires, October 1961, Panamerican Union, Washington 1963.
14. Op. cit., p. 436.

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causes complications in the taxpayer's compliance and application of the law."[15]

The model tax system proposed by the OEA in the Third Inter-American Conference on taxation, held in Mexico in 1972, also was in favor of the use of a single tax rate for the levying of a general sales tax accompanied by a selective tax on specific merchandise or services.[16]

It can be seen from the comments made on the proposed model tax system that there was a noticeable difference between the type of tax rates that should be imposed from Herschel's and Due's point of view.[17] Herschel gave preference to the "redistribution" effect of the variation in tax rates. He emphasized the results which would be achieved by the use of selective consumption taxes. Taxes on consumption, he believed, would serve an important function by influencing the direction of consumption. He therefore recommended that these taxes be given as broad an application as possible within the limitation imposed by the feasibility of its administration. Due, on the other hand, maintained that with any form of general sales tax, but especially with value added tax, a uniform tax rate is very important.[18] He then suggested that any selective tax on consumption should be limited to a relatively small number of goods and that the income tax was a better tool to use in order to achieve progressivity and redistribute income.

The above analysis exceeds the scope of the conference's topic (the structure of rates) for it is a discussion on the policy behind the establishment of tax rates. It must be emphasized, however, that this problem is an important one when decisions are being made on proportional tax rate systems. Because of the conflict between the goals sought to be achieved through the use of a tax rate that is administratively simple and just with those of a rate that will reflect economic goals and the redistribution of wealth, it is important to note that policy differences do exist and can be influential in making a decision on the type of system that will be used. This fact was demonstrated recently when Argentina announced that it was changing its hitherto two-rate value added tax system, in force since 1975, into a single rate of tax.

It must be confessed that it is difficult to come to conclusions on the subject of the structure of a system of proportional rates. The ease of administration and control of a single rate of tax clearly argues in favor of its adoption. On the other hand, in order to accomplish other objectives in developing countries, it is not always possible to realize such objectives through income or wealth taxes so that the use of various rates in consumption taxes is desirable.

Another problem that arises in discussion on selective or specific (excise) taxes on consumption is whether the rates imposed should be levied on an ad valorem or upon a specific unit basis. Specific rates of tax are still, however, the prevailing method of imposition despite the generally recognised advantages of using an ad valorem basis when imposing a tax on consumption, thereby using the sales values of the taxable good or service as the basis for levying the general sales tax, which is also a principal element for determining taxable income in the income tax.

During periods of inflation an ad valorem tax avoids the pitfalls that a specific tax on the taxable goods or services would have.

If a specific per unit tax were imposed on such goods or services during periods of inflation the tax would not keep up with the rapidly increasing rise in prices. The tax would therefore prove to be insufficient as a source of revenue. Under these circumstances such a tax would fail to achieve its stated goals because the basis of its imposition was expressed in units others than its real value.

As was mentioned in an earlier paper on the subject of taxes and inflation,[19] for the above-mentioned reasons Argentina changed in October 1976 to an ad valorem taxing system on a majority of the consumption taxes imposed by the government.

Since the functions assumed by modern states vary according to the prevailing political philosophy of the government which dictates the amount of governmental intervention necessary to provide general services, including the infrastructure needed to supply such services to its citizens, the general level of tax rates and its structure are also due to the role played by the government. In a state where socialist tendencies prevail, taxes generally are higher owing to the fact that the state provides many services that must be financed by the revenue from taxes. In contrast, in a non-socialist state public expenses are lower, therefore the state's need for revenue is lower, which results in a lower tax pressure.

Nevertheless, it is not only the degree to which the government needs to raise revenue, generally known as "fiscal pressure", that determines the level of the different rates of tax, but also the number of taxes that are imposed that determines such level.

In general, tax rates can be lower if the number of taxes is large. Therefore in a tax system in which there are numerous taxes the required revenue can be obtained even though the rates of the particular taxes are low. In contrast, in those systems where very few taxes are levied higher rates are imperative in order to raise the same amount of revenue. The amount of efficiency or lack thereof in the management of public funds is also a determination of the total amount of money needed by

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15. CIAT, Centro Interamericano de Administradores Tributarios. Documents and Minutes de la Primera Asamblea General, 1967. Panamá. Volume issued in Buenos Aires, 1968, Paper entitled Estructura y operación de los impuestos sobre ventas, p. 445.
16. Programa de Finanzas Públicas de la OEA. Reforma Tributaria para América Latina, t. IV, La politica tributaria como instrumento de desarrollo. Documents and conclusions of the III Interamerican Conference on Taxation, General Secretary, OEA Washington, D.C., 1973, p. 17.
17. Herschel, Federico, volume mentioned in note 16, p. 210.
18. Due, John F., volume mentioned in note 16, p. 233.
19. Inflation and taxation. Paper presented as the National Report to the IFA Congress. International Fiscal Association, Cahiers, Vol. LXIIa, Rotterdam 1977, p. 191.

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the state. Consequently the need to increase or decrease the taxes imposed under a given system of taxation is a direct product of this situation. This same efficiency factor is also an important point that can influence taxpayer compliance which must also be included in the calculations that fix the rates for the various taxes. It is a well known fact that because of all-pervasive tax evasion, governments are compelled to increase the tax rates thus placing a relatively heavy tax burden on honest taxpayers. However, other criteria also influence tax rates for there is a definite relationship between the amount of a particular tax imposed by a given fiscal system and the amount of revenue expected from other sources of the same system which, taken into account, influence any decision made on the structure and limits of the tax rates.

Finally, in an effort to give some structure to the discussion, the author feels that it would be appropriate to offer guidelines to be used for the analysis undertaken when a determination is made on what should be the extent of the tax rates applicable to the different types of taxes. It is well known that the steeper the tax rate the more the taxpayers are reluctant to pay the tax. Because of this, the first recommendation made with respect to the level of tax rates is that it should be kept within the level acceptable to most taxpayers. The rates, therefore, should not be so exorbitant that they would prove to be unacceptable to the taxpayers and thereby lead to a greater incidence of tax evasion. Taking into consideration the fact that the Carter Report[20] recommended that the maximum marginal income tax rate for Canada should be 50 percent, it is evident that in the countries represented at the Jornadas there is an exceptionally high rate of tax on income. Although these countries (based upon their gross national products) are poorer than Canada, their tax rates in many cases are the same as or even higher than those in Canada.

On the other hand, this observation must be tempered by the following considerations. First of all, there is no uniform tax base in the various countries as a result of, for instance, the individual governments' policy towards tax exemptions or because of the fact that dividends distributed by joint stock companies are not included in the tax basis for the computation of individual progressive income tax.

Secondly, some taxes have political restraints placed on their imposition. For example, taxes on property owned or transferred as a result of an inheritance are frequently resisted on the basis of the philosophy that taxes should not be so excessive as to become confiscatory. This concept is often seen in the individual national constitutions such as in Argentina in which the inviolability of private property is guaranteed.

When considering taxes on consumption the reason behind the restrictions placed on their level seems to be mainly the attitude of the taxpayer towards the rate of tax. This is so except in those types of multiple stage cumulative taxes (e.g. "cascade" taxes) where there is an additional element to take into consideration: the tax must not distort the form of business organisation (vertical integration). For other taxes, e.g. customs duties, that are imposed for reasons of protection, or an expenditure tax used to lower consumption, rather high rates can be imposed that even exceed 100 percent when they are in keeping with the purpose of the tax.

III. CONCLUSIONS OF THE JORNADAS

Preamble

The following 17 recommendations were made as a result of the discussions held during the Jornadas (summarized in part 1 of this paper). Most of the proposals upon which the recommendations are based are included in the general report to the Congress but are not reproduced herein due to the fact that they are very similar to the ones approved.

The recommendations are as follows:

Whereas

1. The papers were presented to these Jornadas by the national reporters from Argentina, Mr. Jorge Macon; Brazil, Mr. Ives Gandra Da Silva Martins; Chile, Mr. Juan de Dios Vergara Baeza; Spain, Mr. Mariano Sebastián Herrador; Mexico, Mr. Javier Moreno Padilla; Portugal, Mrs. Antonio Joaquín Carvalho and Mr. Manuel Henrique de Freitas Pereira; and Uruguay, Mrs. Betis Inglés de Forecella and Mr. Horacio Fernández Susena.
2. The technical communications were added by Mr. Juan Oscar García Garzón, Mr. Saúl Witis, Mr. Ricardo Calle Saíz, Mr. José Alberto Parejo Gamir, Mr. José Luis Perez de Ayala and Mr. Angel Schindel.
3. The report of the general reporter, Mr. Enrique Jorge Reig, was presented.
4. The propositions and suggestions offered during the discussions that took place during the working sessions of the Commission have been compiled.

Considering

1. That the problem of the tax rates, tariffs or types[21] of tax is based upon a series of factors the most significant being, first, the dominant political philosophy in the particular social-economic community in which it is employed which determines the level of taxes imposed on the taxpayer and, second, the consensus which is reached in that community on the criteria to be used to judge the fairness of the distribution of the tax burden among the population.
2. That it is the efficiency of the government in managing and directing public expenditure, as well as the reasonableness and efficiency of the public administration, in particular the tax administration, that are important elements in establishing differentiated tax rates, which because of their sensibleness will be capable of obtaining the acceptance and the compliance of the taxpayers.
3. That the presence of inflation in most of the

20. The Carter Report, vol. I (1 and 2 of the Report), p. 277.
21. See introduction for the term "tax rates, tariffs and types".

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countries attending this meeting makes it necessary to take into account the distortions it causes in the distribution of taxes and in the taxable base, affecting the fairness that was envisioned when establishing the taxes and the taxpayer attitude with regard to compliance.

4. That likewise, before analyzing the problem of the tax rates and tariffs and types,[22] to achieve an effective imposition of these taxes in the desired amounts as foreseen by the legislature, it is necessary to stress the fundamental importance of the correct and uniform determination of the taxable base.

   In economies suffering from inflation, the rules for estimating the taxable base ought to refer to the same period of time whatever the taxable matter, so that may reflect, for the particular tax, the taxpayer's ability to pay; the time of payment also should be fixed to correspond with the moment the tax arises in the different taxpaying sectors and in the different taxes. If this is not done distortions would result from the failure to consider the above-mentioned factors, so that the fairness sought by distributing the taxes among different sectors of taxpayers is lost and compliance with the obligation of paying taxes is disturbed along with those objectives sought to be achieved by the tax.

5. It must be emphasized that taking into account in the tax system the distortion caused by inflation is not meant to imply an acceptance or agreement with the latter and, on the contrary, fiscal policy as one of the instruments able to do so ought to be utilized to fight inflationary trends.

   The fiscal adjustment of the distortions produced by inflation helps to maintain adequate tax collection levels and to prevent treasury deficits.

6. That the economic and social objectives which are at present achieved through the use of taxation can, in connection with the public expenditure policy, achieve a redistribution of wealth and economic stability and development, intended to improve the well-being of all, also establish general guidelines related to rates, tariffs or types of tax.

7. Before formulating any recommendations about the structure of tax rates, it is felt that given the harmful effect that tax evasion has upon the achievement of the above-mentioned purposes of taxation, as well as being the cause for an increase in tax rates by governments wishing to maintain a specific level of revenue, it is necessary to think about the desirability of funding programs to educate the public on the need for taxes since such knowledge may encourage compliance by giving them a proper picture of the functions of taxation and public expenditure in a modern society.

In view of this, the Eighth Meeting on Tax Studies of Spanish and Portuguese speaking countries recommends the following:

Recommendations

The meeting recommends the following guidelines that must be taken into consideration, when structuring the rates of the various taxes:

(a) Income taxation

1. *Individual income tax should be progressive through the use of a system of scales in which the rate applicable in each bracket exceeds the rate in the preceding bracket but in which the marginal rate gradually approaches the average rate thus taking into account the distribution of the taxpayers' incomes.*

   The rationale for the differences in the width of each bracket, the marginal rate and the number of brackets, should reflect the prevailing consensus on the fairness of the tax, the policy of redistribution of the country's wealth, the administrative efficiency of the tax and the taxpayers' compliance.

   However, this proposed scale system bears an inherent structural conflict since on the one hand it should for simplicity's sake have as few brackets as possible, whereas on the other hand an adequate continuity of graduation would require a large number of brackets. This does not mean that the advantages of the continuous or linear scale method are ignored but it is advised to continue research with the view of finding a simple formula enabling its practical application.

2. *Exemptions or exclusions from the taxable base of the individual income tax should be kept to a minimum so that it would not be necessary to raise the tax rates in order to maintain a determined level of tax revenue.*

3. *In view of the fact that inflation is present in most of the Spanish and Portuguese speaking countries, in order to maintain the level of the tax imposed on the taxpayers there should be a permanent adjustment made in the tax brackets of the progressive scale to compensate for this inflationary trend.*

4. *In cases where inflation turns out to be significant and permanent, in order to eliminate its effect and the lack of compliance on the part of the taxpayers with the resulting loss of revenue and a probable fiscal deficit, it would be desirable to use a system that adjusts the debts owed and credits granted, and taking into account the inflation in the calculation of the advance payments of taxes, when these are based on figures declared in the previous year's tax return.*

5. *Similarly, with respect to taxable bases during periods of inflation, they too should be adjusted to avoid distortions.*

6. *The corporate income tax should be applied at a "proportional" or "uniform" rate since progressive rates are not considered to be appropriate for corporations, and also encourage its artificial structural division. However, as was recommended by the Fifth Jornadas (held in Cordoba, Spain in October 1972), corporate income, at the moment it is*

22. See note 21.

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considered to have been distributed to the shareholders or partners, should be taxed at the progressive rate levied on the individual income tax.

The rates of the capital gains tax ought to relate to those of the regular income tax, and in order to avoid distortions caused by inflation, the tax adjustments should also apply in a manner similar to that proposed for regular income tax. Preferably, capital gains should be included as part of the taxable income. In order to correct the impact that a progressive tax rate would have upon earnings that have accrued during periods of over a year, among the several suggestions proposed, the most acceptable was considered the so called "pro-rata system" that might be used to modify such impact.

In cases when income is derived from personal services and social security contributions are paid based upon this income, the similarity between the bases of these contributions and income tax should be taken into consideration in order to co-ordinate and integrate them upon the principles of tax equity.

b) Taxes on consumption (sales and excise taxes)

It would be desirable that a change be made in the form of tax used, in countries which have adopted a cumulative multiple stage or cascade general sales tax so that these taxes are applied only once to the price. In this way distortions could be avoided in the organization of businesses caused by cumulative taxes and the taxpayers' attitude towards compliance could be improved in particular when the rates are significant.

10. *At present due to the great number of exemptions that frequently exists in the various types of multiple and single stage sales taxes including VAT, higher rates of tax are required on those items which are subject to tax. Therefore, it would be advisable to reduce the exemptions, limiting them to those which are unavoidable to lessen the regressivity of the tax.*

11. *When establishing the appropriate size of the proposed tax rate, besides the fiscal purpose of the tax, the type of sales tax should be taken into consideration and whether it should be cumulative or not in different stages of the economic process as well as at what stages it will be placed, in order to avoid any possible economic distortions between the numerical amount fixed as the rate and the actual incidence of the tax. In addition, taxes similar to a sales tax imposed by different levels of government such as the provinces or the municipalities should be taken into consideration when determining the rate of the proposed tax.*

12. *Due to the advantages to both the tax administration and the taxpayer of a one-rate tax it would be desirable not to use differentiated rates based upon the ability of the taxpayer to pay as revealed in the consumption of the taxable goods or services. Nevertheless, when it may be necessary to have graduated rates as a means of improving the distribution of the tax burden among the taxpayers, it would be advisable to limit the number of tax rates to two, or at the most three. Likewise it would be advisable to reduce the number of such goods and services subject to such different rates.*

13. *It is also advisable with respect to specific excise taxes, that only a limited number of goods and services be included under this special category of taxation separated from the general sales tax. In order better to achieve the purpose of distributing the tax burden according to the "ability to pay" principle and to avoid rates lagging behind, attention should be paid to the possibility of transforming specific per unit taxes into ad valorem ones. For this type of tax the rate can be much higher than those used in the general sales or consumption tax, this tax being levied upon sizeable taxpayer units and its aims are different from those of other such taxes.*

(c) Taxes on capital and net wealth

14. *The criteria listed in paragraph 1 under income taxation are also applicable to any plan to use progressive scales for wealth, inheritance and gift taxes. By taking into consideration the complementary nature of the individual net wealth tax with regard to the income tax, the wealth tax rates should be significantly lower than those of the income tax so that the total tax burden, considering jointly both taxes, would be a reasonable one.*

    In those countries that levy taxes on inheritances and gifts, the same criteria used for structuring progressive scales should be used to plan these rates in addition to the traditional criteria that take into consideration the degree of familial relationship, with the lower rates assigned to transfers between parents and children and to direct ascendants and descendants.

15. *The rates of tax on inheritances and gifts as well as net wealth should be graduated so that the results are not confiscatory, a principle which determines a limit to the rates, varying this according to the prevailing opinion of what is the purpose of the tax in the pertinent country.*

16. *Real property tax and other taxes levied upon determined properties should not use progressive rates when the tax is based upon the isolated value of the property, because they are taxes on* goods or things *as opposed to* personal *taxes. Progressive rates are better applied to those taxes to which individuals or families are subject on all or a major part of the properties they possess, less deduction of debts, among which the individual net wealth tax is the most complete expression.*

17. *It is advisable that the tax on a company's net worth should use proportional or uniform rates for the same reasons expressed above in point 6 under the discussion of corporate income tax. Furthermore, capital invested in companies subject to net worth tax should integrate the net worth tax base with the individual net wealth tax imposed upon its shareholders and partners.*

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ALLOCATIONS OF FOREIGN BLOCKED INCOME UNDER UNITED STATES TAX LAW

by Howard M. Liebman *

In two recent Private Letter Rulings, [1] the Internal Revenue Service (IRS) has taken a position which not only raises a number of conceptual difficulties but may also create significant practical problems for taxpayers doing business with affiliates in countries which have stringent exchange control regulations. In both rulings, the IRS National Office issued Technical Advice Memoranda which supported an allocation of income from a foreign subsidiary to its U.S. parent even though the local law of the foreign country had precluded such payments.

THE BLOCKED INCOME ALLOCATION RULINGS

n the first ruling (No. 7923003), [2] the U.S. taxpayer ad entered into two technical assistance contracts ith its subsidiary in an unnamed foreign country. These ontracts required the U.S. parent to provide the cientific and technical information and documentation ecessary to manufacture, process and sell certain pro-ucts. In return, the foreign subsidiary was obligated o pay a technical assistance fee in the amount of 5 ercent of the revenues generated from the sale of uch products. The agreements were to last for five ears and, if permitted under local law, could be ex-nded for an additional five years. The agreements ere specifically subject to the laws of the susidiary's ost country.

nder the latter's governing law, however, the maximum llowable fee in any particular case could be varied by he authorities, although it could in no event be higher han 5 percent. The law also allowed the authorities to mit the duration during which technical assistance ees could legally be paid. This law applied to dealings oth between related parties and unrelated parties. The elevant authorities in this instance had reduced the llowable fee to 4 percent in the case of one contract nd 2 percent in the case of the second contract, and, addition, had shortened the duration of both of hem. [3]

evertheless, the IRS ruled that if the payments which ere allowed under local law did not constitute arm's ngth charges, Section 482 of the Internal Revenue ode of 1954 (I.R.C.) [4] could be used to allocate dditional income to the parent despite the fact that he foreign law prohibited the payment of such ad-itional income. The ruling does not itself state what he arms length fee should have been, but it does note that the amount of any allocation need not be limited according to the terms of the technical assistance agreements. Any such allocation should instead be based upon all the facts and circumstances surrounding the rendering of the services and the transfers of intangible property in question, applying the standards set forth in the Treasury Regulations. [5] Thus, under this ruling it is conceivable that the arm's length charge could be determined to be in excess of the 5 percent fee provided for originally in the two agreements, despite the absolute upper limit of 5 percent established by the applicable foreign law.

In the second ruling (No. 8001017), [6] a similar factual background was presented. A foreign subsidiary of a U.S. corporation had entered into a license agreement with its parent under which it was to pay royalties to the latter. Subsequently, the foreign country enacted a law whereby all royalty payments to foreign affiliates or parent companies were prohibited. The law also limited the amount of net dividends payable to foreign shareholders. For this reason, the U.S. taxpayer amended

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1. IRS Priv. Ltr. Rul. 7923003, Feb. 22, 1979, noted in Fuller, *U.S.: IRS Private Letter Ruling Report*, 80-1 INT'L TAX REP. 1 (Jan. 28, 1980); IRS Priv. Ltr. Rul. 8001017, Sept. 28, 1979, reprinted in [1980] 10 STAND. FED. TAX REP. (CCH) ¶ 6954, noted in 7 TAX PLANNING INT'L 60 (March 1980).
2. See note 1.
3. The approved durations were not specified in the ruling.
4. "In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses." (26 U.S.C. §482.)
5. See Treas. Reg. §§1.482-2(b) (services); 1.482-2(d) (transfers of intangible property). See generally Surrey, "Reflections on the Allocation of Income and Expenses Among National Tax Jurisdictions", 10 L. & POL. INT'L BUS. 409, 420-424 (1978).
6. See note 1.

its license agreement to suspend the payment of royalties until such time as they would no longer be prohibited under local law. [7] Once again, the IRS ruled that the income "may be allocated under Section 482 of the Code to ...[the U.S. parent] from .... [the foreign subsidiary] even though ... [the foreign subsidiary] is prohibited under the laws of ... [its corporate domicile] from paying such royalties". [8]

II. THE IRS' RATIONALE

The IRS has opted for doctrinal purity of sorts in issuing these two rulings, implying that the overarching principle of the arm's length standard should be sufficient reason to ignore the constraints of foreign law. Instead of offering any further analytical insight into such a proposition, however, both rulings merely concentrate on distinguishing the precedent established by the Supreme Court in the case of *Commissioner v. First Security Bank of Utah, N.A.* [9] That case involved an attempt by the IRS to allocate commission income to two national banks as a result of credit life insurance policies which their customers had purchased from a related, non-bank subsidiary which was a licensed insurance carrier. The Court took note of the fact that it was a customary practice for a sales commission to be paid by the insurer to the party which had sent it the business. Nevertheless, by a 6-3 majority, th Court refused to uphold the IRS allocation on the grounds that, legally, "the Banks could never have received a share of these premiums". [10] The reason for this restriction was found in Federal banking law, which had been interpreted in a number of court decisions as prohibiting a Federally-chartered bank from acting as an insurance agent unless it was located in a very sparsely populated area. The IRS had not contested the fact that the taxpayer-banks were covered by this prohibition. As the Court could find no precedent "wherein a person has been found to have taxable income which he did not receive and *which he was prohibited from receiving*", [11] it therefore would not sanction the allocation in question.

The IRS has sought to distinguish the *First Security Bank of Utah* case on the grounds that the latter only applies when it is illegal for a taxpayer to receive the income "under the laws of the United States". [12] Both Private Letter Rulings use the exact same language in this regard. Relying on a previous published ruling, [13] they both asset that:

> *It is the position of the Service that the restriction on the Commissioner's authority to allocate under Section 482 set forth by the Supreme Court in* First Security Bank of Utah *is limited to that situation where the taxpayer is prevented from receiving income under United States law.* [14]

Given this interpretation, the IRS has no difficulty in finding that I.R.C. Section 482 may be applied to allocate income among related taxpayers when it is a foreign law which prevents the receipt of the income in question.

III. A CRITIQUE OF THE IRS POSITION

An analysis of the decision in *First Security Bank o Utah* would appear to indicate that the IRS' narro interpretation is entirely misdirected. The basis fo the Supreme Court's decision lay in the fact that th taxpayers could not legally receive the income bein allocated. [15] Although the Court naturally explaine why the taxpayers were prohibited from receiving th income and therefore discussed the U.S. Federal law which were behind the prohibition, the Court's rationa is entirely unrelated to whether the U.S. or foreign la is the grounds for the prohibition. According to th Court, "[t]he underlying assumption always has bee that in order to be taxed for income, a taxpayer mus have complete dominion over it". [16] The decision the restated the principle propounded in the seminal case o *Corliss v. Bowers*, [17] namely:

> *The income that is subject to a man's unfettere command and that he is free to enjoy at his ow option may be taxed to him as income whether h sees fit to enjoy it or not.*

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7. The ruling states that in anticipation of the entry into forc of the new law, the U.S. parent had first amended the licens agreement in order to increase the royalty rate and that it i fact collected this increased rate for at least one year pric to the blocking of all further payments. IRS Priv. Ltr. Ru 8001017, see note 1.
8. Idem.
9. 405 U.S. 394 (1972) (per Powell, J.), 1972-1 C.B. 135.
10. Idem, 1972-1 C.B. at 137.
11. Idem, (emphasis added). See also Beecham, Inc. v. U.S 73-2 U.S.T.C, ¶ 9719 (E.D. Tenn. 1973). It should be noted tha the decision in *First Security Bank of Utah* was not received wit entirely favorable reviews. One commentator criticized it fo ignoring the basic thrust of I.R.C. Section 482 and for lackin "foundation in the relevant case law". 14 B.C. IND. & COM L. REV. 165, 168 (1972). See also Aland, "Can IRS Use Sectio 482 to Allocate Income which Cannot be Earned under Ap plicable Law?", 52 J. TAX. 220 n.2 (1980).
12. IRS Priv. Ltr. Rul. 7923003, see note 1; IRS Priv. Ltr. Ru 8001017, see note 1.
13. Rev. Rul. 76-243, 1976-1 C.B. 134.
14. IRS Priv. Ltr. Rul. 7923003, see note 1; IRS Priv. Ltr. Ru 8001017, see note 1. Cf. IRS Priv. Ltr. Rul. 8003011, Oct. 4 1979, reprinted in [1980] 10 STAND. FED. TAX REP. (CCH ¶ 6966 (in the context of a Subpart F question, the Servic applied the *Biddle* rule from the foreign tax credit areas, viz *[I]n the application of United States income tax laws, the co cepts established by that body of law are controlling, despi the fact that a particular transaction under consideration ma have had its origin in a foreign country and, to that extent, ma have been affected by a foreign income tax law.*
Query whether this same principle can also be extended t other areas such as I.R.C. Section 482.
15. See the discussion in the text at notes 10 and 11.
16. Commissioner v. First Sec. Bank of Utah N.A., see note 9 1972-1 C.B. at 137.
17. 281 U.S. 376, 378 (1930). See also Helvering v. Horst, 31 U.S. 112, 116 (1940) (taxable income includes that which constructively derived by the taxpayer from the "use or di position of his power to receive or control the income as t procure in its place other satisfactions which are of economi worth").

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The Court noted that the Treasury Regulations under I.R.C. Section 482 reflect this principle in assuming that the Commissioner's reallocation authority is to be utilized in cases of related taxpayers which have "complete power to cause each controlled taxpayer so to conduct its affairs that its transactions and accounting records truly reflect the taxable income..." [18] But, as the Court concluded, this assumption of "complete power" cannot be extended to include "the power to force a subsidiary to violate the law". [19] Thus, the Court felt that "fairness requires the tax to fall on the party which actually receives the premiums rather than on the party which cannot". [20] In view of the Court's broad rationale, it is difficult to understand how the IRS can limit the decision to cases in which the prohibition involves U.S. law. [21] The fact that the prior case law only discussed the issue in terms of U.S. law is also no reason to hold that the general principle should be narrowed since such prior cases naturally reflected the facts and circumstances at issue, and the fact that such cases involved U.S. as opposed to foreign restrictions was a mere fortuity. [22]

To a certain extent, the recent decision of the Sixth Circuit in the case of *Salyersville National Bank v. U.S.* [23] highlights this point. In that case, the IRS attempted to allocate commissions for credit life insurance premiums paid by a bank's customers to the bank although the purchases were effected by the bank's president, a licensed insurance agent. Federal law was inapplicable since the taxpayer was not a national bank. Instead the taxpayer argued that it was prohibited under Kentucky law from receiving the commissions since it was not a licensed agent. For at least part of the taxable period in question, it was in fact barred by state law from becoming an insurance agent. Although the state insurance code was subsequently amended, the taxpayer had not qualified as an agent under the new law and therefore remained barred from earning or receiving commissions. The IRS argued and the District Court agreed that once the bank was no longer precluded from becoming an insurance agent, an allocation was permissible. Basically, the IRS took the position that "if the bank had the capability of making itself eligible to receive any commissions it was required to do so, even if it could legitimately choose not to do so". [24] The Sixth Circuit refused to accept this argument, however, and reversed the decisions, including *First Security Bank of Utah*, for the principle that a taxpayer need not arrange its affairs so as to maximize its tax liability. [25] In fact, quite to the contrary. [26] A taxpayer may lawfully structure its business in such a way as to minimize its taxes as long as there is a legitimate business purpose in doing so. [27] In this case, the taxpayer was able to provide a number of reasons why it would prefer, as a business decision, not to qualify as an insurance agent -- e.g. insulation from primary liability on the insurance policies; avoiding the requirement to pay fees, and avoiding the necessity of amending its charter if it were to engage in the selling of insurance. The IRS, on the other hand, did not provide the Court with any authority for why the taxpayer should be required to have qualified as an insurance agent. [28] Thus, the Court, after having determined that it would have been illegal for the taxpayer to have received the commissions being allocated to it, determined that the allocation was impermissible. Naturally, it relies heavily on the precedent established by the decision in *First Security Bank of Utah*. In so doing, it interprets the latter in its broadest sense. [29] It does not get stuck at all on the question of whether the Supreme Court only intended the case to apply to banking law, "Federal banking law", federal law in general, or any U.S. (including state) law. [30] Nor do other cases which rely upon the *First Security Bank of Utah* precedent in any way interpret the latter as implicitly having certain geographic limits to its applicability. [31] In fact, the case was even applied to preclude the IRS from attempting to allocate credit life insurance commissions using I.R.C. Section

18. Treas. Reg. §1.482-1(b)(1).
19. Commissioner v. First Sec. Bank of Utah N.A., see note 9, 1972-1 C.B. at 138.
20. Idem.
21. The only time the Court makes such a limiting reference is when it noted that the taxpayer, in effect, lacked the power to shift income among its subsidiaries, "unlessit acted in violation of federal banking laws". (Idem.) But this phrase if probably intended as a statement of fact and not of principle. If it were to be treated as a statement of principle, its effect would be even more restrictive than the principle which the IRS has attempted to invoke. At the very least, it would mean that the case could only stand as precedent in the event of prohibitions under U.S. Federal law. The Supreme Court's opinion has not been interpreted so narrowly however. See, e.g., Salyersville Nat'l Bank v. U.S., below note 23, and the discussion in the text at notes 23-28 below (prohibitions under state law).
22. For example, the Supreme Court in *First Security Bank of Utah* discussed the case of *L.E. Shunk Latex Products, Inc.*, 18 T.C. 940 (1952), *acq. in part and nonacq. in part*, 1953-1 C.B. 6,7 *Comm'r's appeal dismissed nolle prosequi* (June 5, 1953), in which an IRS attempt to allocate income to a taxpayer was frustrated by the OPA Price Regulations of World War II which prohibited the former from increasing its prices.
23. 80-1 U.S.T.C. ₱ 9190 (6th Cir. 1980), *rev'g* 77-2 U.S.T.C. ₱ 9711 (E.D. Ky. 1977).
24. Idem, 80-1 U.S.T.C. at 83,273.
25. Idem., 80-1 U.S.T.C. at 83,274.
26. It is well established that a taxpayer may legally "decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits...". Gregory v. Helvering, 293 U.S. 465, 469 (1935).
27. Salyersville Nat'l Bank v. U.S., above note 23, 80-1 U.S.T.C. at 83,274. Cf. Hansche v. Comm'r, 457 F.2d 429, 433 (7th Cir. 1972) (taxpayer may arrange its affairs to minimize or eliminate tax, although the IRS is not bound to accept "self-serving" characterizations).
28. Salyersville Nat'l Bank v. U.S., above note 23, 80-1 U.S.T.C. at 83,276. 83,276.
29. In *CIR v. First Security Bank of Utah*, 405 U.S. 394 (1972), the United States Supreme Court held that income could not be reallocated to a taxpayer who did not receive the income and who could not lawfully receive it. Idem, 80-1 U.S.T.C. at 83,275.
30. The *First Security Bank of Utah* decision has been applied as an analogy in other State law contexts as well. See, e.g., Delta Life Ins. Co. v. U.S., 363 F.Supp. 410, 73-2 U.S.T.C. ₱ 9663 (E.D. La. 1973) (computation of life insurance reserves pursuant to I.R.C. Section 801 under governing State law).
31. See, e.g, U.S. v. Basye, 410 U.S. 441, 73-1 U.S.T.C. ₱ 9250, at 80,478 n. 13 (1973). See also Aland, above note 11, at 221.

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61 [32] instead of I.R.C. Section 482, when such commissions could not be received by the taxpayer bank under state law. [33]

On a more basic level, the absence of any inherent distinction between the effect of foreign as opposed to U.S. law in invoking the *First Security Bank of Utah* principle should be clear from the fact that I.R.C. Section 482 does not itself distinguish between foreign or wholly domestic transactions. Thus, the general principles should be the same in both contexts. Admittedly, the fact that a foreign transaction is involved may have an effect on the precise calculation of what an arm's length consideration should have been, [34] but it should not otherwise affect the application of the general principle behind the provision, namely "to prevent evasion of taxes" and "clearly to reflect... income". [35] To achieve these goals would appear to require some attention to the governing law, whether it be U.S. of foreign.

IV. THE PRECEDENT OF PRIOR IRS RULINGS

In both of the Private Letter Rulings under discussion, the IRS also relied on the precedent established in two prior Revenue Rulings, the more important of which is Revenue Ruling 76-243. [36] There the IRS held that an allocation was permissible under I.R.C. Section 482 to reflect an appropriate interest charge on an advance charter hire payment made to a foreign subsidiary, despite an agreement with the tax authorities of the foreign country pursuant to which the charter payment was not to be considered as a loan. The Private Letter Rulings contain an excerpt from this previously-published ruling to the effect that

> *any reliance on the holding in* First Security Bank of Utah... *would be misplaced.* [*The U.S. parent and its foreign subisidiary*] ... *were not under a legal disability since they could have accepted or rejected the terms of the contract and there was no United States law that prevented receipt of the interest allocated to* [*the parent*] *corporation...* [37]

The IRS' reliance on thir prior ruling is itself misplaced, however. The Service attempts to rely on it as support for its position that only legal disabilities under U.S. law can be used to invoke the *First Security Bank of Utah* rule. In point of fact, however, Revenue Ruling 76-243 did not involve a violation of foreign law either. The quotation above clearly indicates that the crux of the ruling is that the taxpayer [38] voluntarily acquiesced in an agreement with the tax authorities. Had it not done so, it might admittedly have been subject in the end to the same type of legal disability as is at issue in these two Private Letter Rulings. [39] But since the Revenue Ruling does not discuss that point, it should only be interpreted as having been based on the voluntary nature of the arrangement. In light of the quotation which the Service itself relies upon in the two Private Letter Rulings, the IRS would appear to take a narrow view of its previous Revenue Ruling.

The second published ruling which the Service discusses is Revenue Ruling 74-245. [40] In that ruling, th IRS permitted a taxpayer to invoke the blocked income accounting method of the Treasury Regulations under I.R.C. Section 482 [41] after the taxpayer was advised by legal counsel that the foreign governmental authorities might not allow its foreign subsidiary to make royalty payments for the use of certain registered designs. Although this ruling might be viewed as implying that such blocked income is allocable, there is once again a discernable difference in the factual settings. First, there was no actual prohibition at issue in the Revenue Ruling 74-245, only the opinion of counsel. And the opinion of counsel was to the effect that the foreign government "would not be receptive to allowing" the subsidiary to make the payments and "might consider placing some economic sanctions" on the latter if its parent sought to enforce its license agreement. [42] This would seem to indicate that perhaps no formal legal prohibition existed but rather only a strong policy concern of the foreign government.

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32. I.R.C. Section 61 is the general provision which defines gross income. The IRS has in several cases attempted to allocate income or deductions using this general provision instead of I.R.C. Section 482, ususally without much success however. See, e.g., Rubin v. Comm'r, 429 F.2d 650, 563 (2d Cir. 1970); Richard Rubin, 56 T.C. 1155, 1162 (1971), *aff'd per curiam*, 460 F.2d 1216 (2d Cir. 1972); Philipp Bros. Chems., Inc. (Md.), 52 T.C. 240, 250 n.2 (1969), *aff'd*, 435 F.2d 53 (2d Cir. 1970); Local Fin. Corp., 48 T.C. 773, 789 (1967), *aff'd*, 407 F.2d 629 (7th Cir.), *cert. denied*, 396 U.S. 956 (1969); Grenada Indus., Inc., 17 T.C. 231, 253 (1951), *aff'd*, 202 F.2 873 (5th Cir.), *cert. denied*, 346 U.S. 819 (1953). See generally Levine, "The IRS' Position on Use of Section 482: Recent Cases have Caused Concern", 49 J. TAX. 206 (1978). But see Ogiony v. Comm'r, 80-1 U.S.T.C. ¶ 9265 (2d. Cir. 1980).

33. Olla State Bank of Olla, La. v. U.S., 77-1 U.S.T.C. ¶ 9455 (W.D. La. 1977). But see R.W. Shaw III, 59 T.C. 375, 382 n.4 (1972), *acq.*, 1973-2 C.B. 3 (*First Security Bank of Utah* held inapposite to an assignment of income case under I.R.C. Section 61 when the taxpayer actually received the income).

34. For example, in the case of a transfer or use of intangible property (which is partly at issue in the two Private Letter Rulings under discussion), an arm's length consideration may be determined (in the absence of comparable uncontrolled transactions), after considering a variety of factors -- such as the prevaling rates in the industry, the degree and duration of protection under the governing intellectual property laws, and the availability of substitutes -- any or all of which might vary from a domestic to a foreign context. See Treas. Reg. §1.482-2(d)(2)(iii).

35. I.R.C. §482.

36. See note 13.

37. Rev. Rul. 76-243, see note 13, as quoted in IRS Priv. Ltr. Rul. 7923003, *supra* note 1, and IRS Priv. Ltr. Rul. 8001017, see note 1.

38. Compare U.S. v. Basye, above note 31 (distinguishing a "consensual" arrangement from a legally-imposed disability). See also Aland, above note 11, at 221 n.2. Cf. Prop. Treas. Reg. §1.901-2(a)(2)(ii); Rev. Rul. 76-508, 1976-2 C.B. 225 (denying foreign tax credits in the case of "voluntary" payments to foreign taxing authorities arising from the lack of diligence in pursuing "all effective and practical remedies" to obtain a refund or a reduction of the foreign tax).

39. See Aland, above note 11, at 221.

40. 1974-1 C.B. 124. This Ruling is only discussed in IRS Priv. Ltr. Rul. 8001017, see note 1.

41. Treas. Reg. §1.482-1(d)(6).

42. Rev. Rul. 74-245, see note 40.

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The inference one makes is that the payments could perhaps have been made, but that the breach of policy might have led to the imposition of certain *ex post* penalties.

The fact that the Treasury Regulations make a special provision for allocations involving income, the payment of which "was prevented, or would have been prevented, at the time of the transaction because of currency or other restrictions imposed under the laws of any foreign country", [43] is potentially significant but not dispositive of whether such income is allocable by law. In the interpretive ruling governing the application of this Treasury Regulation, the governing term, "deferrable income", is defined as "income received by, credited to the account of, or accrued to a taxpayer that, owing to monetary, exchange or other restrictions imposed by a foreign country, is not readily convertible into United States dollars or into other money or property which is readily convertible into United States dollars". [44] The thrust of the Treasury Regulation therefore seems to be aimed at alleviating not so much the problems of the U.S. taxpayer who can legally receive or the foreign person who can legally pay the income but rather the problems which arise when the income cannot be converted into other currency and exported. In that respect, the Treasury Regulation would appear to fit with the context of the rule established in the seminal case of *Eder v. Commissioner.* [45] In *Eder*, Judges Frankfurter, Augustus Hand and Learned Hand held that a taxpayer could be taxed on blocked foreign income from a foreign personal holding company. The question presented was not whether the taxpayer earned the funds but whether he could be taxed (constitutionally) on the earnings when they were blocked. [46] The answer to the question was yes, although various relief measures have been introduced to alleviate the sometimes harsh results. [47] At stake in the two Private Letter Rulings, however, is whether or not the taxpayers were even able to legally earn the income in the first place.

V. AN ALTERNATIVE THEORY FOR ALLOCATIONS OF BLOCKED INCOME

According to the Supreme Court, the "purpose of Section 482 is to place a controlled taxpayer on a tax parity with an uncontrolled taxpayer... ". [48] If that is the case, the IRS should not exercise unbridled authority to allocate income when such income is precluded under foreign law from being accrued, let alone paid to the U.S. taxpayer. Such limitations on payments constitute a factor in determining the arm's length price. In effect, the foreign governmental authorities are determining what they will consider to be an arm's length consideration. Such a determination cannot simply be ignored by the United States. This form of interaction between two tax systems was recognized in the report on transfer pricing recently released by the OECD. [49] There, the OECD Committee on Fiscal Affairs remarked:

> The prices charged for goods, services, etc. transferred between associated enterprises in different countries may be affected by, for example, Government interventions in the form of price control,... or by exchange control or exchange rate policies. *It should be observed that the same considerations would apply to transactions between unrelated enterprises and that they would usually influence the prices in such transactions.*
>
> Of these constraints, exchange controls have given cause for more particular comment. Problems may arise for example because exchange controls effectively prevent an associated enterprise which has received a loan from transferring abroad the interest payments as they fall due, thus possibly throwing doubt on the treatment of the interest for tax purposes. While there may be room for more than one solution in both the country of the borrower (which may or may not regard the untransferred interest as having been paid) and the country of the lender (which may or may not be deemed to have received interest not transferred) it is considered that *there is no justification for treating blocked*

43. Treas. Reg. §1.482-1(d)(6).

44. Rev. Rul. 74-351, 1974-2 C.B. 144. It has been noted that the deferral election of the Treasury Regulations is on its face broader in scope than the terms of this ruling. See Aland, above note 11, at 223 n.17.

45. 138 F.2d 27 (2d Cir. 1943). *Accord* Rodney v. Hoey, 53 F. Supp. 604 (S.D.N.Y. 1944). But cf. International Mortgage & Inv. Corp., 36 B.T.A. 187 (1937) (no realized taxable income to a taxpayer unable to use or convert foreign currency due to exchange controls).

46. In the case of state law restrictions, it is clear that income may be taxed to the party who earns it, regardless of state law, when the income is actually received by the earner. See Ross Glove Co., 60 T.C. 569, 592 (1973); R.W. Shaw III, above note 33, at 382.

47. Compare Treas. Reg. §1.482-1 (d)(6) with I.R.C. §964 (b) and Treas. Reg. §1.964-2 (Subpart F does not apply in the case of blocked income). See also Cheska Cooper, 15 T.C. 757 (1950) (where a taxpayer could convert currency but not export it, the income was taxable but at the lower, free market value of the currency instead of at the official exchange rate).
It has been noted that although the blocked income election may be available to taxpayers facing I.R.C. Section 482 allocations, such an election does not fully cushion adverse tax results. First, the taxpayer will be required to allocate expenses to the blocked income under Treasury Regulation Section 1.482-1 (d)(6) with the consequence of, in effect, a disallowance (really a deferral) of deductions (see Aland, above note 11, at 223). Second, the Service has recently ruled that the election only applies "to a taxpayer's election to adopt the deferred income method of accounting for the first year in which the taxpayer receives (and reports under any accounting method) blocked foreign income". Thus, one may lose the privilege of making such an election for any one taxable year if he has not filed in time. IRS Priv. Ltr. Rul. 7912094, noted in Fuller, "U.S. Private Letter Ruling Report", 80-2 INT'L TAX REP. 1 (Feb. 11, 1980).
Compare Canada's *Income Tax Act* §161 (6), c.63, S.C. 1970-71-72 (giving the Canadian Minister of National Revenue the discretion to defer taxation of blocked income, taking into account the "extreme hardship" of the taxpayer, the inability of the taxpayer to transfer the blocked currency to Canada during the tax year, and the inability to dispose of the income in any manner except to pay any foreign income taxes which may be due). See also Interpretation Bulletin No. IT-351, Nov. 15,1976, reprinted in 5 CAN.TAX REP. (CCH) ¶ 52,356 (1977). See generally TAXES INT'L No. 8, at 17 (April 1980).

48. Commissioner v. First Sec. Bank of Utah N.A., see note 9, 1972-1 C.B. at 136, quoting Treas. Reg. §1.482-1(b)(1). See also Lufkin Foundry & Mach. Co. v. Comm'r, 468 F.2d 805, 1972-2 U.S.T.C. ¶ 9632, at 85,510 (5th Cir. 1972), *rehearing denied per curiam,* 72-2 U.S.T.C. ¶ 9744 (5th Cir. 1972).

49. OECD Committee on Fiscal Affairs, Report on "Transfer Pricing and Multinational Enterprises" (1979).

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payments differently for tax purposes when they occur between associated enterprises from the way in which they would be treated if they occurred between unrelated enterprises. It is however considered that exchange control regulations in a country should not preclude the deduction for tax purposes, for either associated or unrelated enterprises, of payments due to persons outside that country, although it is recognized that the tax authorities of the other country may have to take the effects of these regulations into account. [50]

The Council of the OECD has adopted a formal recommendation that the Member States' (which includes the U.S.) tax administrations take the Report into account when "adjusting transfer prices between associated enterprises". [51] Thus, the general principle which should govern the IRS position *vis-à-vis* blocked income is that such foreign restrictions should be taken into account in determining the arm's length price. The IRS' own regulations would require no less. They expressly include "any other fact or circumstance which unrelated parties would have been likely to consider" as among those factors to be taken into account when determining the market value which would be charged for intangible property being transferred to an uncontrolled party. [52] And the parties to an uncontrolled transaction would certainly have taken exchange controls into account in their business calculations.

Had the IRS adopted this approach, the result may have been the same although the reasoning would have been different for each of the two Private Letter Rulings. In IRS Private Letter Ruling 7923003, [53] the foreign law set maximum limits on technical assistance fees which were "equally applicable to dealings between related parties and to those between unrelated parties". [54] Thus, the IRS should have taken those limits into account in determining whether an allocation was proper. In effect, the limitations have established the outer parameters of a legal, arm's length compensation in that foreign country. [55] In IRS Private Letter Ruling 8001017, [56] on the other hand, the foreign law prohibiting the payment of royalties is described as restricting such payments only between related parties. This is the case in Peru and other Andean Pact countries, for example. [57] In such cases, the controls are not really aimed at determining an arm's length price but rather at prohibiting the outflow of currency for fear that multinational companies may be trying to "milk" their local subsidiaries. Thus, it cannot be said that such a restriction delimits the arm's length price. Nonetheless, the discussion in the previous section would still be applicable and would preclude an allocation. If foreign law prohibits the payment of such income altogether (as distinguished from the payment of a royalty into a blocked account), the Supreme Court's injunction that "fairness' requires that the tax not fall on a party which cannot receive the income [58] should still be adhered to.

CONCLUSIONS

Particularly in view of the number of countries which do impose exchange controls of one sort or another, it is disturbing that U.S. taxpayers may be faced with an allocation under I.R.C. Section 482 of income which their foreign subsidiaries may not legally pay to them. As a great majority of the foreign exchange control systems are designed to ascertain whether no more than an arm's length price is being paid to related parties, [59]

50. Idem, at ¶¶ 26 & 27, pp. 20-21 (emphasis added).
51. Recommendation of the Council on the Determination of Transfer Prices between Associated Enterprises, Doc. C(79)83 (final), May 16, 1979.
52. Treas. Reg. §1.482-2(d)(2)(iii)(m). See generally Dickey, "A Guide for Pricing Commodities to Enter the Commerce of the United States", 11 L. & POL. INT'L BUS. 491, 538 (1979); Comment, "The Application of Section 482 to the Transfer or Use of Intangible Property", 17 U.C.L.A. L. REV. 202, 218-224 (1969).
53. See note 1.
54. Based on the description of the foreign restrictions, it would appear that the country involved was the Philippines. See PRICE WATERHOUSE INFORMATION GUIDE, CURRENT FOREIGN EXCHANGE INFORMATION 97-98 (1980).
55. The situation is very similar to that in which the taxing authorities of two countries -- neither of which has exchange controls -- have established different standards of judging the arm's length nature of a royalty or other consideration. This is a very common occurrence among the developed countries, each of which has its own range of acceptable royalty rates. Cf. Madere, "International Pricing: Allocation Guidelines and Relief from Double Taxation", 10 TEX. INT'L L. J. 108, 117-118 (1975). In such cases, the two governments may be forced to resort to the competent authority mechanism to divide the allocable income. See generally Liebman, "The Practice and Procedure of Competent Authority: Seeking Relief from Double Taxation Under Bilateral Tax Treaties", 58 TAXES 363 (1980).
56. See note 1.
57. See, e.g., PRICE WATERHOUSE INFORMATION GUIDE, above note 54, at 96.
58. Commissioner v. First Sec. Bank of Utah N.A., above note 9, 1972-1 C.B. at 138.
59. In Spain, for example, royalties or technical assistance fees may be remitted abroad if the Directorate-General of Foreign Transactions (under the Ministry of Commerce) and the Ministry of Industry and Engery have determined that the underlying contract is standard for the industry and does not contain any unfair or abnormal restrictions. See generally J. Russin, E. Vinardell & D. Bralove, "Business Operations in Spain", 273-2nd T.M. at A-30 (1979); WORLD TAX REP. 3 (March 1980). In Greece, the Ministry of Coordination will also undertake a careful analysis of the terms and conditions of any license agreement before approving the payment of royalties to a non-resident. Intercompany charges must also be approved by the Greek Chamber of Commerce. Even if approval is granted, the royalty payment may not be exported unless a license is granted by the Bank of Greece. See generally G. Stathopoulos, "Business Operations in Greece", 194-3rd T.M. at A-50-A-51 (1979). A similar review by the Foreign Investment Institute and Central Bank takes place in Portugal. See PRICE WATERHOUSE INVESTMENT GUIDE, above note 54, at 100.
Outside of Europe, such controls are even more prevalent. In Latin America, mention might be made, in particular of Argentina, Brazil, and Colombia (see idem, at 4-5, 22, 30), in all of which agreements for technology or know-how transfers must be submitted to special bodies for approvals which, in large part, depend upon an analysis of the necessity or social value of the know-how or technical assistance and the terms and conditions of the contract. See, e.g., D. Perenzin, "Business Operations in Colombia", 260-3rd T.M. at A-2 - A-3 (1978). In Africa, Nigeria has a relatively strict exchange control system, as does Malawi. See PRICE WATERHOUSE INFORMATION GUDIE, above note 54, at 72-73, 86; Alegi, "Nigeria: A Legal and Tax Primer for the U.S. Investor", 78-10 TAX MANAGEMENT INT'L J. 11, 17-18 (Oct. 1978).

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the IRS should take greater cognizance of such restrictions and should not be exercising its reallocation authority in such cases.

Unfortunately, U.S. taxpayers will continue to find themselves in a bind until these letter rulings are either revoked or superseded or the issue is resolved in court. The argument that foreign tax law should have precluded an IRS allocation was raised in a recent I.R.C. Section 482 case, but the court decided in the taxpayer's favor without having to reach this issue. [60] Reportedly, the issue has been squarely raised in another case presently before the Court of Claims. [61] Until that case is decided, taxpayers can expect these two Private Letter Rulings to be followed, regardless of their lack of a solid foundation. [62]

60. See U.S. Steel Corp. v. Comm'r, 80-1 U.S.T.C. ¶ 9307, at 83,704 n. 12 (2d Cir. 1980), *rev'g* 36 T.C.M. 586, 603 (1977).
61. Trans-Arabian Pipe Line Co., Dkt. No. 561-78 (Ct. Cl.). See the discussion in Aland, above note 9, at 221-222.
62. In a recent decision by the Second Circuit Court of Appeals, Judge Oakes commented that although the IRS does not allow taxpayers to rely upon private rulings as precedent, it relies on them itself in order to determine the tax treatment to accord to similarly situated taxpayers. See Ogiony v. Comm'r, above note 32, at 83,525 (2d Cir. 1980) (Oakes, J. concurring), noted in [1980] 10 STAND. FED. TAX REP. (CCH) ¶ 8258.

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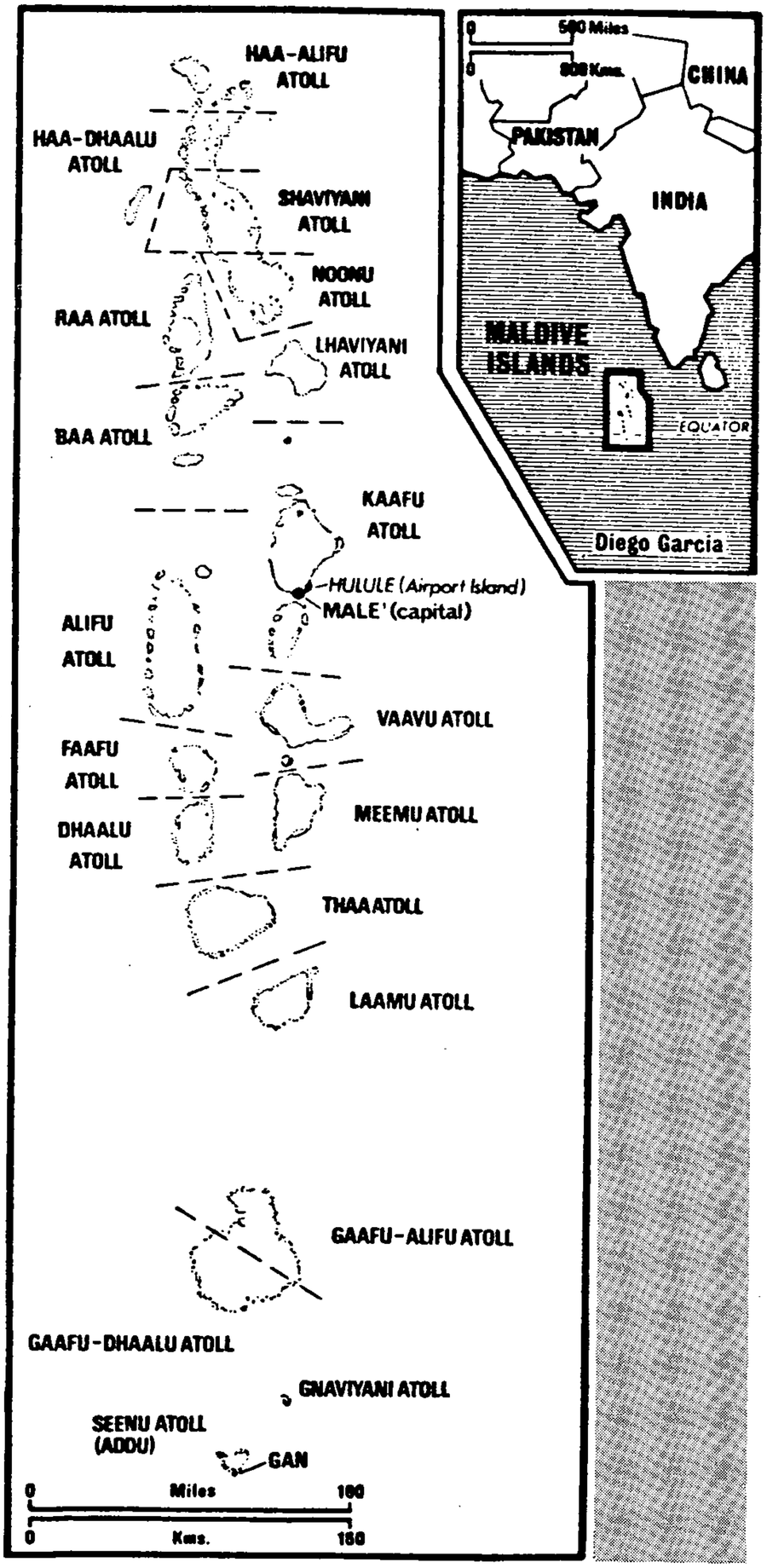
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Maldives: Foreign Investment Law

by Dr. M.P. Dominic

Maldives consists of 1,196 islands in the Indian Ocean to the Southwest of India and Sri Lanka, stretching nearly 500 miles in length and 80 miles in width. They lie from 7 degrees north to 1 degree south of the equator. The land area is only 115 square miles. However, the territorial boundaries have been extended to 200 miles and hence the sea area is considerable. The capital is Male. The population of 143,469 (per 1978 census) is 100 percent muslim (sunni sect). The language is Divehi.

The exchange rate of the Maldivian rupee for official transactions is 3.93 for US$1; for unofficial transactions, the exchange rate is 8.80 Maldivian rupees for US$1.



Foreign investments in Maldives are governed by Law No. 25/79. The law came into force from 1 May 1979. For foreign investment in tourist resorts and tourist hotels, Law No. 15/79 applies.

Foreign investment is welcome. Preference is given to investments which satisfy the following:

- it provides employment for the locals;
- it contributes to the economic and social infrastructure of the country;
- it could not have been made by local investors because of the size of the investment required or due to the lack of technical expertise;
- it is to be located in the outer atolls rather than in the vicinity of Male;
- the product of the proposed investment is locally marketable at competitive prices and thereby the import of such products is reduced;
- it utilizes local materials;
- it trains local employees with the aim of employing them at technical, skilled and management level.

Application for investment must be made in the prescribed form to the Department of Tourism and Foreign Investment together with the following:

- a comprehensive feasibility report;
- draft copy of the Memorandum and Articles of Association;
- a recognized bank reference;
- the draft agreement between the foreign investor and Maldivian investors;
- a covering letter; and
- other information relevant to the proposed venture

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such as the terms and conditions of foreign participation.

The proposed capital of the investment must be clearly stated in a convertible currency acceptable to the Department.

The Department of Tourism and Foreign Investment will appraise the investment project in consultation with other concerned Departments and Ministries of the Government.

The decision to approve or reject the proposal will be made and notified to the applicant as soon as possible; the length of time will depend largely on the completeness and adequacy of the supporting data.

Once the approval is granted, a licence will be issued in the name of the applicant. In general, the project must be implemented within six months from the date of issue of the licence. However, the period of time for the implementation of the project may be varied and specified in the licence, if the circumstances warrant it. Under certain circumstances, the Government may, before issuing the licence, issue a letter of intent so that the prospective investor is assured of the licence after he has incurred expenses of making feasibility and technical studies.

The prospective investor must register his company, within seven days of the issuance of the licence, with the Ministry of Home Affairs, Male. Further, prior to the commencement of the investment project, one fourth of the approved capital must be deposited with a local bank agreeable to the Department of Tourism and Foreign Investment. In addition, the investor must sign an agreement with the Department of Tourism and Foreign Investments.

Guarantee is given against the closure of the investment during the agreement period, except where the investor is engaged in an activity detrimental to the security of the country. The draft agreement provides for a period of five years, but this is renewable.

Remittance of profits in accordance with the terms of the agreement and repatriation of the liquidation proceeds in the event of the closure of the investment (voluntary or compulsory) are guaranteed.

The following incentives are granted:

- exemption from duty on import of machinery, equipment, raw materials and any other articles of daily necessity for the use of the investor or his foreign employees, for a period of eight years;
- exemption of the investor and foreign employees from all corporate tax, income tax and any local taxes for a period of seven years (for local investment, the tax holiday period is limited to five years); however, it must be noted that at present no taxes other than tourism tax and the bed night tax are levied in Maldives;
- exemption from export duty for a period of ten years;
- guarantee for repatriation of profits and capital;
- guarantee against closure of the investment by the Government during the period of the agreement.

Any dispute arising between the Government and the foreign investor will be referred to the Maldivian Court of Law for adjudication; the decision of the court is final and conclusive.

Books of accounts must be maintained in such a manner that expenditure and revenue can be determined therefrom independently. The accounts may be maintained in Maldivian rupees, U.S. dollars or in any foreign currency acceptable to the Department of Tourism and Foreign Investment. The books and the supporting documents must be maintained in Divehi or in English and they must not be destroyed without prior permission of the Department. The Department of Tourism and Foreign Investment may require the investor to submit, for auditing purposes, the books of accounts and supporting documents to the authorised officials. At the end of each financial year or, failing this, every calendar year, the balance sheets and profits and loss statements must be prepared.

Law No. 15/79 applies to investments in tourist resorts and tourist hotels. Tourist resort means an island or a special area of an island where board and lodging facilities are generally provided for tourists. Tourists hotel means a place in an inhabited island where board and lodging facilities are generally provided for tourists. Under this law, tourist resorts and tourist hotels in Maldives must be registered at the Department of Tourism and Foreign Investment. The number of beds in such resorts or hotels must also be registered. Any change in the number of registered beds in a tourist resort or a tourist hotel may be made only after the Department of Tourism and Foreign Investment is duly notified and the change duly registered. Where the owner of such resort or hotel wishes to entrust the management to another party, either by a lease or on any other basis, an application must first be made to the Maldivian Government. The management may be entrusted to such other party only if the Maldivian Government declines to accept the management of the resort or hotel. When approval is obtained, the management must be entrusted to the other party through the Department of Tourism and Foreign Investment. No tourist resort or tourist hotel shall be taken over by the Government without giving at least two years' notice, except where it is required for the country's defence.

Private owners of tourist resorts and tourist hotels will be subject to

- a tourism tax of US$3.00 per registered bed per day, after 2 years of operation; and
- a bed night tax of US$1.00 per registered bed per day.

However, the imposition of these taxes on the number of beds varies according to the tourist season. For November through January, these taxes will be imposed on 80 percent of the registered beds and must be paid before 15 February. For February through April, these taxes will be imposed on 60 percent of the registered beds and shall be paid before 15 May. The taxes for May through October will be on 20 percent of the registered beds; the taxes for May, June and July must be paid before 15 August and the taxes for August, September and October must be paid before 15 November.

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UNITED STATES

TERRITORIAL INCOME TAX SYSTEMS

Income taxation in the Virgin Islands, Guam, the Northern Mariana Islands and American Samoa (A U.S. Treasury Report)

I. INTRODUCTION AND SUMMARY

This Report examines the income tax systems of the Virgin Islands, Guam, the Northern Mariana Islands and American Samoa. The U.S. Treasury has two interests in the workings of these income tax systems. The first and more historical is that these systems bear a special relationship to the Federal income tax. Not only do the territorial tax codes "mirror" the Federal code, but U.S. citizens who are inhabitants of the Virgin Islands, Guam, or the Northern Mariana Islands are relieved of the obligation of filing a Federal return and paying Federal taxes by doing so in the territory. No other tax jurisdictions in the world are accorded this status. This special status, together with the industrial incentive programs which provide for a rebate of territorial income taxes, has created for the U.S. Treasury and Internal Revenue Service an unending series of technical problems which cannot be resolved satisfactorily under existing statutory authority.

More recently, the Administration has been concerned with the slow growth of the private economic sector in the territories, the growing fiscal problems of the territorial governments and their increasing dependence on the Federal government for financial support. Because the dollar value of the territories' income tax collections, despite inflation, has increased only slightly over the last five years, the territorial income tax systems appear to be failing to fulfill their basic, revenue-raising objective.

The Administration's concern for the territories' economic development, financial problems, and political status is reflected in a separate series of Interagency Task Force Reports and, accordingly, will not be addressed in any detail here. This Report has a narrower, more technical objective. It seeks to evaluate the territorial income tax systems in terms of their ability to raise revenues in a straightforward and equitable fashion. Section II reviews the essential features of the Federal income tax laws, which, under the "mirror" systems, are the basis of the territorial income tax systems. Section III describes the operation of each territory's mirror system and the problems of coordination with the Federal income tax system. Section IV evaluates the territorial tax systems in terms of raising revenue, equitable treatment of territorial versus stateside residents, and simplicity of compliance and administration.

The Report concludes that the territorial income tax systems are functioning poorly and should be overhauled. Specific proposals for reform are being considered by the Administration in light of overall Federal policy toward the territories and will be advanced shortly.

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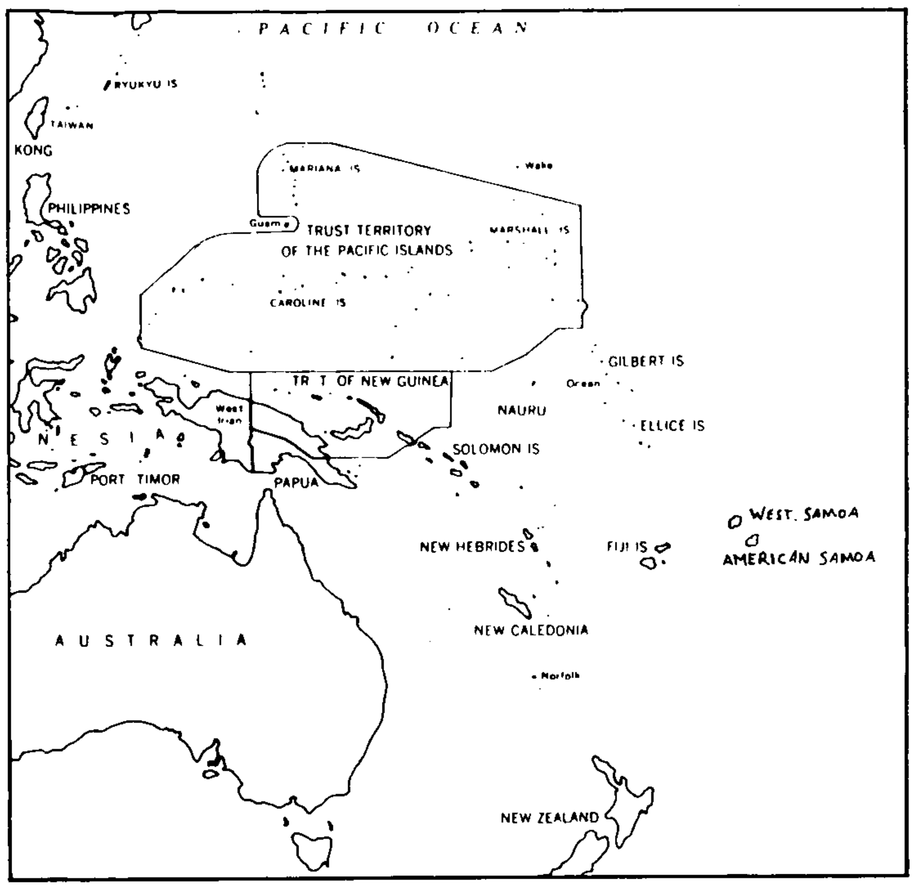
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Summary

In general, territorial residents and corporations operating in the territories file returns and pay taxes to the territory which they inhabit and, by doing so, are relieved of such obligations to the Federal government. Each territory is a separate tax jurisdiction administering income tax laws which are identical to those in force in the United States. To give the Federal code its proper effect in each territory, the words "Virgin Islands", "Guam", "Northern Mariana Islands" or "American Samoa" are substituted for the words "United States" where appropriate in the Federal Internal Revenue Code. This results in what have come to be known as the "mirror" codes. Together with various special provisions differing from territory to territory, but all relating to the coordination of Federal and territorial income taxation, the "mirror" codes govern the system of income taxation in each U.S. territory.

The "mirror" systems are, at least in principle, well suited to meeting three objectives. First and foremost, they provide the territories with local tax revenues for meeting a part of their government expenditures. Second, they subject territorial and mainland residents to comparable income tax burdens. Third, they may simplify income tax administration by providing the territories with a tax code, regulations, tax forms and a judicial system.

Although having the territories mirror the Federal income tax system seems well suited to these three objectives, in actual practice the results have been disappointing. The most obvious disappointment has been in the amount of income tax revenues collected by the territories.

In the Virgin Islands and Guam, income tax revenues as a percentage of gross territorial product fell by more than one third in the period 1973 through 1978. The reports of the Federal comptrollers for the territories and the recently released GAO report on Guamanian tax administration[1] suggest substantial deficiencies in procedures for collecting taxes due. The territories have attributed this drop in income tax collections to recent changes in the Federal income tax (such as the increase in the standard deduction) which were automatically mirrored in the territorial tax codes. As demonstrated below, however, the loss of territorial tax revenues must be attributed to other factors.

The mirror systems have also failed to ensure that territorial and mainland residents are subject to comparable income tax burdens. In all territories, the poor records of administration and compliance have widened the gap between the law and actual practice. Moreover, the substance of the territorial income tax laws produces inequities in the tax treatment of mainland residents vis-à-vis residents of the territories. Under the Virgin Islands mirror system, mainland residents who derive income from the Virgin Islands are eligible for fewer deductions and subject to possibly higher tax rates than they would be if they were V.I. residents. Under the Marianas mirror system, 100 percent of the tax on Marianas-source income is rebated to Marianas residents. Under the Guamanian mirror system, 75 percent of the tax paid to Guam on foreign earned income may be rebated to Guamanian residents. In addition to reducing equity, these rebate provisions undermine Federal tax administration by encouraging U.S. citizens to establish (or claim to have established) residence in the territories in order to avoid having to file a Federal return, pay Federal taxes, and be subject to Federal audit.



1. Report by the Comptroller General of the United States, "The Government of Guam's Administration of Its Income Tax Program", GGD-80-3, October 3, 1979.

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Although basing the territorial income tax systems on the Federal tax laws has the advantage of giving the territories a ready-made income tax together with published regulations, tax forms, and a judicial system, the need to mesh the Federal and territorial tax jurisdictions has given rise to numerous problems. Because the laws governing the coordination of the Federal and territorial tax systems are in many cases conflicting or ambiguous, these questions cannot be resolved satisfactorily under existing statutory authority. For example, section 935 of the Internal Revenue Code provides that Guamanian residents are free of Federal income tax liability. Another section of the Code permits the United States to withhold Federal taxes on pensions paid to retirees resident on Guam. The provisions by which such withholding taxes were paid over to the Guamanian treasury were apparently repealed in 1972. These and other inconsistencies are continual irritants in U.S.-territorial relations.

A final problem with the territorial tax systems is that they provide an inefficient and costly system of tax incentives for territorial investment. In general, current law permits corporations to operate in the territories free of Federal income tax on their territorial source income, while it permits the territories to enact companion tax-incentive programs. The rationale of the current Federal law is to promote the economic development of the territories, but the law does not relate the Federal tax foregone to the benefits received by the territories. The relief from Federal tax and the rebate of territorial tax on territorial source income encourages profit-sharing to the territories, and generates numerous and severe transfer-pricing problems for the Internal Revenue Service. In one case, the tax relief granted by territorial law and then "preserved" by Federal law represented almost $60,000 for every Virgin Islands employee.

II. FEDERAL INCOME TAXATION OF INDIVIDUALS AND CORPORATIONS

A. U.S. citizens, residents and corporations

To understand the systems of income taxation in the Virgin Islands, Guam, the Northern Mariana Islands, and American Samoa, one must first understand certain essentials of the Federal system of taxation of individuals and corporations. U.S. citizens,[2] non-U.S. citizens who are resident in the United States, and corporations organized under the law of the United States or of any State are all taxed on their *worldwide* gross income less allowable deductions. Corporations are taxed on income of unincorporated branches operating abroad as well as at home, and on dividends,[3] interest and other income received from domestic and foreign subsidiaries. U.S. corporations are not subject to Federal tax on earnings retained by a foreign subsidiary unless such income has certain "tax haven" characteristics as defined under the Internal Revenue Code.

In general, deductions are allowed for all ordinary and necessary expenses of earning income. Individuals may either itemize deductions or claim the standard deduction (zero-bracket amount).[4] Individuals may also exempt $1,000 of income for themselves, for each qualifying dependent, and on account of age or blindness. U.S. citizens who are resident in a foreign country may deduct "excess" housing and other living costs, costs of dependents' education, and home-leave transportation.[5]

Net income is taxed at progressive rates: the maximum rate for individuals is 70 percent; for corporations, the top rate is 46 percent. Married individuals filing jointly and unmarried individuals pay a maximum rate of 50 percent on wages, salaries and other personal service income. The total tax liability can be offset by various tax credits, such as the investment tax credit and the foreign tax credit. The investment tax credit generally equals 10 percent of the value of equipment and other qualifying assets "placed in service" in the United States; the credit is not available for assets placed in service outside the United States.[6] The foreign tax credit is a dollar-for-dollar credit available for income taxes paid to foreign governments. However, to prevent the foreign tax credit from offsetting U.S. tax on domestic income, the amount of credit is limited to the U.S. tax liability on foreign source income.

B. Nonresident aliens and foreign corporations

Under some circumstances, a foreign individual will pay a higher U.S. tax if he is not considered a resident of the United States; in other circumstances, his U.S. tax will be lower. Accordingly, the criteria for determining residence are important in determining the U.S. tax liability of a non-U.S. citizen. Regulations issued under the Internal Revenue Code provide standards for the determination of residence:

> "An alien actually present in the United States who is not a mere transient or sojourner is a resident of the

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2. Although persons born or naturalized in the Virgin Islands and Guam are U.S. citizens, for convenience of exposition references in this paper to "U.S. citizens" will mean only individuals born or naturalized within the fifty States and the District of Columbia. The source of this distinction is the Internal Revenue Code, sections 932 and 935, and the Revised Organic Act of the Virgin Islands, section 28(a). Persons born or naturalized in the Northern Mariana Islands will become U.S. citizens upon the termination of the Trusteeship Agreement, expected in 1981.

3. Affiliated corporations that do not file consolidated returns are allowed to deduct from their income 100 percent of "qualifying dividends" received from members of the affiliated group. Only U.S. corporations may qualify as members of an affiliated group for purposes of the dividends-received deduction.

4. The zero-bracket amount is $3,400 for married individuals filing jointly, $1,700 for married individuals filing separately, and $2,300 for unmarried individuals.

5. Taxpayers who must live in construction, mining or other "camps" may exclude $20,000 of income earned abroad in lieu of taking the otherwise applicable deductions for excess living costs.

6. An exception to this rule is made for assets placed in service in a U.S. territory, provided that the taxpayer does not receive the tax relief benefits of section 931, 932, 933, 934, or 936. (U.S. Income Tax Regulations section 1.48-1(g)(vii)).

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United States for purposes of the income tax. Whether he is a transient is determined by his intentions with regard to the length and nature of his stay. A mere floating intention, indefinite as to time, to return to another country is not sufficient to constitute him a transient. If he lives in the United States and has no definite intention as to his stay, he is a resident. One who comes to the United States for a definite purpose which in its nature may be promptly accomplished is a transient; but, if his purpose is of such a nature that an extended stay may be necessary for its accomplishment, and to that end the alien makes his home temporarily in the United States, he becomes a resident, though it may be his intention at all times to return to his domicile abroad when the purpose for which he came has been consummated or abandoned. An alien whose stay in the United States is limited to a definite period by the immigration laws is not a resident of the United States within the meaning of this section, in the absence of exceptional circumstances."[7]

The intention of an individual is usually inferred from the terms of his visa for entering the United States, the length of his stay, his ownership of a home or the terms of an apartment or office lease.

A foreign national who is not a resident of the United States (a nonresident alien) or a foreign corporation may have three types of income for U.S. tax purposes:

1. Income effectively connected with a U.S. trade or business. Such income can be *offset by deductions* and is taxed *according to the same general rules* as those applicable to income earned by U.S. residents and domestic corporations. This category includes an individual's wages, salary or other remuneration for personal services performed within the United States, and profits attributable to a U.S. plant or office of a foreign corporation.

2. Interest, dividends, rents and other "fixed and determinable, annual or periodic" income (plus certain other types of income) which are U.S.-source, but not effectively connected with a U.S. trade or business. This income *cannot be offset by deductions* and is taxed *at a flat rate of 30 percent* (or less if covered by a tax treaty with a foreign country).

3. All other income (including some U.S.-source income) which is *exempt from U.S. taxation.*

Although effectively connected income is generally taxed as if it has been earned by a U.S. resident or domestic corporation, some differences do occur in the tax treatment of a nonresident alien or foreign corporation with respect to such income:

— A nonresident alien's or foreign corporation's losses effectively connected with a U.S. trade or business cannot be used to offset U.S.-source interest, dividends, and other income not effectively connected with a U.S. trade or business.

— A nonresident alien can claim only one personal exemption. Additional exemptions cannot be claimed for dependents or on account of the individual's age or blindness.

— A nonresident alien must itemize deductions — that is, he cannot claim the zero-bracket amount. Apart from charitable contributions, deductions are generally limited to those allocable to income effectively connected with the U.S. trade or business.

— A nonresident alien generally cannot file a joint return with his spouse.[8] Not only will he be subject to the harsher limitations and schedules applicable to married individuals filing separate returns, but he cannot limit his tax on personal services income (wages and salary, etc.) to the otherwise applicable maximum rate of 50 percent.

— A nonresident alien may not elect, nor join with others in electing, to have a U.S. corporation in which he is a shareholder taxed according to the rules of Subchapter S. The Subchapter S rules allow a U.S. corporation with 15 or fewer shareholders to elect not to pay tax provided its shareholders include a proportionate share of the corporation's income or loss in their income.

C. Recent changes in Federal income taxation

Taxation of individuals and corporations was changed significantly by the Tax Reduction Act of 1975, the Tax Reform Act of 1976, the Tax Reduction and Simplification Act of 1977, and the Revenue Act of 1978. The overall thrust of the changes in the taxation of individuals was to offset the impact of inflation on effective tax rates, defined as the ratio of personal taxes to income.

With a progressive tax structure, increases in nominal income that move a taxpayer into a different rate bracket can dramatically increase his tax burden. Furthermore, with exemptions and deductions stated in fixed dollar terms, taxable income during a period of high inflation rises more rapidly than the inflation. Real income — the taxpayer's actual purchasing power — may stay the same or actually decline, but his tax liability increases in real terms as a result of the inflation of his income.

Table 1 on the following page shows the impact on real income tax liabilities of the 50 percent inflation of the dollar in the period 1972 to 1979. This table expresses all amounts in 1979 dollars, and assumes that the real incomes of taxpayers stayed the same in this period. The 1972 income tax in column 2 is calculated by applying the 1972 tax laws to the various income levels translated into 1972 dollars; the hypothetical 1979 income tax in column 4 is calculated by applying the 1972 tax laws to the various income levels translated into 1979 dollars. Comparison of columns 2 and 4 shows that, in the absence of changes in the Federal tax laws, inflation would have increased the effective tax rate for individuals in the lowest income levels by at

7. Income Tax Regulations section 1.871-2(b).

8. If a nonresident alien is married to a U.S. citizen or resident, the nonresident alien may elect to join his or her spouse in filing a joint return. If this election is made, the nonresident alien individual is treated as a resident for U.S. tax purposes, and thus the married couple is taxable on its combined worldwide income.

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least 100 percent. At higher income levels, the effective tax rate for individuals would have risen between roughly 15 and 50 percent in the period 1972 to 1979.

TABLE 1

Impact of inflation on income tax burdens in 1979, assuming 1972 tax law (1979 dollars)

Single returns

1979 Levels of wage income [1]	*1972 Income tax*		*Hypothetical 1979 Income tax*	
	Amount	*Effective tax rate*	*Amount*	*Effective tax rate*
2,500	0	0	n.a.	n.a.
5,000	216	4.3	509	10.2
7,500	640	8.5	1,006	13.4
10,000	1,000	11.0	1,448	14.5
12,500	1,496	12.0	1,807	14.5
15,000	1,900	12.7	2,341	15.6
20,000	2,829	14.1	3,461	17.3
25,000	3,809	15.2	4,738	19.0
30,000	4,875	16.3	6,179	20.6
40,000	7,285	18.2	9,460	23.7
50,000	10,092	20.2	13,214	26.4
100,000	28,100	28.1	32,463	32.5

Joint returns with two dependents

1979 Levels of wage income [1]	*1972 Income tax*		*Hypothetical 1979 Income tax*	
	Amount	*Effective tax rate*	*Amount*	*Effective tax rate*
2,500	0	0	n.a.	n.a.
5,000	0	0	n.a.	n.a.
7,500	21	0.3	255	3.4
10,000	369	3.7	982	9.8
12,500	668	5.3	1,391	11.1
15,000	989	6.6	1,619	10.8
20,000	1,713	8.6	2,414	12.1
25,000	2,458	9.8	3,384	13.5
30,000	3,305	11.0	4,468	14.9
40,000	5,153	12.9	7,083	17.7
50,000	7,259	14.5	10,184	20.4
100,000	22,433	22.4	29,114	29.1

Office of the Secretary of the Treasury
Office of Tax Analysis — June 17, 1979

Note: Deductible expenses assumed to equal 23 percent of gross income.

1 Equivalent 1972 and 1979 real incomes are derived from the consumer price index: 1972 = 125.3; 1979 (estimated) = 214.15

What the changes in the tax law after 1972 did was to offset the tendency of inflation to subject taxpayers to higher tax rates. The general tax credit of $35 for each taxpayer and dependent (regardless of income), the earned-income credit for low-income individuals (a credit which is refunded to the individual if it exceeds his pre-credit tax liability), increases in the amount of the standard deduction,[9] and, in 1975 only, a rebate of 10 percent of the previous year's taxes up to a limit of $200, were all of particular benefit to low-income individuals. The Revenue Act of 1978 focused its tax reductions on middle-to-upper income taxpayers (who, in turn, were hardest hit by the increased Social Security tax). This Act reduced statutory tax rates, widened tax brackets, and increased the personal exemption from $750 to $1,000 per taxpayer and dependent.

Table 2 compares the impact on effective tax rates of the tax law changes and of inflation. Like Table 1, it expresses all amounts in 1979 dollars. Table 2 shows that for income levels below $15,000, the changes in the tax laws offset roughly 85 percent of the increase in tax liabilities caused by inflation. For income levels of $15,000 or more, the changes in the tax laws offset from 66 percent to 15 percent of the increase in tax liabilities due to inflation, with the lower percentages applicable to the higher income levels. Otherwise stated, effective rates were allowed to rise by between 2 and 5 percent of income at the middle and upper income levels.[10]

A critical implication of Table 2 is that despite the substantial tax reductions made by the 1975, 1976, 1977, and 1978 revenue acts (whose cumulative impact is shown in column 2 of Table 2), the ratio of personal taxes to earned income tended slightly to increase for most real income classes. This point will be developed in Section IV below. It has important implications for the validity of the territories' claims for Federal reimbursement for revenue losses incurred as a result of changes in the Federal income tax.

III. TERRITORIAL INCOME TAXATION AND THE RELATIONSHIP TO FEDERAL TAXATION

A. Virgin Islands

1. Basic tax system

"The income tax laws in force in the United States of America and those which may hereafter be enacted shall be held to the likewise in force in the Virgin Islands, except that the proceeds of such taxes shall be paid into the treasuries of said islands."

With this section of the Naval Appropriations Act of 1922, Congress provided for an income tax in the Virgin Islands. Court interpretations have indicated that this provision created an income tax jurisdiction distinct from that of the United States. The Internal Revenue Code defines the United States to include only the fifty States and the District of Columbia, and defines "domestic" when applied to a corporation to mean organized in the United States. Since the Virgin Islands mirror system substitutes the words "Virgin Islands" for the words "United States" where appropriate, United States residents and corporations are treated as

9. Because middle-to-upper income taxpayers tend to itemize deductions, increases in the standard deduction tend to be of less benefit to them.

10. The increase in 1979 effective tax rates at the upper income levels will in future years be partly offset by the more liberal tax treatment of capital gains provided by the Revenue Act of 1978.

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nonresident aliens and foreign corporations for purposes of Virgin Islands income taxation.

Because the Internal Revenue Code subjects nonresidents aliens to different rules than residents, the Virgin Islands mirror system may result in inequities in the taxation of U.S. persons who derive income from the territory. Some of the specific consequences of the V.I. mirror system for a resident of the United States are that:

— His Virgin Islands "not effectively connected" income is taxed at a flat 30 percent rate on a gross basis;

— He is not allowed to take deductions except to the extent that they are related to income effectively connected with the Virgin Islands trade or business;

— He may take only one personal exemption;

— He is not entitled to file a joint return unless his spouse is a Virgin Island resident; if he is unmarried, he may not use the "head of household" rate schedule.

Although a U.S. resident can claim a foreign tax credit against his Federal tax liability for taxes paid to the Virgin Islands, the above provisions of the Virgin Islands Code could compel a tax in excess of the Federal foreign tax credit limitation.

While the Virgin Islands tax administration and the Internal Revenue Service uphold the mirror system, as described above, two recent court decisions[11] have questioned the validity of the treatment of U.S. persons as foreign for purposes of Virgin Islands taxation. In *Chicago Bridge*,[12] the Third Circuit stated that it would be *contrary* to its understanding of Congress' intent to compel a U.S. taxpayer to pay a higher tax to the Virgin Islands than he would be required to pay on the same income to the United States:

> "The scheme of the statute (the Naval Appropriations Act of 1922) is to impose a tax obligation to the Virgin Islands equivalent to what the United States would collect on the same income, but for the mirror system ... More basically, Congress has aided the Virgin Islands by giving them the same tax, not more, than the United States would otherwise collect on Virgin Islands business."

Administering the territorial tax in order to achieve the result of equivalency would require the law to be changed to treat U.S. citizens, residents, and corporations as domestic, not foreign. It means applying the territorial income tax as if the territory included the United States.

A second basic feature of the Federal law government income taxation in the Virgin Islands is that individuals and corporations which are "inhabitants of the Virgin Islands" satisfy their Federal tax liability by filing a Virgin Islands tax return and paying Virgin Islands tax. The Revised Organic Act of 1954, section 28(a), provides that:

> "the term 'inhabitants of the Virgin Islands' as used in this section shall include all persons whose permanent residence is in the Virgin Islands, and such persons shall satisfy their income tax obligations under applicable taxing statutes of the United States by

TABLE 2

Cumulative change in tax liabilities, 1972-1979
(1979 dollars)

Single returns

1979 Levels of wage income [1]	*Change due to change in law* [2]	*Change due to inflation*	*Total change*	
			In amount	*In effective tax rate*
2,500	0	0	0	0
5,000	−259	293	34	0.7
7,500	−313	366	53	0.7
10,000	−272	348	76	0.8
12,500	−222	311	89	0.7
15,000	−293	441	148	1.0
20,000	−345	632	287	1.4
25,000	−374	929	555	2.2
30,000	−460	1,304	844	2.8
40,000	−574	2,175	1,601	4.0
50,000	−654	3,122	2,468	4.9
100,000	−671	4,363	3,692	3.7

Joint returns with two dependents

1979 Levels of wage income [1]	*Change due to change in law* [2]	*Change due in inflation*	*Total change*	
			In amount	*In effective tax rate*
2,500	0	0	0	0
5,000	0	0	0	0
7,500	−255	234	−21	−0.3
10,000	−608	613	5	0.1
12,500	−599	723	124	1.0
15,000	−385	630	245	1.6
20,000	−401	701	300	1.5
25,000	−483	926	443	1.8
30,000	−549	1,163	614	2.0
40,000	−770	1,930	1,160	2.9
50,000	−861	2,925	2,064	4.1
100,000	−1,236	6,681	5,445	5.4

Office of the Secretary of the Treasury
Office of Tax Analysis — June 17, 1979

Note: Deductible expenses assumed to equal 23 percent of gross income.

1 Equivalent real incomes are derived from the consumer price index: 1972 = 125.3; 1973 = 133.1; 1974 = 147.7; 1975 = 161.2; 1976 = 170.5; 1977 = 181.5; 1978 = 195.4; 1979 (estimated) = 214.15.

2 The refundable portion of the earned income credit is not included.

11. *Chicago Bridge and Iron Co. v. Wheatley*, 430 F. 2d 973 (3rd Cir. 1970) and *Vitco, Inc. v. Govt. of V.I.*, 560 F. 2d 180 (3rd Cir. 1977). The *Vitco* case is discussed below.

12. The issue in *Chicago Bridge* was whether a U.S. corporation was entitled to use the Western Hemisphere Trade Corporation deduction to reduce its income tax liability to the Virgin Islands. The District Court denied the deduction on grounds that the U.S. corporation was a foreign corporation for purposes of Virgin Islands income taxation. Reversing the lower court decision, the Third Circuit held that "substantive equality of treatment in determining deduction under V.I. mirror system of taxation requires the term 'domestic' to be given the same meaning under V.I. Code as under [the Federal Internal Revenue Code]." Accordingly, the Third Circuit held that the U.S. corporation was entitled to use the WHTC deduction to reduce its Virgin Islands income tax liability.
At the request of the Virgin Islands, Congress provided that for tax years beginning in 1972, neither U.S. nor V.I. corporations are permitted the WHTC deduction in computing their Virgin Islands income tax liability. (Revenue Act of 1971, P.L. 92-178, section 307).

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paying their tax on income derived from all sources both within and outside the Virgin Islands into the Treasury of the Virgin Islands."

Thus, a resident of the Virgin Islands or a corporation deemed to be a V.I. inhabitant does not file a U.S. income tax return or pay tax to the Federal government. However, all other U.S. citizens, residents and corporations which derive income from the Virgin Islands file two tax returns and receive a foreign tax credit to offset their U.S. tax liability with respect to income derived from or effectively connected with the Virgin Islands.

Section 28(a) of the Revised Organic Act has made the Virgin Islands attractive to U.S. corporations seeking to avoid taxation. In the absence of an IRS ruling to the contrary, certain U.S. corporations have apparently interpreted section 28(a) to provide that a U.S. corporation whose principal office is in the Virgin Islands may qualify as an "inhabitant of the Virgin Islands". Under this interpretation, the U.S. corporation would avoid all taxation on income derived from or effectively connected with the United States. This would be possible because, as a Virgin Islands inhabitant, it would not be subject to U.S. tax and, under the mirror system, it would be liable for Virgin Islands tax only on income derived from or effectively connected with the Virgin Islands. Whether or not a U.S. corporation can qualify as an inhabitant of the Virgin Islands, and thereby avoid U.S. tax, is the subject of a pending revenue ruling.

A further means of tax avoidance may be available to the parent corporation of a U.S. corporation which qualifies as a V.I. inhabitant. Dividends paid by such a corporation to its parent would arguably be eligible for a 100 percent dividends-received deduction, and thus be free of U.S. tax. At the same time, the parent corporation could claim a foreign tax credit for any withholding tax paid to the Virgin Islands with respect to such dividends. This foreign tax credit could offset the parent's U.S. tax liability on income sourced in low-tax foreign countries. In such a case, the foreign tax credit would not serve its intended purpose of relieving double taxation.

Current law may not provide for a reasonable solution either to the proper treatment of U.S. corporations under section 28(a) of the Revised Organic Act or to the inequitable treatment of U.S. citizens under the V.I. mirror system. The Virgin Islands has several times expressed interest in legislation which would provide for identical treatment of U.S. and V.I. persons under the mirror system.[13]

2. Tax incentives for investment in the Virgin Islands

The Virgin Islands has a tax-incentive program which rebates to qualifying companies 90 percent of territorial taxes on Virgin Islands-source income. Section 934 of the *Federal* Internal Revenue Code limits such rebates of Virgin Islands taxes to those corporations 80 percent of whose gross income is Virgin Islands-source and 50 percent of whose income is derived from the active conduct of a trade or business in the Virgin Islands. Provisions of the *Virgin Islands* law establish other requirements which a corporation must meet in order to qualify for the tax rebates. The principal requirements are that it:

— invest at least $50,000, exclusive of inventory, in a Virgin Islands industry or business;

— agree in writing to give preference in employment and contracting to Virgin Islands residents and corporations;

— obtain approval from the Commissioner of Labor prior to hiring nonresident workers; and

— conform to ecological standards established by Federal or local law.

In addition to these specific requirements which must be met by an applicant for V.I. tax relief, the Virgin Islands consider applications in light of the following general guidelines:

— the extent to which the proposed enterprise may pollute the environment;

— the applicant's requirements for utilities, social services, and other resources;

— the applicant's capacity to employ Virgin Islands resident labor; and

— the proposed industry's compatibility with existing businesses in the Virgin Islands.

Corporations which are beneficiaries of the V.I. Industrial Development Program may receive rebates of 90 percent of corporate income taxes paid, rebates of 90 percent of customs duties, and/or 100 percent exemptions from the V.I. real property tax, gross recepts tax and/or excise tax. Any particular package of benefits is negotiated between the applicant and the V.I. Industrial Development Commission. Subsidies and exemptions are permitted for 10 years, but the beneficiary under the Industrial Development Program may be granted renewal of those benefits subject to the approval of the Governor of the Virgin Islands.

A corporation which qualifies under section 934 and the V.I. Industrial Development Program for a rebate of 90 percent of its income taxes, pays a maximum income tax rate in the Virgin Islands of 4.6 percent. If the corporation is also deemed to be a V.I. inhabitant under section 28(a) of the Revised Organic Act, then it is not subject to Federal tax. In 1977, nine U.S.-controlled corporations received the benefits of the V.I. income tax rebates and of section 28(a). The income tax subsidy granted these nine corporations amounted to $13.5 million in 1977. This figure is the total amount of

13. A 1975 resolution of the Virgin Islands legislature urged the U.S. Congress to adopt legislation to "eliminat[e] the so called 'mirror system' of taxation in all instances in which said system results in any United States citizen resident in the Virgin Islands or any Virgin Islands corporation being denied any deduction, credit, election or exemption under the Internal Revenue Code of 1954, as amended, by reason of the fact that the Virgin Islands is a separate taxing jurisdiction from the United States."

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Federal taxes foregone as a result of section 28(a),[14] but only a small part of the Virgin Islands taxes foregone as a result of the V.I. tax-incentive legislation. The full amount of V.I. taxes foregone includes the tax relief provided to approximately 57 V.I. corporations, in addition to the nine U.S.-controlled corporations.[15] It also includes the customs tax rebates and exemptions from V.I. property tax, gross receipts tax, and excise tax. Data are not available to estimate the total amount of taxes foregone by the Virgin Islands.

In 1977, the income tax foregone per employee of the nine U.S.-controlled corporations varied between $59,000 for one company and zero in the case of two companies with net losses. The $59,000 figure is five times larger than the average compensation paid to employees of these companies. The average income tax forgiveness per employee was $4,300, or 36 percent of the average compensation of these employees.[16]

3. "Covering over" of Federal and territorial taxes

The Revised Organic Act in section 28(a) provides that:

> "the proceeds of the United States income tax on the inhabitants of the Virgin Islands ... shall be covered into the treasury of the Virgin Islands, ... provided that ... such persons shall satisfy their income tax obligations under applicable taxing statutes of the United States by paying their tax on income derived from all sources both within and outside the Virgin Islands into the treasury of the Virgin Islands."

Since U.S. government employees stationed in the Virgin Islands are considered to be "inhabitants of the Virgin Islands", the Internal Revenue Service pays over to the Virgin Islands treasury U.S. income taxes imposed upon the compensation of U.S. government employees for services performed in the Virgin Islands. The Internal Revenue Service has interpreted section 28(a) also to authorize the covering over of U.S. income taxes withheld on wage income of individuals who were residents of the United States for part of the tax year, but residents of the Virgin Islands as of the last day of the tax year. This latter source of Federal income taxes covered over has amounted to approximately $1 million annually in recent years.

B. Guam

1. Basic tax system

The 1950 Organic Act of Guam provides, in language identical to that with respect to the Virgin Islands in the Naval Appropriations Act, that "The income tax laws in force in the United States of America and those which may hereafter be enacted shall be held to be likewise in force in Guam". From 1950 to 1972, the Guam territorial income tax was administered according to a mirror system similar to that currently applied in the Virgin Islands. Because of the inequities which resulted under the Guamanian mirror system from taxing U.S. citizens not resident in Guam as nonresident aliens, Guam supported the enactment in 1972 of section 935 of the Internal Revenue Code.

(a) Taxation of individuals

Section 935 simplifies the application of the Guamanian mirror system to individuals. Under this section, a U.S. or Guam citizen is required to file only one tax return — with Guam if he is resident there on the last day of the year, with the United States if he is resident in one of the fifty States or the District of Columbia on the last day of the year. Section 935 also provides that for purposes of the Guamanian individual income tax, income from U.S. sources shall be treated as domestic source income; for purposes of the Federal individual income tax, income from Guamanian sources shall be treated as domestic source. Section 935 allows full credit for taxes paid to or withheld by both jurisdictions without regard to the foreign tax credit limitation. Income taxes withheld by one jurisdiction (e.g., the United States) can be claimed as a credit in the jurisdiction where the individual files his return (e.g., Guam) just as if the taxes had been withheld by the jurisdiction of residence (in this example, Guam).

While P.L. 92-606, which enacted section 935, eliminated inequities in the taxation of U.S. citizens subject to the Guamanian income tax, it gave rise to inequities in the division of revenues between the United States and Guam. Section 935 (and its companion section, 7654) apparently replaced the provisions of the Organic Act of Guam relating to the disposition of Guam taxes.[17] The Organic Act provided, in pertinent part, that "Federal income taxes derived from Guam ... shall be covered into the treasury of Guam." The legislative history of section 935 suggests that Congress intended to preserve Guam's exclusive right to tax full-year residents of Guam and citizens of Guam not resident in the United States. Accordingly, Congress provided in section 935 that such persons were "relieved of liability" for the United States income tax. However, the provisions of the 1972 law did not make Federal tax withholding obligations consistent with the liability rules set down in section 935, nor (as an

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14. In the absence of special Federal provisions, a U.S. corporation deriving income from a territory would have a tax liability to the Federal government as well as to the territorial government equal to 46 percent of its taxable income, less tax credits. To avoid double taxation, the Federal government would ordinarily grant a dollar-for-dollar foreign tax credit for taxes paid to the territory. By relieving territorial source income from Federal taxation, the United States "preserves" the benefit of any tax relief granted by the territory. The amount of the revenue loss to the Federal treasury is the difference between the taxes which would have been paid to the United States in the absence of section 28(a) and the actual tax payment to the territory. Since the territorial income tax system "mirrors" the Federal system, this amount also represents the income tax foregone by the Virgin Islands with respect to U.S.-controlled corporations.

15. Data compiled by the Virgin Islands Commerce Department show that as of December 31, 1978, there were a total of 66 active firms holding grants of tax relief from the Virgin Islands government.

16. For a detailed discussion of the data sources used in estimating the cost of the V.I. tax-incentive program to the Federal treasury, see *The Operation and Effect of the Possessions Corporations System of Taxation, Second Annual Report*, pp. 84-99.

17. Income Tax Regulations section 301.7654-1(a).

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alternative) did they provide a comprehensive mechanism for the Federal government to cover these taxes over to the Guamanian treasury. Inconsistencies exist in three areas:

— The United States withholds (and retains) tax on pension payments to retired military and civil service employees resident in Guam.

— The United States withholds (and retains) tax on compensation paid to citizens of Guam serving in the U.S. armed forces.

— The United States withholds tax on compensation paid to U.S. government employees in Guam. Currently, these withholding taxes are being covered over to Guam. In 1973, the Treasury advised the IRS that it should continue to cover over these withholding taxes as if section 30 of the Organic Act had not been fully superseded.

These three issues have been of concern to both the Treasury and the Administration. The fiscal plight of Guam is increasingly serious and Guam needs to know the amount of Federal tax dollars on which it is entitled to rely. The Treasury Department indicated to the government of Guam that, if necessary, it would be prepared to seek statutory clarification.

(b) Taxation of corporations

Like the Virgin Islands, Guam taxes U.S. corporations as foreign corporations. Similarly, corporations chartered in Guam are considered to be foreign corporations for purposes of U.S. Federal taxation. However, P.L. 92-606 made an exception to this foreign treatment for purposes of the 30 percent withholding tax on interest, dividends, and other fixed or periodical payments. Under the new Code section 881(b), Guamanian corporations are not subject to the withholding tax on U.S.-source interest, dividends, etc. Under the "mirror image" of this provision, U.S. corporations are not subject to the withholding tax on Guam-source interest, dividends, etc.

2. Tax incentives for investment in Guam

Section 936 of the Internal Revenue Code allows a U.S. corporation, 80 percent of whose income is derived from a possession[18] and 50 percent of whose gross income is effectively connected with a trade or business in a possession, to claim a special credit equal to the Federal tax attributable to income from the trade or business and to "qualified possession source investment income". "Qualified possession source investment income" is derived from the reinvestment of income from a trade or business whithin the same territory. The effect of section 936 is to relieve a qualifying U.S. corporation from any Federal tax on income from a possessions trade or business or from qualified investments within the possession in which the trade or business is conducted.[19] Other income (e.g., income earned from a trade of business outside the territory) is subject to the regular Federal income tax.

Dividends paid to a U.S. corporation by a company whose Guam trade or business qualifies it for a section 936 credit must be included in the gross income of the U.S. shareholder. However, such dividends qualify for a 100 (or 85) percent dividends-received deduction, which reduces gross income otherwise subject to Federal tax. Since the dividends-received deduction eliminates most or all of the Federal tax on repatriated earnings, no foreign tax credit is allowed for withholding taxes[20] or income taxes imposed by the territory on the qualified earnings. *The effect of all these provisions taken together is that the only tax imposed on the trade or business income or the qualified possession-source investment income is that imposed by the territory.*

Under Guamanian law, corporations organized in Guam or the United States may qualify for rebates of 75 percent of Guam income taxes. In order to qualify for the rebates, a corporation must meet minimum investment and certain other requirements, such as increasing employment, replacing imports, or creating needed facilities. The rebate is allowed for up to 10 years, but may be renewed.

Section 936 is not a key factor in Guam's industrial development, since few of the tax-exempt companies in Guam are U.S. corporations. In 1977, only four corporations in Guam and American Samoa combined received section 936 benefits, resulting in a total tax saving (Federal tax foregone) of $1.1 million.

3. Newly enacted tax exemption measures

In 1977, the Guam legislature enacted a law (P.L. 14-32) which provides for rebates of 75 percent of Guamanian tax on foreign earned income of U.S. citizens resident in Guam. Foreign earned income is defined to include earned income derived from sources outside the United States and the U.S. territories. Since, under section 935 of the Federal Internal Revenue Code, residents of Guam are free of Federal income tax liability, the effect of this provision is to reduce the effective tax rate on foreign earned income of Guam residents to 25 percent of the rate otherwise applicable to U.S. citizens.

It is an unresolved issue whether Guam has the authority to rebate Guam taxes on foreign earned income. It is clear, however, that this exemption is contrary to the intent of Congress when it provided, in the Organic Act of 1950, that "The income-tax laws in force in the United States of America ... shall be held to be likewise in force in Guam."

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18. The term "possession" as used in section 936 includes Guam, American Samoa, and Puerto Rico. It does not include the Virgin Islands. However, the Revised Organic Act of the Virgin Islands in section 28(a) provides to "inhabitants of the Virgin Islands" benefits similar to section 936 benefits, since "inhabitants of the Virgin Islands" are relieved of the obligation of paying Federal tax by doing so in the Virgin Islands. It is unclear whether or not the term "possession" as used in section 936 includes the Northern Mariana Islands.

19. A corporation which qualifies for the benefits of section 936 may not join in filing a consolidated Federal tax return.

20. Although this provision is presently irrelevant to Guam, it could become relevant should Guam impose a withholding tax similar to the "tollgate" tax in Puerto Rico.

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4. "Covering over" of Federal and territorial income taxes

Under the method imposed by sections 935 and 7654 of the Internal Revenue Code for the coordination of the U.S. and Guam income taxes, the Federal and Guam treasuries generally keep the taxes withheld by Federal and Guam withholding agents, respectively. Individuals file returns in the jurisdiction where they are resident on the last day of the year, claim a credit for taxes within both jurisdictions, and either pay additional tax or obtain a refund from the jurisdiction where they are resident.

There are three exceptions to the principle of "letting the withholding chips fall where they may:

— Federal taxes withheld on compensation paid to members of the U.S. armed forces stationed in Guam. Under the Soldiers and Sailors Relief Act, the U.S. military generally have no tax liability to Guam. The United States covers these taxes over to Guam pursuant to Code section 7654.

— Federal taxes withheld on compensation paid to civilian employees of the Federal government working in Guam.

These individuals have a tax liability to Guam in the case that they are resident there on the last day of the tax year, but can claim a credit for taxes withheld by the United States on wages which offsets their liability to Guam. As explained above, the Treasury Department would support a statutory clarification of the legal basis for covering over these amounts.

— Federal and territorial taxes on individuals with gross income of $50,000 or more and at least $5,000 in gross income from the jurisdiction in which they are not resident on the last day of the year.

These taxes are split between the Federal and territorial treasuries in proportion to the source of the income. For example, a U.S. resident with $100,000 in gross income, $10,000 of which was derived from Guam, would file a Federal return and pay taxes to the Federal government. If the withholding and estimated taxes paid to Guam represented less than 10 percent of his total tax liability, the Federal treasury would cover over the difference to the Guam treasury; if more than 10 percent had been withheld, the excess would be covered over from the Guam treasury to the Federal treasury. The United States covers these taxes over pursuant to section 7654 of the U.S. Internal Revenue Code.

C. Northern Mariana Islands

1. Basic tax system

The Covenant to Establish a Commonwealth of the Northern Mariana Islands, the pertinent sections of which became effective in January 1979, provides in section 601 that the U.S. income tax laws are in force in the Northern Marianas "in the same manner as those laws are in force in Guam." It also provides that references to Guam in the Federal Internal Revenue Code will be deemed to refer to the Northern Mariana Islands, as well.

Pursuant to section 602 of the Covenant, the Northern Mariana Islands have authority to rebate taxes imposed on local source income. The government is prohibited from rebating taxes on income derived from sources outside the Northern Mariana Islands. The Northern Marianas currently rebate 100 percent of taxes collected under the "mirrored" Internal Revenue Code on Marianas-source income. The Northern Mariana Islands instead impose a tax on gross wages and salaries and a business gross revenues tax. The gross wage and salary tax is levied at progressive rates ranging from zero to six percent. The business gross revenue tax is also a progressive tax, with rates from zero to four percent.[21]

2. Tax incentives for investment in the Northern Mariana Islands

It is an unresolved issue whether U.S. corporations operating in the Northern Marianas may qualify for special tax treatment under section 936 of the Federal Internal Revenue Code.

Under Marianas law, corporations receive rebates of 100 percent of the income taxes paid under the mirror system on Marianas-source income. The only territorial tax to which such income is subject is the business gross revenue tax.

3. "Covering over" of Federal and territorial income taxes

The Covenant of the Northern Marianas provides in section 703(b) that the Federal government will pay to the Marianas treasury all Federal income taxes derived from the Northern Mariana Islands. The specific kinds of taxes covered over by the United States are the same as those enumerated for Guam (see above).

D. American Samoa

1. Basic tax system

Alone of the four territories, Congress granted to the legislature of American Samoa the authority to impose its own income tax. In 1963, the American Samoan legislature adopted the mirror system in the American Samoan Tax Act (Revised Code of American Samoa, Title XVIII, Ch. 18.04). This Act provides that:

> "The income tax laws in force in the United States of America and those which may hereafter be enacted ... are hereby adopted by American Samoa. They shall be deemed to impose a separate territorial income tax, payable to the Government of American Samoa."

U.S. citizens who are resident in American Samoa, unlike those resident in any other territory, are not relieved of the obligation of filing a Federal tax return

21. "Commonwealth of the Northern Mariana Islands Tax Act of 1979", First Northern Marianas Commonwealth Legislature, Second Session, 1978. Chapter 1 of this Act provides for the gross wage and salary tax and the business gross revenue tax. Chapter II provides for a rebate of 100 percent of taxes collected under the "mirrored" Internal Revenue Code on Marianas-source income.

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d paying Federal taxes by doing so in American moa. Instead, U.S. citizens resident in or deriving come from American Samoa file two tax returns — ne with the Federal government and one with merican Samoa. To avoid double taxation, the United ates grants a foreign tax credit against the U.S. tax bility of U.S. citizens for taxes paid on income erived from American Samoa. This treatment puts merican Samoa on an equal footing with foreign untries. It means that U.S. citizens resident in merican Samoa, like U.S. citizens at home and in reign countries, file a Federal tax return and are bject to IRS audit. It means that nationals of merican Samoa are subject to U.S. taxation only in the se that they derive income from the 50 States.

t the present time, the legislature of American Samoa considering ways to simplify its income tax system so at it is more suited to the income levels in American moa. The legislature has stated that it believes that

"everyone should pay something, which, given the level for the earned income credit in the Internal Revenue Code, does not occur under the mirrored or partially mirrored U.S. American Internal Revenue Code."[22]

Tax incentives for investment in American Samoa

.S. corporations operating in American Samoa may ualify for special U.S. tax treatment under section 936 f the Federal Internal Revenue Code in the same anner as domestic corporations operating in Guam. he only tax imposed on the qualified income which ch corporations derive from Amercian Samoa is that nposed by the territory.

merican Samoan law provides that certain corpora- ons are exempt or partially exempt from territorial come taxes. In order to qualify, the corporation must e owned by a resident of American Samoa and employ work force at least 75 percent of which consists of moan residents. The period of tax exemption is for up 10 years, although it may be made to terminate rlier if the cumulative amount of income taxes rgiven equals 100 percent of the net current vestment in American Samoa.

ection 936 and related provisions of the Federal ternal Revenue Code are not a key factor in the dustrial development of American Samoa. In 1977, here were only four corporations receiving section 936 enefits in American Samoa and Guam combined. They ccounted for a total tax saving (Federal tax loss) of 1.1 million.

. Covering over of federal and territorial income taxes

here are no covering over procedures in place between he United States and American Samoa. This imposes a urden on individuals employed by the U.S. ederal government in American Samoa. The tax ability of such individuals on income derived from merican Samoa is to the territory, not to the United tates.[23] Nonetheless, pursuant to section 3401(a)(8) f the Internal Revenue Code, the United States with- olds income tax on compensation paid to these Federal employees. In order to satisfy their American Samoan tax obligations, these individuals must request a refund on their Federal Income tax return of the Federal withholding taxes, and then pay the refund to American Samoa, together with interest if the Federal refund is delayed.

The Internal Revenue Service has proposed a technical amendment[24] to the Internal Revenue Code which would exempt U.S. government employees in the territories from Federal withholding taxes. It would also require the United States, on the request of a territory, to enter into an agreement to withhold *territorial* income taxes on the wages of individuals employed by the U.S. government in the territory.

IV. EVALUATION OF CURRENT SYSTEMS OF TAXATION

The current systems of income taxation in the territories may be evaluated according to three criteria: (A) raising revenue (B) equitable treatment of territorial versus stateside residents, and (C) simplicity of interpretation, administration, and compliance.

A. Raising revenue

Congress intended that the mirror systems provide the territories with local tax revenues for meeting a part of their government expenditures. As the territorial economics grew, it was expected that the revenues collected under the graduated income tax would grow by an even larger amount and provide a source of funds for infrastructure projects as well as government operating expenses.

In fact, Virgin Islands net income tax collections declined from 15.8 percent of gross V.I. product in 1973, to 10.2 percent in 1978 (see Tabel 3). Guamanian net income tax collections declined from 12.9 percent of gross territorial product in 1973, to 7.3 percent in 1977.[25] In dollar terms, the amount of income tax collections, net of rebates, stayed roughly constant in these two territories between 1973 and 1978. This may be compared to the U.S. Federal income tax collections, which in dollar terms increased by 70 percent between 1973 and 1978, and as a percentage of GNP rose from 10.8 percent to 11.4 percent.

Members of the Virgin Islands government have stated that the comparison of the 1973 and 1978 V.I. tax/GNP ratios is misleading because the dramatic rise in the value of oil refined by one tax-exempt company in the

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22. Attachment to a letter from the Legislature of American Samoa to the White House, dated October 5, 1979.
23. As explained above, the United States grants a dollar-for-dollar offset (credit) against U.S. income taxes for taxes paid to American Samoa.
24. See *Taxation and Finance*, No. 68, April 7, 1978. The Bureau of National Affairs, Inc., Washington, D.C., pp. J-1 to J-2.
25. The V.I. and Guam gross product statistics are estimates of the Commerce Department of each of the territorial governments, which note that they require further refinement.

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TABLE 3

Virgin Islands and Guam and the United States income tax and income tax effort, fiscal years 1973–1979

	1973	1974	1975	1976	1977	1978	1979*
VIRGIN ISLANDS							
Income tax, net of rebates, in million	53.8	63.3	62.4	51.2	58.7	50.9	56.8**
Net income tax as percent of gross territorial product***	15.8%	16.2%	14.2%	10.8%	12.0%	10.2%	n.a.
GUAM							
Income tax, net of rebates, in millions of dollars	46.2	50.9	51.2	39.9	33.2	45.9	46.1
Net income tax as percent of gross territorial product***	12.9%	10.8%	11.3%	8.0%	7.3%	n.a.	n.a.
UNITED STATES							
Income tax, in millions of dollars	139,399	157,572	163,007	173,012	212,517	240,940	273,909
Income tax as percent of gross national product***	10.8%	11.2%	10.7%	10.2%	11.3%	11.4%	n.a.

Office of the Secretary of the Treasury
Office of Tax Analysis
August 28, 1979.

* Estimated.
** Amount prorated from income tax collected in FY 1979 and 3-month transitional period.
*** Computed as the amount of income tax divided by gross product for the previous calendar year.

Source: For the territories, income tax data for FY 1976 to FY 1979 are taken from information provided by the U.S. Government Comptrollers for the Virgin Islands and Guam. Income tax data for the earlier years are taken from the chart prepared by Richard Miller for the U.S. Department of the Interior, "Funds Available to the Virgin Islands Government by Source, FY 1970 to FY 1977;" and from **Guam Needs Assessment,** U.S. Department of the Interior, Table II-1. Statistics on the V.I. gross territorial product are taken from "Comparative Growth Statistics," estimated by Jerome McElroy. Statistics on Guam gross territorial product are taken from Russell C. Kreuger and Clara M. Okada, "**The Gross Islands Product of Guam,**" Department of Commerce, Government of Guam.
For the United States, income tax data are taken from **The Budget of the U.S. Government, FY 1980** and **Annual Report of the Secretary of the Treasury on the State of the Finances, FY 1978.** Statistics on the U.S. GNP are taken from the **Survey of Current Business,** U.S. Department of Commerce, various issues.

Virgin Islands swells the gross product estimates, while it has a much smaller effect on taxable income. The Virgin Islands government has also claimed that a major cause of the decline in income tax burdens was the *Federal* revenue acts of 1975, 1976, 1977 and 1978, which reduced individual income tax liabilities. The Virgin Islands accurately points out that the U.S. revenue acts had a greater adverse impact on V.I. tax liabilities than on U.S. tax liabilities because a larger proportion of V.I. taxpayers are in the low tax brackets, which were most affected by the revenue acts. Finally, the Virgin Islands argues that it is not fair to apply effective tax rates calculated for the United States to the Virgin Islands, because "annual increases in wages in the Virgin Islands [since 1970] have averaged about six percent per year, while the states' annual yearly increases have averaged 10 percent per year."[26]

In order to evaluate these last two arguments, the Treasury Department has made a rough estimate of the impact of inflation and tax law changes on effective tax rates in the Virgin Islands. These estimates are based on the assumption that the incomes of V.I. taxpayers rose at an average annual rate of 6 percent, compared to the average annual rate of U.S. inflation of 8 percent in this period. Since U.S. inflation is exported to the Virgin Islands, the assumption of a 6 percent average annual wage increase is tantamount to assuming that the real purchasing power of Virgin Islands taxpayers dropped in this period. Based on this assumption, the average V.I. effective tax rates over all income brackets and filing statuses[27] would be as follows:

Year	Applicable law	Average V.I. effective tax rate on earned income
1973	1973	7.2%
1978	1973	8.9%
1978	1978	6.6%

The table above shows that the post-1973 tax law changes only slightly over-compensated for the effect of inflation. The average effective tax rate over all income tax brackets and filing statuses in the Virgin Islands dropped by only 8 percent between 1973 and 1978, from 7.2 percent to 6.6 percent. This is less than the 14 percent drop in individual income tax collections in this period, from $37.9 million to $32.7 million. The tax law changes thus could not be the sole or even the primary cause for the sharp decline in the ratio of tax collections to gross V.I. product after 1973.

An alternative approach to measuring the impact of Federal tax law changes on V.I. income tax burdens

26. Peter Pflaum, "Changes in Federal Tax Law Adversely Affect Islands"; *Virgin Islands Daily News*, September 12, 1979.
27. The average effective rates are estimated by weighting the effective tax rate for each income level and filing status by the percentage of V.I. taxpayers subject to that rate. The income distribution and filing status data were derived from a sample of 200 individual income tax returns filed with the Virgin Islands for tax year 1977.

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ould be to assume that all taxes due the Virgin Islands ere in fact collected. This would mean that income tax llections would equal tax liabilities. Using the ffective V.I. tax rates on earned income for 1973 and 978, it is possible to impute the change in taxable rned income which would have had to occur to nerate the actual change which occurred in income x collections. This calculation gives rise to an timated drop in taxable income of 5.7 percent for the eriod 1973 to 1978, from $526 million to $495 illion.

ear	Individual income tax collections	Average V.I. Effective tax rate on earned income	Amount of imputed personal income
973	$37.9 M	7.2%	$526 M
978	$32.7 M	6.6%	$495 M

his imputed decline in personal income is at variance ith most of the growth indicators for the Virgin lands for this period. For example, it is estimated that ourist expenditures in the Virgin Islands rose by 60 ercent between 1973 and 1978. The same period saw a rowth of 4 percent in the employed labor force.[28]

n summary, the decline of V.I. income tax collections s a percentage of gross product must be attributed rimarily to factors other than changes in the Internal evenue Code. Evidence suggests that the principal actors are (1) deficiencies in tax administration, (2) nsufficient incentives to local tax efforts, and (3) the erritorial tax-incentive programs.[29] These problems are iscussed below with reference to both the Virgin slands and Guam.

. Deficiencies in tax administration

he 1978 report of the Federal Comptroller for the irgin Islands find that the V.I. administration is lax in s tax enforcement and collection activity.[30] According o a 1977 report prepared by IRS personnel at the equest of the Virgin Islands government,

> "The present Tax Division salary scale is unrealistic considering salaries paid for competitive positions in other agencies."
> "... since the proposed tax deficiencies for Fiscal Year 1977 amounted to an average of $705,000 per agent, it is apparent that the Virgin Islands Government could increase its revenues substantially by increasing the Revenue Agent staff and by increasing the agents' salary to attract and retain the best qualified personnel."[31]

he recently released GAO report on Guam tax dministration finds that Guam lacks procedures to dentify individuals and firms which have not filed ncome tax returns or to cross-check information eported on income tax returns with information on ithholding statements. The GAO report also notes that nremitted withholding taxes totaled $3.5 million as of 978, and that Guam has no adequate procedures to nsure the timely collection of these or other delinquent axes. Another problem noted is that the Guam tax dministration has never used the courts to assist in the ollection of taxes due.

2. Insufficient incentives to local tax effort

In the 1970's, Federal aid has filled an ever larger gap between stagnant territorial tax revenues and the growing expenditures of the territorial governments. In addition to the regular channels of Federal aid, the Virgin Islands and Guam have received ad hoc appropriations for capital improvement and other projects and for "tax loss reimbursement." The territories' lack of full autonomy over their income tax helped them convince Congress and the Administration that they should be reimbursed for the reduction in the tax revenues resulting from their "mirroring" of changes in the Federal tax law. Their efforts produced the following results:[32]

	Appropriations for tax loss reimbursement	
	Virgin Islands	Guam
Tax Reduction Act of 1975	$ 8,500,000	$15,000,000
Tax Reform Act of 1976	$14,000,000	
Tax Reduction and Simplification Act of 1977	$ 1,938,013	$ 3,215,399
Revenue Act of 1978	Presidential veto of H.R. 13719, which would have authorized reimbursement for tax losses incurred in CY 1978 through 1982.	

The appropriations for tax loss reimbursement to the Virgin Islands and Guam represented additional Federal aid. The Federal tax changes did not cause a reduction in the well-being of the territories, but only a transfer of funds from the treasuries of the territories to the taxpayers of the territories. If the Virgin Islands and Guam did not want to cut their tax then, they could have increased their own non-income based taxes. As of 1976, in the case of the Virgin Islands, and 1977, in the case of Guam, these territories also could have imposed a 10 percent income tax surcharge. By providing tax loss reimbursements, the Federal government was simply

28. V.I. Commerce Department.
29. A fourth factor applicable to the Virgin Islands is the decision in the *Vito* case (cited on page 15 above) that V.I.-source interest, dividends, and other passive investment income paid to U.S. persons were not subject to the 30 percent V.I. withholding tax. This decision deprived the Virgin Islands of a source of revenues it had first tapped in 1974. It therefore is not a factor which can help to account for the drop in V.I. tax effort between 1973 and 1978.
30. "Financial Condition of the Government of the Virgin Islands of the United States", U.S. Government Comptroller for the Virgin Islands, June 1978, Report No. 541-77-00, p. 10.
31. Report by the Internal Audit Division, IRS, for Fiscal Year 1977, pp. 35 and 43.
32. American Samoa was not authorized to receive reimbursement for tax losses incurred as a result of the 1975 and 1976 Federal tax changes because Congress believed that the continuing authorization to support the American Samoan government was sufficient to compensate for the reduction in territorial income tax liabilities. Congress did authorize American Samoa to receive reimbursement for the reduction in tax liabilities resulting from the Tax Reduction and Simplification Act of 1977, but American Samoa has to date not requested an appropriation.

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making an additional general appropriation to these territories, while allowing territorial taxpayers to enjoy a tax reduction.

3. Territorial tax-incentive programs[33]

Between fiscal years 1973 and 1977, the Virgin Islands rebated $118 million in corporation income taxes to tax-exempt firms. This compares to net corporation income taxes collected in the same period of $87 million. Thus, tax rebates deprived the Virgin Islands government of 57 percent of the $205 million in total corporation income taxes collected in this five-year period.

In Guam, total income taxes and gross receipts taxes rebated in the period FY 1976 to FY 1980 are estimated to be $19.7 million.[34] This represents 10 percent of the total of the gross corporate income taxes plus gross receipts taxes collected in this five-year period.

B. Equitable treatment of territorial versus stateside residents

Despite the fact that Federal statutes provide that "the income tax laws in force in the United States of America are likewise in force" in the Virgin Islands, Guam and the Northern Mariana Islands, U.S. residents who derive income from the Virgin Islands and U.S. citizens resident in Guam or the Northern Mariana Islands are not, in general, subject to income tax burdens comparable to those of other U.S. citizens. As explained above, U.S. residents are treated for purposes of V.I. income taxation as nonresident aliens. This makes them eligible for fewer deductions and, with respect to "not effectively connected" income, subject to possibly higher tax rates than they would be if they were V.I. residents.

In contrast, the tax systems of Guam and the Northern Mariana Islands extend more favorable tax treatment to territorial residents than is available under Federal law to other U.S. citizens. Residents of Guam may benefit from the rebate of 75 percent of their income taxes attributable to foreign earned income. Residents of the Northern Mariana Islands benefit from the rebate of 100 percent of their taxes on Marianas-source income. This forgiveness of territorial income taxes is made effective by section 935 of the Internal Revenue Code, as applied by the United States. This section provides that residents of Guam and the Northern Mariana Islands are not liable for Federal income taxes.

C. Simplicity

In principle, basing the territorial income tax systems on the U.S. Internal Revenue Code should have minimized the problems of tax interpretation, administration, and compliance in the territories. Under the mirror systems, U.S. tax forms, instructions, and other Internal Revenue Service publications do double duty, as do training programs for revenue personnel. Because Federal court rulings are accepted as precedents in the territories, the territorial governments are spared the problems of adjudicating tax cases through their own court system.

In fact, however, the interpretation of the mirror systems raises complex questions, many of which have been answered in different ways by the courts and the Internal Revenue Service, or have yet to be answered at all. The *Vitco* case, cited [on page 15] above, is the most recent example of a shifting understanding of the Virgin Islands mirror system. This case involved the question whether the U.S. income tax regulation which exempts V.I. inhabitants from U.S. withholding taxes should be "mirrored" into the Virgin Islands tax law. The Internal Revenue Service and the V.I. tax administration took the position that V.I. tax law mirrors only the Internal Revenue Code and the regulations which derive from it, and that since the regulation in question[35] does not derive from the Internal Revenue Code, it should not be mirrored into V.I. law. The Third Circuit Court of Appeals rejected this argument. It held that the V.I. mirror system imposes a tax obligation to the Virgin Islands equivalent to what the United States would collect on the same income. This decision is certain to increase tax litigation. It raises many new questions and is at odds with the interpretation of the mirror system held in earlier court decisions.

While the Virgin Islands mirror system is more complicated than that of the other territories, issues of coordination of the Federal tax system with that of Guam and the Northern Mariana Islands also raise difficult questions of interpretation. In Guam, one of the more complex issues is the proper treatment of Federal withholding taxes on the pensions of retired Federal military and civil service employees resident in Guam (see [pp. 22-23] above). With respect to the Northern Mariana Islands, the most recent issue to come before the Treasury Department is whether the reference to "possessions" in section 936 of the Internal Revenue Code includes the Northern Mariana Islands. The law provides no clear guidance on this issue.

In addition to the complex interpretative questions raised by the territorial tax systems, these systems also create severe problems of administration. The Internal Revenue Code is exceedingly complex and the territorial tax administrations do not have the resources to enforce the Code effectively. They also have difficulty keeping abreast of changes in the Federal internal revenue laws. The V.I. tax administration was unaware until 1979 of a provision of the Tax Reform Act of 1976 alleviating a prior "inequity" in the mirror system.[36]

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33. Data on total income tax subsidies paid by American Samoa and the Northern Mariana Islands are not available.
34. Data on rebates of income taxes alone are not available.
35. U.S. Income Tax Regulations section 1.1441-4(d). This section conforms the Internal Revenue Code (as applied by the United States) to the Revised Organic Act of the Virgin Islands, section 28(a).
36. Internal Revenue Code section 6013(g) allows a married couple, one of whom is a nonresident alien, to elect to file a joint return. Under the mirror system, this provision would seem to allow a couple, one of whom was resident in the Virgin Islands, the other in the United States, to satisfy its U.S. tax liability by filing a joint return and paying taxes in the Virgin Islands.

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With regard to enforcement, a difficulty of the mirror system is that they are easily abused by persons wishing to avoid and evade Federal taxes. Under the mirror systems, a resident of the Virgin Islands, Guam, or the Northern Mariana Islands is relieved of the obligation to report his income or pay tax to the United States. The IRS is not well positioned to prevent the evasion of U.S. taxes by individuals with dubious claims to residence in a territory.

Under the territorial tax rebate programs, U.S. corporations have an incentive to shift profits to the territories. Particularly in the Virgin Islands, the IRS encounters numerous and difficult transfer-pricing problems with respect to transactions between U.S. corporations and their affiliates. U.S. parents commonly lease plant and equipment to their territorial affiliates, which may have the effect of artificially inflating the income subject to a territorial tax rebate.

A further aspect of the complexity of the mirror systems is that they are difficult for taxpayers to comply with. In general, U.S. corporations operating in the territories have not been made aware that they are subject to territorial taxation under the rules applicable to foreign corporations. A sample of U.S. corporate tax returns filed with the Virgin Islands showed that they are typically filing Form 1120 as V.I. domestic corporations, rather than Form 1120F as foreign corporations. Several of the V.I. corporate returns sampled were duplicates of the corporations' U.S. income tax returns, except that a zero was indicated in the space for V.I. tax liability. These corporations apparently took the position that they owed no taxes to the Virgin Islands, perhaps on the theory that as "residents" of the United States, they satisfied their Virgin Islands tax liability by filing a return and paying taxes in the United States — as if Code section 935 applied to corporations in the Virgin Islands. In tax systems which depend as much on voluntary compliance as do the Federal and the territorial income tax systems, these discrepancies between principle and practice should be of concern.

Virgin Islands: Residency

The following United States Revenue Ruling (80-40) describes the case in which a United States corporation is treated as a resident of the Virgin Islands for the application of United States and Virgin Islands income tax law. However this corporation is treated as a domestic United States corporation for purposes of the dividend received deduction.

ISSUES

1. Is a United States corporation that has its principal office in the Virgin Islands and qualifies for certain Virgin Islands tax incentives treated as a Virgin Islands inhabitant so that it satisfies its United States income tax obligation by paying tax on its income from all sources to the Virgin Islands?

2. Is such a United States corporation a "domestic corporation" for purposes of the dividends received deduction of section 243 of the Internal Revenue Code?

FACTS

P, a corporation organized in state *X*, is engaged in manufacturing in state *X*. In order to take advantage of certain income tax incentives offered by the Virgin Islands, *P* organized *S* to carry out part of *P*'s manufacturing operations in the Virgin Islands. *S* is incorporated in state *Y*.

S conducts all of its manufacturing operations in the Virgin Islands and derives 80 percent or more of each taxable year's gross income from Virgin Islands sources, and 50 percent or more of each taxable year's gross income from the active conduct of its business in the Virgin Islands. *S* maintains its principal office in the Virgin Islands. Management and control of *S* is in the Virgin Islands and all policy is made there. Board of directors and shareholders' meetings are held in the Virgin Islands, and all officers and some directors of *S* are Virgin Islands residents. *S*'s corporate receipts are received in the Virgin Islands and deposited in Virgin Islands bank accounts. All disbursements are made from the Virgin Islands and the corporate books and records are maintained and audited there.

LAW AND ANALYSIS – ISSUE (1)

Section 934(a) of the Code prevents the Virgin Islands from reducing by subsidy its income tax on United States source income of a United States corporation. However, section 934(b) provides that in the case of a domestic corporation, subsection (a) shall not apply to the extent such corporation derived its income from sources without the United States: (1) if 80 percent or more of the gross income of such corporation for the 3-year period immediately preceding the close of the taxable year (or for such part of such period immediately preceding the close of such taxable year as may be applicable) was derived from sources within the

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Virgin Islands; and (2) if 50 percent or more of the gross income of such corporation for such period or such part thereof was derived from the active conduct of a trade or business within the Virgin Islands.

Section 1.934(b)(3) of the Income Tax Regulations explains how to compute income tax liability incurred to the Virgin Islands and attributable to income derived from sources without the United States by a United States corporate inhabitant of the Virgin Islands. Section 1.934-1(b)(5) explains how to make a similar computation for a United States corporation which is not an inhabitant of the Virgin Islands. Section 934(d) of the Code provides that section 934(b) will only apply to corporations who supply the information required by section 1.934-1(d) and (e) of the regulations.

Section 1.901-1(g)(5) of the regulations states that a United States foreign tax credit is not allowable to persons who are inhabitants of the Virgin Islands.

Authority for income taxation in the Virgin Islands is derived from the Naval Appropriations Act, approved July 12, 1921 (U.S.C. 1937). This Act mirrors the income tax laws of the United States into the Virgin Islands as if the Virgin Islands legislature had adopted the Internal Revenue Code and applied it to United States persons in the same way the United States applies the Code to foreigners.

Under the mirror system the United States and the Virgin Islands are separate and distinct taxing jurisdictions even though their income tax laws arise from an identical statute applicable to each (the Code). *See* Rev. Rul. 73-315, 1973-2 C.B. 225. Thus, the effect of this mirror system of taxation is to require all persons including United States corporations incurring income tax obligations to both the United States and the Virgin Islands under Chapter 1 of the Code (as applicable in each jurisdiction) to file tax returns and pay income tax to both jurisdictions.

Section 28(a) of the Revised Organic Act of the Virgin Islands (R.O.A.), 48 U.S.C. section 1642 (Supp. 1979), makes substantial changes in this system as it affects "inhabitants of the Virgin Islands." Section 28(a) requires inhabitants to satisfy their United States and Virgin Islands income tax obligations arising under Chapter 1 of the Code (as applicable in each jurisdiction) by filing a single return with, and paying to, the Virgin Islands the Virgin Islands territorial income tax (the Code as mirrored into the Virgin Islands) on their income from all sources. *See* Rev. Rul. 60-291, 1960-2 C.B. 407.

Section 28(a) of the R.O.A. defines "inhabitants of the Virgin Islands" as all persons whose permanent residence is the Virgin Islands."

A United States corporation can qualify as an inhabitant of the Virgin Islands because (1) under section 7701(a)(1) of the Code, the term "person" includes a corporation, and (2) in adopting section 28(a), Congress rejected an attempt to limit the definition of "inhabitants of the Virgin Islands" to — "U.S. citizens" instead of "all persons". *See* Conf. Rept. No. 2105, 83rd Cong., 2d Sess. 22 (1954). Also, section 934 of the Code and section 1.934-1(b)(3) of the regulations operate on the assumption that a United States corporation can qualify as an inhabitant of the Virgin Islands. *See* S. Rept. No. 1767, 86th Cong., 2d Sess. 3 (1960).

In the present situation, all of the officers and some directors of *S* are Virgin Islands residents. All significant business operations, shareholder meetings, and Board of Directors meetings are conducted in the Virgin Islands, and *S* meets the percentage tests of section 934(b) of the Code. In addition, *S* is carrying on a trade or business in the Virgin Islands within the meaning of section 864(a). This is sufficient to constitute *S* a permanent resident, and therefore an inhabitant, of the Virgin Islands for purposes of section 28(a) of the R.O.A.

The United States does not tax a foreign corporation on its non-United States source income that is not effectively connected with the corporation's conduct of a trade or business within the United States. See sections 881(a) and 882. Therefore, under an exact mirror system, non-Virgin Islands source income that is not effectively connected with a United States corporate inhabitant's conduct of a Virgin Islands trade or business would escape territorial income tax since the inhabitant is considered a foreign corporation by the Virgin Islands. However, Congress, in section 28(a) of the R.O.A., made it clear that such income of inhabitants of the Virgin Islands would not escape taxation by using the words "paying their tax on *income derived from all sources both within and outside the Virgin Islands* into the Treasury of the Virgin Islands" (emphasis added). Thus, in effect, *S* is taxed as if it were a Virgin Islands corporation and satisfies both its United States and Virgin Islands income tax obligations by paying the Virgin Islands territorial income tax on its income from all sources. If *S* fails to file a return or pay tax on its income from all sources to the Virgin Islands, then *S* does not satisfy its U.S. tax obligations.

LAW AND ANALYSIS – ISSUE (2)

Under section 243 of the Code, a deduction is allowed for dividends received from a domestic corporation that is subject to taxation under Chapter 1 of the Code.

As a domestic corporation, *S* is still subject to taxation under Chapter 1 of the Code as applicable in the United States. Section 28(a) of the R.O.A. merely requires *S* to satisfy this obligation by paying income tax to the Virgin Islands on *S*'s income from all sources. Thus dividends paid by *S* are not excluded from qualifying for treatment under section 243 when received by *P*.

HOLDINGS

1. *S* is treated as an inhabitant of the Virgin Islands and must satisfy its United States and Virgin Islands income tax obligations by paying tax on its income from all sources to the Virgin Islands.

2. *S* is a domestic corporation for purposes of the dividends received deduction of section 243 of the Code.

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TAX GLOSSARY

by H.W.T. PEPPER *

SPORTING TAXES — In the U.S.A. an 11 percent Federal Excise tax is imposed on bows and arrows and associated equipment — in essence, a tax on hunters and sportsmen to help finance wild life preserves. Bows and arrows are increasingly used to hunt game, as being more "sporting", and less likely than firearms to eliminate the game altogether. In the U.K. there was at one time an exemption of participation sports, such as cricket or football, from entertainment tax on admission money, which the tax was, however, levied on other types of entertainment.

SPOUSE ALLOWANCE — In personal income tax systems it is customary to grant larger RELIEFS (q.v.) to married couples than to a single person. Whether a man supports a wife, or the wife is the breadwinner, the higher relief would apply to the joint income. See also INCOME-SPLITTING, RELIEFS.

SPREADING — A number of countries permit the spreading over a limited period of years of exceptional income earned within a short time, e.g. by writers, international sports stars, etc., who may earn high incomes only for a small part of their careers. Canada allows farmers (including racehorse owners and fishermen) to average their incomes over a five-year period, authors who have spent over 12 months on a manuscript may spread income over two or three years, and there are somewhat similar provisions in the U.S.A. and in the U.K.

SPRINKLER TRUST — The term used in the U.S.A. for a discretionary trust, i.e. a trust in which the trustees have absolute discretion to distribute the trust income in any proportions among the beneficiaries. As the beneficiary has no specified income or interest in the trust's assets, special legislation is usually necessary to counter the tax avoidance element in the arrangement.

STAGGERING OF TAX PERIOD — See PAYMENTS, SPREADING OF; SPREADING.

STAMP DUTIES — Duties, formerly — and in some cases still — paid by pre-purchase of Government stamps which are fastened by adhesion to the documents representing the dutiable transaction. Traditionally, stamp duties were charged upon legal documents such as contracts, deeds, receipts, cheques, and the conveyance, or transfer of ownership of property. Many countries have now abolished (a) minor levies on transactions and/or (b) the use of stamps in taxing those transactions which yield worthwhile revenue, although still collecting the duty by more modern methods.
In Italy, which retains many stamp taxes, deeds must be drawn up on specially stamped paper (carta bollata) obtainable from specially licensed shops. (See also FORMS, TAX, and TELEVISION LICENCE FEES.)

STAMP TAXES — See STAMP DUTIES.

STANDARD DEDUCTION — A device in the U.S.A. tax code (and previously used in Canada) whereby a taxpayer instead of detailing various minor deductions could opt instead for a "standard" deduction of 15 percent of gross income, up to a maximum deduction of $10,000, a useful administrative short-cut. The system has now been superseded by the ZERO BRACKET AMOUNT (q.v.). (See also OPTIONAL TAX.)

STANDARD INDUSTRIAL TRADE CLASSIFICATION (S.I.T.C.) — The classification of goods adopted by the United Nations for the compiling of statistics on international trade.

STANDARD RATE — In the U.K. income tax system a "standard rate" of 30 percent is currently (1979/80) applied to a broad band of taxable income in the graduated rate scale of personal income tax, and is also the rate at which ADVANCE CORPORATION TAX (q.v.) is payable, and the rate at which tax is deducted at source from dividends, interest, royalties and other sources liable to withholding.

STATE TAXES — See LOCAL RATES; TAXES.

STATUTE OF LIMITATIONS — In some countries, a general statute of limitations may apply for various purposes in connection with the administration of taxes. In Japan there is a three-year time limit on the tax authorities to determine or make corrections in a company's or an individual's tax liability. In case of fraud the limit is extended by a further two years, and taxpayers have a five-year period in which to claim adjustments. In the U.K. there is a six-year time limit for the Revenue to make additional assessments and for the taxpayer to claim refunds, but the six-year limit does not apply for additional assessments in cases of tax fraud. The position varies from country to country as to the actual time limits for Revenue and taxpayer claims.

STATUTORY BOOKS AND FORMS — For the purpose of administering various types of tax, the tax law may require a taxpayer's books to be kept in a certain prescribed form (in some cases the books have to be purchased from government publishers or produced by private publishers to government specifications) in order to facilitate official checking of the taxpayer's records. The forms on which income, capital, sales, etc., must be declared for tax purposes are almost invariably printed by the relevant tax department for completion by the taxpayer. The exception, since the development of data processing, is that where a business uses some form of such processing it may be permitted to render some of the information required for tax purposes in the form of the output of its mechanical or electronic equipment, which may incidentally, in some instances, be compatible with the input requirements of the tax department's own equipment.

STEUERBELASTUNG — (Germany) Tax burden.

STEUERFLUCHT — (Germany) Tax exile, i.e. removal to another country (e.g., a TAX HAVEN, q.v.) to escape or reduce tax liability in the former country.

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STEUERGUTSCHRIFT — (Germany) See AVOIR FISCAL.

STEUEROASENLÄNDER — (Germany) Tax havens (tax oases).

STEUERPFLICHT — (Germany) Tax liability.

STEUERPFLICHT, BESCHRÄNKTE — (Germany) Limited tax liability, e.g. for non-residents.

STEUERPFLICHT, UNBESCHRÄNKTE — (Germany) Unlimited tax liability.

STOCK DIVIDENDS — See BONUS SHARES TAX.

STOCK OUTIL — (France, Belgium, Luxembourg) BASE STOCK (q.v.) valuation method.

STOCK RELIEF — Because of the increased cost of financing the holding of business stocks and inventories owing to the impact of monetary inflation, provision has been made, e.g. in the U.K. tax law, for "stock relief". In the U.K. the relief, broadly, consists of a deduction of the increase in stock value over the accounting period, less 15 percent (formerly 10 percent) of the income from trade in that period. Where the value of stocks *diminishes* over any subsequent accounting period there is a RECAPTURE (q.v.) or recovery of relief previously given to the extent of the fall in value, or the unrecovered past relief, whichever is less. The relief is regarded as a deferral of tax, not a permanent reduction in liability.

STOCK VALUATION — The stock-in-trade or inventory of a business has to be valued for tax purposes in accordance with certain rules which usually coincide with those adopted in ordinary commercial practice and in any Companies Act or Commercial Code. Briefly, the main rules are that the same basis should be adopted at the beginning and end of the accounting period, that the stock may be valued at cost or market value, whichever is the lower, and that this basis may be applied to each individual article of stock, that reserves against possible future devaluation of stock cannot ordinarily be allowed, and that the FIFO (first in first out) method of valuation should be used. Some countries allow different bases of valuation, and exceptions to the above rules, but usually only do so on the basis that whatever approved basis is adopted should be applied consistently in subsequent years. Where the value of stock is of importance for sales taxation, similar principles would apply. The quantum and value of stock may also be of significance in a transition from one type of sales tax to another, if the stock in hand has been subjected to the old tax and it is desired to allow a rebate in respect of this tax against the liability under the new tax, which may arise when the goods are sold (see also BASE STOCK, STOCK RELIEF).

STOOL TAX — Small, flat-rate levies on those owing allegiance to a particular chieftain (named after the ceremonial stool, or throne of the chief) to provide the necessary revenue for local administration (see also HUT TAX, GRADUATED POLL TAX).

STRAF (FOR URIGTIG SELVANGIVELSE — (Denmark) Penalty (for false return).

STRAIGHT LINE DEPRECIATION — The method of calculating depreciation for income tax purposes on qualifying assets (in contrast to the REDUCING BALANCE METHOD, q.v.) whereby the annual allowance is based on a percentage of the original cost, ignoring subsequent wear and tear of devaluation of the asset.

STUDENT, WORKING — See WORKING STUDENT.

STUMPAGE — A royalty or other charge made by the owner of standing timber, usually calculated on the volume of usable timber removed from the forest or woodlands by the timber contractor.

SUBPART F — A major anti-avoidance provision in the U.S.A. tax code, relating to the income of foreign corporations which are controlled by United States shareholders. Section 951 provides for the inclusion in U.S.A. tax liability of Subpart F income which includes undistributed income of foreign (controlled) corporations.

SUBSIDY — The term previously used to refer to a tax which produced revenue for the monarch in Britain. "Subsidy" nowadays usually refers to a government grant rather than taxation.

SUBSTITUTE INHERITANCE TAX — The tax charged in some countries on "legal persons" who, not being mortal, are not subject to ordinary death or inheritance taxes. The tax usually takes the form of a small annual tax on capital.

SUBVENTION PAYMENTS — Payments made by one company to an associated company which, because of trading losses or for other reasons, requires financial support. In British tax law such payments may now be deducted by the paying company in computing its profits and will represent income to be brought into the calculation of profits of the receiving company.

SUCCESSIERECHT — (Holland) Succession duty.

SUCCESSION — On the takeover of a business by a new proprietor, the newcomer is usually treated as commencing a new enterprise. In the case of company takeover, however, where the shares change hands but the company remains in existence, the change in ownership may in certain circumstances be disregarded in computing the tax liability of the new proprietors. The matter is of importance in that the business may have incurred losses which may be available to the new proprietors and may thus be a factor in encouraging the salvage of a declining business by new entrepreneurs.

SUCCESSION, DROIT DE — (Belgium, France, Luxembourg) Succession duty.

SUCCESSION DUTIES — Duties chargeable upon assets passing to the successors of a deceased person (see also ESTATE DUTY, LEGACY DUTY). Such duties are usually graduated by reference (a) to the degree of CONSANGUINITY (q.v.) of the heir, and (b) to the size of the inheritance.

SUCCURSALE — (Belgium, France, Luxembourg) Branch establishment.

SUM-OF-THE-YEARS'-DIGITS METHOD OF COMPUTING DEPRECIATION — This method of computing depreciation is one of the options open to taxpayers under the U.S. tax code. the SOYD method concentrates larger allowances in the early years of the working life of an asset. If the life is estimated at ten years, the digits for each of the ten years are added, i.e. 10 + 9 + 8 + 7. . . . + 1 = 55 and the allowance for the first year is 10/55, year 2 allowance is 9/55, and so on to 1/55 for the tenth year.

SUMPTUARY TAXES — Indirect taxation charged upon luxuries.

[to be continued]

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- Dr. Wenzel (German Federal Republic) on the practical problems resulting from the recent reform of the German VAT system especially with a view to transactions with Austria;
- Dr. Bechinie and Dr. Halpern from Austria and Dr. Willemsen from the German Federal Republic discussed the current tax situation in their countries with Dr. Bechinie paying special attention to the work of the Austrian Tax Reform Committee which completed its task a few months ago;
- Dr. Miehler and Dr. Menck from the German Federal Republic and Dr. Huber from Austria reported on the current situation with respect to the exchange of information between the tax administrations of the two countries.

More detailed information is to be found in the German language in *Internationale Wirtschaftsbriefe* of June 10, 1980 at 343.

National meeting of the Swiss Branch on June 20, 1980 in Zurich

On June 20, 1980 the Swiss Branch of IFA will hold its 30th national meeting in Zurich. Subject of discussion will be the taxation of annual rental value of real property and incentives for the acquisition of owner-occupied dwelling houses.

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SCHEDULAR AND GLOBAL SYSTEMS OF INCOME TAXATION:

THE EQUITY DIMENSION

by Sylvain R.F. Plasschaert*

I. INTRODUCTION: DEFINITION OF SCHEDULAR, GLOBAL AND MIXED SYSTEMS

The present paper is part of a broader enquiry into "schedular, global and mixed systems of income taxation", with particular reference to developing countries. Other policy-oriented chapters compare the schedular and global prototypes of income taxation with respect to their likely economic effects and their administrative feasibility and efficiency.

In order to render this paper self-contained, the reader is reminded of the following fundamental concepts.

In a *schedular* income tax system, each of the various *incomes*, such as salaries, dividends or business profits, that flow to a particular taxpayer, is subject to a separate tax. In other words, the schedular system of income taxation consists of a co-ordinated set of separate taxes on various types of *income*.

In a *global* income tax, all (partial) *incomes*, from whatever source derived, that accrue to the same taxpayer, are taxed jointly as a single mass of *income*.

A *mixed or composite* system consists merely of a set of schedular taxes and of a global-type tax. Thus, a mixed frame of income taxation is not original, structurally speaking. In a mixed system, a "complementary" global tax is superimposed on a schedular system.

The separate or aggregate taxation of income carries some implications for the design of the income tax. Thus, in a coherent or "rational" schedular system, in which the basic tenets that underly the schedular approach would be scrupulously adhered to, each type of income ought to be taxed, without any reference to the personal circumstances of the income-recipient. In other words, the schedular tax system essentially has an objective character. Each "schedule" carries a flat or proportional rate; capital incomes are subjected to a higher rate than incomes from labour. In "rational" global-type systems, on the contrary, such reference or personalization is quite appropriate, as are progressive rates.

In actual "empirical", or "historical", tax systems, however, there are numerous deviations from the parameters and rules, that would follow from the uncompromising application of the underlying paradigms of the respective schedular and global systems.

The present paper discusses the equity aspects of the schedular or global tax systems, but contains no analysis of the merits and drawbacks of the mixed or composite system.

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II. IN GENERAL: PROGRESSIVE AND PROPORTIONAL FORMULAE

The equity dimension is of overriding significance for any tax system and any particular tax. Explicit or implicit equity standards determine how the tax burden is apportioned over the taxpaying subjects. The latter will only psychologically and politically accept the tax if the overwhelming majority of the citizens view the tax as equitable — unless all opposition or disagreement is forcibly suppressed.

Unfair taxes are morally repulsive. But one must admit that the concept of tax equity is elusive and value-infected and owes more to ethical considerations and political judgements than to unassailable scientific guidelines.

The burden of the income tax is distributed over the taxpaying units, through tax formulae, which are applied to the statutory taxable base. One distinguishes a regressive, proportional or progressive rate — more commonly, a series of rates — according to whether the tax liability rises more slowly, at the same pace or faster than the taxable base. In somewhat simplified form, progressive taxes take an increasing share of income as the latter rises. By definition, in a progressive rate formula and provided progressivity is maintained over the whole range of taxable income, the marginal rate (the tax rate on additional units or brackets of taxable income) exceeds the average rate of income tax. Under those circumstances, the marginal rate will rise (from zero on the first, untaxed bracket) to the top marginal rate, say 60 percent or 80 percent, which is still held applicable.

There is no need to investigate the various conceivable slopes of a set of progressive rates. Suffice it to say that in most actual tax systems, the marginal — and hence, the average — rate does not rise in a steady, but in a discrete or non-continuous fashion: the given marginal rate applies to a given segment or bracket of the income ladder — as explained, a moment ago. Besides, the combination of flat rates with an initial exemption on the first bracket of income results in the so-called Bentham progression. For example, if a 30 percent flat rate applies to taxpayers A, B and C, with an income of respectively $ 2,000, $ 10,000 and $ 30,000, and if all three taxpayers enjoy an initial exemption of $ 2,000, the average tax ratios, as a percentage of the above-mentioned income levels, will amount to respectively zero for A, 24 percent for B and 28 percent for C. This indirect form of progression is also called the "degressive" progression, as the percentage tax "saving" resulting from the initial exemption declines as income increases.[1]

Rate formulae such as progressive rate schedules or proportional rates are only technical parameters. While, conceivably, rates could be assigned at random to various types or levels of income, neither the citizens nor the legislators would accept the resulting chaotic interpersonal distribution of tax burdens. The latter must reflect well-established and widely-accepted tax equity principles which are implemented through appropriate tax formulae.

In schedular tax systems, by definition, each category of income is taxed separately and made subject to a tax rate. Historically, the schedular compartmentalization has been rationalized in the light of the "quantitative discrimination" principle, according to which each schedule should carry a flat rate: those rates, however, must be differentiated according to the nature of each of the incomes, with incomes from capital being subjected to a distinctly higher flat rate than earnings from labor inputs. Global systems, on the other hand, utilize progressive tax formulae.

A simplified outline of the diverging distributional pattern of tax burdens over the various taxpayers is shown in Figure 1. The schedular system carries a 20 percent flat rate on labour income, and a 40 percent rate on incomes from capital, whatever the level of such incomes. The global tax carries a discrete progressive formula, whereby there are five brackets. The first slice of income is exempted, or, in other words, is subjected to a zero rate. The (marginal) rate schedule on each of the following brackets of taxable income starts with 10 percent and rises by 20 percent for each of the subsequent brackets of income, to reach a final marginal rate of 70 percent. In progressive formulae the marginal rate rises faster than the average one. A dotted line shows how, in this particular case, the average rate rises over the income spectrum.

This graph is purely hypothetical and highly simplified. Two particular preoccupations should be noted. First, whether the two systems would yield the same amount of revenue would depend on the underlying distribution of incomes. We hypothesize here that such equal-revenue distribution exists; this would probably require that, as in the graph, few exemptions would be granted, not even on labor incomes. Second, in order to avoid some distortions, to be discussed in section VI, theoretically all exemptions for low-income levels in the categories of the schedular tax should be barred; however, the equity arguments in favor of a zero rate on such low-income brackets have proven quite strong in historical tax systems. Hence, the dotted line over the first stretch of the horizontal lines which depict the flat rates, respectively, on capital and labor income.

In this chapter, we first evaluate the basic rationales which have been adduced to support the above-mentioned interpersonal[2] distribution of tax burdens in the two systems.

---

1. In this case, progressivity emerges when the resulting average tax rate is related to "taxable income gross of the allowance". It would be wrong to infer that the tax burden is thereby unjustifiably lowered. The statutory rates must apply on statutory income. Modern income taxes contain a basic allowance. Hence, the tax formula should only hit "income net of the allowance". But an unwarranted decline, in equity terms, in the effective rate, as against the nominal (30 percent) rate, would result if each of the taxpayers were to evade US$ 2,000 of statutorily taxable income.

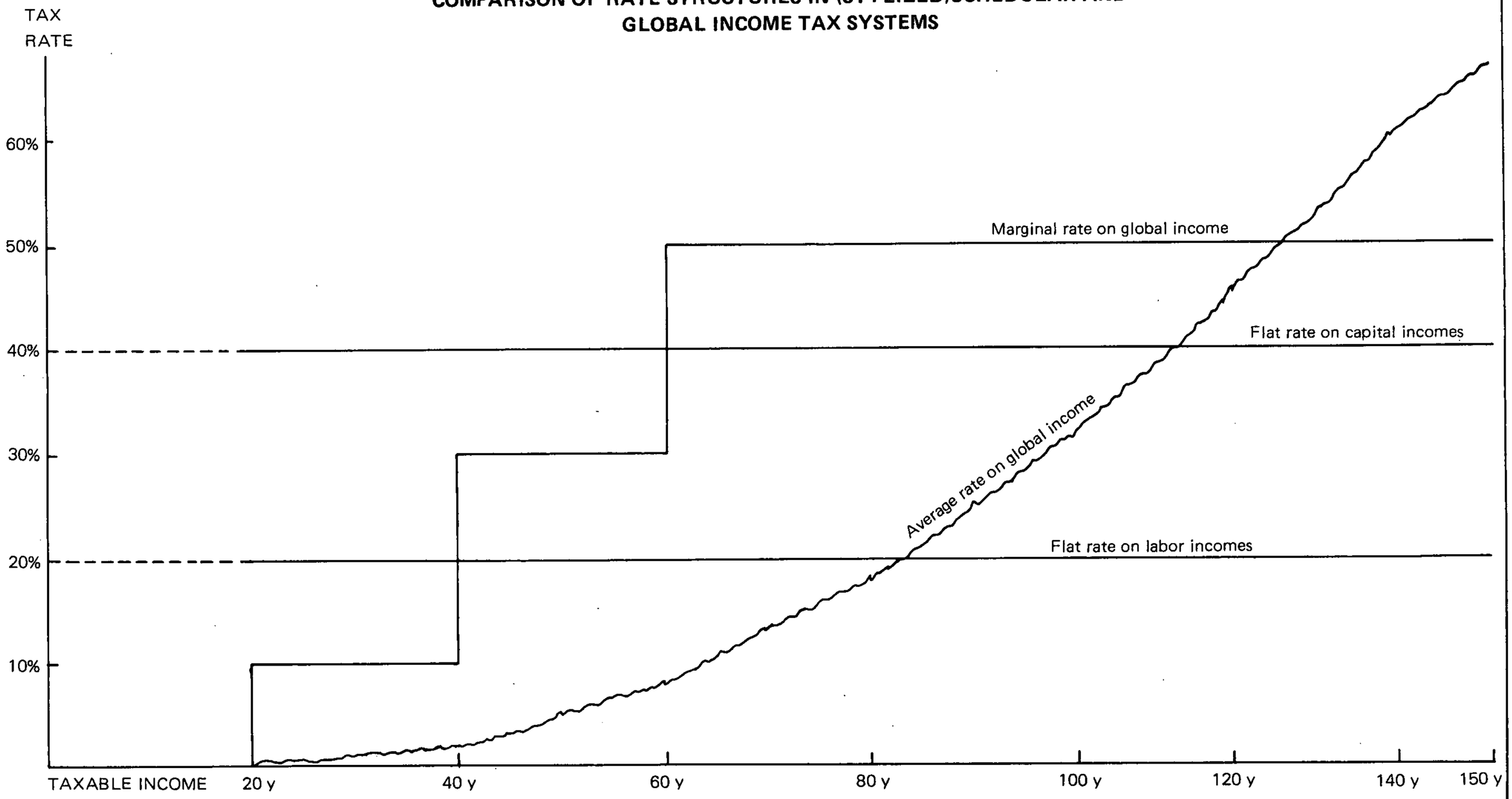
2. We abstract, in this paper, from the rather complex problem, whether individuals or households must be viewed as proper taxable subjects, and from the impact which a separate tax on corporate net profits may have on the interpersonal distribution of income.

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FIGURE 1

COMPARISON OF RATE STRUCTURES IN (STYLIZED)SCHEDULAR AND GLOBAL INCOME TAX SYSTEMS



In section VI, we revert to tax formulae and examine whether progressive rates which would reflect both the ability-to-pay principle and the socially recognized objective of some (relative) redistribution of income can be rationally built into a schedular income tax system.

In section VII, we ascertain whether, to what extent and why, numerous structural "impurities" have emerged in "historical" tax systems.

Finally, we venture some comments as to the question whether the schedular approach, based on the qualitative discrimination doctrine, which is found to be no longer appropriate for present-day developed economies, could be advocated for low-income countries.

III. THE QUALITATIVE DISCRIMINATION THEORY

This theory, which holds that incomes from capital should be taxed at higher (proportional) rates than incomes from labor, was elaborated long ago, especially by Italian scholars of public finance.[3] Equally, Italy is probably the country where the tenets of the doctrine were fairly consistently observed until the mixed system was replaced by a global one in 1974. In principle, the flat rates which apply to the various schedules are arranged in such a way that the tax is higher as a given type of income originates more in capital assets and less in labor inputs.

A look at the Italian income tax system prevailing in the early 1960s may serve as an illustration. There were, first, two separate taxes on the return from land and buildings. The assessment was in essence based on the cadastral system; the flat rates were respectively 10 percent and 5 percent. The most important schedular tax, however, was the "imposta sui redditi di ricchezza mobile", which, in turn, was subdivided into several categories:

— category A: on incomes from financial assets, subject to a 26 percent rate, withheld at the source (dividends, however, were exempted in this category, as they were taxed as part of business profits, in category B);

— category B: on "mixed" incomes, deriving from the inputs of both capital and labor, i.e. basically on business profits. The law distinguished between joint-stock enterprises and unincorporated units. The former carried flat rates of 18 percent for the slice of taxable profits below 10 million lire, and of 24 percent above that cut-off point. Individual business-men, however, enjoyed a personal allowance of 240,000 lire; the rate was 9 percent for the income between 240,001 and 900,000 lire. Above that level, an 18 percent rate applied;

— category C1: on earnings of professionals. The first slice of 240,000 lire was exempted, the 240,001-960,000 lire bracket carried a 4 percent rate and the remainder an 8 percent rate;

— category C2: on wages and salaries. They were subject to withholding at the source at the same rates applicable to the earnings of professionals in category C1;

— income from agricultural activities, accruing to the owner of the land, were taxed, according to the cadastral system, at 10 percent. Those incomes were not entitled to personal allowances (income from tenants was subject to category B).

Preferential treatment of labor income

A number of arguments have been advanced in support of the preferential treatment of incomes from labor over those from capital. The main argument is that labor earnings have less lasting power as, contrary to capital incomes, the flow of labor earnings may be interrupted by layoffs or by illness; even more importantly, the employment period comes to an end. In order to sustain his living during the retirement period or other periods of interrupted income flows, the worker must set aside a reserve fund out of his current income. The income stream from capital assets, on the other hand, is permanent and more regular as to its amount. In other words, nominally equal incomes from capital or labor are not equivalent in the economic sense. Equivalence can be restored, or aimed at, by way of subjecting incomes from labor to a lower (flat) rate — or, what amounts to the same, through surcharges on incomes from capital. It has also sometimes been argued that, objectively, capital embodies more "capacity-to-pay" than labor. Since, however, not objects but persons pay taxes, it appears more appropriate to use the expression "capacity-to-pay" in a more subjective setting, as discussed in the next section.

This argument can easily be faulted in terms both of principle and of present-day circumstances. Whether the stream of labor income is actually more vulnerable than capital income to interruption or termination is basically an empirical question. In *developed countries*, nowadays, almost all salaried employees and workers benefit from a comprehensive scheme of social security. The latter provides cash payments, in case of termination of labor and the payment of pensions in old age; the widow is also entitled to a pension. Medical expenses of some importance are reimbursed; unemployment payments of income compensate loss during periods of involuntary unemployment. The social security systems transcend the principle of personal insurance, whereby each person would only be entitled to benefits on the basis of and in proportion to his own contribution. As a matter of fact, the social security approach pools risks, with subsidies from the government budget frequently filling any shortfall of the contributions made by employers and employees.

It is fair to say that the present situation in developed economies with respect to the termination and inter-

3. One may mention particularly *L. Einaudi, Principi di Scienza della Finanza*, 4th edition (Turin, 1949) and *E. d'Albergo, Economia della Finanza Pubblica*, vol. I (1951). For a brief survey of the arguments involved, see *C. Brasca*, "La discriminazione fiscale a favore dei redditi di lavore", *Rivista internazionale delle scienze sociale*, July-August 1955, pp. 322-40. We do not at all imply, of course, that Italian writers have a monopoly on the subject, which has exercised the minds of many great economists, such as *J. Stuart Mill*, as early as the middle of the previous century.

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ruption of labor income differs completely from that in the second half of the 19th century, when the qualitative discrimination doctrine was being formulated. The benefits, distributed nowadays through the social security system, provide a substantial cushion against the loss of income resulting from the occurrence of the above-mentioned risks. Unemployment is also covered by the system. There is factual evidence that employers, in business cycle downturns, do not easily dismiss workers lest they may have difficulty in hiring them back when the economy picks up again. Besides, in several countries, lay-offs by employers involve substantial severance payments. In sum, incomes from salaried employment have become "funded" to quite an extent. Furthermore, contrary to the assumption implicit in the above main argument in favor of the discrimination principle, employee contributions are almost everywhere tax deductible. Self-employed persons, however, are clearly much less protected by the social security system; for one thing, by definition, they face the risk of periods in which they earn no income, for lack of customers: hence unemployment coverage is inconceivable for them.

It is not quite true that incomes from capital are immune against nominal or real losses. Equity investments, by their very nature, involve the risk of loss of substance; over the last inflation-ridden decade, in many countries, investments in shares appear to have been less well protected against erosion than wages, the more that the latter have widely become index-linked. The share of labor in national income has increased in most developed economies during the 1970s. The yield from fixed-rate financial instruments had trended upwards but the additional nominal yield has usually only partially compensated for the rate of inflation.

Admittedly, in *developing countries* the situation differs significantly from that in high-income countries; there also exists considerable variation amongst countries in the developing world. On the whole there is some tendency towards the extension of social security benefits to a larger number of beneficiaries. Pension benefits have been legislated for in many countries, although mostly only for public sector employees. Coverage of health hazards is rare; large segments of the population, especially in rural areas, may have almost no access to modern health services. Unemployment benefits are also non-existent and, if available at all, restricted to the private modern sector. One must also remember that in developing countries time-honored informal systems of social security exist, whereby extended families, or clans, display a significant degree of solidarity and provide needy persons, such as the elderly or unemployed, with the means to subsist. Thus, the social security system, at best, metes out modest benefits to the workers who happen to be employed in the "organized" industrial sector; a "reserve army" of un- and underemployed threatens the stability of employment in the modern sector and exerts a downward pressure on the wage level. And yet, those workers in the modern manufacturing sector often are better off, both in terms of income and of job stability, than the mass of poor peasants. In any event, the level of per capita income, the structure of employment — with most people in the agricultural sector — and the wide incidence of un- and underemployed persons would render the financing of a modern, comprehensive scheme of social security utterly untenable.

The "lasting power" argument has only limited validity

Is the "lasting power" argument, in favor of the doctrine of qualitative discrimination, still relevant to the developing world of our days? To the extent a general answer is warranted, considering the large divergence in actual circumstances, the case for discrimination between the two sources of income, on the basis of the above argument, is clearly a very weak one. Those who earn a comparatively high income from labor in the modern sector, such as business managers, physicians or upper-rank government officials, have sufficient means to contract insurance against the major risks and to build up a pension for their old age; salaried people in the lower-ranks can also frequently benefit from old-age pensions that are fed by their own contributions and those of their employers. But in both cases, the rationale advanced in support of the lower tax burden on labor incomes, i.e. the need to set aside reserves, which should receive preferential tax treatment, is fulfilled by way of the deductibility of the contributions of employees (and employers). Low-income recipients, such as the large numbers of self-employed peasants, artisans, and unskilled workers in urban areas without security of employment, should, by virtue of the above argument, be entitled to a lower tax burden. Yet, in the light of sound equity and administrative considerations, such low-income recipients of labor incomes remain generally outside the income-tax net in developing countries.

But, even assuming that taxable labor incomes are substantially subject to interruption and/or termination, there is a more fundamental reason why the above line of reasoning is flawed. In order to form a private retirement or unemployment fund, the wage earner must set aside a portion of his current income. Although there is still considerable disagreement among economists about the determinants of savings — which comes as no surprise, considering the variety of the motivations, and of the behavior of households — the level of the overall income of households is obviously a major, and almost certainly the main, determinant of the saving ratio.

It follows that it would hurt generally accepted norms of justice if one were to more heavily impose on an old widow who lives parsimoniously off a small securities portfolio than on the well-paid executive, by virtue of the argument that capital income requires a higher tax rate than on earnings from labor.

In essence, the lower tax urged for the "reserve fund" is predicated upon the same considerations that underly various personal allowances (such as those for dependents) which are nowadays part and parcel of the modern income tax: a portion of current income is not freely disposable but must be set aside to meet pressing, unavoidable outlays and contributions towards the re-

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serve fund qualify for exemption or preferential tax treatment. But, even admitting the above argument, the benefit of a lower tax burden should only be granted to that portion of labor incomes which is required to form the reserve fund, not to the taxpayer's total income from labor, irrespective of the level of the latter.

It also follows that the preferential treatment on labor incomes can technically be accommodated more appropriately, within a global tax system, through a specific allowance for earned income than through a lower flat rate in the relevant category of the schedular tax system. The first approach acknowledges the level of overall income and of the capacity for saving, whereas the latter procedure does not.

Other arguments for qualitative discrimination

Other arguments are also held in support of qualitative discrimination.[4] Thus it is claimed that the earner of income is exposed to more costs of production than the "capitalist" who "lives on his rents". Costs must be incurred to build op professional skills or, in the contemporary parlance of economists, "human capital" must be accumulated before one actually earns income from labor. It is also stressed that labor, although a deep-seated vector of man's creativity, involves effort and toil, whereas the clipping of coupons is a painless act. To obtain earnings from labor, one must exert eight or more hours of work, whereas capital produces a yield "while one sleeps".

Those arguments in favor of labor incomes do not cut much ice, either. Truly, educational costs are involved to build up skills, but, as the Meade Report observes, if one follows that line one should also hold taxable the "rents" and "capital gains" out of improved "human capital".[5]

The reference to the painful character of labor could be construed in welfare-theoretic terms. The person who lives on capital incomes can indulge in leisure, an untaxed component of welfare, whereas leisure is incompatible with the exertion of labor; the lower tax burden on labor income would then somewhat offset the impossibility to enjoy leisure. One must remark, however, that most people probably would prefer activity over permanent idleness; human beings yearn for life's blessings, but are also moved by creative urges.

Is there then no argument that gives sufficiently strong backing to the "qualitative discrimination" theory? And how can one account for the fact that, despite the weak reasons traditionally submitted in support of that doctrine, almost all actual systems, in one way or another, impose capital incomes more stringently than earnings from labor? [6] It would seem to us that a fairly strong case can be constructed along the following lines. First, usually, income from capital is complementary to earnings from labor inputs; few are the people — if one excepts retired ones benefiting from official or private pension plans — who can afford to live without working; the more basic needs of households can, in most cases, be met by the incomes from labor; purchasing power derived from capital assets would then create scope for spending on less essential goods and services. Also, wealth begets income which in turn allows wealth to accumulate. And, apart from income, wealth undoubtedly provides a supplementary yardstick of (subjective) "capacity-to-pay" (taxes). As a matter of fact, if two persons obtain $ 50,000 per year from labor and capital, respectively, the latter is clearly better off; besides enjoying the income flow, he maintains a store of value. Wealth also affords prestige and status; it allows better access to credit facilities. Finally, one must not overlook that wealth typically is not held by widows of little means. Available data on, for example, the United States and France, show that the ownership of shares, and to a lesser extent of bonds and real estate, is heavily concentrated in the upper-income ranges of the income pyramid. It follows that when capital incomes are systematically discriminated against in schedular systems of income taxation, one approximates, albeit in a rough fashion, the vertical interpersonal distribution of tax burdens, which is intended in global-type systems and which subjects income-rich(er) persons to a higher average tax burden than their poor(er) countrymen. The argument, clearly, also has ethical overtones; in this connection, we may notice that the expressions "earned" and "unearned" (incomes) stand for "funded" and "unfunded" incomes, and carry the connotation of respectively "meritorous" and "undeserved".[7]

Those considerations give support to the case for treating incomes from labor more leniently than those from capital. But they do not postulate that income from capital be discriminated against by way of specific tax schedules, carrying different flat rates. Besides, the schedular approach to qualitative discrimination runs into a host of practical difficulties. Capital and, even more, labor are not homogeneous categories of income, neither in developed nor in low-income economies. Hence, more sub-schedules would be required to differ-

4. We have refrained from discussing the argument based on the so-called "double taxation of savings", first as a component of income and, subsequently, when the investment produces a yield. This question has, since J. Stuart Mill, been part of the "qualitative discrimination" issue and has provoked an inordinate amount of learned controversy. The topic, however, is not relevant to our study. The thesis, if accepted, would posit preferential treatment of incomes from capital; it can be adduced as an argument for a tax on expenditures but there is now general recognition that, within the income tax, the yield from the investment is a new income item whose taxability cannot be questioned.

5. "The Structure and Reform of Direct Taxation *(Meade Report*, 1978), p. 39.

6. The higher burden on income from capital as compared to labor earnings in an equal amount is attributable not only to (a) differentiated flat rates, (b) allowances for earned income or surcharges on income from capital, and (c) a separate tax on net wealth but also to the corporate profits tax, the existence of which, alongside an individual income tax, involves an extra burden on income from capital.

7. Marxist views, alleging that the capitalist's income is exploitative and, hence, is undeserved as it appropriates "Mehrwert", produced by the workers, may have contributed towards shaping the connotation of undeservedness of capital income.

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entiate between skilled and unskilled labor; self-employed and "other"-employed persons; dividends and interest. Several of those distinctions are actually to be found in schedular tax statutes. Furthermore, the category of business profits presents rather stubborn problems. Especially in family-type, small enterprises, inputs of labor and capital by the same persons are intimately intertwined. Procedures such as those used in Morocco, whereby, for purposes of applying the schedular tax on business profits, a first slice of income is deemed to be derived from labor and is subjected to a comparatively low rate, remain rather rough artifices. Especially in segmented low-income economies, the capital-labor ratios may differ dramatically between, for example, the traditional handloom and the modern textile mill; in strict adherence to the principles of the schedular system, these two classes of business should receive a different tax treatment. Finally, there is no scientifically convincing yardstick which determines to what exact degree capital income should be taxed more severely than earnings from labor of some amount, or, in other words, by how much the flat rate on capital incomes should exceed that on earnings from labor.

In sum, the case for a schedular system, predicated upon the "qualitative discrimination" doctrine, is — or more exactly, has become — particularly weak, especially as far as developed countries are concerned. The basic idea which underpins the "qualitative discrimination" theory, viz., that labor incomes ought to be burdened less, has, however, remained politically forceful. But to implement such a principle, it appears by far preferable to take into account not only the nature of incomes, but also the level of total income; this would advocate the granting of an allowance for earned incomes within global systems. Furthermore, wealth, besides income, provides an additional yardstick of taxable capacity. It follows that a net wealth tax is an appropriate way of reaching the taxable capacity embodied in wealth. In countries where this type of tax is politically not feasible or would not be efficiently implemented, such discrimination against capital incomes as exists in income tax systems may function as a second-best substitute for a net wealth tax.

We reached a rather negative conclusion about the suitability of the schedular system to "qualitatively discriminate" between capital and labor incomes. Besides, the underlying theory clearly cannot possibly provide the only criterion for apportioning the tax load. More specifically it appears advisable to account for the relative levels of total income. Our findings, however, should, at this juncture, not be interpreted as a wholesale indictment of any schedular approach to income taxation. Conceivably, rate discriminations between various categories of income may be consonant with acceptable or advisable tax principles, other than the "qualitative discrimination" doctrine.

IV. THE ABILITY-TO-PAY CRITERION AND THE PROGRESSIVITY ISSUE

The criterion which states that each taxpaying unit must contribute to the goverment's purse in accordance with its relative capacity or ability-to-pay (taxes) has become solidly entranched in tax practice and in tax philosophy. It is also generally claimed that, in order to modulate the interpersonal income tax burden, according to the ability-to-pay, a progressive rate formula is in order. Although the arguments in favor of progressivity remain intellectually somewhat weak and although the issue is readily contaminated by explicit and implicit value judgements, the progressivity tenet apparently no longer evokes strong opposition.[8] Political ideologies have greatly contributed towards the acceptance of the progressivity principle. Socialist parties view progressive taxation as a major instrument of social policy; but also middle-of-the-road parties appear widely to accept moderately-redistributive income taxes as a method for correcting the ("primary") income distribution, resulting from the market processes.

The "ability-to-pay" canon and what looks like its natural companion, viz., the technique of progressive rates, has generated a considerable amount of writing and discussion. We do not intend to rehearse the debate at length, but limit ourselves to highlighting the major facets.

A. Ability-to-pay

In the income tax, the "capacity-to-pay" (such tax) must be related to income. The tax statute must determine which amount and level of income can be considered as representing such ability. In modern income taxes, capacity to pay can be equated with what the Carter Commission in Canada has called "discretionary income", which is viewed as the true expression of the taxpayer's economic power.[9] Not only is the income tax duly based on a net concept and are production costs subtracted from gross income; but, there are also some (first) slices of income which are necessarily earmarked for non-compressible expenses, and which allow the taxpayer to subsist. Accordingly, modern income tax systems grant the deductibility of a personal allowance; they also account, through dependent's allowances, for the size of households. A bachelor has only himself, but the breadwinner of a family of six children has not less than eight mouths to feed. Such statutory provisions "personalize" the income tax, in that they adjust tax liabilities to differential personal circumstances; they can also be viewed as applying the canon of "horizontal equity".

Horizontal equity

Such personalization does not at all guarantee that the statutory allowances accurately reflect the actual outlays, which, say, the average taxpayer incurs in taking

8. In *Theorie und Praxis der modernen Einkommensbesteuerung* (Bern, 1947), pp. 71-73, F. Neumark documents how, in the 19th century, the progressivity criterion was strongly opposed in many circles. It would seem that this is no longer the case, nowadays, in low-income countries.

9. See the so-called *Carter Report*, "Report of the Royal Commission on Taxation", vol. III, Ottawa, 1966.

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care of himself or his dependents. On the level of principles, the issue arises whether the allowances should reflect a physiological minimum level or a more generous amount of expenditures, which is in line with prevailing socio-economic standards of living. The exact amount of the allowance tends to be determined largely by revenue considerations and political expediency. One must remember that whenever progressive rates apply, such allowances result in the rich man saving more tax dollars than his poorer counterpart. Finally, as Musgrave remarks, income is viewed here as the only indicator of taxpaying capacity. This can be challenged. We mentioned already that wealth also embodies capacity to pay taxes. Furthermore, leisure, which goes untaxed, is also a vector of welfare.[10]

B. Progressivity

The "ability-to-pay" principle holds that a person A with ample "discretionary income" should bear more tax than his neighbor B with less scope for compressible outlays. But one must also state to what extent the "rich" person should pay more tax than the "poorer" man. Should the amputation of taxable, discretionary income involve the same amount of dollars? Or the same proportion of taxable income? Or, a higher proportion as income rises? The first two solutions, the regressive and even the proportional ones, are nowadays generally rejected. Prevailing tax philosophy favors the application of progressive formulae to income.

Sacrifice theories

The justification for progressive rates on income has traditionally been cast in terms of "sacrifice theories", which, in essence, apply the marginal utility theory to income and taxation. Additional units of income, it is claimed, afford less utility; or, in other words, as income rises, its marginal utility declines. Proportional rates, applied to discretionary income, would imply that rich men would sacrifice a smaller proportion of their utility than the poor men. Some have argued that the sacrifice lost through the tax should be equal; other authors, more numerous, have contended that fiscal sacrifice should be proportional to the total utility embodied in the taxpayer's (discretionary) income. Depending on the shape of the curve which portrays the declining marginal utility of income, the resulting interpersonal distribution of the tax burden, measured in units of money surrendered by the taxpayer, will be progressive, proportional or even regresssive. However, under the equi-proportional sacrifice standard it is most likely to be progressive.[11]

And yet, the case for progressive taxation has remained "uneasy".[12] On the theoretical level, the sacrifice theories suffer from several weaknesses and lack analytical rigor. First, the search for the proper version of the sacrifice standard readily escalates into the so-called "minimum aggregate sacrifice" version; lopping off, through confiscatory 100 percent marginal rates, income above a certain level would equalize the marginal utilities of all taxpayers; and overall tax sacrifice would be minimized. The concern for an equitable distribution of the tax burdens, then, makes room for the maximization of welfare in society.

But not even the most egalatarian government would dare to redistribute income in such a drastic way, which would no doubt have disastrous effects on the willingness to produce income. Besides, the sacrifice theories assume that utility can be measured in terms of cardinal quantities and that the utility curves of taxpayers are the same. Modern welfare economics holds that neither such cardinal measurement nor meaningful interpersonal comparisons of utility is intellectually acceptable, apart from their utter impracticability. Third, one may wonder whether, once more basic needs have been fulfilled, the utility curve further declines regularly; taxpayers at income levels well above subsistence may not at all perceive their additional outlay as bearing on futile luxuries. In dynamic economies, new wants are constantly being created and social groups and income classes tend to imitate the aspirations and consumption patterns of more affluent groups.

Viewed as theoretical propositions, sacrifice theories are now discredited. But it would be unwise to negate their strong appeal, ethically, politically and, one should add, also in economic terms. The impressive array of critiques against sacrifice theories cannot erase the essential truth embodied in marginal utility theory that the marginal dollar is objectively more useful for the "poor" man than for the "rich" man, as the former will thereby be able to buy more essentials and "basic" goods and services than the latter. This ethical standard emerges clearly when extremes in the income pyramid are compared; as a matter of fact, it would hurt normal sentiments of justice if the pauper were obliged to contribute the same proportion of his income as the Croesus. Besides, the impossibility of interpersonal comparisons of the utility of incomes and of the disutility of taxes, though valid in theory, should not be carried too far. Income tax legislation, as any other enforceable law, cannot be completely tailored to the individual utility profiles and whimsies of all members of society. Laws are applicable to all members or to broadly-defined subgroups of society. The law has to abstract largely from individual characteristics and idiosyncrasies. Pushed to its logical extreme conclusions, the thesis that each individual being has different perceptions of utility postulates that tax liabilities would have to be "individualized", not according to measurable units of money but of individual utility curves.

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10. See R.A. Musgrave, *The Future of Fiscal Policy. A Reassessment*, Prof. G. Eyskens Lectures, Leuven, 1978, p. 10.
11. For an excellent analysis of the sacrifice literature one may consult, besides Blum and Kalven's *The Uneasy Case for Progressive Taxation* (Chicago and London, 1953), R. Musgrave, *A Theory of Public Finance* (McGraw-Hill, New York-Toronto-London, 1959), chapter VIII, and R. Musgrave and A. Peacock, (eds.) *Classics in the Theory of Public Finance* (McMillan-St Martins Press, London-New York, 1967), pp. IX-XIX.
12. See Blum and Kalven, op. cit.

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Considering the theoretical inadequacy of subjective sacrifice theories, a justification or at least an explanation of the progressivity principle has been advanced along other lines. Two decades ago, Groves already noticed the evaluation "towards a social theory of progressivity".[13] Nowadays, most authors basically accept the same view, perhaps more out of despair than conviction. Progressivity, it is claimed, has become widely established as a primary feature in income tax systems because governments and prevailing public opinion in modern societies do not accept as immutable the "primary" distribution of income which emerges from the production process. Tax systems, and particularly income taxes, should be instrumental in vertically redistributing income, by taking away a larger percentage of discretionary income as one moves up the income pyramid scale (subject, somewhere near the apex of that pyramid, to a maximum permissible marginal or/and average rate). The resulting "secondary" redistribution of income represents a step toward that distributional pattern of incomes after taxes which society perceives as optimal. On the theoretical level, reference is often made to a "social welfare function". In the words of Musgrave, "social utilities are assigned to income dollars and optimal tax patterns (or transfer patterns) may be determined on that basis".[14]

This approach, no doubt, reflects reality. It poses the issue of tax formulae and of redistributive aims and effects, essentially in political terms. But it remains vulnerable to serious objections. First, who decides about the social welfare function? The political majority, as elected through democratic "public choice" mechanisms? Or dictators who are usually repressive and only seldom benevolent? Or is this social welfare function to be viewed in the additive sense, i.e. as the aggregation of individual welfare functions, a conception which regains favor with many welfare economists. But how to trace the concrete shape of the progressivity formulae? Such statements as the progressivity slope adopted is the one which society seem to prefer risk being no more than tautological.

A supplementary equity argument in support of progressivity in income taxation is that regressive or proportional distributional features in other types of taxes can thereby be offset, to some extent. Income taxes, or even the tax system as a whole, are not the only channels through which the budget redistributes income. In this respect, in developed countries, in recent years, other conduits have attracted more attention. Social security contributions and subsidies, the inverse of taxes, must also be taken into account. The very fact that, as Okun remarks, in developed countries state budgets nowadays consist predominantly of transfer payments has greatly enlarged the redistributive potential of budget policy.[15] Besides, one should also heed the distributional effects of non-transfer budget expenditures, which are nowadays encompassed in the concept of "tertiary" (re)distribution.

V. REDISTRIBUTION AND (UN)EQUALITY

In this section, we have no intention whatsoever to cover at length the complex problems of the measurement of the economic effects and ideological values connected with the distribution of income and wealth. We select a few comments which are relevant to our enquiry. We first draw attention to some implications that follow from the mechanics of progressive and flat rates. Besides, we wonder whether and in what ways the redistribution of income through the income tax instrument presents different features in low-income as compared to high-income countries. And finally, we indicate that, to a large extent, the "horizontal" functional distribution of tax burdens, which is inherent in the set of flat rates of rational schedular systems, may approximate the "vertical" interpersonal redistributive effects that are achieved through openly progressive formulae in global-type systems. Throughout this section, we further assume that both types of income taxation are implemented in strict adherence to the normative canons of tax-burden distribution discussed in the previous sections. This assumption will be relaxed in section VII to allow for the many structural "imperfections" which characterize empirical systems of income taxation. We should also stress that the expression "redistribution" only refers to the tax ledger of the budget. Reducing the incomes of the rich does not, in itself, improve the position of the poor, in absolute terms. If all revenue collected from the rich were spent to their exclusive benefit, the budget process would not exert any redistributive effect whatsoever.

A. Implications of proportional and progressive rate formulae

It is sometimes overlooked that a proportional rate does have redistributive effects if one looks at the *absolute* distance or "gap" between the "richer" and the "poorer' income recipient within a given schedule or with respect to overall income. A 40 percent flat rate which applies to taxable incomes of respectively US$ 50,000 and US$ 10,000 reduces the after tax, or "disposable", incomes to respectively US$ 30,000 and US$ 6,000. Thus, the gap, in absolute terms, had been substantially narrowed from US$ 40,000 to US$ 24,000. However, under the proportional tax the *relative* distance is unaffected; in our example the post-tax ratio between the incomes of the two taxpayers remains identical to the pre-tax ratio, at 5:1. Progressive taxes, on the contrary, also reduce the relative gap or ratio. If, in our example, the two incomes are subjected to respectively 40 percent and 20 percent, the tax bite would have narrowed the absolute gap to US$ 22,000 and reduced the relative ratio from 5:1 to 3.75:1.

Whether narrowing only the absolute gap or also the relative gap should be the proper principle in pursuing a redistributive policy is a rather involved question which

13. H. Groves, "Towards a Social Theory of Progressive Taxation", *National Tax Journal*, March 1956.
14. See R.A. Musgrave, G. Eyskens Lectures, op. cit. p. 61.
15. See A.M. Okun, *Equality and Efficiency, the big Trade-off*, The Godkin Lectures, The Brookings Institution, 1975, pp. 101-2.

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cannot be kept uncontaminated by value judgements about the fair or optimal state of distribution of income and wealth in a given society. One may contend that one should not go beyond the reduction of substantial absolute gaps in income even if the relative ratio remains constant; in this way socially unacceptable discrepancies in living standards and consumption patterns would already be remedied. But, as already mentioned, modern income tax systems are more maximalist and aim at narrowing the relative gap, by way of progressive rates. Observation of actual social life clearly shows that individuals and social groups are concerned about their relative position, which they are eager to improve. This is evidenced by the fact that in democratic high-income countries, some redistribution of income positions is typically part of government programs, while the same aim figures prominently in the development plans of low-income countries. In both cases, the emphasis upon the principle is often matched by lack of specification as regards the degree of redistribution sought. Consumption patterns of richer households tend to be envied and emulated by people at somewhat lower levels of living when the latter have become exposed to a "demonstration effect". Thus, relative positions and the connected issue of redistribution clearly matter.

It is also worthwhile to point to what we may call the "amplification" effect, which is inherent in the mechanics of progressive rates. When the base of taxable income expands under a progressive rate formula, the average tax liability rises as the additional income is subjected to a marginal rate that exceeds the average one. The converse is equally true: a reduction of the effectively taxed base reduces the average tax burden. We may call this the "split-effect".[16] It also follows that if an allowance of a fixed amount is granted, the tax bill of the rich person will be reduced more, in absolute amounts, than that of the poorer person (whether the relative ratio will shrink depends on the actual figures and parameters involved). Accordingly, taxpayers have an interest in attempting to split the base of taxable income. As a matter of fact, the average tax rate on twice US$ 10,000 may be substantially less than on US$ 20,000.

It also follows that nominal rates may be highly misleading when gauging the real effects of redistributive taxation. Exemptions, deductions and allowances tend to considerably reduce the effective average rate to much lower levels than the nominal average rate would lead us to believe — abstracting even from evasion and avoidance. The effective rate is then calculated with reference to a level of income which, in the light of accepted tax standards, should constitute the taxable base. Hence, there exists a conflict between such "tax breaks" and the aim of secondary redistribution through the tax medium. Contrary to frequent assertions, however, no undesirable erosive effects can be attributed to personal allowances and the like, which are meant to refine the concept of "ability-to-pay" (as represented by "discretionary income") since progressive formulae should be applied on "discretionary income" and not on "net (produced) income".

B. Tentative thoughts about the scope for redistribution in high-income and low-income countries

We should briefly draw attention to a paradox in most countries of the Western world. Their societies have reached an unprecedented level of affluence; comparatively few people can be said to be poor, even if the poverty line is drawn well above a physiological minimum income level; furthermore, those poor are not a homogeneous social group but are scattered over various segments of the population.[17] Thus, one might have expected that the issue of the relative income gaps would come to rest and that there would be few claims to reduce that distance. And yet, the relative dimension draws attention not only in academic circles but, even more, on the political level. Various political parties and trade unions want to reduce the income spectrum to low multiples, mainly by way of narrowing the wage differentials, or, in other words, through intervention in the primary distribution. Well-organized social and pressure groups strive to improve their position: the claims are frequently predicated on references to other groups who are perceived to be in a better but

A paradox: in rich countries a tendency to equalize incomes

undeserved position. Hirsch has addressed himself to the above-mentioned paradox which he attributes to the increasing scarcity of "positional goods" (such as vacations on non-crowded beaches), as "the vast increase in material productivity has pushed the frontier of mass demand into terrain where there is no longer more for all".[18] Scitovsky has also found "rankhappiness" to be relevant to present affluent societies.[19] Whether the strong urge for further redistribution will be a lasting phenomenon or, on the contrary, is symptomatic of a recessionary period cannot easily be prognosticated. Some pointers, such as the growing awareness of the disincentive effects of high tax burdens and even some overt signs of tax revolt, suggest that redistributive policies, particularly through the tax medium, may be widely looked upon with disfavor before long.

In the typical low-income country, the situation is utterly different. Two series of remarks are to the point. First, income inequality is probably in most cases

16. The expression "split" is used here in a general sense, whereas in the tax literature it tends to refer specifically to the treatment of the incomes of spouses.
17. See, for example, P. Taubman, *Income Distribution and Redistribution* (Addison-Wesley, 1978), pp. 22-25. The official poverty line in the U.S.A. is defined as three times an emergency food level and stood at US$ 5,000 in 1974, for an urban family of four. The incidence rate of absolute poverty had declined from 33 percent of the population in the late 1940s to about 11.5 percent today.
18. F. Hirsch, *Social Limits to Growth* (Routledge and Kegan, 1977). The excerpt is on p. 117.
19. T. Scitovsky, *The Joyless Economy. An Inquiry into Human Satisfaction and Consumer Dissatisfaction* (Oxford University Press, 1977), especially chapter VII.

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somewhat more pronounced than in present-day affluent societies.[20] Notice a number of qualifications, however. The statistical data are generally of poor quality and cross-sectional comparisons, between countries, require great caution. Much depends on the underlying distribution of assets and of skills, indeed on the social structure, itself. For example, in Latin American countries, with their latifundia [21] the overall inequality is likely to be greater than where, as in South Asia, ownership of land is already highly fragmented. On the whole, economists tend to recognize the "Kuznetz effect", which holds that, in the early stages of growth, inequality widens. There also does not seem to be a clear relationship between the growth rate and the degree and the trend in inequality; much depends on the actual policies followed.[22]

Another feature dominates the profile of income distribution in low-income countries, namely, the widespread occurrence of absolute poverty.[23] In most developing agricultural occupations, the absolutely poor are found predominantly in the rural sector. Even people who, in a vertical-income pyramid, would be situated well above the, say, lowest two deciles do not exhibit any or very little taxable capacity, although they may be three times "better off" than the poorest people. In other words, the connotation of income, well above a minimum, poverty level, which accompanies the expression "middle classes", as used within the context of high-income countries, is not relevant in poor developing countries.

The basic point to be made is that, with respect to such matters as fiscal redistribution and (income) tax policy, the absolute or cardinal dimension of the pattern of income distribution cannot be overlooked. Consequently, the coverage of the income tax in low-income countries tends to be limited to the higher-income ranks and to the modern sector. "The income tax is a class not a mass tax" as the saying goes. Moreover, as in numerous (but not all) low-income countries, the upper strata of taxpayers enjoy a standard of living which is comparable to that of the top-ranked taxpayers in developed countries, steeply progressive taxes would shave off relatively more income than in a developed country. But, again, in countries in which no large "middle class" has yet developed, siphoning off income from the comparatively few "absolutely rich" would yield only little revenue, which, even if spent in favor of the large numbers of the absolutely poor, would only marginally improve the individual lot of the latter. In developed countries, on the contrary, fiscal redistribution is partly made possible because middle classes form the bulk of the population and are subjected to progressive income taxation. The income tax must also be expected to be a relatively less productive generator of revenue than in rich countries; this is confirmed by the actual data.

C. Redistribution in schedular and global tax systems

Assuming that some degrees of redistribution should be achieved, or at least attempted, through the income tax medium, our specific question now is whether such an objective can be reached more easily within schedular or global systems of income taxation, of equal yield and otherwise equal circumstances, by virtue of the distributional formulae which are found in the schedular or global types.

Conclusions with respect to the redistributive impact exerted by flat rates, differentiated per schedule in the schedular system, and progressive rates in global systems are already foreshadowed in the previous analysis. Obviously, progressive rates reduce not only the absolute but also the relative gap between taxpayers at different levels of the income pyramid. Within each category of the schedular tax, a flat rate narrows the distance, in absolute terms, but leaves the relative ratio constant.

As has been clearly established, different levels of overall income involve differences in the compositions of income. Generally speaking the share of income from capital in total income increases when one moves upwards along the income pyramid. This is particularly true with respect to the top-layer incomes, which are most often derived largely from capital assets. Capital assets are usually found to be more unequally distributed than incomes.[24] This holds for developed countries, but also, and perhaps even more, for most low-income countries, although the nature of the income-generating assets will differ, with land holdings being comparatively more important than financial assets. Conversely, and on the same grounds, the progressive rate formula on global income contains a built-in qualitative discrimination against capital incomes, even when the tax statute does not openly specify any such discrimination.

This similarity of redistributive and discriminatory effects, however, is a very crude and an imperfect one. When one looks, statistically, at large numbers, one finds that as income rises, it will tend to be composed relatively more of income from capital. But there are bound to be many deviations of individual cases vis-à-vis such general correlation. To apply the same general rule to such deviating cases would result in unfair treatment. The widow, living on her meager savings, would be taxed at the same flat rate as the rich "capitalist", in the schedular system. Besides, there are many types of capital assets, and their degree of concentration in

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20. See the tabulation for a large group of countries in H.B. Chenery et al., *Redistribution with Growth* (Oxford University Press, 1974), p. 8-9.
21. Or large estates, owned by absentee landowners.
22. See S. Kuznets, "Quantitative Aspects of the Economic Growth of Nations: VIII. Distribution of Income by Size", *Economic Development and Cultural Change*, vol. XI, No. 2, part II, January 1963.
23. See D. Morawetz, "Twenty-five Years of Economic Development: 1950 to 1975", The World Bank, 1977, p. 41. The absolute poverty line for the "destitute" was put in the ILO publication *Employment, Growth and Basic Needs. A One World Problem* (Geneva, 1976) at respectively US$ 90 in Latin America, US$ 59 in Africa and US$ 50 in Asia. 39 percent of the population of the developing market economies were estimated to belong to that category of "destitute" and 67 percent to a broader category of "seriously poor". See p. 22.
24. See, for example, A.M. Okun, op.cit., p. 66.

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high-income brackets is dissimilar; the ownership of government bonds, for example, is known to be broader than that of shares. The schedular system would also imply the same flat rate on the income derived from or attributed to the tiny parcels of land held by the minifundista and to the large estates of the latifundista.

In sum, the object-centered system of schedular taxes, which are predicated on the functional distribution of income, can only inadequately perform the role of a redistributive progressive tax, which is meant to influence the personal distribution of income. The converse does not equally hold. As explained in section III, in progressive systems, allowances, which discriminate in favor of labor incomes, can be inserted. They appear to be even more appropriate techniques than the open rate-discrimination which characterizes the schedular approach to income taxation.

Which system is better?
Global income taxes or schedular schemes?

Should one then conclude, without any reservation, that global income taxes score better than schedular schemes? As a matter of fact, the former allow taxpayers to be subject to progressively distributed tax burdens, in function of the ability-to-pay of each taxpayer and, furthermore, also permit some "hidden" application of the qualitative discrimination principle, to the extent such a canon is deemed relevant. It would seem, indeed, that the above conclusion is warranted; provided, however, that the progressive income tax on global income is implemented in a consistent and effective way. If large components of overall income which, according to basic principles, should be effectively taxed remain outside the tax net, for whatever reason, the logic of the progressivity technique is perverted and its applications eroded and distorted. Let us suppose, in a rather extreme example, that almost all incomes from capital are escaping tax, either as a result of statutory exemptions or because such incomes are not reported. Rich taxpayers would then benefit in a double way: first, because capital incomes are concentrated in high-income echelons; and, second, because, as explained earlier, the non-taxation of a slice of income results in a larger "split effect" or tax savings (in absolute terms) for the rich than for the poor taxpayers. One may conclude that global systems, endowed with progressive rate formulae, are exacting systems, in that they require both a consistent tax design and a tight implementation. Any statutory exceptions to the ability-to-pay principle should be fully justified and the tax should be administered without major leakages and underreporting. Otherwise, the use of progressive rate formulae results in gross inequities and in a parody of sound tax principles. The nominal rates may create the illusion of an equitable and even of a severely redistributive system,[25] but, upon inspection, the distribution of *effective* tax burdens may tell a quite different story.

VI. INCOMPATIBILITY OF PROGRESSIVE RATE FORMULAE WITH SCHEDULAR SYSTEMS

We just concluded that the differentiation in the flat rates within the schedular system is at best a hidden and an imperfect substitute for openly progressive rates — but that the latter call for highly-effective tax administration. The question then arises whether the insertion of progressive rates in schedular systems — about which some authors have hypothesized that it is an easier system to administer — could provide an optimal or, at least, a "satisfactory" solution. In other words, could progressive rate formulae in schedular systems apportion taxes according to the ability-to-pay standard?

As a matter of fact, in historical schedular systems and in the more frequent schedular layers of mixed systems, the category of labor income typically contains elements of progressivity. In a number of countries, especially in Latin America, the schedule which lists the profits of corporations or of enterprises (when no separate corporation tax exists) carries progressive taxes.[26] Other less familiar cases of graduated rates, as on rental incomes in Zaire, can be cited. One could also visualize that, as an indirect instrument of land reform, the rates on income from land would be progressive — although graduated taxes on land property which do not penalize the diligent farmer may be more appropriate to that end.

One can easily demonstrate that the aim of apportioning the income tax burden according to the capacity-to-pay principle can only be achieved within a schedular framework in a consistent way and without distortive effects, provided two conditions are fulfilled, viz. (a) that each taxpayer would only obtain income from a single source, *and* (b) that the formula of progressive rates would be identical in all schedules.

The extent to which taxpaying units obtain income from different sources is essentially an empirical question. Table I contains some data about the U.S.A. and Brazil. The table does not convey a direct frequency distribution of taxpayers, in terms of multi-source income; yet, a comparison of the numbers of salaried and self-employed, as compared to those with other incomes, indirectly provides insights into the occurrence of multiple-source incomes. Earnings from labor may be considered as "core" incomes as most people, in good health and of working age, want to be gainfully active and to employ their "human" capital.

25. The astronomically high top marginal rates, up to, say, 90 percent which are featured in some tax statutes should not create too many illusions, except that they may make believe that the country pursues a vigorous redistributive policy. It may well be that no taxpayer whatsoever is subject to such a confiscatory rate.

26. One tally reveals that, out of 18 Latin American countries, 12 had an extended set of progressive rates on corporate profits. See G.E. Lent, "La politica tributaria en cuanto determinante de la combinación optima de los factores capital y trabajo", in *Reforma tributaria para América Latina. IV La Política tributaria como instrumento del desarrollo*, Organización de los Estados Americanos, Washington D.C., 1973, pp. 328-29.

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TABLE I

Number of "schedular entries" in global income tax returns in the U.S.A. and Brazil: 1976 incomes (in millions)

	United States	*Brazil*
Comp. Population	215.1	110.0
Overall Number of Returns (in '000)	84.7	5.2
of which – taxable	64.4	0.9
– non-taxable	20.2	1.9
of which – simplified forms	28.6	1.6
– full forms	56.1	4.1
Number of Returns with Income from Designated Sources		
salaries and wages (gross)	75.5	1.53
business (*) and professions (**)		0.29(*)
– net profit	5.7	0.86(**)
– net loss	1.8	
farm		0.39
– net profit	1.3	
– net loss	1.5	
partnership (net)	2.6	
sales of capital assets		
– capital gains	6.1	
– capital losses	2.4	
dividends	9.0	
interests	42.6	
pensions	5.6	
rents		0.69
– net income	3.9	
– net loss	2.9	
royalties (net)	0.6	0.17

Source: Internal Revenue Service, Statistics of Income 1976, Individual Income Tax Returns/Annuario economico-fiscal de 1977, Ministerio da fazenda, Secretaria de Receita federal.

On a priori grounds and in the light of the available evidence, one should not overrate the proportion of taxpayers who derive taxable income from more than one source. Incidentally, the fact that a great many taxpayers only derive income from one (labor) source explains why many countries allow a simplified return: dependent labor incomes can be easily taxed at the source; no subsequent adjustments are required when no other taxable income accrues to the taxpayer. The important point, however, is that multiple incomes can be expected to occur more frequently in higher-income echelons, where wealth is known to be concentrated.

Both Brazil and the United States have a global tax system. The statistics detail the entries for each of the different incomes which have been recorded in the returns. One first notices the enormous difference in coverage, i.e. in the ratio of returns to the total population, which works out respectively at 39.4 percent for the U.S.A. and 4.5 percent for Brazil, although Brazil is distinctly a middle-income developing country, with a per capita income of US$ 1,140 in 1976. The number of returns reporting income from agricultural activities is very low in Brazil, although a large proportion of the population poorly lives on farms. This factor may largely explain the low ratio of returns. In both countries, the possibility exists for specified taxpayers — particularly those with only labor income — to file a simplified form.

Comparing the number of "schedular entries", i.e. of different types of income declared, to the number of returns which contain "core" incomes (i.e. from labor, both salaried and self-employed) one finds a ratio of 2.13 in the U.S.A. For Brazil, and looking only at the data for those who file a full report, the ratio stands at 1.47. One should not infer too much from the difference in the ratio as an accurate comparison is difficult, for various reasons. It would appear, however, that even in a developing country, those who must file a return frequently have more than one income source. This comes as no surprise if one recalls that the coverage of the income tax tends to be restricted to those who are comparatively well-off in the modern sector and that wealth and income tend to be more concentrated in developing than in developed countries.

One must expect the number of taxpayers with multi-source income to increase, when: per capita income rises, as whenever essential and non-compressible consumption needs are fulfilled, there is scope for savings; financial investment grows, thus engendering additional income. The extent to which the frequency of multiple incomes shows up in the statistics depends largely on specific arrangements in the actual tax statutes.

Thus, the absolute and relative number of taxpayers with more than one income will increase when:
— imputed rents on owner-occupied homes are held taxable;
— the household is viewed as the proper taxable unit and more persons in the household obtain taxable income. Recent years have witnessed, in Western Europe and in the United States, a growing number of married wives entering into the salaried work force;
— the tax administration becomes more efficient as when, for example, the beneficiaries of income from securities, which are taxed at the source, can be identified;
- the tax legislator brings small incomes within the reach of the income tax. Even small incomes from savings deposits may be taxable, as in the U.S.A., whereas elsewhere they often are exempted, thus considerably reducing the number of households with taxable income from multiple sources.

A real-life illustration of the distortions which progressive rates may cause in some — not all — schedules is given in table II, which reflects the rates in the schedular layer of the mixed system in Portugal, in 1976.

The differential tax burdens for taxpayers with the same overall nominal[27] net income of 1 million Esc. are fairly substantial. Taxpayer B is 16.5 percent below and taxpayer D 18.3 percent above the average tax burden on the 1 million Esc. income. Such divergences could conceivably be rationalized on the basis of the qualitative discrimination theory; but then the higher burden on "pure" labor income, as compared with business income of "mixed" origin, is an obvious anomaly.

27. Abstracting from differential degrees of underreporting.

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Technically speaking, global type tax systems could conceivable also be endowed with proportional rates. But rate formulae are no more than technical parameters which can only be called suitable in the light of the accepted standards of equity, a given society wishes to adhere to. As a progressive rate formula is viewed as an appropriate instrument to modulate tax burdens, according to the "ability-to-pay" canon — as discussed in previous sections of this paper — actual global type income taxes are equipped with progressive rates. And, as just stressed, the globalization of the taxable base is a prerequisite, if progressive rates are to be operated in a logical and consistent manner. One must add, as was analyzed in detail in a previous paper,[28] that personalizing devices, such as allowances for dependents, should also refer to overall income. If such personalizing features, which narrow the taxable base, are available in one or in several schedules, taxpayers with the same overall discretionary income would be taxed differently, depending on the source(s) and composition of their incomes.

TABLE II
PORTUGAL – SCHEDULAR LAYER – 1976

Differential nominal tax burdens on hypothetical taxpayers with overall income of 1 mln. Esc. from different sources (in Escudos)

	wages salaries	*business profits*	*rents*	*interest dividends*	*total tax*
A. Income tax	1,000,000 (220,000)				220,000
B. Income tax		1,000,000 (174,000)			174,000
C. Income tax			1,000,000 (240,000)		240,000
D. Income tax				1,000,000 (240,400)	240,000
E. Income tax	800,000 (149,600)		200,000 (31,460)		181,060
F. Income tax		800,000 (139,200)		200,000 (49,280)	188,480
				Average:	208,357

Source: Computed from Portuguese income tax rates.

Above, we noticed that, in order to render progressive rates compatible with rational schedular systems, the same rate formula should be applied in all schedules. But, as already stressed, this condition is only relevant if taxpayers are drawing income only from one source. In the fairly substantial number of cases in which multiple incomes are enjoyed, even identical schemes of progressivity would distort tax burdens amongst taxpayers with the same overall income, but with different components. Besides, some categories of income are not amenable to the imposition of progressive taxes. Thus, the yield from securities in bearer form is often taxed at the source, in a "blind way", without the tax authorities being intent upon identifying the beneficiary; such payments occur at irregular dates and in a fragmented way. Hence, progressive rates, at the time the coupons are cashed, are not feasible. And if the withholding levy were operated as "installment" payments, to be credited against the tax liability which the taxpayer would incur on all his income from securities or on his overall income, subsequently a return would be required from the taxpayer. However, once returns are requested for incomes of one type, the door is opened to have all incomes reported in the annual declaration — a more convenient procedure both for the taxpayer and the tax administration.

VII. FACTS VERSUS PRINCIPLES

So far, we have evaluated the wisdom of alternative canons of equitable distribution of the tax burden which provide the logical underpinnings for the schedular or global types of income taxation. We assumed, somewhat unrealistically, that the two prototypes of income taxation would be designed in strict adherence to their basic distributional canons. We should now briefly descend from the highland of principles into the valley of actual, historical tax systems. In this context, the cases in which given techniques are inserted in a given structural mold, despite the deviations and inconsistencies which they entail, should attract particular attention, as they highlight the strong appeal of particular tax principles.

One fact stands out. In schedular systems, various personalizing features have, over the years, been inserted. This is particularly the case for the "core incomes", i.e. those resulting from the productive use of human labor. Those schedules have usually, to some extent, been equipped with progressive rates; and a basic personal exemption, sometimes complemented by allowances for dependents, has been granted — despite the fact that schedular layers have mostly been capped by a complementary tax, of a global nature, which, by definition, contains a progressive formula and various personalization parameters. Some decades ago, the French author Laufenburger rightly referred to the then prevailing schedular systems as "semi-personalized" ones.[29] Furthermore, in recent years, several countries, including some in the Third World (such as Peru and Bolivia and, in a half-way fashion, Mexico), have converted their mixed systems into global types of income taxation.

Those facts suggest that the ability-to-pay principle and the redistributive aims which the progressive rate formula tends to achieve cannot be ignored, not even in a schedular system, although the latter, on account of its object-centered nature and its fragmented approach, cannot accommodate progressivity without giving rise to

28. See S. Plasschaert, "The Definition of Net Income in Schedular and Global Types of Income Taxation", *32 Bulletin for International Fiscal Documentation* 201 (1978).
29. See H. Laufenburger, in *Théorie économique et psychologique des finances publiques* (Paris, 1956), and in other publications.

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inconsistencies and distortions in tax burden distribution. One should add, however, that the drawbacks associated with the insertion of progressive rates in schedular systems are greatly attenuated by the fact that a large number of taxpayers receive income from only one source, viz. from their labor inputs. Our analysis also allows the conclusion that the qualitative discrimination doctrine is theoretically not convincing and can, to the extent deemed desirable, be implemented within a global scheme without necessitating the schedular technique.

In the light of the arguments advanced earlier this conclusion would also hold in low-income countries. Admittedly, labor incomes are not given the comprehensive protection which they enjoy in the welfare state of modern developed societies. But when incomes from labor are taxed, contributions to voluntary pension reserve funds can easily be made tax-deductible. Besides, the size of taxable income is a more relevant determinant of the capacity for saving than the nature of such income. And, finally, on account of the low per capita income and the large incidence of absolute poverty the income tax covers only comparatively well-to-do classes.

It would be wrong to infer that, in historical global systems, the ability-to-pay canon and the progressivity technique are implemented in a logically consistent way. In actual fact, various portions of income, which according to the above canon would have to be taxable, do escape taxation, with the result that, owing to what we called the "split effect", the progressive distribution of tax burdens is weakened, usually resulting in higher "tax breaks" (expressed in absolute terms), for the rich than for the poorer taxpayer.

Such leakages are due to various causes, and more particularly to:

— some discriminations between classes of taxpayers which result from the way the global tax must be designed. Usually, and for good reasons, the individual income tax of global vintage is accompanied by a flat rate tax on profits of corporations. Thus, enterprises are treated differently according to their legal form;

— some portions of income, while taxable in principle, cannot effectively be taxed because of sheer administrative difficulties; or the government renounces its claims in order to avoid some undesirable side effects. For example, the definition of gross income would call for the taxation of unrealized capital gains enjoyed by individuals. But no country appears in a position to fully comprehend such accretion to economic power, and one must content itself with taxing only realized gains;

— underassessment also results from illegal evasion and its cousin, tax avoidance;

— various tax breaks, which are meant to induce the taxpayer towards the use of his income into desired channels, such as given savings instruments. Those incentives imply a transgression of the ability-to-pay benchmark.

Global income tax superior to schedular tax

At this point, however, one important conclusion emerges from the analysis in this paper. The global type income tax appears as clearly superior to the traditional schedular systems in the light of modern equity standards, but it is an exacting method of taxing income. There should be a high degree of restraint towards granting tax favors, which erode the taxable base. If such breaks are afforded, they should have been carefully reconciled with the goals one wishes to achieve through them. Secondly, the global system calls for effective administration; here again, one should realize that administrative inadequacies, if they cannot realistically be remedied, must be weighted against the loss of equity. In both instances the resulting actual ("effective") distribution of tax burdens may deviate substantially from the intended apportionment, as expressed in the formula of nominal rates. The nominal formula may not be more than a travesty of sound equity rules which masks a large number of undesirable inequities.

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THE GROWTH AND TRENDS OF TAX REVENUES IN THE CARIBBEAN*

by Dr. Kempe R. Hope **

INTRODUCTION

In recent times a number of articles have appeared in various international journals pertaining to the role of external borrowing and its changing composition and importance to less developed countries. This taxation article, which is a case study of the Caribbean, was written to demonstrate that, despite the growing significance of external borrowing by the Caribbean countries, the role of tax revenues is still of major importance in the development process and an important fiscal tool. This is so primarily because the nature and rate of taxation are internally controlled and, as such, not subject to developments in the international money markets which are difficult to foresee.

Taxation remains the major fiscal tool on the revenue side. It is that fact that rationally dictates that borrowing should only occur when government expenditures exceed revenues and tax revenues cannot be beneficially increased. This paper assesses the growth, trends, and possible scope of tax revenues, in the Caribbean, in the future.

INDIRECT TAXES

First we look at the indirect taxes in the Caribbean which, as seen in Table 1, constitute the major component of total tax revenues in Guyana and Jamaica. In Jamaica, the indirect taxes have been steadily increasing while the direct taxes have been declining. In contrast, in Guyana, direct taxes have been increasing along with the increases in indirect taxes. Both in Barbados and Trinidad and Tobago the indirect taxes are not the major component of total tax revenues. During the period 1960-75, indirect taxes in Guyana and Jamaica increased significantly. The increases were a little more than 600 percent in each case during that period. After 1975, indirect taxes in both countries exhibited uneven declines.

The indirect taxes are composed primarily of production and sales taxes and international trade taxes as shown in Table 2. In all of the countries the changes in each component of the indirect taxes have been inconsistent. In Trinidad and Tobago, after 1973, trade taxes declined in importance and production and sales taxes became the major source of indirect tax revenues. The increase in production and sales taxes in Trinidad and Tobago has been due to the government's immediate response to the boom in world petroleum prices by overhauling the tax system to tap windfall profits of the petroleum companies. The government enacted a refinery tax on each barrel of oil and instituted a production levy designed to fund a domestic subsidy on petroleum products.

In Jamaica, except during 1974 and 1975, the production and sales taxes have consistently dominated the indirect taxes. The major part of Jamaica's indirect taxes is derived from the bauxite industry which provides approximately 23 percent of Central Government revenues. In 1974, the Jamaican government launched an ambitious plan to (1) increase its share in the profits of the bauxite industry, and (2) extend its control over bauxite and alumina operations. One of the results of that plan was the enactment of a bauxite levy which obliged the bauxite and alumina companies to pay a levy for all bauxite mined in Jamaica. However, since 1976, receipts from the bauxite levy have been declining considerably owing to large declines in production.

In Guyana, until 1976, the trade taxes were the major component of indirect taxes. In 1974 and 1975, there was an increase in the consumption tax revenue and windfall amounts were also collected in those same two years after the imposition of a sugar export levy in 1974. After 1976, however, the output of Guyana's three major industries — bauxite, sugar, and rice — declined considerably as a result of poor weather and labour disputes. This resulted in a decline in indirect tax revenues and in overall government revenues.

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* This paper is a case study of the more developed Caribbean countries: Barbados, Guyana, Jamaica, and Trinidad and Tobago.

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TABLE 1

Central government tax revenues, 1960-78
(Millions of U.S. Dollars)

Year	Barbados			Guyana			Jamaica			Trinidad and Tobago		
	Direct taxes	*Indirect taxes*	*Total tax revenue*	*Direct taxes*	*Indirect taxes*	*Total tax revenue*	*Direct taxes*	*Indirect taxes*	*Total tax revenue*	*Direct taxes*	*Indirect taxes*	*Total tax revenue*
1960	3.8	9.3	13.1	11.6	18.9	30.5	30.9	58.2	89.1	34.5	32.9	67.4
1965	7.2	11.8	19.0	12.9	24.5	37.4	58.9	113.3	172.2	45.1	51.1	96.2
1970	13.8	16.7	30.5	26.3	33.3	59.6	67.6	82.4	150.0	144.3	130.3	274.6
1973	33.5	51.6	85.1	39.5	44.4	83.9	265.7	275.5	541.2	124.7	110.2	234.9
1974	32.4	29.3	61.7	37.2	86.2	123.4	249.4	416.1	665.5	287.4	105.9	393.3
1975	39.2	28.7	67.9	44.6	139.7	184.3	235.1	439.0	674.1	324.4	103.5	427.9
1976	46.3	43.0	89.3	51.8	93.5	145.3	230.9	371.1	602.0	354.9	123.9	478.8
1977	49.2	40.0	89.2	65.9	55.6	121.5	185.0	329.2	514.2	409.2	143.9	553.1
1978	48.4	41.6	90.0	59.4	56.2	115.4	187.6	469.5	657.1	425.9	138.3	564.2

Sources: Inter-American Development Bank, *Economic and Social Progress in Latin America* (Washington, D.C.: IDB, Several Years); and *World Tables 1976* (Baltimore: Johns Hopkins University Press, 1976).

TABLE 2

Composition of indirect tax revenues, 1970-78
(Millions of U.S. Dollars)

Year	Barbados				Guyana				Jamaica				Trinidad and Tobago			
	Production and sales taxes	*Trade taxes*	*Other[a]*	*Total*	*Production and sales taxes*	*Trade taxes*	*Other[a]*	*Total*	*Production and sales taxes*	*Trade taxes*	*Other[a]*	*Total*	*Production and sales taxes*	*Trade taxes*	*Other[a]*	*Total*
1970	6.8	9.4	0.5	16.7	9.1	21.9	2.3	33.3	36.1	34.1	12.2	82.4	18.0	88.1	24.2	130.3
1971	9.4	12.2	0.5	22.1	10.6	22.4	2.8	35.8	81.9	77.6	32.7	192.2	10.9	51.1	12.4	74.4
1972	9.3	12.0	0.5	21.8	11.4	19.2	3.1	33.7	93.4	88.4	25.1	206.9	14.9	51.2	17.0	83.1
1973	14.1	19.1	18.4	51.6	21.2	21.0	2.2	44.4	155.6	93.9	26.0	275.5	66.5	36.7	7.0	110.2
1974	10.5	18.3	0.5	29.3	24.9	57.2	4.1	86.2	154.1	240.9	21.1	416.1	75.8	25.3	4.8	105.9
1975	13.5	14.6	0.6	28.7	25.1	110.5	4.1	139.7	170.7	250.7	17.6	439.0	70.5	27.9	5.1	103.5
1976	19.3	15.8	7.9	43.0	32.2	55.9	5.4	93.5	192.8	163.6	14.7	371.1	80.2	37.7	6.0	123.9
1977	19.4	20.1	0.5	40.0	29.3	21.4	4.9	55.6	206.3	108.2	14.7	329.2	89.8	46.4	7.7	143.9
1978	20.8	19.8	1.0	41.6	33.9	16.8	5.5	56.2	272.2	197.3	0	469.5	77.6	52.9	7.8	138.3

Sources: Same as for Table 1.

a Includes revenue from fiscal monopolies, business and professional licenses, motor vehicle registrations, and stamps.

Until 1975, Barbados' trade taxes were the major component of indirect taxes. During 1977 and 1978 the Barbadian government took a number of fiscal measures in recognition of the growing precariousness of public sector finances. This resulted in increases in the consumption tax rates on luxury goods and the enactment of an employment levy which considerably boosted government revenues.

The indirect taxes in developing countries tend to work positively, for the most part, by encouraging savings and conserving foreign exchange for the necessary import of capital goods. Such taxes also help to prevent prices from rising too rapidly when ongoing investment is increasing personal incomes faster than the output of finished goods and services is rising. These taxes are popular not only because of their administrative simplicity, but also because they can satisfy the principles of progressivity and built-in stability as well as equity. One additional property of indirect taxes of particular interest to developing countries is their ability to allocate resources to desired areas of development.

Equity is served by exempting necessities and the produce of peasant farmers from taxation while graduated taxes imposed on non-essentials and luxuries, especially if established through scientific studies of family budgets, allow indirect taxes to satisfy the principle of ability-to-pay and the built-in flexibility property. By raising the cost of consumption relative to saving, indirect taxes tend to encourage the latter at the expense of the former. In a system of indirect taxes, saving is stimulated as it virtually escapes taxation and resources are released from consumption to capital formation whose contribution to economic development cannot be overemphasised.

Indirect taxes serve the purpose of industrialisation by diverting resources to desirable activities. On the one

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hand, import duties graduated according to the degree of luxury of imported commodities provide incentives for domestic production. The particular stimulation given to semi-luxury or luxury goods should be dealt with carefully and their local production discouraged at times by heavy sales or excise taxes or even by outright prohibition because resources should be used for the production of more urgently needed commodities.

Indirect taxes imposed on locally produced goods are, on the other hand, designed to divert resources from the production of luxuries to semi-luxuries and necessities, by affecting the rate of return. This goal is not always easy to achieve and its attainment depends, in the final analysis, on the diversionary effect of taxes on particular commodities with different elasticities of supply and demand. If, however, indirect taxes fail to change the allocation of resources and the pattern of investment, other measures affecting relative prices and relative profitability must be employed.

The structure of indirect taxes should be such as not to stifle altogether the production of semi-luxury goods, defined as those widely consumed by people above the subsistence level, but kept at low levels as a stimulant for increased participation in the development process. The favourable tax treatment of necessities should not be taken to mean that the majority of resources released through taxation are used to expand the production of necessities. It is important that the production of necessities increase at least at the same rate as the population growth, but due to the prevailing poverty in the Caribbean, it is easy for income increases to be spent exclusively on consumption. As such, to protect the long-term development interests of the Caribbean countries, part of the increased incomes must be diverted to investment through mass commodity taxation. Indirect taxes have an important role to play in this respect by transferring resources from consumers to the public sector, which in turn uses these resources for investment. Mass commodity taxation is therefore fully justified as it serves to raise the incremental saving ratio.

Taxes are commonly classified according to the kind of action that creates the liability or the nature of the base on which the tax is levied. Taxes on goods and services may include all taxes and duties levied on production, sale, transfer, leasing, and delivery of goods and rendering of services, or in respect of taxes on the use or ownership of goods or permission to use goods or perform activities. [1]

Historically, excise taxation has been associated with domestically produced commodities. Any countervailing duty on goods coming from abroad is incorporated in the importy duty, and sales taxes are levied as general taxes on the sale of goods and services. The scope of coverage emerges as the most useful distinction between excises and sales taxes. Under an excise system, taxable commodities are individually enumerated in the law; while under a sales tax the tax base is typically defined to include all commodities for sale other than those specifically exempted. In Jamaica and Trinidad and Tobago there are no sales taxes while Barbados has a sales tax at the retail level and Guyana has a manufacturers sales tax. With respect to the excise taxes, in Barbados, Jamaica, and Trinidad and Tobago the coverage is extended which means the tax spans almost the whole range of production activities in those countries. In Guyana, the excise tax coverage is limited to specified domestically produced goods and similar goods imported from CARICOM.

While indirect taxes are inadequate, by usual standards, as sole measures of tax capacity, the traditional case for indirect taxes in the Caribbean has been made on the basis of their potential revenue yield and their administrative simplicty when compared to the income tax. It would seem though that the prevailing indirect tax structure is satisfactory from the point of view of the criterion of income elasticity. In order to conform to the criterion of economic stabilisation, indirect taxes should be levied on goods with a high income elasticity of demand. The significance of this criterion lies in the fact that such indirect taxes would be ideally suited for maximum volume of resource mobilisation.

From Table 4, we can see the rate of change of indirect taxes as percentage of total current revenue and Gross Domestic Product during 1960-78. For all of the countries the rate of change was uneven and inconsistent. However, a better gauge of the relevant significance of indirect taxes in the Caribbean can be obtained from examining indirect tax revenues as a ratio of total tax revenue as exhibited in Table 3. In Barbados, after 1973, indirect taxes declined to less than 50 percent. A similar situation prevailed in Trinidad and Tobago and Guyana after 1972 and 1976 respectively, while in Jamaica indirect taxes have never been less than 50 percent during 1960-78 indicating the growing and significant importance attached to indirect taxes as a source of development finance in Jamaica. Moreover, it has been claimed that Jamaican indirect taxes are essentially proportional to both income or expenditure, except in the highest in-

TABLE 3

Percentage of total tax revenue from indirect taxes, 1960-78

Year	*Barbados*	*Guyana*	*Jamaica*	*Trinidad and Tobago*
1960	70.9	62.0	65.3	48.8
1965	62.1	65.5	65.8	53.1
1970	54.8	55.9	54.9	47.5
1971	49.2	59.1	52.9	49.1
1972	50.5	50.0	51.9	50.1
1973	60.6	52.9	50.9	46.9
1974	47.5	69.9	62.5	26.9
1975	42.3	75.8	65.1	24.2
1976	48.2	64.3	61.6	25.9
1977	44.8	45.8	64.0	26.0
1978	46.2	48.7	71.5	24.5

Sources: Same as for Table 1; Table 2.

1. S. Cnossen, *Excise Systems: A Global Study of the Selective Taxation of Goods and Services* (Baltimore: Johns Hopkins University Press, 1977), p. 7.

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come bracket. [2] In Guyana, indirect taxes were found to have an income elasticity coefficient of 2.1, in Jamaica the income elasticity was 1.9, and in both Barbados and Trinidad and Tobago the income elasticity was 0.9. [3] The average income elasticity of indirect taxes for the four countries as a whole is 1.5.

TABLE 4

Indirect tax revenues as a ratio of total current revenue and GDP, 1960-78
(Percentages)

Year	Barbados		Guyana	
	As a ratio of current revenue	*As a ratio of GDP*	*As a ratio of current revenue*	*As a ratio of GDP*
1960	69.9	4.5	57.1	6.8
1965	56.5	11.2	59.9	11.4
1970	44.5	8.7	48.2	12.5
1971	41.5	11.2	50.1	11.8
1972	42.9	11.3	43.0	11.5
1973	65.7	13.7	32.3	8.4
1974	40.9	8.0	63.4	20.5
1975	36.3	7.8	71.2	29.9
1976	42.9	11.2	55.2	19.1
1977	40.3	10.0	38.8	12.1
1978	40.9	9.9	38.2	12.3

Year	Jamaica		Trinidad and Tobago	
	As a ratio of current revenue	*As a ratio of GDP*	*As a ratio of current revenue*	*As a ratio of GDP*
1960	49.9	3.9	38.8	3.8
1965	59.9	12.4	41.3	7.5
1970	49.8	5.1	40.5	12.6
1971	49.3	9.2	40.8	6.9
1972	45.2	9.1	42.8	7.4
1973	47.8	9.5	42.6	8.0
1974	59.4	14.5	24.3	7.7
1975	95.9	15.4	22.6	7.1
1976	58.5	14.0	23.3	7.6
1977	58.7	12.9	24.1	8.3
1978	68.3	19.0	23.0	7.5

Sources: Same as for Table 1; Table 1.

The coefficient of income elasticity of tax revenue indicates by how many percentage points a specific revenue source increases with an increase of one percentage point in income as well as it expresses the ratio between the marginal tax rate and the tax ratio of the earlier period. When the elasticity coefficient is greater than one, taxes are considered to be elastic and regarded as inelastic if the coefficient is less than one. In terms of the individual indirect taxes, the elasticity coefficients are shown in Table 5.

As one might expect, there is considerable variation in the value of the coefficient for the indirect taxes in the four countries. However, both Guyana and Jamaica have elastic indirect taxes while only the production and sales taxes indicate some degree of elasticity in Barbados

TABLE 5

Income elasticities of indirect tax revenues, 1970-76

Country	*Production and sales taxes*	*Trade taxes*	*Total indirect taxes* [a]
Barbados	1.3	0.5	0.9
Guyana	2.8	1.8	2.1
Jamaica	4.8	4.2	1.9
Trinidad and Tobago	2.1	−0.4	0.9

a 1960-76.

and Trinidad and Tobago. All of the four countries have relied relatively more on their production and sales taxes than on the international trade taxes, in terms of tax effort, as suggested by the data. These data, therefore, lend some support to the general impression that with the growth and diversification of their economies the developing countries have been turning more effort toward the exploitation of internal taxes with diminishing relative reliance on international trade taxes.

Indirect taxes in the Caribbean have been instrumental in bringing about an allocation of resources to some priority uses. Excise taxes have resulted in the reduction of the production of goods not regarded as essential for development; thus, resources have been channeled into the production of high priority goods under the assumption that demand is not perfectly inelastic. In the context of the growth of industrial production which in many cases means the production of domestic goods as substitutes for foreign imports, excise taxation not only makes up the loss in revenues caused by a fall in the proceeds from import taxes, but also becomes a very productive and expansive source of development finance.

One of the greatest weaknesses of indirect taxes in less developed countries, and the Caribbean is no exception, is their inability to reach high concerntrations of income and wealth as effectively as direct taxes. To that extent, indirect taxes can be regarded as regressive. Under the ability-to-pay principle taxes should bear some relationship to people's capacity to pay them. That is, the amount of taxes should be the same for people in the same economic position (horizontal equity), but different for people in different economic positions (vertical equity). Historically, however, indirect taxes, by their very nature, have never been able completely to satisfy these two criteria both in developed and developing countries.

2. Charles E. McLure, Jr., *The Incidence of Jamaican Taxes 1971-1972* (Kongston, Jamaica: Institute of Social and Economic Research, University of the West Indies, Working Paper No. 16, 1977), pp. 74-75.

3. Estimates of elasticities have been derived by fitting a long-linear function to the data for the period 1960-76 with gross domestic product as the independent variable.

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DIRECT TAXES

As for the direct taxes in the Caribbean, Table 6 indicates that they have been growing as a source of revenue. In all four countries total direct taxes have shown an uneven growth during the period 1970-78. In terms of the relative magnitude of the growth with respect to current revenues, increases in direct taxes as a percentage of current revenues were most pronounced in both Guyana and Trinidad and Tobago. In Guyana, direct taxes were up from an annual average of 32.7 percent of current revenues in 1972-76 to 40.3 percent in 1978, and in Trinidad and Tobago, from 59.7 percent to 70.8 percent.

TABLE 6

Composition of direct tax revenues, 1970-78
(Millions of U.S. Dollars)

	Barbados			*Guyana*		
Year	*Income taxes*	*Property taxes*	*Total*	*Income taxes*	*Property taxes*	*Total*
1970	13.0	0.8	13.8	24.1	2.2	26.3
1971	20.1	2.8	22.9	23.2	1.6	24.8
1972	18.4	3.0	21.4	33.1	1.7	34.8
1973	28.5	5.0	33.5	37.3	2.2	29.5
1974	27.0	5.4	32.4	35.6	1.6	37.2
1975	35.0	4.2	39.2	43.4	1.2	44.6
1976	41.9	4.4	46.3	49.3	2.5	51.8
1977	43.8	5.4	49.2	63.6	2.3	65.9
1978	43.6	4.8	48.4	57.2	2.2	59.4

	Jamaica			*Trinidad and Tobago*		
Year	*Income taxes*	*Property taxes*	*Total*	*Income taxes*	*Property taxes*	*Total*
1970	66.5	1.1	67.6	124.1	20.2	144.3
1971	168.4	2.8	171.2	74.4	2.8	77.2
1972	188.2	3.2	191.4	80.0	2.7	82.7
1973	247.9	17.8	265.7	108.8	15.9	124.7
1974	234.0	15.4	249.4	277.4	10.0	287.4
1975	210.3	24.8	235.1	315.3	9.1	324.4
1976	209.3	21.6	230.9	344.9	10.0	354.9
1977	163.7	21.3	185.0	397.9	11.3	409.2
1978	184.4	19.2	187.6	411.4	14.5	425.9

Sources: Same as for Table 1; Table 1.

Regarding the composition of direct taxes, Table 7 shows that income taxes (personal and corporate) constitute by far the most important form of direct tax revenue. However, only in Trinidad and Tobago did income taxes average more than 50 percent of current revenues while only Barbados had property taxes of more than 4 percent.

The personal income tax is a compulsory payment to government that is imposed by legislation. Income taxes really belong to a fairly advanced stage of economic development yet they are found in operation in a large number of developing nations, the reasons being quite simply that everyone is expected to contribute toward the expenditures that lead to development and this contribution is derived primarily from income.

TABLE 7

Direct taxes as a ratio of current revenues, 1972-76 and 1978
(Percentages)

	Income taxes		*Property taxes*		*Total direct taxes*	
Country	*1972-76*	*1978*	*1972-76*	*1978*	*1972-76*	*1978*
Barbados	39.8	43.0	5.7	4.7	45.5	47.7
Guyana	31.2	38.9	1.5	1.4	32.7	40.3
Jamaica	36.4	24.5	2.5	2.8	38.9	27.3
Trinidad and Tobago	55.8	68.4	3.9	2.4	59.7	70.8

Sources: Same as for Table 1; Table 6.

Taxation of net income in the Caribbean is complicated by many problems relating to permissible business expenses, including treatment of depreciation, exemptions and credits, and capital gains or casual profits. Hence, the measurement of net income for tax purposes is difficult and, as such, requires a high standard of administration for equitable results. However, personal income taxes in the Caribbean have been reasonably effective in reaching wage and salary income, where concealment is difficult.

As a percentage of total tax revenue, direct taxes in Barbados increased after 1973 to more than 50 percent. A similar situation prevailed in Trinidad and Tobago after 1972 and in Guyana after 1976. In Jamaica, direct taxes have always been less than 50 percent of total tax revenues during 1960-78.

TABLE 8

Percentage of total tax revenue from direct taxes, 1960-78

Year	*Barbados*	*Guyana*	*Jamaica*	*Trinidad and Tobago*
1960	29.1	38.0	34.7	51.2
1965	37.9	34.5	34.2	46.9
1970	45.2	44.1	45.1	52.5
1971	50.8	40.9	47.1	50.9
1972	49.5	50.0	48.1	49.9
1973	39.4	47.1	49.1	53.1
1974	52.5	30.1	37.5	73.1
1975	57.7	24.2	34.9	75.8
1976	51.8	35.7	38.4	74.1
1977	55.2	54.2	36.0	74.0
1978	53.8	51.3	28.5	75.5

Sources: Same as for Table 1; Table 1.

Direct taxes, or more specifically income taxation, are a very convenient device for introducing the principle of equity in tax structure. Due to the capacity of income taxation to introduce an element of built-in flexibility in the tax structure, it is regarded even in developed countries as a very important counter-cyclical device for achieving economic stabilisation. Thus, in the analysis of taxation in developing countries, the traditional objectives of progressivity and equity in taxation have pointed strongly to, and have resulted in, more aggressive use of net income and wealth taxation.

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Though a highly progressive income tax with high marginal rates on upper income ranges is a very desirable fiscal instrument both on grounds of resource mobilisation for the public sector and redistributive considerations which are very important in less developed countries, it tends to conflict with the criteria of economic efficiency and progress in a context where the growth of savings and investment occupies an important place in the process of economic development, [4] as is the case in the Caribbean. Moreover, except in Trinidad and Tobago, income taxes are relatively elastic as seen in Table 9.

TABLE 9

Income elasticities of direct tax revenues, 1970-76

Country	*Income taxes*	*Property taxes*	*Total direct taxes*
Barbados	1.6	0.3	1.7
Guyana	1.2	0.6	1.1
Jamaica	2.3	22.3	2.6
Trinidad and Tobago	0.9	−0.3	1.2

For the period 1970-76, there is considerable variation in the elasticity coefficients for direct taxes in the Caribbean. In both Barbados and Jamaica, property taxes have a higher than average income elasticity coefficient. Since 1973 Jamaica has been steadily increasing its property tax yield due to increasing property tax rates. However, overall, it may be said that all of the countries have relied relatively more on income taxes. In 1973, the Jamaican government proposed income tax relief for pensioners, payments of mortgage interest, health insurance and medical expenses, and premiums for equity-linked life insurance. But since the advantage of these reliefs are available only to Jamaicans paying income tax, and because the benefit of the reliefs rises with the taxpayer's marginal tax rate, these tax reductions reduce the burdens on upper income households, and therefore weaken the progressivity of the income tax and of the overall Jamaican tax system. [5]

Since 1974 the structure of the tax system has not undergone any major modification in Trinidad and Tobago. Largely because of the unique position of the country's petroleum sector and measures designed to tap the increased petroleum profits, income taxes now account for more than two thirds of total current revenues. In Barbados, the domestic revenue effort has been relatively stable since 1970, except for the strongly recessionary years of 1974-75. The country's income tax effort has shown some improvement due to increases in corporation tax rates and higher wages and salaries.

The increasing importance of the taxation of income and company profits in the Caribbean underline the need, therefore, for encouraging the growth of individual and business savings, and the ploughing back of retained profits of business into the expansion of investment. The tax policy should therefore be directed to further mobilisation of resources for development and allocating them according to development planning priorities.

AN ASSESSMENT

Tax revenues represent the major proportion of all revenues collected in the Caribbean by the Central Government. Current tax revenues averaged about 86 percent of total current revenue in Barbados and Guyana, about 93 percent in Jamaica and about 90 percent in Trinidad and Tobago during 1970-78. Taxes, therefore, constitute an important part of the public finances of the Caribbean economy and as such a very important fiscal tool. The significance of tax revenue in the Caribbean can also be determined by examining the ratio of tax revenues to GDP. Tax revenues averaged 21.5 percent of GDP in Barbados, 26.3 percent in Guyana, 20.8 percent in Jamaica, and 23 percent in Trinidad and Tobago during 1970-78. The yield from taxation seems to indicate the response that migh be expected in a period of growing investment and national income as the countries attempt to move forward on their developmental paths. The tax ratios in the Caribbean are substantially higher than the average ratios in developing nations. The average ratio in developing nations, according to the most recent study, is 16.1 percent. [6]

As a fiscal tool, taxation has to aim at directing productive resources to uses which are necessary for development but which the private sector is unwilling to provide for, as is the case in the Caribbean. Such a direction of resources may be needed at certain times in developed countries also and may be engineered through a system of checks and incentives operating on decision-making units in the private sector. In the less developed nations, however, this may require, in addition, direct participation by government in production and investment activities. The major point being made here is quite simply that if fiscal policy is to make a net contribution to growth, its operations have to be supplemental to whatever can normally be expected to be achieved by the existing constellation of forces in the economy.

The object of both fiscal and development policy, therefore, is not to balance the budget of the public sector, but to balance the economy as a whole. In this respect, budgetary rules are different for governments than for individuals. It is important that governments should feel free to make appropriate use of budget surpluses or deficits, in conjunction with monetary and other policies, to counteract excesses or deficiencies of demand in the rest of the economy. [7]

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4. Kempe R. Hope, *Development Policy in Guyana: Planning, Finance, and Administration* (Boulder: Westview Press, 1979), p. 164.
5. McCLure, *The Incidence of Jamaican Taxes 1971-1972*, p. 40.
6. See Alan Tait et al., "International Comparisons of Taxation for Selected Developing Countries, 1972-76", IMF *Staff Papers 26* (March 1979), pp. 129-130.
7. Walter Heller et al., *Fiscal Policy for a Balanced Economy* (Paris: OECD, 1968), p. 15.

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TABLE 10

Ratios of total tax revenues to total current revenue and GDP, 1960-78
(Percentages)

Year	*Barbados*		*Guyana*	
	Tax/GDP	*Tax/Current revenue*	*Tax/GDP*	*Tax/Current revenue*
1960	6.4	98.5	10.9	92.1
1965	18.0	90.9	17.4	91.4
1970	21.9	81.4	22.4	87.6
1971	22.5	84.4	20.0	84.8
1972	22.0	85.1	23.3	87.5
1973	21.3	86.0	20.8	80.0
1974	20.1	86.2	29.3	90.8
1975	18.4	85.9	39.4	93.9
1976	23.3	89.1	29.6	85.8
1977	22.2	89.8	26.3	84.7
1978	21.5	88.7	25.3	78.5

Year	*Jamaica*		*Trinidad and Tobago*	
	Tax/GDP	*Tax/Current revenue*	*Tax/GDP*	*Tax/Current revenue*
1960	5.9	76.3	7.8	79.4
1965	18.8	91.2	14.1	77.7
1970	17.4	90.7	14.8	85.4
1971	18.4	93.2	14.6	83.1
1972	18.3	87.0	15.3	85.4
1973	19.2	93.9	15.0	90.8
1974	20.8	95.0	26.0	90.3
1975	23.7	95.2	29.2	93.5
1976	22.7	94.9	29.5	90.1
1977	20.2	91.7	31.8	92.9
1978	26.6	95.6	30.6	93.8

Sources: Same as for Table 1; Tables 1, 2, 6; and United Nations, *Yearbooks of National Accounts Statistics* (Several Years).

In determining the size of the budget, tradition in the theory of public finance takes its cue from welfare economics: it is rewarding to transfer money from the private sector through taxation — and to give up individual decision power in the process — only to the extent that the public authority is presumed to spend the money better, i.e. to the extent that the public services provide better value than would have been derived from spending the money on individual goods and services. [8]

Though some advances in economic thought have conquered sufficient ground for these principles to have been accepted among most policy makers, one of the obstacles to their effective implementation has been the persistence of widespread public suspicion of unbalanced budgets. It is true that, as spending is generally popular and taxation is not, the temptation to political leaders to run budget deficits, not justified by the overall state of the economy, can be great. This can bring about all those consequences of excess demand and inflation, frequently combined with misallocation of resources, which prudent governments would seek to avoid. But no simple predetermined rules for the balancing of budgets can guarantee responsible government. Protection against irresponsible fiscal policy must rest on informed leadership coupled with the development of wide public understanding of the questions at issue. [9] Methods of ensuring that the leadership is adequately informed and public understanding sufficiently developed are, accordingly, subjects to be emphasised.

In light of the currently accepted social goal of an equitable distribution of the national product and on the basis of the above discussion of fiscal policy, the main objectives that should govern tax and budgetary policy in LDC's, such as those in the Caribbean, may be stated as follows: (1) a further increase in the rate of investment by further control over actual and potential consumption, (2) a further encouragement of the flow of investment into channels judged to be most desirable from the point of view of maximum benefit to society, and (3) a regulation of the flow of purchasing power in accordance with the overall pattern laid down in the development plans.

All of these objectives have been advocated and imposed by the International Monetary Fund on most of the Caribbean economies in recent years. These objectives are related to the ultimate goals of rapid increase in national income and of improvement in its distribution. The problem is to design and maintain a tax structure that will be conducive to the accomplishment of these objectives.

Given the level of revenue now derived from taxation, then the tax system in the Caribbean need only be directed increasingly toward meeting the long-term needs of development. This, therefore, implies a tax system with more administrative flexibility, one where incidence can be rationalised, and one which can be used as a means of controlling inflation — a major problem in the Caribbean. One of the major objectives of taxation in the Caribbean should be that of the mobilisation of internal resources to meet development financing requirements. The amount raised by a government is not necessarily linked to the amount it spends in providing services. Public funds come from other sources than taxation, but the power to tax is uniquely a power of government and its exercise is a matter of crucial importance to the economic and social life of a nation.

CONCLUSIONS

It seems that the determining factors of tax structure for the Caribbean are primarily economic. The character of and change in the economic bases to be taxed are more important than the style of taxation. Taxation policies should be viewed in terms of their ability to support the government's needs for capital to finance economic development within the framework of the limits to the sources of the taxes. Excessive taxation may restrict economic incentives and productive efforts and may cause business activity and national income to decline. However, no definite answer can be given to the question of what is the optimum taxation level that could be carried by the Caribbean economies, or any economy for that matter. It seems, however, that given the elastic nature of the total direct taxes in all of the countries, they are prime candidates for increased tax rates. But, of course, these increased tax rates must be considered within the context of increased revenue, encouragement to non-inflationary impact, and administrative feasibility.

8. Dirk J. Wolfson, *Public Finance and Development Strategy* (Baltimore: Johns Hopkins University Press, 1979), p. 33.
9. Heller et al., *Fiscal Policy for a Balanced Economy*, p. 16.

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The effect of Income Taxes on Capital Budgeting in Nigeria

by A.C. EZEJELUE*

I. INTRODUCTION

Capital budgeting means long-term planning for proposed long-term capital investments and their financing. It is a many-sided activity that includes searching for new and more profitable investment proposals, investigating engineering and marketing considerations to predict the consequences of accepting the investment, and making economic analyses to determine the profit potential of each investment proposal. [1] *Management is often faced with the problem of planning and controlling capital expenditure programmes for adding new facilities, replacement of existing equipment, introduction of new products, and embarking on extraordinary repairs. These are usually long-term propositions involving large outlays of money which may be financed out of working capital, or out of long-term borrowing, or out of share issues.*

Therefore, before getting involved in such a capital expenditure programme it is desirable that management seek assurance that the expenditure will be worthwhile. Worthwhileness is more generally measured in terms of profitability. A number of factors will undoubtedly contribute to the profitability of such expenditure. "The capital budget, itemising the company's capital acquisitions, its appropriations, expenditures, tax shields and grants, will ultimately determine the company's profitability and in addition, its very ability to survive..." [2]

The purpose of this article is not to examine the modern techniques of capital budgeting, but rather to show the impact, if any, on a project's profitability of income taxes and related issues of capital allowances, and/or depreciation deductions and methods in the Nigerian environment. The fact has earlier been highlighted [3] *that the implications of many investment decisions in Nigeria are so far-reaching that some projects considered otherwise as borderline cases may become worthwhile proposals, and therefore full consideration should always be given to the tax savings in every investment proposal.*

II. INCOME TAX EFFECTS

Although a number of other forms of taxes may have some influence on the issue of capital budgeting, we shall limit our discussion here to the effects of company income tax.

Income taxes being cash disbursements are capable of playing an important role in capital budgeting by influencing the quantum and the timing of cash flows. But this depends on the possibility of reduction and/or reallocation of tax payments through non-cash expense deductions such as depreciation and capital allowances. Therefore corporate income taxes *per se*, as the impression is often created, do not always affect the incentive to invest in capital assets. Income taxes may or may not be a factor in evaluating capital expenditure. [4]

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IV. EFFECT OF OUR TAXING POLICY ON INVESTMENT DECISIONS

V. POSSIBLE TAX ADVANTAGE THROUGH CAPITAL ALLOWANCES MANOEUVRABILITY

VI. SUMMARY

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1. Harold Bierman and Seymour Smidt, *The Capital Budgeting Decision* (New York: MacMillan Co. Inc., 1975), p. 4.
2. Walter S. Goff, *Management Accounting for Managers* (London: MacDonald & Evans Ltd., 1975), p. 277.
3. See A.C. Ezejelue, "Nigeria: Tax Considerations for investment and business decisions", 33 *Bulletin for International Fiscal Documentation* (1979), pp. 398-408.
4. Gerald R. Crowningshield and Kenneth A. Gorman, *Cost Accounting* (New York: The MacMillan Co., 1972), p. 212.

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Much will depend on the taxing law in operation in the particular environment. If the relevant *lex situs* on taxation makes it possible, through the treatment of depreciation and/or capital allowances, for the tax payment to be reduced or re-allocated so that, in the latter case, the payments could occur at more favourable times, then tax planning becomes an important factor in evaluating capital expenditure even though the total tax bill as measured in monetary units remains the same in the long run.

III. EFFECTS OF DEPRECIATION AND DEPRECIATION METHODS

A. Depreciation deductions

Where depreciation deductions which are non-cash expenses are allowable deductions for tax purposes, then they will afford tax shelters since they will protect an equal amount of earnings generated by the investment from taxation. In this kind of situation, therefore, it becomes financially expedient to introduce income tax effects into depreciation analysis. "[D]epreciation accounting in the absence of income taxes did not affect the investment decision, but the depreciation computed for tax purposes does affect the investment decision." [5] One effect of income tax depreciation accounting analysis is the possibility of improving the cash flow with the income tax saved as a result of treating the depreciation on the investment as a deductible expense for tax purposes.

Since the cost of the investment less its residual value represents a future tax deduction over the useful life of the asset, the present value of the deduction will depend on its specific yearly effects on future income tax payments. [6] In other words, the present value will be influenced not only by the tax rates and the discount rate but also by the depreciation method used.

B. Depreciation method in use

If depreciable assets are the subject of the investment appraisal, the method of calculating depreciation will change the time pattern of the after-tax cash flows. A number of depreciation methods exist, including straight-line method, reducing balance method, sum-of-the-years's-digits method, and revaluation method. If companies have considerable leeway in the choice of depreciation method to write off their assets for tax purposes, any method that is advantageous from a cash position point of view should be adopted in making capital expenditure decisions. For example, in the United States, "Under the internal revenue code, a company has a choice (among other methods) of depreciating a new asset by using straight-line depreciation, sum-of-the-year's digits, or twice straight line on the declining balance... [I]t has frequently been noted that the choice of depreciation method will affect the profitability of the investment." [7]

From the illustration below, it is clear that any of the decreasing-charge methods, such as the sum-of-the-year's-digits or the reducing balance, will accelerate depreciation deductions in the earlier years and therefore maximize the present values of income tax savings. The beauty of the accelerated methods as applied to capital budgeting is that they provide a larger tax shelter by postponing tax outlays to future periods. In view of the time value of money, present tax savings are more advantageous than future tax savings. The motto in income tax planning is: "When there is a legal choice, take the deduction sooner rather than later; and recognise taxable income later rather than sooner." [8]

Illustration I

Chinasa Ltd. has just bought block moulding equipment for ₦40,000. The equipment has a four-year life and no residual value. The minimum desired rate of return, after taxes, is 10 percent. Assuming that the relevant tax law recognises depreciation as a tax deductible expense, show the financial effects of using (i) an accelerated depreciation method, and (ii) a fixed instalment method, given that the tax rate for the period remains at 50 percent.

(i) *Sum-of-the-year's-digits depreciation*

Sum of digits = S = $\frac{n(n+1)}{2}$ (where n = years of estimated life) = $\frac{4(4+1)}{2}$ = 4 x 2.5 = 10

Year	*Multiplier*	*Deduction*	*Income tax effect: tax savings at 50%*	*Present value at 10% factor*	*TOTAL PV*
		₦	N ₦	₦	₦
1	4/10	16,000	8,000	.909	7,272
2	3/10	12,000	6,000	.826	4,956
3	2/10	8,000	4,000	.751	3,004
4	1/10	4,000	2,000	.683	1,366
				TOTAL PRESENT VALUE ...	₦16,598

(ii) *Straight-line depreciation*

Yearly depreciation = ₦40,000 : 4 = ₦10,000

Income tax effect: Savings at 50% = ₦5,000

Present value of ordinary annuity of ₦1.00 at 10% factor = 3.170

Present value of ordinary annuity of ₦5,000 at 10% factor = 3.170 x 5,000 = ₦15,850

The net difference in total present values in favour of using an accelerated method of depreciation is ₦(16,598 — 15,850) = ₦748. It follows therefore that where depreciation is an allowable expense for tax

5. Harold Bierman and Allan R. Drebin, *Managerial Accounting* (New York: The MacMillan Co., 1972), p. 212.
6. Charles T. Horngren, *Introduction to Management Accounting* (New Jersey: Prentice-Hall, Inc., 1978), p. 392.
7. Bierman and Smidt, op. cit., p. 132.
8. C.T. Horngren, op. cit., p. 393.

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purposes, the depreciation method used has a major influence on the present value of the stream of tax savings. Although we have assumed a fixed tax rate, tax rates and discount rates also have material influences on the present value of the tax deductions.

C. Tax treatment of depreciation in Nigeria

As we have shown earlier, depreciation computed for tax purposes affects investment decisions only if the relevant tax law treats depreciation as a deductible expense for tax purposes.

The present position in Nigeria is that the relevant tax laws [9] disallow depreciation of any asset, among other deductions, for tax purposes. In its place, the law grants capital allowances [10] on qualifying capital expenditure to companies and businesses. These capital allowances are principally made up of initial and annual allowances. Since in our illustration above we assumed a zero residual value at the end of the estimated useful life of the equipment there will be no balancing adjustment by way of either balancing allowance or balancing charge. However, in order to encourage investment in agriculture, all capital expenditures on plant and equipment incurred in agricultural production attract an investment allowance of 10 percent in addition to the existing capital allowances. [11]

IV. EFFECT OF OUR TAXING POLICY ON INVESTMENT DECISIONS

The total effect of disallowing depreciation for tax purposes in Nigeria is to nullify the financial effect of any selected depreciation method on investment decisions. Therefore depreciation methods in use do not offer any inducement to investment in new capital assets. Rather, the inducements are offered through capital allowances and the investment allowance where applicable.

CURRENT SCHEDULE OF NIGERIAN CAPITAL ALLOWANCES

The current schedule of Nigerian capital allowances is to be found in the Companies Income Tax Decree 1979 (Decree No. 28) Schedule 2 as amended by Section 35 of the Finance (Miscellaneous Taxation Provisions) Decree 1979 (Decree No. 98):

Qualifying expenditure in respect of	*Initial Allowances*	*Annual Allowances*
	Rate %	Rate %
Qualifying building expenditure	5	10
Qualifying industrial building expenditure	15	10
Qualifying mining expenditure	20	12½
Qualifying plant expenditure	20	12½
Qualifying plantation expenditure	25	15

This is unlike in the United States, where the method of depreciation selected by a company has a significant effect on the tax computations. What is relevant for capital budgeting purposes in Nigeria, therefore, are the various capital allowances (investment allowances in some cases) and not depreciation because only the former shelter the company's profits from tax. Thus:

	₦
Accounting profit before taxation	30,000
Add: Depreciation	12,000
Adjusted profit for tax purposes	42,000
Deduct: Capital allowances (tax shield)	15,000
Taxable income	₦27,000

The position appears to be the same in Nigeria as in the United Kingdom. "Taxation would affect the negative cash flow caused by buying and using the machine by virtue of investment grants, writing down allowances and balancing allowances or balancing charges." [12] Therefore, for capital budgeting purposes it is the capital allowances which produce the tax shelter.

Illustration II

Chizoba Ltd. is considering buying breadmaking equipment for ₦20,000. The equipment which will earn ₦5,000 annually will be scrapped for ₦1,000 at the end of its sixth year. Assume that the initial allowance for this kind of asset is 40 percent while its annual allowance is 25 percent. The minimum desired rate of return is 10 percent. Assume also a fixed tax rate of 45 percent. Will the investment be advisable?

Since there is a negative net present value, the desired investment is not worthwhile. This view is also supported by the profitability index which is less than one. The investment could have been acceptable if the net present value $\geqslant 0$ or the profitability index $\geqslant 1$. So long as the net present value $\leqslant 0$, which suggests a rejection of the proposal, the profitability index may be superfluous. However, the profitability index tends to make the present value approach more appreciable to management and would be more meaningful for making a choice among conflicting proposals.

The above illustration shows how our capital allowance and not depreciation constitutes a tax shelter to a company. It does this by its offsetting effect against earnings, thereby legally reducing or avoiding tax liability. A going concern has no choice either in the rates of capital allowances or in the way or ordering capital allowances claims to any greater advantage.

9. See S. 22(c) of Companies Income Tax Decree (Decree No. 28) 1979; S. 18(g) of Income Tax Management Act, 1961.
10. See paragraphs 6, 7, 8, 10 of Schedule 2 to Companies Income Tax Decree 1979; paragraphs 7, 8, 10, 11 of Fifth Schedule to Income Tax Management Act, 1961.
11. A.C. Ezejelue, op. cit., p. 404.
12. R.E. Palmer and A.H. Taylor, *Financial Planning and Control* (London: Pan Books Ltd., 1972), p. 260. (Some of these allowances are similar to our capital allowances.)

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CHIZOBA LTD

Solution: Investment appraisal

(Tax considerations using present-value approach)

	1	2	3	4	5	6	7	8	9
YEAR	*Written down value*	*Annual cash earnings*	*Initial allowance*	*Annual allowance*	*Taxable earnings*	*Tax at 45% on PYB**	*After-tax earnings*	*Discount at 10% factor*	*Total present value*
	beginning of year		40%	25%	(2-3-4)	(45% of 5)	(2-6)	*PV Table*	(7 x 8)
	₦	₦	₦	₦	₦	₦	₦	₦	₦
1	20,000	5,000	8,000	5,000 [13]	(8,000)	—	5,000	.909	4,545
2	7,000	5,000	—	1,750	3,250	(3,600)	8,600	.826	7,104
3	5,250	5,000	—	1,313	3,687	1,463	3,537	.751	2,656
4	3,937	5,000	—	984	4,016	1,659	3,341	.683	2,282
5	2,953	5,000	—	738	4,262	1,807	3,193	.621	1,983
**6	2,215	5,000	—	—	3,785	1,918	1,867	.564	1,053
7	—	—	—	—	—	(1,703)	(1,703)	.513	(874)
Total present value									18,749
Net present value ₦(20,000 – 18,749)									(1,251)

Profitability/Desirability index: $\frac{\text{Present value of net cash benefits}}{\text{Present value of outlays}} = \frac{E}{C} = \frac{19623}{(20000 + 874)} = \frac{19623}{20874} = 0.940$

* The lag factor applied in tax payment is due to the application of the preceding year basis (PYB) of assessment.

** At the end of year six, a balancing adjustment is made. The loss on disposal of ₦1,215 = (2,215 — 1,000) at the end of year six is deducted from the earnings of year six and charged to tax in year seven. The loss constitutes a balancing allowance. There is nil annual allowance in the year of disposal. The adjustment, i.e. the merging of earnings and loss on disposal in year six, is necessary for the purposes of present-value computation.

Although the rates are subject to change, they are matter for the tax law which must be adhered to by all concerned.

It is occasionally obliquely implied [14] that even in a place such as Nigeria where depreciation is not tax deductible that the effect of the depreciation method selected could affect a capital budgeting decision if (as is often the case) the depreciation deductions used for prudent accounting purposes are greater than the capital allowances used for tax purposes.

This conception appears to be erroneous for the simple fact that once depreciation is non-tax deductible, it has no place in the capital budgeting analysis. Out tax law *simpliciter* does not admit it, and therefore we need not include it when discussing non-cash items that provide tax shelters in capital budgeting. Any depreciation deduction made as may be necessitated by prudent accounting is added back for tax purposes, thereby making it ineffectual in providing a tax shelter. Since governments use tax laws to influence the level of capital investments, capital expenditure decisions are expected to be consistent with the relevant tax laws of the particular environment.

However, where it becomes possible in future for our tax law to incorporate an option for companies to choose an annual rate considered suitable to them for calculating the annual allowances, then it becomes intelligible, as in the case of the depreciation method selected, for companies to talk of an accelerated or reduced rate as it affects their tax-sheltered items.

Where there is zero or inadequate earnings to take care of the capital allowances claims, they may be carried to a future year with higher earnings. For the purposes of present value, however, the tax shelter should be phased into the period in which tax becomes payable.

When the asset is scrapped, sold, or disposed of it attracts either a balancing allowance or a balancing charge. [15] Where the proceeds or a sale or disposal exceed the residual value of the assets (arrived at after deducting the cumulative capital allowances to the date of disposal) there will be a balancing charge. The reverse effect attracts a balancing allowance. For capital budgeting purposes, a balancing charge incurs a tax liability for a company while a balancing allowance provides a tax shield.

13. It is assumed that the basis period for the first year of assessment is a period of not less than one year — otherwise the annual allowance would be proportionally reduced. See provisos to paragraph 7 of Schedule 2 to Companies Income Tax Decree 1979 and to paragraph 8 of Fifth Schedule to Income Tax Management Act 1961.

14. See, for example, F.O. Okafor, *Analysis of Financial Statements*, Monograph, April 1980.

15. See paragraph 9 and 10 of Schedule 2 to Companies Income Tax Decree 1979 and paragraphs 10 and 11 of Fifth Schedule to Income Tax Management Act, 1961.

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V. POSSIBLE TAX ADVANTAGE THROUGH CAPITAL ALLOWANCE MANOEUVRABILITY

We have said earlier that a going concern cannot manoeuvre capital allowance claims to any special advantage. However, this kind of manoeuvrability is possible in the case of new Nigerian businesses.

Our tax laws [16] allow a new company the option to elect to be assessed for its second and third years of operation on the actual profits of those years instead of being assessed for those years on the special rules for new trades or businesses. The implication of this is that the exercise of this option by a company will accelerate the claiming of capital allowances in respect of any assets bought within the first three financial years. [17] Thus:

Illustration III

Chidinma commenced business on January 1, 1974 and makes up its account to December 31 of each year. The following assets qualifying for initial allowance were bought:

January 1, 1974 ...	₦3,000
May 1, 1974 ...	₦4,000
September 1, 1975 ...	₦2,000
February 27, 1976 ...	₦1,500

The initial allowances will fall to be claimed as follows:

Date bought	*Cost Naira*	*Where no option is exercised*	*Where option is is exercised*
Jan. 1, 1974	3,000	1973 - 74	1973 - 74
May 1, 1974	4,000	1974 - 75	1974 - 75
Sept. 1, 1975	2,000	1976 - 77	1975 - 76
Feb. 27, 1976	1,500	1977 - 78	1975 - 76

(*Source:* A. C. Ezejelue, "Nigeria: Tax Considerations for Investment and Business Decisions", 33 *Bulletin for International Fiscal Documentation* (1979), p. 405.

From the capital budgeting point of view the accelerated claiming of capital allowances has the same effect as the accelerated depreciation deductions in the earlier years, that is to say, maximizing the present values of income tax savings because it provides a larger tax shield by postponing tax outlays to future periods.

VI. SUMMARY

Capital budgeting usually involves a large investment outlay of funds in one time period with a promise to obtain a net funds inflow in a future time period. The impact of such huge outlay on the profitability and continued existence of any organization is so far reaching that it is not a matter to toy about with. Therefore all available merits of the investment must be analysed before embarking on the investment proposal.

Nowadays, the effects that taxation will have on cash flows is of much relevance in appraising the merits of any capital expenditure. In fact, the forces of taxation are too large to ignore, and the analyst must recognize them, giving particular attention to the options his firm faces that may permit lessening the adverse effects of the tax claim on the project he is studying. [18]

The present value of a project will depend on the quantum and the timing of the cash flows occasioned by the project. The Nigerian government attempts to stimulate capital investments through granting of capital and investment allowances rather than depreciation which is employed purely for prudent accounting purposes. Decreasing the total amount of taxes to be paid during the life of the asset has an inducement effect of increasing the present values of the benefits expected from the investment proposals. Alternatively, it decreases the present values of the expected expenditure proposals.

Since the Nigerian tax laws grant liberal capital and investment allowances to stimulate investments, managers should not only have a wide appreciation of their possible tax effects on capital budgets but will seek expert advice and analysis where necessary. This is particularly urged because no capital allowance shall be granted to any company unless claimed by it or where the tax board is of the opinion that it would be reasonable and just to grant it. [19] The possibility of the latter appears to be remote.

16. See S. 24 (3)(d) of Companies Income Tax Decree 1979; Sec. 20 (3)(d) of Income Tax Management Act 1961.
17. A.C. Ezejelue, op. cit. p. 405.
18. Pearson Hunt et al. *Basic Business Finance* (Illinois: Irwin Inc., 1975), p. 155.
19. Paragraph 22 of Schedule 2 to Companies Income Tax Decree 1979; paragraph 27 Fifth Schedule to Income Tax Management Act 1961.

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Nigeria:
BUDGET 1980

Extract of a statement made by the Federal Minister of Finance, Professor S.M. Essang, on March 31, 1980.

. . . .

2. As you are aware, this is the first budget, which the new Civilian Administration has prepared since it came into office on the 1st of October, 1979. Moreover, an important feature of this Budget is that this fiscal year will run for only 9 months as against the normal 12 months because of the change over to calendar year which runs from January to December.

3. As an elected Government which was voted to office to carry out the promises it made to the electorate, our proposals differ in emphasis from those in the previous years. Accordingly, various measures I will announce to you now are designed to achieve the present Administration's policy objectives which consist of:

(i) rationalisation of existing fiscal measures with a view to removing unwarranted impediments in the areas of production and trade;
(ii) diversification of the Government revenue base;
(iii) facilitating the dispersal of industries;
(iv) encouraging the manufacturing sector to increase the use of local raw materials and thereby local value added;
(v) facilitating vigorous and relentless implementation of government's priority programmes in the areas of agriculture, housing, industrialization, etc.;
(vi) increasing the availability of essential food items to the generality of our people;
(vii) reduction of the level of unemployment by increasing the tempo of economic activities;
(viii) reduction of the rate of inflation by increasing local production through a combination of the foregoing measures and supplementing local production with imports of essential items as well as by appropriate combination of fiscal and monetary measures;
(ix) ensuring a more equitable distribution of output and incomes in the economy.

FISCAL MEASURES

4. The Federal Government has made a critical review of the various fiscal measures adopted by the previous Administration since 1975 with a view to determining a new direction of policy and in order to achieve the objectives stated above. As you are aware, the policy of imports liberalisation which characterised the 1975/76 and 1976/77 budgets had to be reversed in the subsequent budgets in order to avoid disaster. There was a swing of the pendulum to the other extreme of severe import restrictions which imposed considerable hardship on both consumers and entrepreneurs in the economy. For example, even though the rationale behind import restriction was to maintain a healthy external reserve and protect local industries, yet the severity of those restrictions led to higher domestic prices, higher rate of smuggling and under-utilisation of port facilities. It is against this background that the present Administration has decided to adopt a combination of policies that will produce a self-reliant economy and at the same time bring about a healthy balance of payments position. However, we are aware that frequent changes in fiscal policy tend to generate an atmosphere of uncertainty, which militates against investment decisions. Therefore, I wish to caution that the mere fact that we are currently experiencing rising crude oil prices should not be taken as a signal for pursuing the kind of import liberalisation policy of 1975 to 1977.

Agriculture

5. In addition to the existing incentives granted in previous years, and because of the importance attached to agriculture by this Administration, import duty on fishing vessels is abolished in order to bring the concession in line with free import duty on agricultural machinery and equipments.

Manufacturing Industry

6. The industrial policy of this Administration is to promote geographical spread of industries in order to achieve even industrial development throughout the whole country. To this end, concessions on a sliding scale in the form of approved user scheme will be granted to industries located in the hinterland which import their raw materials. The farther inland and away from the port the smaller the duty payable and vice versa. To encourage the use of local raw materials the higher the local value added the less excise duty shall be payable.

(i) *Commercial vehicle assembly/manufacturing plants*

To protect the local assembler/manufacturer of commercial vehicles the duty or CBU (completely built up) vehicles is raised from 20 percent to 35 percent. To take account of differences in location, the following differential rates of duty are introduced on CKD parts imported by local commercial vehicle assemblers/manufactureres:

(a) approved assemblers/manufacturers in Lagos 20 percent;
(b) approved assemblers/manufacturers in Ibadan 18 percent;
(c) approved assemblers/manufacturers in Enugu 15 percent;
(d) approved assemblers/manufacturers in Kano 10 percent;
(e) approved assemblers/manufacturers in Bauchi 5 percent.

(ii) *Electric fans*

To protect local assemblers/manufacturers of ceiling fans;

(a) import duty is raised from 50 percent to 75 percent;
(b) duty on motors is reduced from 331/3 percent to 10 percent.

(iii) *Galvanized flat sheet*

The duty on flat galvanized iron sheet is raised from 20 percent to 25 percent to protect local industry. Because of excess local capacity, an import licence shall not be granted without a letter of release.

(iv) *Lamp shades*

To protect local industry, import duty on lamp shades is raised from 40 percent to 50 percent.

(v) Duty has also been revised upwards for such items as tarpaulin, paper napkins, musical instruments, brass bed ornaments, wheel barrows to protect local industries and to raise revenue.

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(vi) To correct some anomalies in the existing rates of duty whereby raw materials imported for further processing attract the same duty with the finished products, changes have been introduced on some raw materials such as bentonite and barite, artificial resins, raw materials for dumpers, brake lining and disc pad.

(vii) *Cement*

Duty has been removed on paper bags and selected spare parts of the machinery used by cement factories.

Excise duty

7(i) Excise duty has been reduced on the following items:

(a) margarine	10 to 5 percent
(b) toothpaste	25 to 15 percent
(c) perfumery products	25 to 15 percent

(ii) Excise duty has been imposed on umbrellas and metal crown corks at the rates of 25 kobo each and 5 percent respectively.

Import prohibition

8(i) In order to encourage and protect local industries, the following items have been added to the import prohibition list:
(a) bicycle tyres and tubes in sizes 28 x $1^{1}/2$; 26 x $1^{3}/8$; 26 x $1^{3}/8$ and 26 x $1^{1}/2$ x $1^{1}/8$;
(b) concentrated malt extract;
(c) jute bags;
(d) fabrics for furniture.

(ii) To facilitate early resettlement and as a gesture to Nigerians returning home after a prolonged stay abroad to bring with them their personal effects, cars of engine capacity of 2,500cc and above brought by Nigerians who have stayed abroad for a period of not less than 9 months and for which foreign exchange transfer is not involved are removed from the import prohibition list. Such cars, will, however, attract 500 percent import duty.

Import licence

9. To encourage sporting activities and for safety consideration of industrial workers the following items have been removed from prohibition list and placed under import licence:
(a) sporting equipment not manufactured locally — football boots, spike shoes, boxing boots, cycling shoes, hockey boots, basketball boots, golf shoes, football jerseys and track suits;
(b) Industrial protective footwear, disciplined forces footwear, gloves and apparel are to be imported under approved user licence.

Open general licence

10. In addition to the items already on open general licence the following items have also been placed on open general licence:
(a) stockfish;
(b) louvre frames;
(c) insulated electric wire;
(d) plastic pipes;
(e) linoleum of all types in rolls;
(f) ceramic products such as sinks, wash hand basins, water closets, urinals and bidets.

The removal of these building materials from import restriction is to facilitate the implementation of the Federal and state governments' housing programme as well as to encourage the construction of individual owner-occupied houses.

TAXATION

11. **Changes in the accounting year of government and its consequential effect on assessment years and basis periods**

The accounting year of government is now from 1st January to 31 December and consequently the annual assessment year for tax purposes shall also be from 1st January to 31st December. In respect of the year of assessment which under the existing procedure will be 1980/81, the assessment year will now be "1980 Assessment Year" and shall be for the period 1st April, 1980 to 31st December, 1980. All assessments and payment of tax shall be completed between nine months instead of the usual twelve months. As from 1981, the normal 12 months assessment year shall commence on 1st January, 1981.

12. **Basis period for assessment**

(a) The existing procedure of assessing on income of the previous year remains unchanged.

(b) Basis period for assessment year 1980 in respect of income of individuals (other than employment income) therefore remains 1/4/79 — 31/3/80, while employment income will continue to be treated on current year basis. However, for the assessment year 1981, the basis period for individuals (other than employment income) shall be for the nine months ended 31/12/80.

(c) In respect of companies to which the Companies Income Tax Decree 1979 is applicable, the following distinctions have been made:
(i) those who make up accounts for accounting years ending between 1st April to 31st December:
(ii) those who make up accounts for accounting years ending between 1st January and 31st March;
(iii) petroleum producing companies;

In respect of companies of business in category (i), the normal preceding year basis will apply without change in 1980, 1981 and future years. For those in category (ii) it has been decided that for the assessment year 1980, the basis period will be the period beginning from the commencement of their accounting year up to 31st December, 1979. For example, if a company makes up its annual accounts up to 28th February, the basis period for 1980 year of assessment will be 1st March, 1979 — 31st December, 1979. This means the basis period will be less than 12 months. For the assessment year 1981, the basis period will be from 1st January, 1980 up to the end of the accounting year. In the case of the company in the above example, the basis period for the year 1981 will be 1/1/80 — 28/2/80.

13. The normal procedures in commencement and cessation cases will continue to apply, provided where taxpayers' options are exercised in accordance with the Companies Income Tax Decree 1979 for assessment on actual basis in the 1980 assessment year, the profits of the full 12 months are to be computed where necessary on pro-rata basis.

14. Provisions as to payment of tax on receipt of notice of assessment remain unchanged, except payments of tax have to be completed between 1st January and 31st December instead of 1st April and 31st March of the following year. In this connection, "21st day of March" as contained in S.58 of the Company Income Tax Decree will now read 14th December.

15. In the case of Personal Income Tax, existing dates will be related and converted appropriately to equivalent dates in the new assessment year, e.g. 1st December in the old system will become 1st September in the new assessment year and 1st April becomes 1st December and 31st March becomes 31st December, etc. Taxpayers are expected to clear with relevant tax authorities, if in doubt. Petroleum producing companies will continue to pay tax on current year basis as usual from 1/1/80 — 31/12/80 without change.

16. The present system of regarding a Company and its shareholders as two distinct persons for income tax purposes will continue. Companies will therefore continue to pay Companies Income Tax at the rate of 45 percent while shareholders will in addition pay tax on the dividends or similar distributions from companies.

17. However, where dividends are paid by one Nigerian company to another, in order

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to ensure that such dividends or such other distributions are not subjected to double taxation, the following procedure will be introduced this year:

(a) A company which is resident in Nigeria will be required to account to the Federal Board of Inland Revenue for income tax on the profits of the company and for income tax in respect of dividends paid or credited and other similar distributions made by it.

(b) A company, on paying or crediting a dividend or making any other payment which is a distribution in respect of which it is required to account for income tax, is authorised to deduct out of the distribution an amount equal to the income tax for which it is liable to account. In the case of dividends paid or credited by one company to another, the tax to be accounted for shall be at the rate of 45 percent and in the case of individuals the amount of tax to be accounted for shall be at the rate of 12½ percent.

(c) Dividends and other such distributions received by a company resident in Nigeria from another resident company on which the paying company is liable to account for income tax should be described as "franked investment income" of the recipient company. The recipient company is not charged to further income tax on such "franked investment income" but unless otherwise specifically exempted from tax, it is not entitled to repayment of the income tax accounted for by the paying company.

(d) In the case of a company or a non-resident individual, the tax deducted shall be accounted for to the Federal Board of Inland Revenue, and in all other cases to the relevant tax authority in which the individual is resident.

(e) In accounting for tax so deducted to a tax authority, the company shall state in writing the following particulars, that is to say:
  (i) the gross amount of the dividend or such similar distributions to each shareholder;
  (ii) the name and address of such recipient;
  (iii) the period of the accounting year in respect of which the dividend or distribution is paid;
  (iv) the amount of tax deducted and accounted for.

18. Distribution of profits after tax

Companies may distribute as dividends either a maximum of 60 percent of profits after tax or 25 percent of the paid-up capital, whichever is higher, provided such distributions are made out of current year profits.

19. Tax deduction at source on rents paid by companies

For the avoidance of doubt, the existing practice which was approved by government last year is as follows:

(i) Where any rent becomes due or payable by one company to another company or from one company to an individual, the Company paying such rent shall at the date when the rent is paid or credited, whichever first occurs, account to the Federal Board of Inland Revenue, or to a relevant State Tax Authority, income tax at the rate of 12½ kobo for each Naira.

(ii) A company, on paying any rent in respect of which it is required to account for income tax, shall deduct out of the rent paid or credited an amount equal to the income tax for which it is liable to account.

(iii) In accounting for the tax so deducted to the Federal Board or to any State Tax Authority, the company shall state in writing the following particulars, that is to say:
  (a) the gross amount of rent paid, credited per annum;
  (b) the name and address of the company to whom the rent has been paid or credited and the period in respect of which such rent has been paid or credited; and
  (c) the address or accurate description of the location of the property on which the rent is being paid.

20. In respect of payments of rent from one company to another, or from one company to a non-resident individual, the tax so deducted shall be remitted to the Federal Board of Inland Revenue. In all other cases, tax deducted shall be remitted to the relevant tax authority of the State in which the beneficiary of the rent is resident.

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COPYRIGHT ROYALTIES:

Conventions for the avoidance of double taxation

The International Conference of States convened jointly by the UNESCO and the World Intellectual Property Organization (WIPO) in Madrid in November-December 1979 adopted the final text of a Multilateral Convention for the Avoidance of Double Taxation of Copyright Royalties, to which was annexed an optional Model Bilateral Agreement on the same subject. In 33 *Bulletin for international fiscal documentation* 382 (1979) Prof. J. van Hoorn Jr. made some critical observations with respect to the draft model multilateral treaty. In this issue the final text — which deviates from the draft — is reproduced together with the proposed draft bilateral treaty.

MULTILATERAL CONVENTION FOR THE AVOIDANCE OF DOUBLE TAXATION OF COPYRIGHT ROYALTIES

The Contracting States,

Considering that the double taxation of copyright royalties is prejudicial to the interests of authors and thus constitutes a serious impediment to the dissemination of copyrighted works, which is one of the basic factors in the development of the culture, science and education of all peoples,

Believing that the encouraging results already achieved by action against double taxation, through bilateral agreements and domestic measures, whose beneficial effects are generally recognized, can be improved by the conclusion of a multilateral convention specific to copyright royalties,

Being of the opinion that these problems must be solved while respecting the legitimate interests of States and particularly the needs specific to those where the widest possible access to works of the human mind is an essential condition to their continuing development in the fields of culture, science and education,

Seeking to find effective measures designed to avoid double taxation of copyright royalties where possible and, should it subsist, to eliminate it or to reduce its effect,

Have agreed on the following provisions:

CHAPTER I
DEFINITIONS

Article 1
Copyright royalties

1. For the purposes of this Convention and subject to the provisions of paragraphs 2 and 3 of this Article, copyright royalties are payments of any kind made on the basic of the domestic copyright laws of the Contracting State in which these royalties are originally due, for the use of, or the right to use, a copyright in a literary, artistic or scientific work, as defined in the multilateral copyright conventions, including such payments made in respect of legal or compulsory licences or in respect of the "droit de suite".

2. This Convention shall not, however, be taken to cover royalties due in respect of the exploitation of cinematographic works or works produced by a process analogous to cinematography as defined in the domestic copyright laws of the Contracting State in which these royalties are originally due when the said royalties are due to the producers of such works or their heirs or successors-in-title.

3. With the exception of payments made in respect of the "droit de suite" the following shall not be considered as copyright royalties for the purposes of this Convention: payments for the purchase, rental, loan or any other transfers of a right in the material base of a literary, artistic or scientific work, even if the amount of this payment is fixed in the light of, the copyright royalties due or if the latter are determined, in whole or in part, by that of the said payment. When a right in the material base of work is transferred as an accessory to the transfer of the entitlement to use a copyright in the work, only the payments in return for this entitlement are copyright royalties for the purpose of this Convention.

4. In the case of payments made in respect of the "droit de suite" and in all cases of the transfer of a right in the material base of a work referred to in paragraph 3 of this Article and independently of the fact that the transfer in question is or is not free of charge, any payment made in settlement of or as a reimbursement for an insurance premium, transport of warehousing costs, agent's commission or any other remuneration for a service, and any other expenses incurred, directly or indirectly, by the removal of the material base in question, including customs duties and other related taxes and special levies, shall not be a copyright royalty for the purposes of this Convention.

Article 2
Beneficiary of copyright royalties

For the purposes of this Convention, the "beneficiary" of copyright royalties is the beneficial owner thereof to whom all or a part of such royalties is paid, whether he collects them as author, or heir or successor-in-title of the author, or whether he collects them in application of any other relevant criterion as agreed to in a bilateral agreement concerning double taxation of copyright royalties.

Article 3
State of residence of the beneficiary

1. For the purposes of this Convention, the State of which the beneficiary of the copyright royalties is a resident shall be deemed to be the State of residence of the beneficiary.

2. A person shall be deemed to be a resident of a State if he is liable to tax therein by reason of his domicile, residence, place of effective management or any other relevant criterion as agreed to in a bilateral agreement concerning double taxation of copyright royalties. But this term does not include any person who is liable to tax in that State in respect only of income from sources in that State as capital he possesses there.

Article 4
State of source of royalty

For the purposes of this Convention, a State shall be deemed to be the State of source of copyright royalties when such royalties for the use of, or the right to use,

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a copyright in a literary, artistic or scientific work are originally due:

a) by that State or by a political or administrative subdivision or local authority of that State;
b) by a resident of that State except where they result from an activity carried on by him in another State through a permanent establishment or from a fixed base;
c) by a non-resident of that State, where they result from an activity carried on by him through a permanent establishment or from a fixed base.

CHAPTER II
GUIDING PRINCIPLES FOR ACTION AGAINST DOUBLE TAXATION OF COPYRIGHT ROYALTIES

Article 5
Fiscal sovereignty and equality of rights of states

Action against double taxation of copyright royalties shall be carried out, in accordance with the provisions of Article 8 of this Convention, with due respect for the fiscal sovereignty of the State of source and the State of residence, and due respect for the equality of their right to tax these royalties.

Article 6
Fiscal non-discrimination

The measures against double taxation of copyright royalties shall not give rise to any tax discrimination based on nationality, race, sex, language or religion.

Article 7
Exchange of information

In so far as it is necessary for the implementation of this Convention, the competent authorities of the Contracting States will exchange reciprocally information in the form and under the conditions which shall be laid down by means of bilateral agreement.

CHAPTER III
IMPLEMENTATION OF THE GUIDING PRINCIPLES FOR THE ACTION AGAINST DOUBLE TAXATION OF COPYRIGHT ROYALTIES

Article 8
Means of implementation

1. Each Contracting State undertakes to make every possible effort, in accordance with its Constitution and the guiding principles set out above, to avoid double taxation of copyright royalties, where possible, and, should it subsist, to eliminate it or to reduce its effect. This action shall be carried out by means of bilateral agreements or by way of domestic measures.

2. The bilateral agreements referred to in paragraph 1 of this Article include those which deal with double taxation in general or those which are limited to double taxation of copyright royalties. An optional model of a bilateral agreement of the latter category, comprising several alternatives, is attached to this Convention of which it does not form an integral part. The Contracting States, while respecting the provisions of this Convention, may conclude bilateral agreements based on the norms that are most acceptable to them in each particular case. The application of bilateral agreements concluded earlier by the Contracting States is in no way affected by this Convention.

3. In case of adoption of domestic measures, each Contracting State may, notwithstanding the provisions of Article 1 of this Convention, define copyright royalties by reference to its own copyright legislation.

CHAPTER IV
GENERAL PROVISIONS

Article 9
Members of diplomatic or consular missions

The provisions of this Convention do not affect the fiscal privileges of members of diplomatic or consular missions of the Contracting States, as well as of their families, either under the general rules of international law or under the provisions of special conventions.

Article 10
Information

1. The Secretariat of the United Nations Educational, Scientific and Cultural Organization and the International Bureau of the World Intellectual Property Organization shall assemble and publish relevant normative information concerning taxation of copyright royalties.

2. Each Contracting State shall communicate, as soon as possible, to the Secretariat of the United Nations Educational, Scientific and Cultural Organization and to the International Bureau of the World Intellectual Property Organization, the text of any new law, as well as all official texts concerning the taxation of copyright royalties, including the text of any specific bilateral agreement on the relevant provisions on the said subject contained in any bilateral agreement dealing with double taxation in general.

3. The Secretariat of the United Nations Educational, Scientific and Cultural Organization and the International Bureau of the World Intellectual Property Organization shall furnish to any Contracting State, upon its request, information on questions, relating to this Convention; they shall also carry out studies and provide services in order to facilitate the application of this Convention.

CHAPTER V
FINAL CLAUSES

Article 11
Ratification, acceptance, accession

1. This Convention shall be deposited with the Secretary General of the United Nations Organization. It shall remain open until October 31, 1980, for signature by any State that is a member of the United Nations, any of the Specialized Agencies brought into relationship with the United Nations or the International Atomic Energy Agency, or is a party to the Statute of the International Court of Justice.

2. This Convention shall be subject to ratification or acceptance by the signatory States. It shall be open for accession by any State referred to in paragraph 1 of this Article.

3. Instruments of ratification, acceptance or accession shall be deposited with the Secretary-General of the United Nations.

4. It is understood that, at the time a State becomes bound by this Convention, it will be in a position in accordance with its domestic law to give effect to the provisions of this Convention.

Article 12
Reservations

The Contracting States may, either at the time of signature of this Convention or at the time of ratification, acceptance or accession, make reservations as regards the conditions of application of the provisions contained in Articles 1 to 4, 9 and 17. No other reservation to the Convention shall be permitted.

Article 13
Entry into force

1. This Convention shall enter into force three months after the deposit of the tenth instrument of ratification, acceptance or accession.

2. For each State ratifying, accepting, or acceding to this Convention after the deposit of the tenth instrument of ratification, acceptance or accession, this Convention shall enter into force three months after the deposit of its instrument.

Article 14
Denunciation

1. Any Contracting State may denounce this Convention by a written notification addressed to the Secretary General of the United Nations.

2. Such denunciation shall take effect twelve months after the date of receipt of

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the notification by the Secretary General of the United Nations.

Article 15
Revision

1. After this Convention has been in force for five years, any Contracting State may, by notification, addressed to the Secretary-General of the United Nations, request that a conference be convened for the purpose of revising the Convention. The Secretary-General shall notify all Contracting States of this request. If, within a period of six months following the date of notification by the Secretary-General of the United Nations, not less than one-third of the Contracting States, provided the number is not less than five, notify him of their concurrence with the request, the Secretary-General shall inform the Director-General of the United Nations Education, Scientific and Cultural Organization and the Director General of the World Intellectual Property Organization, who shall convene a revision conference with a view to introducing into this Convention amendments designed to improve action against double taxation of copyright royalties.

2. The adoption of any revision of this Convention shall require an affirmative vote by two-thirds of the States attending the revision conference, provided that this majority includes two-thirds of the States which, at the time of the revision conference, are parties to the Convention.

3. Any State which becomes a party to the Convention after the entry into force of a new Convention wholly or partially revising this Convention shall, failing an expression of a different intention by that State, be considered as:

a) a party to the revised convention;
b) a party to this Convention in relation to any State which is a party to the present Convention but is not bound by the revised convention.

4. This Convention shall remain in force as regards relations between or with the Contracting States which have not become parties to the revised convention.

Article 16
Languages of the convention and notifications

1. This Convention shall be signed in a single copy in Arabic, English, French, Russian and Spanish, the five texts being equally authoritative.

2. Official texts shall be established by the Director-General of the United Nations Educational, Scientific and Cultural Organization and the Director General of the World Intellectual Property Organization, after consultation with the interested Governments concerned, in the German, Italian and Portuguese languages.

3. The Secretary-General of the United Nations shall notify the States referred to in Article 11, paragraph 1, as well as the Director-General of the United Nations Educational, Scientific and Cultural Organization and the Director General of the World Intellectual Property Organization of

a) signature of this Convention, together with any accompanying text;
b) the deposit of instruments of ratification, acceptance or accession, together with any accompanying text;
c) the date of entry into force of this Convention under Article 13, paragraph 1;
d) the receipt of notifications of denunciation;
e) the requests communicated to him in accordance with Article 15, as well as any communication received from the Contracting State concerning the revision of this Convention.

4. The Secretary-General of the United Nations shall transmit two certified copies of this Convention to all States referred to in Article 11, paragraph 1.

Article 17
Interpretation and settlement of disputes

1. A dispute between two or more Contracting States concerning the interpretation or in the matter of application of this Convention, not settled by negotiation, shall, unless the States concerned agree on some other method of settlement, be brought before the International Court of Justice for determination by it.

2. Any State may, at the time of signing this Convention or depositing its instrument of ratification, acceptance or accession, declare that it does not consider itself bound by the provisions of paragraph 1. In the event of a dispute between that State and any other Contracting State, the provisions of paragraph 1 shall not apply.

3. Any State that has made a declaration in accordance with paragraph 2 may at any time withdraw it by notification addressed to the Secretary-General of the United Nations.

IN WITNESS WHEREOF, the undersigned, being duly authorized, have signed this Convention.

DONE at Madrid on December 13, 1979.

Model bilateral agreement for the avoidance of double taxation of copyright royalties

PREAMBLE OF AGREEMENT

The Government of (State A) and the Government of (State B),

Wishing to apply the principles set out in the Multilateral Convention for the Avoidance of Double Taxation of Copyright Royalties and thus to eliminate such double taxation or to reduce its effect,

Have agreed on the following provisions:

I
SCOPE OF THE AGREEMENT

Article I
Persons and royalties covered

1. This Agreement shall apply to persons who are residents of one or both of the Contracting States.

2. This Agreement shall apply to copyright royalties when they arise in one Contracting State and their beneficiary is a resident of the other Contracting State.

Article II
Taxes covered

Alternative A

1. This Agreement shall apply to compulsory taxes or deductions imposed on behalf of each Contracting State, (of its political subdivisions or its local authorities), irrespective of their description, their kind and the manner in which they are levied, provided that they are imposed on copyright royalties and are assessed on the amount of royalties, excluding taxes of a fixed nature calculated without reference to the amount of the royalty.

2. The existing taxes to which the Agreement shall apply are in particular:

a) in (State A)
   (i) [income tax applicable]
   (ii) [other taxes applicable]
   (iii) . . .
b) in (State B)
   (i) [income tax applicable]
   (ii) [other taxes applicable]
   (iii) . . .

3. This Agreement shall apply also to future taxes identical [or substantially similar] to those referred to in paragraph 1, which are imposed after the date of signature of this Agreement in addition to, or in place of, existing taxes.

4. The competent authorities of Contracting States shall communicate [at the

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beginning of each year] any changes in their respective laws and their application [made during the preceding year].

Alternative B

1. This Agreement shall apply to taxes imposed on behalf of each Contracting State [of its political subdivisions or its local authorities], irrespective of their description or the manner in which they are levied, provided that they are imposed on copyright royalties and are assessed on the amount of the royalties.

2. The taxes to which this Agreement shall apply are:

a) in (State A)
   (i) [total income tax]
   (ii) [other income taxes]
   (iii) . . .
b) in (State B)
   (i) [total income tax]
   (ii) [other income taxes]
   (iii) . . .

3. The competent authorities of Contracting States shall communicate [at the beginning of each year] any changes in their respective tax laws and their application [made during the preceding year].

II
DEFINITIONS

Article III
General definitions

For the purposes of this Agreement, unless the context otherwise requires:

a) the terms "a Contracting State" and "the other Contracting State" shall, depending on the context, refer to (State A) or (State B);
b) the term "person" includes an individual, a company and any other body of persons;
c) the term "company" means any body corporate or any entity which is treated as a body corporate for tax purposes;
d) the terms "enterprise of a Contracting State" and "enterprise of the other Contracting State" mean respectively an enterprise carried on by a resident of a Contracting State and an enterprise carried on by a resident of the other Contracting State;
e) the term "nationals" means:
   (i) all individuals possessing the nationality of a State;
   (ii) all legal persons, partnerships and associations deriving their status as such from the law in force in a State;
f) the term "competent authority" means:
   (i) in (State A), ... and,
   (ii) in (State B), ... ;
g) the term "copyright royalties" shall be interpreted in accordance with the definition given in Article 1 of the Multilateral Convention for the Avoidance of Double Taxation of Copyright Royalties;
h) the term "beneficiary of copyright royalties" shall be interpreted in accordance with the definition given in Article 2 of the Multilateral Convention for the Avoidance of Double Taxation of Copyright Royalties;
i) the term "State of source of royalties" shall be interpreted in accordance with the definition given in Article 4 of the Multilateral Convention for the Avoidance of Double Taxation of Copyright Royalties;
j) the term "State of residence of the beneficiary" shall be interpreted in accordance with the definition given in Article 3 of the Multilateral Convention for the Avoidance of Double Taxation of Copyright Royalties completed by Article IV of this Agreement.

Article IV
Resident

1. For the purposes of this Agreement, a person shall be deemed to be a resident of a State if he is so considered in application of the provisions of Article 3, paragraph 2, of the Multilateral Convention for the Avoidance of Double Taxation of Copyright Royalties.

2. Where by reason of the provision of paragraph 1 an individual is deemed to be a resident of both Contracting States, then his status shall be determined as follows:

a) he shall be deemed to be a resident of the State in which he has a permanent home available to him. If he has a permanent home available to him in both States, he shall be deemed to be a resident of the State with which his personal and economic relations are closer (centre of vital interests);
b) if the State in which he has his centre of vital interests cannot be determined, or if he has not a permanent home available to him in either State, he shall be deemed to be a resident of the State in which he has an habitual abode;
c) if he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident of the State of which he is a national;
d) if he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

3. Where by reason of the provisions of paragraph 2 a person other than an individual is deemed to be a resident of both Contracting States, [it shall be deemed to be a resident of the Contracting State in which its place of effective management is situated] [the competent authorities of the Contracting States shall settle the question by mutual agreement].

Article V
Permanent establishment — fixed base

1. For the purposes of this Agreement, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

[2. The term "permanent establishment" includes especially:

a) a place of management;
b) a branch;
c) an office;
d) an industrial installation;
e) a store or other sales outlet;
f) a permanent exhibition at which orders are received or solicited;
g) the furnishing of services, including consultancy services, by an enterprise through employees or other personnel, where activities of that nature continue, for the same or a connected project, in the territory of the same State [for . . . . months].

3. Notwithstanding the provisions of paragraphs 1 and 2, a "permanent establishment" shall not be deemed to include:

a) the use of facilities solely for the purpose of storage or display of goods belonging to the enterprise;
b) the maintenance of a stock of goods belonging to the enterprise solely for the purpose of storage or display;
c) the maintenance of a stock of goods belonging to the enterprise solely for the purpose of processing by another enterprise;
d) the maintenance of a fixed place of business solely for the purpose of purchasing goods, acquiring rights or collecting information for the enterprise;
e) the maintenance of a fixed place of business solely for the purpose of advertising, for the supply of information, for scientific research or for similar activities which have a preparatory or auxiliary character, for the enterprise.

4. Notwithstanding the provisions of paragraphs 1 and 2, a person acting in a Contracting State on behalf of an enterprise of the other Contracting State — other than an agent of an independent status, to whom paragraph 5 applies — shall be deemed to be a "permanent establishment" in the first-mentioned State:

a) if he has, and habitually exercises in that State, an authority to conclude contracts in the name of the enterprise, unless his activities are limited to the purchase of goods, or to the acquisition of rights, for the enterprise; or
b) if he has no such authority but habitually maintains in the first-mentioned

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State a stock from which he regularly delivers merchandise on behalf of the enterprise.

5. An enterprise of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business there through a broker, general commission agent, literary agent, or any other intermediary of an independent status, where such persons are acting in the ordinary course of their business. However, when the activities of such an intermediary are devoted exclusively or almost exclusively to that enterprise for more than . . . consecutive months, he shall not be deemed an agent of an independent status within the meaning of this Article.

6. The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of another Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not in itself constitute such a company as a permanent establishment of the other].

7. In this Agreement, the term "fixed base" means a place of residence and of work, or a place of work, where an individual habitually carries on a part at least of his activities of an independent nature.

III
RULES OF TAXATION

Article VI
Taxation methods

1st Alternative

Article VI A
Taxation by the State of residence subject to the existence of a permanent establishment or fixed base in the other State

1. Copyright royalties arising in a Contracting State and paid to a resident of the other Contracting State shall, subject to the provisions of paragraph 2, be taxable only in that other State if such resident is the beneficial owner of the royalties.

2. The provisions of paragraph 1 shall not apply with respect to taxes on income if the beneficiary of the royalties carries on an industrial or commercial activity in the other Contracting State in which the royalties arise, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right, activity or property in respect of which the royalties are paid is effectively connected with such permanent establishment or fixed base. In such a case, the royalties may be taxed solely in the State where the permanent establishment or the fixed base is situated, but only to the extent that these are attributed to that establishment or that base.

3. In each Contracting State, the royalties that the beneficiary might have been expected to collect if he had created a distinct and separate enterprise or if he had installed a distinct and separate place of work engaged in the same activities under the same or similar conditions independently of the centre of activity of which this enterprise or this place of work constitutes a permanent establishment or a fixed base, shall be attributed to that permanent establishment or that fixed base. There shall be allowed as deductions expenses directly connected with the copyright royalties and incurred for the purposes of the permanent establishment or fixed base, including executive and general administrative expenses so incurred, whether in the State in which the permanent establishment or the fixed base is situated, or elsewhere. The royalties attributed to the permanent establishment or the fixed base shall be calculated by the same method year by year, unless there is good and sufficient reason to the contrary.

[4. If a royalty is more than the normal, intrinsic value of the rights in respect of which it is paid, the provisions in paragraphs 1 and 2 may be applied only to that part of the royalty corresponding to this normal, intrinsic value].

2nd Alternative

Article VI B
Allocation of taxation between the State of residence and the State of source with the same tax ceiling in both Contracting States

1. Copyright royalties arising in a Contracting State and paid to a beneficial owner who is a resident of the other Contracting State shall be exempt in the first-mentioned State from the taxes covered under paragraph[s] 2(a)(ii) [and 2(a)(iii)] of Article II in the case of (State A) or under paragraph[s] 2(b)(ii) [and 2(b)(iii)] of Article II in the case of (State B).

2. Where royalties are subject to income tax in the Contracting State of source according to the law of that State and in the Contracting State in which the beneficial owner is resident, the tax so charged may not exceed "x"% of the amount of the royalty in the State of source and "y"% of the gross amount of the royalty in the State of residence.

3. The provisions of paragraphs 1 and 2 shall not apply if the beneficiary of royalties, being a resident of a Contracting State, carries on an industrial or commercial activity in which the royalties arise through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right, activity or property in respect of which the royalties are paid is effectively connected with such permanent establishment or fixed base. In such a case the royalties may be taxed solely in the State where the permanent establishment or the fixed base is situated, but only so much of them as is attributable to that permanent establishment or fixed base.

4. In each Contracting State, the royalties that the beneficiary might have been expected to collect if he had created a distinct and separate enterprise or if he had installed a distinct and separate place of work engaged in the same or similar activities under the same or similar conditions independently of the centre of activity of which this enterprise or this place of work constitutes a permanent establishment or a fixed base, shall be attributed to that permanent establishment or that fixed base. There shall be allowed as deductions expenses incurred for the purpose of the permanent establishment or fixed base, including executive and general administrative expenses so incurred, whether in the State in which the permanent establishment or the fixed base is situated, or elsewhere. The royalties attributed to the permanent establishment or the fixed base shall be calculated by the same method year by year, unless there is good and sufficient reason to the contrary.

[5. If a royalty is more than the normal, intrinsic value of the rights in respect of which it is paid, the provisions in paragraphs 1, 2 and 3, may be applied only to that part of the royalty corresponding to this normal, intrinsic value].

3rd Alternative

Article VI C
Allocation of taxation between the State of residence and the State of source with different tax ceilings in each Contracting State

1. Copyright royalties whose source is in a Contracting State and paid to a beneficial owner who is a resident of the other Contracting State shall be taxable in both Contracting States. They shall, however, be exempt from the taxes covered by paragraph[s] 2(a)(ii) [and 2(a)(iii)] of Article II in the case of (State A) or in paragraph[s] 2(b)(ii) [and 2(b)(iii)] of Article II in the case of (State B).

2. Where such royalties are subject to income tax in the Contracting State in which they have their source, according to the law of that State, and in the Contracting State of which the beneficiary is a resident, the tax so charged may not exceed:

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a) in the case of royalties whose source is in (State A) and paid to a resident of (State B) "x" percent of the gross amount of the royalties in the case of the tax levied in (State A) and "x" percent of the gross amount of the royalties in the case of the tax levied in (State B).
b) in the case of royalties whose source is in (State B) and paid to a resident of (State A) "y" percent of the gross amount of the royalties in the case of the tax levied in (State A) and "y" percent of the gross amount of the royalties in the case of the tax levied in (State B).

3. The provisions of paragraphs 1 and 2 shall not apply if the beneficiary of the royalties, being a resident of a Contracting State, carries on business in the other Contracting State in which the royalties arise, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right, activity or property in respect of which the royalties are paid is effectively connected with such permanent establishment or fixed base. In such a case the royalties may be taxed solely in the State where the permanent establishment or the fixed base is situated, but only so much of them as is attributable to that permanent establishment or fixed base.

4. In each Contracting State, the royalties that the beneficiary might have been expected to collect if he had created a distinct and separate enterprise or if he had installed a distinct and separate place of work engaged in the same or similar activities under the same or similar conditions independently of the centre of activity of which this enterprise or this place of work constitutes a permanent establishment or fixed base, shall be attributed to that permanent establishment or that fixed base. There shall be allowed as deductions expenses directly connected with the copyright royalties and incurred for the purposes of the permanent establishment or fixed base, including executive and general administrative expenses so incurred, whether in the State in which the permanent establishment or the fixed base is situatied, or elsewhere. The royalties attributed to the permanent establishment or the fixed base shall be calculated by the same method year by year, unless there is good and sufficient reason to the contrary.

[5. If a royalty is more than the normal, intrinsic value of the rights in respect of which it is paid, the provisions in paragraphs 1, 2 and 3, may be applied only to that part of the royalty corresponding to this normal, intrinsic value].

4th Alternative

Article VI D
Taxation by the State of source

Copyright royalties whose source is in a Contracting State and paid to a resident in the other Contracting State are taxable exclusively in the State of source of the royalties.

5th Alternative

Article VI E
Allocation of taxation between the State of residence and the State of source with the tax ceiling in the State of source

1. Copyright royalties arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

2. However, such royalties may also be taxed in the Contracting State in which they arise and according to the laws of that State, but if the recipient is the beneficiary of the royalties, the tax so charged shall not exceed "x" percent of the gross amount of the royalties. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation.

6th Alternative

Article VI F
Allocation of taxation between the State of source and that of residence with the tax ceiling in the State of residence

1. Copyright royalties whose source is in a Contracting State and which are paid to a beneficial owner resident of the other Contracting State, shall be taxable in the State of source of the royalties.

2. However, said royalties may also be taxed in the Contracting State where the beneficial owner of the royalties resides, but not to exceed x percent of the gross amount of the royalties.

IV
ELIMINATION OF DOUBLE TAXATION

Article VII
Methods for avoidance of double taxation

1st Alternative

Article VII A
Exemption method

1st Alternative: Article VII A (i) — Ordinary exemption

Where a resident of a Contracting State receives royalties which, in accordance with the provisions of Article VI, may be taxed in the other Contracting State, the first-mentioned State shall exempt such royalties from the tax on the income of this resident and shall not take them into account in calculating the amount of this tax.

2nd Alternative: Article VII A (ii) — Exemption with progression

Where a resident of a Contracting State receives royalties which, in accordance with the provisions of Article VI, may be taxed in the other Contracting State, the first-mentioned State shall exempt such royalties from the tax on the income of this resident. Such State may nevertheless take into account the exempted royalties in calculating the amount of tax on the other income of this resident and may apply the same rate of tax as if the royalties in question had not been exempted.

3rd Alternative: Article VII A (iii) — Exemption maintaining taxable income

Where a resident of a Contracting State receives royalties which, in accordance with the provisions of Article VI, may be taxed in the other Contracting State, the first-mentioned State shall allow as a deduction from tax on the income of that resident, that part of the tax which is applicable to the royalties received from the other Contracting State.

2nd Alternative

Article VII B
Credit method

1st Alternative: Article VII B (i) — Ordinary credit

1. Where a resident of a Contracting State receives royalties which, in accordance with the provisions of Article VI, may be taxed in the other Contracting State, the first-mentioned State shall allow as a deduction from the tax on the income of that resident, an amount equal to the income tax paid in the other Contracting State. Such deduction shall not exceed that part of the income tax, as computed before the deduction is given, which is attributable to the royalties which may be taxed in the other Contracting State.

2. For the purposes of this deduction, the taxes referred to in paragraphs 2(a)(i) and 2(b)(i) of Article II shall be deemed to be income tax.

2nd Alternative: Article VII B (ii) — Full credit

1. Where a resident of a Contracting State receives royalties which, in accordance with the provisions of Article VI, may be taxed in the other Contracting State, the first-mentioned State shall allow as a deduction from the tax on the income of that resident an amount equal to the tax paid in the other Contracting State.

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2. For the purposes of this deduction, the taxes referred to in paragraphs 2(a)(i) and 2(b)(i) of Article II shall be deemed to be income tax.

3rd Alternative: Article VII B (iii) — Matching credit

1. Where a resident of a Contracting State receives royalties which, in accordance with the provisions of Article VI, may be taxed in the other Contracting State, the first-mentioned State shall allow as a deduction from the tax on the income of that resident, an amount equal to .... percent of the gross amount of such royalties, whether or not the amount deducted in the State where the royalties arise equals this percentage.

2. For the purpose of this deduction, the taxes referred to in paragraphs 2(a)(i) and 2(b)(i) of Article II shall be deemed to be income tax.

4th Alternative: Article VII B (iv) — Tax sparing credit

1. Where a resident of a Contracting State received royalties which, in accordance with the provisions of Article VI, may be taxed in the other Contracting State and benefit there from special tax relief, the first-mentioned State shall allow as a deduction from the tax on the income of that resident, who is the beneficiary of royalties, an amount equal to the total sum which, without this relief, would have had to be paid in that other State as tax on such royalties.

2. For the purposes of this deduction, the taxes referred to in paragraphs 2(a)(i) and 2(b)(i) of Article II shall be deemed to be income tax.

V
MISCELLANEOUS PROVISIONS

Article VIII
Non-discrimination

1. In accordance with the principle of non-discrimination set out in Article 6 of the Multilateral Convention for the Avoidance of Double Taxation of Copyright Royalties, the nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation assessed on the amount of a copyright royalty or any requirement connected therewith, which is other or more burdensome than those to which nationals of that other State in the same circumstances are or may be subjected. Notwithstanding the provisions of Article I, this principle also applies to persons who are not residents of one or both Contracting States.

2. Stateless persons who are residents of a Contracting State shall not be subjected in either Contracting State to any taxation on copyright royalties or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of the State concerned in the same circumstances are or may be subjected.

3. The taxation on copyright royalties to which a permanent establishment of an enterprise of a Contracting State is subjected in the other Contracting State shall not be less favourably levied in that other State than the taxation on the same kind of copyright royalties to which enterprises of that State having the same status for tax purposes and carrying on the same activities are subjected. This provision shall not be construed as obliging a Contracting State to grant to residents of the other Contracting State any personal allowances, reliefs and reductions for taxation purposes on account of civil status or family responsibilities which it grants to its own residents.

4. Subject to the provisions of [paragraph 4 of Article VI A] [paragraph 5 of Article VI B or VI C], the royalties paid by an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable profits of such an enterprise, be deductible under the same conditions as if they had been paid to a resident of the first-mentioned State.

5. Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned State to any taxation assessed on copyright royalties or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which other similar enterprises of the first-mentioned State are or may be subjected.

6. The provisions of this Article shall, notwithstanding the provisions of Article II, apply to taxes of every kind and description.

Article IX
Mutual agreement procedure

1. Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Agreement, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of the Contracting State of which he is a resident or, if his case comes under Article VIII (1), to that of the Contracting State of which he is a national. This case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the Agreement.

2. The competent authority shall endeavour, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution within a period of .... or such extended period as may be communicated by it to the competent authority of the other State, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with this Agreement. Any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting States.

3. The competent authorities of the Contracting States shall endeavour to resolve by agreement any difficulties or doubts arising as to the interpretation or application of the Agreement. They may also consult together for the avoidance of double taxation in cases not provided for in this Agreement.

4. The competent authorities of the Contracting States may communicate with each other directly for the purpose of reaching an agreement in the sense of paragraphs 1, 2 and 3. When it seems advisable in order to reach agreement to have an oral exchange of opinions, such exchange may take place through a Commission consisting of representatives of the competent authorities of the Contracting States.

Article X
Exchange of information

1. The competent authorities of the Contracting States shall exchange such information as is necessary for carrying out the provisions of this Agreement or of the domestic laws of the Contracting States concerning taxes covered by this Agreement in so far as the taxation thereunder is not contrary to the Agreement. The exchange of information is not restricted by Article I of this Agreement. Any information received by a Contracting State shall be treated as secret in the same manner as information obtained under the domestic laws of that State and shall be disclosed only to persons or authorities, including courts and administrative bodies, involved in the assessement or collection of, the enforcement or prosecution in respect of, or the determination of appeals in relation to the taxes covered by this Agreement. Such persons or authorities shall use the information only for such purposes. They may disclose the information in public court proceeding or in judicial decisions.

2. In no case shall the provisions of paragraph 1 be construed so as to impose on a Contracting State the obligation:

a) to carry out administrative measures at variance with the laws and administrative practice of that or of the other Contracting State;
b) to supply information which is not

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obtainable under the laws or in the normal course of the administration of that or of the other Contracting State;

c) to supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or information, the disclosure of which would be contrary to public policy (ordre public).

Article XI
Members of diplomatic or consular missions

Nothing in this Agreement shall affect the fiscal privileges of members of diplomatic or consular missions of the Contracting States as well as of their families, either under the general rules of international law or under the provisions of special conventions.

Article XII
Entry into force

1. This Agreement shall be ratified and the instruments of ratification shall be exchanged at ..... as soon as possible.

2. The Agreement shall enter into force upon the exchange of instruments of ratification and its provisions shall have effect:
a) in (State A) .....
b) in (State B) .....

Article XIII
Termination

This Agreement shall remain in force until terminated by a Contracting State. Either Contracting State may terminate the Agreement, through diplomatic channels, by giving notice of termination at least six months before the end of any calendar year after the year . . . . . In such event, the Agreement shall cease to have effect:
a) in (State A) .....
b) in (State B) .....

Article XIV
Interpretation

As regards the application of this Agreement by a Contracting State, any term not defined therein shall, unless the context otherwise requires, have the meaning which it has under the Multilateral Convention for the Avoidance of Double Taxation of Copyright Royalties or, failing this, under the law of that State.

Article XV
Relations between this Agreement and other treaties on double taxation

In the event of any difference between the provisions of this Agreement and those of another treaty on double taxation concluded by the Contracting States, the provisions of this Agreement shall take precedence in the relations between these States in matters relating to the taxation of copyright royalties.

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TAX GLOSSARY

by H.W.T. PEPPER *

SUPERSNAKE — The European currencies involved in the earlier agreement (see SNAKE IN A TUNNEL) were the German mark, Belgian franc, Austrian schilling, Dutch guilder, Swiss franc, and Luxembourg franc. The proposed European Monetary System (EMS), sometimes known as SUPERSNAKE, would embrace members of the EEC and a few other countries, would involve fixed exchange rates between members, the institution of a Common Market currency called the ECU, and the establishment of a Common Market fund which would be used to support exchange rates which came under pressure, although by joining the members would gain strength for their currencies against those of non-members.

SUPER TAX — A tax charged in addition to income tax. The term was formerly used to refer to the tax charged in Britain (from 1909 to 1927) subsequently known as surtax, and has also been used in a similar context, e.g. in India.

SUPPLEMENTARY TAX — A tax charged in addition to income tax, particularly in a country with a schedular tax system which charges tax at flat rates on certain types of income. The supplementary tax is usually charged at graduated rates on those with incomes above a certain limit. (See also RESIDENTS' TAX.)

SURCHARGE — A tax which is often levied as a percentage addition to existing taxes, usually on a temporary basis. If the additional charge is required upon a more permanent basis, the surcharge will usually be superseded in due course by a revision of the substantive rates of tax. Recent examples of the imposition of surcharges have arisen in the U.S., where a ten percent surcharge was applied to the federal income tax rates (raising the maximum from 70 to 77 percent) during President Johnson's term of office, and an import surcharge imposed in 1971 by President Nixon — both these surcharges having been subsequently cancelled. In Britain, there has also recently been an import surcharge and there is power under the CUSTOMS REGULATOR (q.v.) (a provision which has to be renewed annually by Parliament) by means of which the Treasury may make an order increasing or decreasing the principal revenue duties by up to 10 percent. Holland has similar powers (see REGULATOR TAX).
Two recent examples of further uses of this term in connection with taxation are (a) the surcharge imposed in West Germany in 1970 and 1971, which was actually in the form of a "LOAN" LEVY (q.v.) which the Government pledged would be refunded before 1973; and (b) the additional charge on investment income in Britain from 1973 with the abolition of EARNED INCOME RELIEF (q.v.).

SURRENDER OF LOSS — Under U.K. tax law, a company in a GROUP (q.v.) (where one company is a 75 percent subsidiary of another, or both are 75 percent subsidiaries of a third company) or a CONSORTIUM (q.v.), which makes a trading loss may surrender the loss in favour of a "claimant company" in the same group.

SURTAX — In the U.K., surtax (formerly called SUPER TAX, q.v.) was applied to income taxpayers with incomes above a certain limit during the period 1909 to 1973. Somewhat different rules applied for the calculation of income for surtax purposes. Both income tax and surtax were replaced by UNIFIED TAX (q.v.) from 1973/74. In the U.S.A. corporations' incomes are subject to NORMAL TAX (q.v.) at 22 percent and to surtax where the income exceeds $250,000 at rates which in recent years have varied from 26 to 30 percent.

T

TADPOLE LEASE — A tax avoidance device whereby an entrepreneur owning business premises grants a lease thereof for a long period, say 60 years, to another person in return for a large premium and a small annual rent. The entrepreneur then rents the premises back on a sub-lease for rental payments which are very high in the first few years (constituting more or less the return of the premium). The object is to obtain enhanced tax deductions in respect of the high initial sub-rents while avoiding tax (or paying only at capital gains tax rates) on the premium received. Anti-avoidance measures in the U.K. have largely countered this device. (See also LEASE-BACK).

TAKE-HOME PAY — An employee's net remuneration after deductions for income tax and other compulsory levies, such as Social Security Contributions (e.g. National Health Insurance) and pension contributions.

TALENT TAX — The term was used in the U.K. with regard to moves by the Inland Revenue Department to tax awards made by the Arts Council and other bodies to authors, artists, and poets. It was argued that a tax on such awards was a tax on talent. Such talent awards had not previously been regarded as taxable provided they had not been solicited by the recipient and were not made in return for work done by the recipient for the donor.

TANGIBLES — Tangible business assets such as factories, machinery (in Italy *all* fixed assets except land) in general qualify for capital allowances if used in the production of business profits, whereas intangibles in general do not (exceptions may include patent, copyright, or mineral rights). In Holland's V.A.T. law, goods are defined (section 5) as "all *tangible* objects".

TANTIEME — Percentage (of profits), bonus, commission, or profits.

TAX AGENT — The term "tax agent" may either mean (as, for example, in Australian parlance) a tax adviser who assists the taxpayer to perform his duties under the taxing acts, or may mean the person charged under the taxing acts with collecting tax either by deduction or withholding at source, in the case of an income tax, or as the person required to register and pay the tax in the case of sales taxation.

TAX AVOIDANCE — See AVOIDANCE.

TAX BASE — See TAXABLE BASE.

[to be continued]

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FOR FURTHER INFORMATION PLEASE WRITE TO:

Associação Fiscal Portuguesa, Rua das Portas de Santo Antão 90, 1100 Lisbon, Portugal.

Business International Institute/Asia, 301-305 Asian House, One Hennessy Road, Hong Kong.

Confédération Fiscal Européenne, Secrétariat Général (C.F.E.), D-5300 Bonn 1, Dechenstrasse 14, German Federal Republic or Siège Social F-75009 Paris, 9 rue Richepanse (France).

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LEGISLATION DANS LES PAYS D'AMERIQUE LATINE ET CRITERES APPLICABLES A L'IMPOSITION SUR LE REVENU (AVEC UN AVANT-PROPOS DE RAMÓN VALDÉS COSTA)

Etude présentée à l'occasion de 34ème Congrès de l'IFA à Paris et résumant la situation de l'impôt sur le revenu dans 18 pays d'Amérique Latine. La structure des systèmes d'imposition sur le revenu est étudiée ainsi que le champ d'application des impôts sur le revenu et la mesure dans laquelle les dépenses peuvent être déduites. Une attention particulière est donnée aux dépenses encourues et prestations de services réalisées à l'étranger.

DIE GESETZGEBUNG IN DEN LÄNDERN LATEINAMERIKAS UND RELEVANTE MERKMALE DER EINKOMMENSBESTEUERUNG (MIT EINEM VORWORT VON RAMÓN VALDÉS COSTA)

Dieses Dokument, das anlässlich des 34. IFA-Kongresses in Paris vorgelegt wird, fasst die Situation der Einkommensbesteuerung in 18 Ländern Lateinamerikas zusammen. Es wird sowohl die Struktur der Einkommensteuersysteme als auch deren Umfang untersucht. Berücksichtigung findet ferner die Frage, in welchem Ausmass Aufwendungen als abzugsfähige Ausgaben geltend gemacht werden können. Besondere Aufmerksamkeit is den Problemen im Zusammenhang mit im Ausland getätigten Aufwendungen und im Ausland geleisteten Diensten gewidmet.

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AUSLEGUNG VON DOPPELBESTEUERUNGSABKOMMEN

Dieser Artikel beschäftigt sich insbesondere mit der Art und Weise, in der kanadische Gerichte die Bestimmungen der Doppelbesteuerungsabkommen auslegen, wobei ständig Vergleiche mit der Entwicklung der Rechtsprechnung in anderen Ländern angestellt werden, hauptsächlich den U.S.A.

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DEVELOPPEMENTS FISCAUX EN AFRIQUE
ACTIVITES DE LA COMMISSION ECONOMIQUE DES NATIONS UNIES POUR L'AFRIQUE

Les activités suivantes sont entre autres mentionnées: la réunion de documents avec l'aide du Bureau International de Documentation Fiscale; l'organisation de conférences, cours de formation professionnelle et groupes de travail, les activités consultatives et de recherche. Une mention spéciale a trait à la Conférence qui s'est tenue à Monrovia en février 1980 et pendant laquelle l'Association des Administrateurs Fiscaux Africains fut formellement établie.

ENTWICKLUNGEN AUF DEM GEBIET DES STEUERRECHTS IN AFRIKA

Aktivitäten der Wirtschaftskommission der Vereinten Nationen für Afrika

Die folgenden Aktivitäten werden unter anderem vorgestellt: die Aufstellung einer Dokumentation mit Unterstützung des Internationalen Steuerdokumentationsbüros, die Organisation von Konferenzen, das Veranstalten von Schulungskursen sowie Beratungs- und Forschungstätigkeiten. Besondere Aufmerksamkeit ist der Konferenz gewidmet, die im Februar 1980 in Monrovia stattfand, und während der die Vereinigung afrikanischer Steuerverwalter formell gegründet wurde.

COMMONWEALTH ASSOCIATION OF TAX ADMINISTRATORS
TECHNICAL MEETING ON THE COLLECTION OF TAXES AND TRAINING OF COLLECTION PERSONNEL 413

Subjects discussed included: tax delinquency and its causes and effects; the collection organization and the relation with other work areas of the revenue department; enforced collection; training of tax officers; and publicity programs to raise social conscience to encourage compliance with the law.

L'ASSOCIATION DES ADMINISTRATEURS FISCAUX DU COMMONWEALTH BRITANNIQUE
REUNION TECHNIQUE SUR LA PERCEPTION DES IMPOTS ET LA FORMATION PROFESSIONNELLE DU PERSONNEL DE LA PERCEPTION

Les sujets étudiés comprennent: la délinquance fiscale, ses causes et ses effets; l'organisation de la perception et les relations avec les autres divisions du département des revenus; le commandement; la formation du personnel fiscal et les programmes de publicité destinés à élever la conscience sociale afin d'encourager l'application de la loi.

VEREINIGUNG DER STEUERVERWALTUNGEN DES COMMONWEALTH
ARBEITSTAGUNG ZUR STEUERERHEBUNG UND AUSBILDUNG DES ZUSTÄNDIGEN PERSONALS

Die behandelten Themen umfassten u.a.: Steuervergehen — Gründe und Auswirkungen; der Aufbau einer Steuererhebungsbehörde und ihr Verhältnis zu anderen Arbeitsbereichen der Finanzverwaltung; Steuereintreibung; Ausbildung der Steuerinspektoren sowie Öffentlichkeitsarbeit im Hinblick auf ein ausgeprägteres Rechtsempfinden in Sachen Steuermoral.

Kailash C. Khanna:
INDIAN BUDGET 1980/81 418

Brief evaluation of the Indian Budget 1980/81 discussing, inter alia, the proposals regarding tax holidays and retrospective legislation which the Indian Government intends to introduce to the detriment of the taxpayer.

BUDGET DE L'INDE POUR 1980/81

Evaluation rapide du Budget de l'Inde pour 1980/81 étudiant, entre autres, les dispositions concernant les suspensions d'imposition et la législation à effet rétroactif que le gouvernement indien a l'intention d'introduire au détriment du contribuable.

DER INDISCHE HAUSHALT 1980/81

Diese kurze Stellungnahme zum indischen Haushalt 1980/81 befasst sich unter anderem mit den Vorschlägen bezüglich einer zeitweisen Steuerbefreiung und mit gesetzlichen Vorschriften, die die indische Regierung mit rückwirkender Kraft zum Nachteil der Steuerpflichtigen einführen will.

Kailash C. Khanna:
INDIA: THE CENTRAL BUDGET FOR 1980/81 419

Summary of the main tax proposals presented by the Finance Minister of June 18, 1980.

INDE: LE BUDGET CENTRAL POUR 1980/81

Résumé des principales dispositions fiscales présentées, le 18 juin 1980, par le Ministre des Finances.

INDIEN: DER HAUSHALT DER ZENTRALREGIERUNG FÜR 1980/81

Zusammenfassung der wichtigsten Vorschläge auf steuerlichem Gebiet, die in der Haushaltsvorlage des Finanzministers enthalten sind.

INDIA: BUDGET SPEECH 1980 421
"Bold" says industry

Extracts from the Budget Speech 1980 pronounced on June 18, 1980 by the Finance Minister Mr. R. Venkataraman.

INDE: DISCOURS DU MINISTRE SUR LE BUDGET
"AUDACIEUX" DIT L'INDUSTRIE

Extraits de la présentation du Budget de 1980 prononcée la 18 juin 1980 par le Ministre des Finances M. R. Venkataraman.

INDIEN: BUDGET SPEECH 1980
DIE INDUSTRIE BEZEICHNET IHN ALS "KÜHN"

Auszüge aus der Rede des Finanzministers, Herrn R. Venkataraman, die dieser anlässlich der Vorlage des Haushalts am 18. Juni 1980 gehalten hat.

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IFA NEWS

Many national branches of IFA organise meetings throughout the year, sometimes jointly. In past issues of the BULLETIN papers have been published which had been discussed during such meetings and which are of interest to people outside the branches concerned. See, for instance, the issue of February-March, 1980 for papers discussed by the U.S. branch.

U.S. Branch

This issue contains a paper which Mr. Nathan Boidman, member of the Canadian branch, presented to the fourth annual meeting of the U.S. branch on the interpretation of tax treaties.

Hong Kong Branch

The following is a report on the activities of this youngest branch of IFA which was officially admitted during the 33rd Congress held in Copenhagen, September 1979:

February 1, 1980:
Executive Committee meeting followed by a talk delivered to the branch by Prof. J. van Hoorn Jr. on the use of double taxation agreements.

March 24, 1980:
Executive Committee meeting followed by a moot (debate) on the relevance of an English court decision (Sharskey v. Wernher 36TC 275 (HL)) in the Hong Kong context.

June 10, 1980:
Executive Committee meeting followed by four talks on the subject of "The current situation relating to the utilisation from overseas of the principal treaty links as it applies to (name of country)".
The four speakers were all visitors to Hong Kong and members of an international tax group and were, in order of speaking:

John Avery Jones:	U.K.
Raoul Lenz:	Switzerland
Maarten Ellis:	Netherlands
Sanford Goldberg:	U.S.A.

In addition to the above, the branch has also made a representation to the Hong Kong Government relating to the introduction of a piece of retrospective legislation.

Belgo-Luxembourg and French Branches

On March 7, 1980 the members from Belgium, France and Luxembourg met in Brussels to discuss the implication of Article 9 of the Sixth VAT Directive of May 17, 1977. This provision deals with the important issue of the place where, for VAT purposes, services are deemed to be rendered.

The time needed for the preparation of this special Congress issue of the BULLETIN did not allow for a publication not only of the papers submitted by members from the three countries but also of a summary of the discussions. It was felt that all these should be published together. This will be done in the next (October) issue of the BULLETIN, in French, with résumés in English, and preceded by a foreword of Professor Paul Sibille.

FUTURE CONGRESSES

Berlin — The 35th Congress will be held in West-Berlin from September 21 to 25, 1981. The main discussion themes will be: I — *Mutual Agreement — Procedure and Practice*; II — *Unilateral Measures to Prevent Double Taxation.*

Montreal — Canada will host the 36th Congress to be held from September 12 to 16, 1982. Subject I is *The Tax Treatment of Interest in International Economic Transactions.* The title of the second main subject is *Taxation of Transportation of Passengers and Goods in International Traffic.*

Venice — The Italian branch of IFA has decided to hold the 37th Congress in Venice, probably from October 10 to 14, 1983. The subjects for this Congress are under consideration.

Buenos Aires — Dates and subjects for the 38th Congress to be organised by the Argentinian branch have not yet been fixed.

EUROPEAN TAXATION

Articles by the Bureau's team of international tax specialists, and its network of local tax experts.

- Developments and trends in European tax law
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The Congress of Paris



ALUN G. DAVIES
President of IFA.

It is a great pleasure to introduce the Congress of Paris 1980 to the members of IFA through the pages of the IFA Bulletin which, as Dr. Mitchell Carroll said in the Bulletin in 1950 (Vol. 4, No. 1), is the organ of the association as a whole. (The more is the pity that more members of the association don't subscribe to it; it is excellent value for the money.) It is my fervent wish that the International Bureau of Fiscal Documentation, a daughter organisation born out of IFA, should work more closely with IFA. The Bureau has immense resources in the fiscal field, and it is obvious that its formidable battery of fiscal expertise and documentation should be more extensively used by IFA members for their own benefit.

This is the second occasion that Paris has been the venue for the annual congress of IFA, and I feel sure that the Parisian setting will have all the elegance and éclat that we have learned to expect from our French friends. Not even the fact that we are gathered at Paris to discuss some of the esoteric mysteries of the fiscal world will make the ambience of Paris less attractive.

When I first heard that the first subject to be discussed at the Paris Congress was "*the dialogue between the tax administration and the taxpayer up to the filing of the tax return*", my heart fell. I felt like the prophet Ezekiel when he had the vision of the Valley of Dry Bones. Like Ezekiel, I saw a valley full of bones, and they were very dry. I said to myself, can these bones live? Can breath be entered into them, and can sinews and flesh be put upon them? My base expectations have been upset. Monsieur Delorme has breathed upon the dry bones and brought life into them. "*And they stood up upon their feet, an exceedingly great army.*" M. Delorme, formidably backed up by some very good national reports, has introduced life into what could have been a very barren subject indeed. I am intrigued that he should have referred to the relationship between the taxpayer and the fisc as a dialogue. I regret to say that it has often seemed to me to be a dialogue between two deaf persons. The taxpayer has often not wished to hear the words, not perhaps of comfort, but of explanation, from the fisc. He has imagined that the words issuing from the fisc are not "*come unto me all ye that are heavy laden with taxes, and I will help you with your burdens*" but something more tiberian like "*render unto Caesar*".

Apart from this unfortunate lack of liaison, there are many, many in the Valley of Dry Bones who are tax-wraiths, unable and unwilling to participate in any kind of dialogue with the fisc, suspecting, if I may change the metaphor, that the Judas-lamb they are invited to follow will lead them into a tax slaughterhouse, rather than to the promised land. I refer of course to the vast numbers of taxpayers who are members of the black economy, who wish for nothing better than total ignorance of the fisc and its propensity to invite them to participate voluntarily in the process of extraction.

The British national report is itself something of a surprise, because it is written in collaboration between a high official in the Board of Inland Revenue and one of the leaders of the accounting profession in the United Kingdom. The opening words of the British report, quoting Edmund Burke as saying "*to tax and to please... is not given to men*" summarises only too well the minefields which exist in this controversial area.

The second subject at Paris "*the rules for determining income and expenses as domestic or foreign*" is poles apart from the first subject. The problems of the determination of source, and the subsequent tax treatment of a source, are fundamental in many national tax systems. The variations in the concept of source from country to country bring in their trail two unfortunate consequences, the first is that double taxation is likely to ensue, and the second is that the variations are a natural and fertile source of tax avoidance. The purpose of international tax treaties is a twin one, to avoid double taxation and to prevent tax avoidance. They have not wholly succeeded on either count.

Apart from the two subjects which have been published in the Cahiers of the Paris Congress, and which will form the basis of our discussions, there are two seminars. The first is on a subject which attracts debates in so many

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tax conferences, like moths attracted to a candle — *the use and abuse of tax havens.* I would have thought that we had heard the last words on this subject, but no, we come back to it again with the addiction of an alcoholic to the bottle. This is not to say that the subject is without its fascinations. It certainly has, and we shall play with it again, like children playing with fire.

The second seminar, on the *French fiscal system*, should be very fascinating. The French have given the European Community the imputation system in direct taxation, and the TVA in the world of indirect taxation. It is an achievement for the French to have won acceptance for both the main instruments of taxation in the direct and indirect taxation fields. I must confess that when the French Government introduced imputation in 1965 just as the British Government dumped it after a century and a half, I had a strange foreboding that one of them was very wrong. Well, the British returned to imputation in 1972 and the classical system walls of the British fiscal Jerusalem built by James Callaghan in 1965 were destroyed by the successor parliament. The prophecies of the British equivalent of Tobias and Sanballat proved to be too true.

Our French hosts are offering a fiscal feast at the Congress of Paris. I hope it will be as acceptable as the gastronomical delights of the city undoubtedly will be.



Cette photo est reproduite avec l'autorisation du propriétaire, le Palais des Congrès de Paris.

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Quelques Aspects Originaux de la Fiscalité Française

PAR MAURICE PAPON

La présentation de l'ensemble d'un régime fiscal nécessiterait de trop longs développements qui n'auraient pas leur place dans les dimensions d'un article sauf à procéder à des "raccourcis" par trop simplificateurs. C'est pourquoi il m'a semblé que c'étaient les aspects originaux de notre législation qui étaient les plus susceptibles d'intéresser les lecteurs étrangers. La France, en effet, a souvent joué un rôle novateur en matière fiscale puisque, par exemple, dans deux domaines essentiels — la taxe sur la valeur ajoutée et l'avoir fiscal — les règles mises au point dans notre pays tendent à se généraliser dans la plupart des Etats européens.

Après avoir rappelé la spécificité de la structure de nos prélèvements obligatoires, je m'attacherai aux principales particularités de la législation française. Je mettrai enfin l'accent sur quelques mesures nouvelles d'adaptation de la fiscalité aux nécessités économiques.

1) EVOLUTION ET STRUCTURE DES PRELEVEMENTS OBLIGATOIRES EN FRANCE

La France, comme tous les pays industrialisés, a connu ces dernières années une croissance sensible des prélèvements obligatoires. Toutefois, cette croissance globale recouvre des évolutions assez différentes voire divergentes selon la nature des prélèvements qui reflètent la multiplication des interventions publiques et des opérations de transfert nécessitées par la situation économique.

a) Progression globale des prélèvements obligatoires moins rapide que celle de ses partenaires

De 1975 à 1980, l'ensemble des prélèvements obligatoires français est passé de 37,4 pour cent du Produit intérieur brut (P.I.B.) à 41,6 pour cent. Cette augmentation a cependant été nettement moins rapide que dans beaucoup d'autres pays. En effet, en 1965, la France venait au 3ème rang des pays de l'O.C.D.E. après la Suède et les Pays-Bas, pour l'importance de ses prélèvements obligatoires par rapport à son P.I.B. Selon le même critère, elle n'était plus qu'en 6ème rang en 1976 et au 8ème rang en 1977-1978.

Malgré cette évolution, la France continue à présenter un poids de prélèvements obligatoires supérieur à celui



MAURICE PAPON,
Ministre du Budget

Né le 3 septembre 1910, à Gretz (Seine-et-Marne), M. Maurice PAPON après des études supérieures de droit, d'économie et de sciences politiques et de sociologie (Diplôme d'études supérieures de droit public et d'économie politique, Diplôme de l'Ecole Libre des Sciences Politiques), est entré en 1935 au Ministère de l'Intérieur.

Nommé Préfet en 1944, les principales étapes de sa carrière sont les suivantes:

Préfet des Landes (1944), de la Corse (1947), de Constantine (Algérie 1949), Secrétaire Général du Protectorat du Maroc (1954-1955), Igame de la région de l'Est Algérien, Préfet de Constantine (1956-1958), Préfet de Police de Paris (Mars 1958 à décembre 1966). M. PAPON a également à diverses reprises assumé des fonctions dans des cabinets ministériels.

En 1967-1968, il est Président Directeur Général de Sud-Aviation.

Elu député du Cher (3ème circonscription: Saint-Amand) en juin 1968 il sera constamment réélu depuis (mars 1973 et mars 1978). Il est Maire de Saint-Amand Montrond depuis 1971. A l'Assemblée Nationale où il siège, M. Maurice PAPON est inscrit au Groupe de l'Union des Démocrates pour la République (U.D.R.), mouvement dont il fut le Trésorier National, puis au Groupe du Rassemblement pour la République (R.P.R.).

Après avoir été Président de la Commission des Finances de l'Assemblée Nationale (1972), il est Rapporteur Général de cette Commission de 1973 à 1978.

Il est, depuis le 5 avril 1978, Ministre du Budget dans le 3ème Cabinet de M. Raymond BARRE.

Ouvrages publiés:
"L'Ere des responsables" — 1954.
"Vers un nouveau discours de la méthode" — 1965.
"Le Gaullisme ou la loi de l'effort" — 1973.

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de ses principaux partenaires commerciaux, ainsi qu'en témoigne le tableau suivant:

Total des prélèvements obligatoires en pourcentage du produit intérieur brut en 1978

France	*Allemagne fédérale*	*Etats-Unis*	*Italie*	*Royaume-Uni*
39,4	38	30,4	34,5	35,2

b) La structure des prélèvements obligatoires

La fiscalité ne représente en France qu'un peu plus de la moitié des prélèvements obligatoires. Le poids des cotisations sociales est en effet un des plus élevés des pays de l'O.C.D.E. et, au cours des années récentes, ce sont ces cotisations qui ont été responsables de la croissance des prélèvements obligatoires. Leur montant est passé de 12,9 pour cent du P.I.B. en 1970 à 18 pour cent en 1980. Cette particularité explique pour partie la relative faiblesse de la part de l'impôt sur le revenu en France, par rapport à de nombreux pays étrangers, puisque les cotisations sociales peuvent être assimilées à un impôt direct assis sur les rémunérations et prélevé par voie de retenue à la source.

Au cours de la même période 1970-1980, le prélèvement fiscal global est resté de l'ordre de 23 pour cent du P.I.B. Encore faut-il observer que cette stabilité de la fiscalité recouvre elle-même deux phénomènes de sens opposé: une diminution d'un point du P.I.B. de la fiscalité d'Etat, de 1970 à 1980, qui a été compensée par une augmentation équivalente de la fiscalité locale.

c) Le rééquilibrage entre impôts directs et indirects

Enfin, à l'intérieur des impôts d'Etat, le partage entre fiscalité directe et indirecte a beaucoup évolué depuis une quinzaine d'années, la part de ces derniers ne cessant de diminuer.

Certes, par rapport à plusieurs de ses principaux partenaires commerciaux, la France reste un pays à forte fiscalité indirecte. Le tableau qui suit montre cependant l'ampleur du rééquilibrage intervenu:

	1962	*1970*	*1975*	*1979*
Impôts directs	28,5	33,3	34,9	37,2
Impôts indirects	71,5	66,6	65,1	62,8
Total de recettes fiscales d'Etat	100	100	100	100

Au total, la taxe sur la valeur ajoutée fournit encore à l'Etat français la moitié de ses recettes; toutefois, plusieurs abaissements de ses taux ont déjà permis de réduire sensiblement la part de cet impôt dans les recettes fiscales. Ainsi, début 1973, le taux normal de la T.V.A. passait de 23 pour cent à 20 pour cent et le taux réduit de 7,5 pour cent à 7 pour cent. Début 1977, le taux normal était ramené de 20 pour cent à 17,60 pour cent. En outre, le taux applicable à plusieurs produits de consommation courante a été abaissé: les produits pharmaceutiques et les transports en commun de voyageurs ont ainsi pu bénéficier de taux réduit de T.V.A.

En dehors de cette action volontariste, la réduction des impôts indirects trouve aussi son origine dans l'absence d'indexation systématique, sur le niveau général des prix, de certains droits indirects fixés en valeur absolue. Or, d'une part, il est difficile de demander chaque année au Parlement de relever les barèmes de certaines accises. D'autre part, lorsqu'un relèvement intervient, il ne s'agit généralement que d'un rattrapage, avec un certain retard, de l'indice général des prix.

En sens inverse, l'impôt sur le revenu a connu une très forte croissance puisqu'il représente 25,4 pour cent des recettes fiscales de l'Etat en 1980 contre 18,1 pour cent en 1970. Sans doute cette augmentation est-elle pour partie imputable à une sous-indexation volontaire des tranches les plus élevées du barème. Mais, en dehors de toute sous-indexation, la progression de l'impôt sur le revenu a surtout correspondu, au cours de la décennie écoulée, à la croissance du revenu réel des français.

En effet, du fait de la progressivité de l'impôt, toute augmentation du revenu se traduit par un accroissement plus que proportionnel de l'impôt. La structure du barème français est telle que le produit de l'impôt croît en moyenne deux fois plus vite que les revenus déclarés.

2) QUELQUES PARTICULARITES DE LA LEGISLATION FRANÇAISE

Si la structure des prélèvements obligatoires demeure en France assez différente de ce qu'elle est dans les pays voisins, le législation fiscale comporte également des particularités.

Je retiendrai tout d'abord les principales originalités de l'impôt sur le revenu français: quotient familial et absence de retenue à la source. Puis j'aborderai les modalités spécifiques d'imposition des petites ou moyennes entreprises et je présenterai enfin les pouvoirs dont dispose l'administration française pour lutter contre la fraude et les garanties données aux contribuables.

a) Les originalités de l'impôt sur le revenu

(i) Le quotient familial

La Déclaration des Droits de l'Homme et du Citoyen de 1789 proclame le droit à l'égalité des citoyens devant l'impôt, selon leurs facultés. Le système français d'impôt sur le revenu considère que cette faculté contributive doit être appréciée au niveau de chaque cellule familiale. L'impôt s'applique donc aux revenus globaux d'un foyer, mais sa progressivité est atténuée par le jeu du quotient familial qui consiste à appliquer le barème au revenu moyen dont dispose chaque membre de l'unité familiale.

Ce mécanisme procure des avantages appréciables aux familles ayant la charge d'enfants et il constitue d'ailleurs l'un des principaux instruments de la politique familiale.

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Ce n'est toutefois pas son unique objet puisque le quotient familial est également un quotient conjugal. La France ignore, sauf exception, l'imposition séparée des époux.

En pratique, le revenu total imposable du foyer fiscal est divisé par un nombre de parts qui réflète les charges de famille ou la situation particulière du foyer. [1] Chacune de ces parts de revenus est imposée selon le barème progressif. L'impôt total exigible correspond à la somme des impôts applicables à chaque part.

Prenons l'exemple d'un ménage comprenant 4 enfants et ayant donc droit à 4 parts de quotient familial qui a perçu 80.000 Fr.Frs. de revenus nets imposables en 1979.

Le barème progressif de l'impôt est appliqué au revenu global divisé par le quotient familial, soit 20.000 Fr.Frs., ce qui donne un impôt par part de 1.710 Fr.Frs.

L'impôt total dû part le ménage sera donc de: 1.710 x 4 = 6.840 Fr.Frs., ce qui équivaut au total des impôts que devraient payer 4 célibataires ayant perçu chacun 20.000 Fr.Frs. de revenus, mais ce qui est largement inférieur aux 24.293 Fr.Frs. d'impôt dûs par un célibataire ayant eu des revenus de 80.000 Fr.Frs.

(ii) La perception de l'impôt par voie de rôle

La seconde caractéristique assez originale de l'impôt sur le revenu français tient à son mode de perception. A la différence de nombreux pays étrangers, la France ne recouvre pas, en règle générale, l'impôt par voie de retenue à la source.

Même s'ils ne perçoivent que des salaires, les contribuables français doivent eux-mêmes déclarer chaque année leurs revenus de l'année précédente et acquitter l'impôt correspondant qui est calculé par l'administration fiscale.

En raison du délai nécessaire pour accomplir ces diverses opérations, il existe un décalage important entre l'encaissement des revenus et le versement de l'impôt correspondant.

Ainsi, quel que soit le système de versement adopté par les contribuables, ce n'est en principe pas avant septembre-octobre 1980 que les revenus perçus en 1979 seront effectivement imposés.

En revanche, les cotisations sociales, dont l'importance a été soulignée au début du présent article, sont retenues à la source par les employeurs.

b) Les modalités d'imposition des petites ou moyennes entreprises

La France a toujours cherché à préserver ses petites ou moyennes entreprises qui maintiennent une vie économique dans les 36.000 communes du territoire national. Mais elle le fait d'autant plus volontiers depuis le début de la crise que ce sont les entreprises de taille modeste qui s'avèrent les plus capables de créér des emplois.

Les principales originalités de la législation fiscale concernent le régime du forfait et certaines mesures récentes destinées à améliorer la gestion des petites entreprises.

Le régime du forfait industriel et commercial s'applique aux contribuables dont le chiffre d'affaires annuel est inférieur, en principe, à 500.000 Fr.Frs. Alors que les régimes réels d'imposition obligent les contribuables à déclarer à l'Administration leurs résultats calculés à partir d'une comptabilité complète, le régime du forfait se caractérise par une intervention a priori de l'Administration dans l'évaluation du bénéfice. Celui-ci est fixé lors d'une négociation avec le contribuable qui n'est tenu de fournir qu'une déclaration très simplifiée comportant essentiellement les achats. La négociation a pour objet de déterminer la marge nette applicable à ces achats, compte tenu des marges habituellement pratiquées par la profession et des particularités éventuelles de l'entreprise.

Le forfait a le mérite de permettre aux plus petites entreprises de payer l'impôt sans sujétion excessive ni pour le contribuable ni pour l'Administration. Il concerne encore actuellement plus d'un million de contribuables, mais ce nombre tend à diminuer sous les effets conjugués du non relèvement des limites de chiffres d'affaires, fixées voici plus de dix ans, et des incitations offertes pour l'adoption d'autres régimes d'imposition.

En effet, bien que des recoupements aient démontré que le régime forfaitaire permet globalement de cerner d'assez près les résultats réels, il n'exige pas la tenue de documents comptables suffisants pour assurer une gestion correcte.

C'est pourquoi les pouvoirs publics ont mis en place, depuis 1974, un système qui permet aux entrepreneurs individuels et aux travailleurs non salariés de bénéficier d'avantages équivalents à ceux réservés auparavant aux salariés tout en améliorant la gestion de leur entreprise. Les salaires sont en effet imposés après un abattement de 20 pour cent qui est justifié par la bonne connaissance de ce type de revenus qui est déclaré par des tiers. Un tel avantage ne pouvait être accordé aux petits entrepreneurs en raison de l'imprécision qui entachait jusqu'ici la connaissance de leurs revenus. Afin de rapprocher les conditions d'imposition des salariés et des non salariés, ces derniers ont été autorisés à adhérer à des organismes agréés par l'administration fiscale. Ces organismes, appelés centres de gestion agréés, apprécient la sincérité de la comptabilité de leurs adhérents qui doivent obligatoirement être soumis à un mode réel d'imposition.

Ces diverses obligations permettent d'accorder aux adhérents un abattement de 20 pour cent sur leur bénéfice imposable, équivalent à celui dont bénéficient les salariés. D'une façon plus générale, toutes les professions dont les revenus sont déclarés ou contrôlés par des tiers possèdent désormais des avantages analogues.

Enfin, l'aide aux petites et moyennes entreprises revêt également la forme de systèmes devant faciliter la création d'entreprises nouvelles.

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1. En règle générale: 1 part pour chaque conjoint + 1/2 part par enfant à charge. Un célibataire a donc une part, un ménage sans enfant 2 parts, et, par exemple, un ménage avec 4 enfants 4 parts.

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Les petites et moyennes entreprises peuvent ainsi se voir accorder une exonération totale de leurs bénéfices réinvestis au cours de l'année de leur création et des deux années suivantes.

Elles peuvent aussi bénéficier — mais cette mesure ne se cumule pas avec la précédente — d'un abattement limité au tiers de leurs résultats, pour l'année de leur création et les quatre années suivantes.

c) Les moyens de lutte contre la fraude et les garanties des contribuables

L'équité d'un système fiscal n'exige pas seulement que les règles d'établissement de l'impôt soient justes, mais encore qu'elles soient respectées. Le contrôle de l'impôt constitue donc un des objectifs essentiels de l'administration fiscale française qui se voit reconnaître par la loi des pouvoirs très importants.

L'évolution de ces dernières années a été marquée par un double mouvement:

— en renforcement des moyens de lutte contre la fraude,
— et un renforcement des garanties des contribuables.

(i) Des moyens de lutte renforcés

En premier lieu, le droit de communication de l'administration française est très étendu, il porte sur tous les documents comptables et pièces annexes des industriels et commerçants et de la plupart des professions libérales. Ce droit de communication est assorti des restrictions nécessaires à la protection de toutes les informations couvertes par le secret professionnel telles que celles que peuvent détenir des médecins sur leurs malades. Cette communication a pour objet, non de contrôler l'entreprise qui détient ces documents, mais d'obtenir des informations sur les opérations réalisées par des tiers.

En outre, tous les établissements financiers ont l'obligation de déclarer à l'administration les ouvertures et clôtures de comptes. Cette formalité peut être désormais accomplie de façon automatisée, par la simple communication de bandes magnétiques, ce qui est un gage de rapidité et d'efficacité. Sur requête des fonctionnaires de l'administration fiscale, les établissements bancaires doivent également présenter le détail des opérations réalisées par certains de leurs clients. L'administration peut ainsi, à partir des opérations financières réalisées par un contribuable, déterminer quelles ont été ses dépenses et ses recettes et tenter de reconstituer ce que fut son revenu réel.

Afin de restreindre encore davantage les possibilités de fraude lors de paiements par chèque, une loi récente a assujetti les carnets de chèques non barrés et endossables à un droit de timbre spécial. Surtout, l'administration fiscale peut désormais obtenir à tout moment communication de l'identité des personnes auxquelles les formules de chèque non barrées ont été délivrées. Enfin, les adhérents de centres de gestion et associations agréés sont tenus d'accepter le paiement par chèques non endossables rédigés à leur nom et ils doivent informer leur clientèle de cette obligation.

Les contribuables dont le train de vie est manifestement disproportionné par rapport aux revenus qu'ils déclarent peuvent se voir imposés soit d'une façon forfaitaire, en fonction d'un barème appliqué aux principaux "signes extérieurs" de leur richesse (résidence, automobiles, bateaux, domestiques), soit d'après leurs dépenses notoires. Cependant, cette procédure doit revêtir un caractère exceptionnel et elle n'est utilisée par l'administration qu'en cas de forte présomption de fraude, ce qui représente cependant plusieurs centaines de cas chaque année.

Les services fiscaux disposent également de moyens substantiels pour combattre la fraude des entreprises. Plusieurs mesures ont pour objet de limiter le gonflement des frais généraux. Les entreprises doivent fournir chaque année à l'administration un relevé détaillé de certaines catégories de frais qui comprennent notamment les rémunérations les plus importantes, les frais de réception, les frais de voyage et les cadeaux. De plus, c'est à l'entreprise qu'il appartient de démontrer que toutes ces dépenses ont été engagées dans l'intérêt direct de son exploitation.

Mais la lutte contre la fraude doit de plus en plus prendre la mesure des aspects internationaux. Là aussi un net renforcement des moyens vient renforcer le développement de la coopération internationale.

L'administration française peut ainsi refuser la déduction de toute somme versée à une personne physique ou morale établie dans un paradis fiscal au titre de licences, brevets ou services rendus lorsque l'entreprise française n'apporte pas la preuve que ces dépenses correspondent à des opérations réelles et qu'elles ne présentent pas un caractère exagéré.

Enfin, deux mesures récentes devraient entraver certaines formes d'évasion fiscale internationale. L'une permet à la France d'imposer les bénéfices réalisés par certaines entreprises sous le couvert de filiales ayant leur siège dans un paradis fiscal; l'autre assouplit les conditions permettant de soumettre à l'impôt français des sommes versées à l'étranger au titre de services rendus en France.

(ii) Des garanties accrues pour les contribuables

Mais, ainsi que Montesquieu l'observait fort justement: "C'est une expérience éternelle que tout homme qui a du pouvoir est porté à en abuser: il va jusqu'à ce qu'il trouve des limites. . . Pour qu'on ne puisse abuser du pouvoir, il faut que, par la disposition des choses, le pouvoir arrête le pouvoir". Le renforcement des moyens dont dispose l'administration fiscale pour prévenir et sanctionner la fraude a donc été parallèlement complété par un développement des garanties accordées aux contribuables. Les conditions permettant la taxation d'office ont été précisées; c'est à l'administration qu'il appartient désormais de prouver le caractère intentionnel d'une fraude; un certain nombre de pouvoirs ont été transférés de l'administration fiscale aux tribunaux.

Par ailleurs en 1976, a été créée la charte du contribuable vérifié qui rappelle aux contribuables tous leurs droits et leur est envoyée avec l'avis de vérification.

Surtout, depuis 1978, les contribuables ne peuvent plus

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être poursuivis pénalement pour fraude fiscale que sur avis conforme d'une commission indépendante de l'administration fiscale. En outre, un comité, composé de hauts magistrats, supervise le contentieux fiscal et, en particulier, émet un avis sur toutes les remises de pénalités excédant un certain montant.

Ceci résulte de la loi sur les garanties des contribuables (1971) qui contient de nombreuses autres mesures notamment pour ce qui est des rectifications d'office, des notifications préalables indispensables.

Ce double mouvement — moyens renforcés et garanties accrues — peut apparaître contradictoire. Il est en fait dans mon esprit, parfaitement complémentaire. L'administration doit être mise à même de disposer des moyens pour faire face à des agissements qui s'apparentent au vol. L'immense majorité des citoyens qui ne fraudent pas ne doit pas avoir à pâtir de ces pratiques puisque ce sont eux qui sont appelés à compenser ces défaillances.

Les garanties renforcent l'impact psychologique de la lutte contre la fraude. Elles évitent tout phénomène de rejet et lui permettent donc de se dérouler efficacement. En quelque sorte, il faut peu à peu arriver à un système où le contrôle devient normal et la fraude anormale.

3) L'ADAPTATION DE LA FISCALITE AUX BESOINS DU DEVELOPPEMENT ECONOMIQUE

L'ampleur de la crise économique que connaît le monde développé a suscité, en France comme ailleurs, diverses mesures d'adaptation de la fiscalité aux nouveaux besoins de l'économie.

Les dispositions les plus originales introduites dans notre législation concernent le soutien de l'investissement et le développement de l'épargne affectée au financement du secteur productif.

a) Le renforcement des mesures en faveur de l'investissement

La législation fiscale française est de manière permanente favorable à l'investissement, tant par l'existence d'un système d'amortissement dégressif que par une appréciation très libérale des durées d'amortissement. Les nécessités de la conjoncture ont cependant conduit à renforcer l'incitation à l'investissement.

Dès 1975, pour compenser les effets dépressifs de la première flambée des prix du pétrole sur le volume des investissements, les pouvoirs publics ont institué une aide fiscale égale à 10 pour cent du prix des nouveaux équipements. Certes, ce type de mesure a souvent été pratique à l'étranger, mais généralement sous la forme d'une déduction opérée en fin d'année sur les bénéfices. Au contraire, l'aide de 1975 était immédiatement imputable sur la taxe sur la valeur ajoutée due par les entreprises.

Toutefois, s'appliquant à tous les investissements commandés entre avril 1975 et janvier 1976, cette aide présentait l'inconvénient de bénéficier à de nombreux équipements qui auraient été acquis, en tout état de cause. Son efficacité n'était donc pas à la mesure de son coût.

Tirant les conséquences de cette expérience, une loi de juillet 1979 a institué un nouveau dispositif de soutien à l'investissement qui constitue, semble-t-il, une première mondiale.

Ce mécanisme permet en effet aux entreprises de bénéficier d'une déduction fiscale, non plus sur la masse totale de leurs nouveaux équipements, mais sur l'accroissement net de leurs investissements par rapport à l'année précédente. Cette aide a ainsi permis aux entreprises de déduire de leurs résultats 10 pour cent de l'excédent de l'investissement net réalisé en 1979, par rapport à l'investissement net de 1978, et elle s'applique de la même façon en 1980.

D'autre part, les coefficients qui permettent de passer de l'annuité d'amortissement linéaire à l'annuité d'amortissement dégressif sont utilisés à des fins conjoncturelles et structurelles. C'est ainsi que les coefficients ont été majorés d'un demi point pour les biens acquis ou fabriqués en 1977. Cette majoration a été rendue permanente pour les matériels permettant soit de lutter contre la pollution, soit de récupérer ou d'économiser l'énergie et les matières premières.

Enfin, depuis 1979, les matériels affectés à la recherche acquis par les petites et moyennes entreprises peuvent faire l'objet la première année d'un amortissement exceptionnel de 50 pour cent, la valeur résiduelle étant au cours des années suivantes amortie selon le mode dégressif.

b) Une panoplie étendue de mesures en faveur de l'épargne

Le nombre des mesures fiscales en faveur de l'épargne dépasse la vingtaine, ce qui constitue certainement en soi une originalité.

La simple lecture du tableau suivant, qui ne comprend que les principaux avantages, rendra compte de la diversité de ces mesures et du coût important qu'elles représentent pour le budget de l'Etat en tant que "moins values" fiscales.

Cependant, il est apparu que la plupart de ces mesures, dont plusieurs parmi les plus coûteuses pour le budget de l'Etat, bénéficiaient à l'épargne courte et au logement, et non pas à l'épargne longue orientée vers le secteur productif.

Or, l'insuffisance des fonds propres constitue en France l'un des obstacles les plus importants au développement des entreprises et, par suite, à la promotion de l'emploi.

Le législateur français s'est donc efforcé, depuis plusieurs années de réorienter les avantages fiscaux accordés à l'épargne en réduisant ceux bénéficiant au logement ou à l'épargne courte et en développant parallèlement ceux favorisant l'épargne longue.

Ce redéploiement a notamment consisté à réduire la déduction forfaitaire applicable aux revenus des immeubles et à majorer sensiblement les taux du prélèvement libératoire d'impôt sur le revenu applicable aux produits de placements à revenu fixe.

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PRINCIPAUX AVANTAGES FISCAUX ACCORDES A L'EPARGNE

Nature de la mesure	*Estimation du coût de la mesure en 1980, au titre des revenus de 1979 (en millions de Fr.Frs)*
EPARGNE OU A COURT TERME	
o Exonération des intérêts correspondant aux sommes déposées sur certains livrets et comptes (caisses d'épargne, Crédit Mutuel etc. . .)	6.650
o Prélèvement libératoire sur les produits des placements à revenu fixe	1.120
EPARGNE LONGUE	
o Prélèvement libératoire sur les produits de placements à revenu fixe	830
o Avoir fiscal attaché aux dividendes de sociétés françaises (personnes physiques)	1.900
o Abattements sur les produits de certains placements	1,160
o Détaxation du revenu investi en actions de sociétés françaises	1.600
o Déduction des primes d'assurance-vie	1.200
LOGEMENT	
o Aide fiscale accordée par l'Etat aux propriétaires qui logements donnés en location:	
— déduction forfaitaire sur les revenus fonciers	1.000
— déduction des frais divers liés à ces logements	2.400
o Aide fiscale accordée par l'Etat aux propriétaires qui se logent eux-mêmes:	
— déduction de certaines charges concernant l'habitation principale (intérêts d'emprunt, dépenses d'isolation thermique. . .)	3.700

En contrepartie, une loi de juillet 1978 a institué plusieurs mesures originales destinées à orienter l'épargne vers le financement des entreprises.

D'une part, cette loi permet aux sociétés cotées en bourse qui se constituent ou qui procèdent à des augmentations de capital entre le 1er janvier 1977 et le 31 décembre 1981 d'inclure dans leurs charges d'exploitation les dividendes versés aux actions ainsi émises, pendant 7 exercices s'il s'agit d'actions ordinaires et pendant 10 exercices s'il s'agit d'actions à dividende prioritaire sans droit de vote. Cette disposition équivaut, d'une façon certes temporaire, à un avoir fiscal de 100 pour cent pour les actions ainsi émises.

D'autre part, la loi encourage les épargnants à acquérir des actions puisqu'elle permet aux contribuables ayant un domicile fiscal en France de déduire de leur revenu imposable, sous certaines conditions, les sommes nouvellement investies en actions dans la limite annuelle de 5.000 Fr.Frs., majorable en fonction des charges de famille.

Le marché financier français bénéficie d'un net regain d'intérêt depuis la mise en oeuvre de cette loi.

* * *

L'exposé de quelques particularités de notre système fiscal montre qu'imagination et fiscalité peuvent faire bon ménage. Ainsi que je l'ai montré, il ne s'agit pas uniquement d'un legs du passé puisque nous avons continué à introduire de nombreuses innovations dans notre législation au cours des dernières années.

Cependant, il convient maintenant de s'attacher à une bonne application de la législation plutôt que d'ajouter de nouvelles réformes à celles qui n'ont pas encore eu le temps d'être parfaitement assimilées.

Une pause fiscale paraît souhaitable.

Celle-ci doit revêtir un double aspect.

Elle doit tout d'abord consister à stabiliser le poids des prélèvements obligatoires qui ne pourrait continuer à s'accroître au rythme de ces dernières années sans risquer de susciter des réactions de rejet de l'impôt analogues à celles qu'ont connues certains pays dans un passé récent.

En second lieu, il convient de marquer une halte dans le foisonnement législatif qui a apporté chaque année une cinquantaine de dispositions nouvelles au code général des impôts. Cette instabilité législative s'oppose en effet à une bonne compréhension du système fiscal par les contribuables et à sa bonne application par l'administration.

Pour autant, cette pause fiscale ne doit pas être synonyme d'immobilisme. J'entends, en particulier, que l'administration fiscale française mette à profit ce répit législatif pour développer, notamment tant sur le plan interne qu'en coopération avec les administrations étrangères, la lutte contre la fraude et l'évasion fiscales.

Dans la période difficile que traversent nos économies, l'acceptation des efforts demandés à l'ensemble de la population exige en effet une répartition equitable du prélèvement fiscal.

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FRANCE: A Survey of Its Tax System

by D.A. van Waardenburg *

I. INTRODUCTION

In the preceding article the French Minister of the Budget, Mr. Maurice Papon, explains the originality of a number of aspects of French tax legislation.

The present article, written on the occasion of the 34th congress of IFA in Paris, describes some of these aspects as they appear in the most important French taxes, with a view to giving our non-French readers a bird's eye view of the French tax system as it is today. It is largely based on information published in our loose-leaf publication, SUPPLEMENTARY SERVICE TO EUROPEAN TAXATION. Of course, a brief survey is necessarily incomplete so that the reader who wants more detailed information is referred to the books and articles listed in the selected bibliography published at the end of this article. French taxes are generally categorized in the following manner:

I. Direct taxes

A. Individual income tax.
B. Corporate income tax.
C. Miscellaneous taxes levied by the Central Government, mostly payroll taxes.
D. Local taxes, including various real property taxes and the business tax.

II. Indirect taxes

A. Value added tax.
B. Excise on, inter alia, alcoholic beverages, wine, theatrical performances, etc.
C. Miscellaneous taxes (on bank credits, forestry products and the "para-fiscal" taxes).

III. Registration and stamp taxes

These include taxes levied at the transfer of real property, capital contribution tax at the creation of a company and inheritance and gift tax.

INVESTMENT INCOME RELIEF

Individual taxpayers receive important incentives for investment. The most important are:

(a) Dividends received from a French corporation entitle the shareholder to a credit (avoir fiscal) of one-half of the dividend.
(b) Dividends received from French corporations are exempt up to an amount of 3,000 Fr.Frs. provided that the recipient's taxable income does not exceed 180,000 Fr.Frs.
(c) Interest in an aggregate amount of 3,000 Fr.Frs. received on bonds issued by French or foreign entities is exempt provided that the bonds are quoted on a French stock exchange and that they are not subject to an index clause.
(d) Persons owning the house in which they live are not subject to income tax with respect to the annual rental value of the house; they may, however, within certain limits, deduct interest paid on loans contracted for the construction or important repairs of the house and expenses connected with the resurfacing of stonework.
(e) Interest and dividends received under certain long-term saving schemes (minimum duration 5 years) are within certain limits exempt.
(f) Interest on the first savings bank book with the Postal Services and interest on savings accounts for housing construction and some other purposes are exempt.
(g) Any excess of purchases over sales of certain French shares during the period between June 1, 1978 and December 31, 1981 may be deducted from income provided no use is made of the deduction under (b) and the exemption under (e). The maximum deduction is 5,000 Fr.Frs. increased by 500 Fr.Frs. for each of the first two dependent children and 1,000 Fr.Frs. for each next dependent child.

II. INDIVIDUAL INCOME TAX

A. Residents

1. Domicile and scope

Individuals — whether French nationals or foreigners — who have their domicile in France are subject to individual income tax (impôt sur le revenu) on their worldwide income. A taxpayer is deemed to have his domicile in France:

(i) if he has his home or principal place of abode in France; or
(ii) if he performs personal services in France either as an employee or independently, unless he can prove that these services are of a subordinate importance; or
(iii) if he has his center of economic interests in France.

Note, however, that tax treaties may have an important impact on a taxpayer's tax liability. Special relief provisions apply to employees who are sent abroad but who retain their domicile in France.

2. Taxable base

A resident taxpayer's taxable base is composed of the following elements:

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(i) net income from industrial, commercial and handicraft activities;
(ii) net real property income;
(iii) net agricultural income;
(iv) net employment income, pensions and annuities;
(v) net income from non-commercial activities;
(vi) net income received by directors of limited liability companies;
(vii) certain net capital gains;
(viii) certain net gains derived from real property.

The sum total of these net incomes is called the *gross total income (revenu global brut).* In order to arrive at the *taxable income* a number of deductions may be taken.

One of the most important rules is that any deficit in one of the above income categories may be deducted from gross total income. If the taxable income is *negative* the loss may be carried forward and deducted from gross total income of the next five years. Note, however, that this is only a *general* rule and that there exist important exceptions which considerably limit the possibility to offset losses.

Other deductions which may be taken from gross total income include: interest on loans for the acquisition, construction and repair of the taxpayer's principal residence as well as expenses incurred to save energy, alimony, social security premiums, gifts to charities, savings used for construction of dwellings, life insurance premiums and certain investments in shares. Note that these deductions are only allowed if a number of conditions have been fulfilled and that they are generally limited in some way or other.

3. Rates

Individuals are generally subject to a progressive rate of income tax. The tax table is determined at the end of the tax year, i.e. the tax table on 1980 income will be fixed by the Finance Law 1981 which will be published at the end of December 1980. Thus, the most recent tax table applies to 1979 income, as follows (single persons):

Taxable income	*1980 (on 1979 income) (%)*
0 — 8,725 Fr.Frs.	0
8,725 — 9,125 Fr.Frs.	5
9,125 — 10,825 Fr.Frs.	10
10,825 — 17,125 Fr.Frs.	15
17,125 — 22,275 Fr.Frs.	20
22,275 — 28,000 Fr.Frs.	25
28,000 — 33,875 Fr.Frs.	30
33,875 — 39,075 Fr.Frs.	35
39,075 — 65,125 Fr.Frs.	40
65,125 — 89,575 Fr.Frs.	45
89,575 — 105,950 Fr.Frs.	50
105,950 — 125,050 Fr.Frs.	55
In excess of 125,050 Fr.Frs.	60

The rates are applied to each successive slice of income.

Where a taxpayer is married his income and that of his spouse are added together with that of their children under 18 years of age. Relief is given by dividing the aggregate income by a coefficient (depending on marital status, number of dependents, their health situation etc.). The income tax table is then applied to the result and the income tax thus computed is subsequently multiplied by the same coeffieient. [1]

In some cases individuals are subject to a flat rate of income tax. Some of the most important cases are:

— 15 percent on capital gains derived from the sale of a substantial participation in a company (generally a shareholding exceeding 25 percent) and gains derived from major transactions (generally totaling more than 150,000 Fr.Frs. annually) connected with shares or bonds with a regularly quoted price;
— 25 percent of interest from bonds and other negotiable debt instruments (the taxpayer may opt for an exemption of income tax);
— 30 percent on gains derived from habitual stock exchange transactions (generally if borrowed money is used or share options are involved or if the total amount involved during a year exceeds 1.6 times the value of the securities owned by the taxpayer at the end of the preceding year and provided further that total sales exceed 10,000 Fr.Frs. during the year);
— 38 or 40 percent on interest from savings deposits, current accounts (40 percent on interest accrued before January 1, 1980) (the taxpayer may opt for an exemption from income tax);
— 38 or 42 percent on interest from certain treasury bonds (42 percent if the recipient is not disclosed);
— 33 1/3 percent on gains derived by persons who improve real property with a view to its sale if they sell completed dwelling houses (this privilege is limited to 400,000 Fr.Frs. per four years).

B. Non-residents

Non-residents, i.e. persons who do not have their domicile in France, are subject to French income tax with respect to income from French sources covered by the categories of income listed above. Non-resident aliens who possess one or more residences in France are subject to tax on a minimum income of three times the annual rental value of their residence(s) in France. This provision does not apply to non-resident French citizens and citizens of countries which have concluded a tax treaty with France containing a non-discrimination clause.

The general rule is that the taxable income of non-residents is computed in the same manner as for resident taxpayers and that the same income tax rates apply. However, for a non-resident — whether a French national or an alien — a minimum rate of 25 percent is applicable unless he can show that the overall rate of French income tax on his world-wide income would be lower than 25 percent in which case the lower rate applies. If the income tax levied at 25 percent does not exceed 2,000 Fr.Frs. it will not be collected.

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1. See for a detailed explanation and computation examples, SUPPLEMENTARY SERVICE TO EUROPEAN TAXATION, Section B : France.

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There are a number of exceptions to the above rule of which the most significant are discussed below.

Non-resident taxpayers are subject to a graduated withholding tax with respect to their French-source employment income. Its rates on an annual basis are:

up to 25,800 Fr.Frs.	nil
from 25,800 — 76,100 Fr.Frs.	15 percent
in excess of 76,100 Fr.Frs.	25 percent

The rates are applied to each successive slice of income and apply to *1980* income. The taxable base is the *net* income after deduction of expenses (see box). This withholding tax is a final tax for that part of the employment income which does not exceed 76,100 Fr.Frs. provided that the recipient of the income is either a French national or a person possessing the nationality of a country with which France has concluded a tax treaty containing a non-discrimination clause. The remainder is also subject to the individual income tax but the withholding tax may be credited against the individual income tax. However, a refund is not given.

A flat-rate 33 1/3 percent withholding tax applies to gross income from non-commercial activities exercised in France or to French-source royalties connected with copyrights, patent rights and other industrial property, provided that the debtor of the income is established in France and the creditor does not have a fixed base in France. The withholding tax may be credited against the individual income tax but it is never refunded.

In a number of cases there is a withholding tax levied at a flat rate which replaces the graduated individual income tax, for instance:

- 25 percent on dividends distributed by French companies;
- 25 percent on interest from French bonds and certain other negotiable loan instruments, and at varying rates (33 1/3, 38, 40 or 42 percent) on other interest;
- 33 1/3 percent on certain taxable capital gains (for instance, French-situs real property capital gains);
- 50 percent on certain French-situs real property gains in case of speculation or building construction.

III. CORPORATE INCOME TAX

A. Resident corporations

1. Residence and scope

Corporations resident in France are with respect to their "active" income (income from business operations) subject to corporate income tax (impôt sur les sociétés) on income earned or deemed to have been earned in France. With respect to their "passive" income (investment income such as dividends, interest and royalties), the tax is levied on world-wide income. Resident corporations are those corporations which have been incorporated in France or which have their seat (siège social) in France.

Foreign-source "active" income, i.e. income earned through a foreign-situs permanent establishment, or representative established abroad or through the completion of a cycle of commercial activity abroad is generally exempt. Under certain circumstances, subject to the approval of the tax authorities, a French corporation may consolidate its income with that of its foreign permanent establishments or even its foreign subsidiaries. French corporate income tax is then imposed on the aggregate income of the French corporation, its permanent establishments and subsidiaries and any foreign income and withholding tax may be credited against French corporate income tax.

Recent legislation introduced an anti-tax avoidance measure under which — if a number of conditions have been satisfied — a French parent corporation may receive an additional corporate income tax assessment for a proportional share of income earned by a foreign subsidiary in which it holds at least a 25 percent interest, provided that the foreign subsidiary is established in a low-tax area. In this event there is no consolidation of income, so that any foreign losses are disregarded. Foreign income or withholding taxes may be credited against French corporate income tax assessed on the foreign subsidiary's income or dividend contributions. [2]

Double tax treaties may allocate income items to France for taxation which thus become part of a corporation's taxable income even in those cases where the income would under the French national rules have been exempt. This is particularly significant for income derived through the completion of a commercial cycle abroad which would otherwise not be subject to income tax at all. Another deviation from the rule that French corporate income tax is only imposed on French-source business income is that a provisional deduction is available with respect to initial losses incurred for (i) the installation of a foreign sales office, (ii) a foreign information office or (iii) a foreign office to conduct research either through a foreign permanent establishment or, indirectly, through a foreign subsidiary. Similarly, a provisional deduction is allowed with respect to certain industrial investment in developing countries (see *reserve for investment abroad*, infra).

2. Taxable base

Some significant factors which determine the computation of the taxable base for corporate income tax purposes are discussed below:

a. *Depreciation of business assets*

Depreciation may be taken on all tangible assets, fixed or movable, owned by and used in the business, which necessarily diminish in value over time and whose useful life exceeds one year. Patents and relating manufacturing rights can also be depreciated. Other intangible rights such as good will, copyrights, trademarks, secret processes, etc. and land may, however, be the object of provisions where the value of the business as a whole is

2. See D.A. van Waardenburg, "France: Finance Law 1980", in 20 EUROPEAN TAXATION 113 (1980).

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EMPLOYMENT INCOME RELIEF

The French "tax climate" is particularly mild for wage earners, who generally only pay income tax on 72 percent of their net salary income.

They may take the following deductions:

(a) old age pension premiums;
(b) from the remaining amount, the taxpayer may deduct the greater of either 10 percent of that amount, or a lump sum amount of 1,800 Fr.Frs. or actual expenses (hereinafter referred to as "ordinary deduction"); for 1979 income the maximum deduction is 40,000 Fr. Frs.;
(c) the balance is further reduced by an "extra deduction" of 20 percent on the first 360,000 Fr.Frs.; this deduction is reduced to 10 percent for persons who hold directly or indirectly more than a 35 percent interest in a company with respect to salaries in excess of 150,000 Fr.Frs. which they receive from that company.

For special categories of employed persons (e.g. journalists, artists) a supplementary deduction is allowed at percentages varying from 5 percent to 30 percent up to a maximum of 40,000 Fr.Frs. (1979 income) or 50,000 Fr.Frs. (1980 income). This deduction is applied after the ordinary deduction of 10 percent is made.

reduced and a substantial fall in profits is demonstrated. [3]

In principle both the straight-line and declining balance methods of depreciation are permitted. However, whereas straight-line depreciation is always applicable, the field of application of the declining balance method is narrower since it may not be used with respect to buildings (with the exception of hotel buildings and light construction whose maximum life does not exceed 15 years). Also, second-hand assets are generally excluded from declining-balance depreciation, with the exception of renovated assets, assets used for construction abroad and second-hand ships.

The rate of straight-line depreciation is computed by dividing the expenditure by the estimated number of years of its life. The rate of declining balance depreciation is computed by multiplying the rate of the straight-line depreciation by a certain coefficient prescribed by law:

— 1.5 if the life of the asset is 3 or 4 years;
— 2.0 if the life of the asset is 5 or 6 years;
— 2.5 if the life of the asset exceeds 6 years.

Deviations from the main rule:

(i) *Assets acquired between June 30, 1974 and July 1, 1975*

Reduction of the coefficients to 1, 1.5 and 2.

(ii) *Assets acquired or manufactured in 1977 (when purchased the order must have been placed before June 1, 1977)*

Increase of the coefficients to 2, 2.5 and 3.

The above increase coefficients also apply to energy-saving equipment acquired from January 1, 1977 onwards; to equipment-saving raw materials used from January 1, 1978 onwards; and to assets used in energy-saving projects from January 1, 1979 onwards.

In some cases depreciation on the basis of "unit of production" has been permitted, thus adapting depreciation to the intensity of use in case of double or triple shift work (e.g. in steel factories).

Deduction of depreciation is compulsory up to the amount of straight-line depreciation, which means that depreciation must also be taken in loss years. However, in such a case any loss corresponding to the amount of depreciation may be carried forward indefinitely to later years and is not limited to five years as would normally have been the case.

A change-over from declining-balance to straight-line depreciation is permitted when the depreciation deduction computed according to the declining balance method is less than the deduction computed by dividing the net depreciable balance by the remaining years of useful life.

b. *Accelerated depreciation*

Accelerated depreciation is only possible in a limited number of cases specifically regulated by the law. It consists mostly in an initial deduction ranging from 25 to 100 percent and straight-line depreciation with respect to the residual value (if any) of the asset. The following initial deductions are available:

(i) 25 percent for investment in certain industrial and commercial real property in certain development areas under Government approval, provided that their construction was started before December 31, 1977;
(ii) 50 percent for buildings for scientific or technical research and for certain buildings for the prevention of water or air pollution, which have been completed before January 1, 1981; also for subscription to shares of Government-approved research companies and "financial innovation" companies;
(iii) 50 percent of the cost price of assets for scientific or technical research, to be defined in a decree, provided that the investment is effected in France. Enterprises which employ more than 2,000 persons do not qualify nor do companies more than half of whose shares are directly or indirectly owned by companies whose stock is listed at the stock exchange;
(iv) 100 percent for subscription of shares in Government-approved companies for the development of agriculture, industry and commerce.

c. *Investment deduction*

The following investment deductions are available:

3. This definition appears in THE TAXATION OF COMPANIES IN EUROPE, Chapter France at 79. See generally: "France: Part II of a comparative analysis of fiscal depreciation and investment allowance facilities available to corporate entities in the Common Market", in 11 EUROPEAN TAXATION I/186 (1971).

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(i) 10 percent of *additional* investment (investment in excess of preceding year's investment) made in 1979 and 1980. Qualifying assets are depreciable tangible assets utilized in France. A number of enterprises are excluded from this relief such as insurance companies, real property companies, most financial institutions and in general those enterprises the cost price of whose depreciable tangible assets qualifying for declining-balance depreciation is less than 2/3 of the cost price of total depreciable tangible assets (not including buildings).

(ii) Enterprises publishing newspapers and certain magazines which are to a large extent devoted to the dissemination of political information are granted relief for the acquisition of business assets (excluding land and participations). This measure, which has been changed numerous times, provides for 1980 that 65 percent of income from daily newspapers and 40 percent of income from other publications may be used or placed in a reserve free of income tax. Only 90 percent of the cost price of assets for daily newspapers and 55 percent of the cost price of assets for other publications may be financed through this provision.

(iii) Enterprises employing more than 100 employees must participate in a profit sharing scheme on behalf of their employees. For this purpose they must make an annual contribution to a special reserve of 50 percent of their adjusted taxable income times a coefficient which is based on the ratio between the payroll and the value added. This contribution may be deducted from the taxable income of the subsequent year and the enterprise may, in addition, place an amount equal to a certain percentage of the amount entered in the reserve for the profit sharing scheme in a tax free reserve, to be used within 12 months, for the acquisition of fixed assets.

d. *Depletion deduction*

A depletion deduction is available to companies which are engaged in the search for and exploitation of gas or oil or in the extraction of certain specified solid minerals. The amount deducted from taxable income must be reinvested within five years. For gas and oil, the deduction amounts to the lower of 23.5 percent of turnover or 50 percent of the profit resulting from this turnover. For qualifying minerals the deduction is the lower of 15 percent of turnover or 50 percent of the profits resulting from the pertinent turnover.

e. *Reserves*

(i) *Reserve for investment abroad*

Companies investing abroad through a foreign branch office or through a foreign subsidiary company may during the first five years after the investment enter certain amounts in a tax free reserve, provided Government approval has been obtained. A distinction is made between investment in *commercial* and *industrial* enterprises.

If investment takes place in a *commercial* enterprise in a Common Market country (other than France) the amounts placed in the tax free reserve may not exceed the lesser of (i) the accumulated losses of the first five years and (ii) the accumulated amount of the investment. If investment is made in a non-Common Market country, the full amount of the investment may be placed in the tax free reserve, but Government approval is generally only available if investment takes place in a developing country.

If investment takes place in an *industrial* enterprise abroad an amount not exceeding 50 percent of the investment may be placed in the tax free reserve, but generally only investment in a developing country qualifies for this privilege.

A recent law has extended the above privilege to banks and other enterprises participating in foreign commercial and industrial ventures in support of a French company investing abroad.

The amounts thus deducted from taxable income must after five years be added back to income in five equal annual installments.

(ii) *Reserve for commodity market fluctuations*

A reserve for commodity market fluctuations may be created by resident corporations whose main business is the processing of certain raw materials (including gold, silver, certain textiles and oil seeds, rubber, cocoa, etc.) to take account of world commodity market fluctuations and, for some other raw materials, French commodity market fluctuations connected with the world market.

(iii) *Reserve for price increases*

A reserve for inventory price increases may be created in any year in which, on an item by item basis, the unit price has increased by more than ten percent during a period which may not exceed two accounting years. The reserve must be added back to taxable income within a period of six years.

f. *Inventory valuation*

Inventory is valued at either cost or current sales price, whichever is less. With respect to inventory determination some form of the FIFO system (first in, first out) or an average cost method is used. LIFO (last in, first out) is generally not permitted unless it reflects actual practice of the enterprise.

g. *Deductibility of taxes paid*

Generally only income taxes are non-deductible This rule also applies to foreign income taxes pertaining to foreign exempt income. Foreign income taxes pertaining to income subject to French corporate income tax are, absent tax treaty provisions to the contrary, deductible. Examples of deductible taxes are: registration and stamp taxes, payroll taxes, business tax and excises. However, the value added tax is not normally deductible since it is not an effective burden on the company.

h. *Deductibility of dividends received (parent-subsidiary relationships)*

Dividends received are generally included in taxable income for purposes of corporate income tax grossed up by the 50 percent "avoir fiscal" (special credit) to which the

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recipient corporation is entitled. However, dividends received from either a resident or non-resident corporation are exempt for 95 percent of their amount (sometimes less) provided that the participation is:

- at least 10 percent of the distributing corporation's share capital (or less, if the participation percentage drops below 10 percent merely as a result of the increase of the capital of the subsidiary *and* the cost price of the participation at the moment of its acquisition was at least 2,000,000 Fr.Frs.); or
- was acquired for at least 10,000 Fr.Frs.; or
- the shares were acquired in a merger operation.

Other conditions for the deduction are: (i) the parent corporation must have acquired the shares in exchange for its contribution to the subsidiary's capital or it must be bound to hold the stock for at least two years and (ii) it must hold the shares in registered form or the shares must be deposited in an approved organization.

Dividends received from resident and non-resident subsidiaries (in case of dividends distributed by resident subsidiaries grossed up to include the 50 percent "avoir fiscal") are exempt in the hands of the qualifying parent corporations for 95 percent of their net amount. If the parent corporation proves that its expenses incurred from the participation are less than 5 percent of the amount of the dividends, the exempt proportion of 95 percent may be increased accordingly.

If a French parent corporation re-distributes to its own shareholders exempt dividends received from its foreign or domestic subsidiary, it is subject to an additional 50 percent tax [4] — the so-called "précompte" — with respect to those dividends. With respect to dividends received from a domestic subsidiary the "précompte" is completely offset by the "avoir fiscal". This is not the case, however, with dividends received from a foreign subsidiary. The "précompte" is refunded to shareholders of the French parent corporation who are resident in a country with which France has concluded a tax treaty.

i. *Deductibility of dividends distributed*

Dividends distributed by a French corporation are not normally deductible for purposes of the corporate income tax. However, in order to stimulate the French economy, such deduction is permitted to French corporations which are created or which increase their capital between January 1, 1977 and December 31, 1981. They may, during the first seven years (for shares with preferential dividend, ten years) following such creation or increase, deduct the dividends they distribute with respect to the newly issued shares, provided that the contributions were made in cash and that the shares were quoted on the stock exchange within three years. The latter condition has been waived for shares issued between June 1, 1978 and December 31, 1981. The deduction is limited to 7.5 percent of the capital contributed.

This deduction is also applicable to dividends distributed on shares at the conversion of certain loans into share capital with the provision that these loans must have been granted for a period of at least twelve months by shareholder-directors of the corporation and that after the capital increase less than 50 percent of the voting power is held by one or more corporations.

j. *Relief for small and medium-sized industrial businesses*

Small and medium-sized industrial businesses (PMI's) created between June 1, 1977 and January 1, 1981 may either (i) deduct in the year that they are created and in the four succeeding years, from their taxable income before deduction of losses carried over from preceding years, one third of this taxable income, or (ii) they may benefit from a tax holiday under which their undistributed income of the year of their creation and the next two years is exempt from corporate income tax, provided that:

(i) their turnover does not exceed 30,000,000 Fr.Frs. and their staff does not exceed 150 employees; and
(ii) the total acquisition cost of the assets which qualify for declining-balance depreciation equals at least two thirds of the total acquisition cost of all tangible depreciable assets (exclusive of buildings); and
(iii) other companies do not directly or indirectly hold more than 50 percent of the voting rights.

Where a company opts for the tax holiday it must in addition convert the exempted income into capital.

K. *Losses*

The general rule is that losses may be carried forward to be set off against the profits of the next five years. However, losses corresponding to depreciation may be carried forward indefinitely. Where a corporation has created a long-term capital gain reserve (see below under 3. Rates), this reserve may be used to offset ordinary losses irrespective of their age and long-term capital losses of the following ten years. Long-term capital losses may also be deducted from long-term capital gains of the following ten years.

3. Rates

The normal rate of corporate income tax is 50 percent. The balance of long-term capital gains and long-term capital losses (generally connected with business assets held for at least two years) is subject to a tax at a reduced rate of 15 percent (or 25 percent for the sale of building lots). The capital gains less the amount of tax due must be placed in a reserve; on distribution, the gains are taxed at the normal rate of corporate income tax but the tax already paid is creditable. An additional 50 percent [5] tax (précompte) is due at the distribution of income exempt from French corporate income tax (or subject to a rate less than 50 percent). This is, for instance, the case with income derived from a foreign branch office or dividends received from a subsidiary (see h. Deductibility of dividends received (parent-subsidiary relationships), above). The "précompte" is also imposed on income which has been retained for more than five years.

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4. The rate is 50 percent if related to the net dividend distributed, but it is 33 1/3 percent if related to the income *before* dividend.
5. Id.

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Corporations are also subject to an annual lump sum tax of 3,000 Fr.Frs. This tax is creditable against corporate income tax payable in that tax year and the next two tax years. Newly created corporations are exempt from this tax for three years, provided that at least 50 percent of their capital was contributed in cash.

B. Non-Resident Corporations

Non-resident corporations are subject to French corporate income tax at the rate of 50 percent with respect to income derived from business activities in France through either:

- a permanent establishment in France; or
- a permanent representative in France; or
- a "complete cycle of commercial activity" in France.

This income less the corporate income tax due is also subject to a substitute withholding tax of 25 percent, so that foreign corporations are normally subject to a rate of 62.5 percent. If it can be proved that the total income actually distributed by the foreign corporation within twelve months following the tax year is less than the French branch's net distributable income, an appropriate refund of the substitiute withholding tax is made. This will also be the case where it can be demonstrated that the foreign corporation made dividend distributions to shareholders resident or established in France. Under tax treaty provisions the substitute withholding tax is usually reduced or even waived.

A non-resident corporation receiving French-source non-business income such as rentals from French-situs real property is only subject to the standard 50 percent rate of corporate income tax. French-source dividends are only subject to a withholding tax at the rate of 25 percent, whereas interest is subject to withholding tax at varying rates (23, 33 1/3, 38, 40 or 42 percent). Royalties are subject to a 33 1/3 percent withholding tax which may be credited against the corporate income tax due. Tax treaties generally reduce these rates.

A 33 1/3 percent rate of corporate income tax is imposed on accessory income from housing construction by foreign corporations which are financial institutions or which appoint a representative in France. To be recognized as "accessory" the income must not exceed 25 percent of the foreign corporation's total income.

IV. PAYROLL TAXES

The following payroll taxes are levied:

A. Taxe sur les salaires

The salary tax (taxe sur les salaires) is not due where the taxpayer is subject to value added tax on at least 90 percent of his turnover.

1. Taxable base

The taxable base is the goss amount of salaries and wages paid during a calendar year including payments in kind. Social security payments due by the employer are generally not included in the taxable base.

2. Rates

The normal rate is 4.25 percent. This rate is increased to:

- 8.5 percent for that part of individual salary which exceeds 32,800 Fr.Frs. but does not exceed 65,600 Fr.Frs.; and
- 13.6 percent for that part of individual salary which exceeds 65,600 Fr.Frs.

B. Taxe d'apprentissage

The purpose of the apprenticeship tax (taxe d'apprentissage) is to finance apprenticeship schemes and technical training. Partial or total exemption from this tax can be obtained if the enterprise has an internal training program or apprenticeship scheme for its minor personnel or if the enterprise voluntarily contributes to schools and organizations serving such purposes.

1. Taxable base

The taxable base is generally the same as for the salary tax.

2. Rates

The normal rate is 0.5 percent. In the departments of Haut-Rhin, Bas-Rhin and Moselle the rate is 0.1 percent. The tax is temporarily increased by a surtax of 0.108 percent of 1979 payroll.

C. Participation des employeurs au financement de la formation professionnelle continue

Every employer domiciled or established in France employing at least 10 employees is required to invest annually a certain amount in training programs for his personnel or applicants for work. If he does not contribute to such training programs he must pay an equal amount to the Treasury.

1. Taxable base

The taxable base is generally the same as for the salary tax. Enterprises which in 1979 or in 1980 become liable to this tax for the first time receive a reduction of the tax in that their taxable base is reduced: by 360,000 Fr.Frs. for the first year, by 240,000 Fr.Frs. for the second year and by 120,000 Fr.Frs. for the third year.

2. Rate

The rate is 1.1 percent.

D. Participation obligatoire des employeurs à l'effort de construction

Every employer domiciled or established in France employing at least 10 employees is obliged to invest a certain amount in the construction of dwelling houses.

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This may be effected in the form of granting loans to employees to assist them to finance their housing.

1. Taxable base

The taxable base is generally the same as for the salary tax, except that salaries paid in the *preceding* calendar year are taken. Enterprises which in 1979 or 1980 become liable to this tax for the first time receive a reduction of the tax in that their taxable base is reduced by 360,000 Fr.Frs., 240,000 Fr.Frs. and 120,000 Fr.Frs. respectively in the first, second and third years of their existence.

2. Rate

The rate is 0.9 percent, but upon failure to meet its obligation the enterprise must pay a penalty of 2 percent of the taxable base to the Treasury.

E. Social security contributions

The total of social security contributions an employer has to pay for each employee can be broken down as follows:

For illness	8.95% on C^1
	+ 4.5 % on total salary
For old age	8.2 % on C^1
For child benefits	9 % on C^1
For housing aid	0.1 % on C^1
For unemployment	2.76% on C^2
For salary guarantee	0.25% on C^2
For supplementary pensions	
executives	2.64% on C^1
	+ 6.18% on $C^2 - C^1$
non-executives	2.64% on $C^2 - C^1$

Where C stands for the maximum amount per employee subject to social security contribution:

C^1	=	60,120 Fr.Frs.
C^2	=	240,480 Fr.Frs.
$C^2 - C^1$	=	180,360 Fr.Frs.

Note that in various branches of business different social security contributions apply, in particular with respect to accident insurance. Special levies are imposed on employers in the Paris area to finance transportation (2 percent on C^1 plus 23 Fr.Frs. per employee).

V. BUSINESS TAX

1. Scope

The business tax (taxe professionnelle) is imposed on all taxpayers carrying on commercial, industrial or certain types of professional activities.

2. Taxable base

The taxable base consists of two elements:
(i) the annual rental value of buildings and equipment used for the taxable activities; and
(ii) one fifth (sometimes one tenth) of payroll.

It is the Government's intention to replace this twofold taxable base by a single one: the value added by the enterprise.

3. Rate

Since the business tax is a local tax, rates differ from municipality to municipality.

VI. VALUE ADDED TAX

1. Scope

The value added tax (taxe sur la valeur ajoutée (VAT)) is a non-cumulative tax, imposed at each stage of the production and distribution cycle. An entrepreneur may credit the VAT invoiced to him (input tax) against the VAT which is due on his sales (output tax). The tax is levied on the sale of goods, the rendering of services and the importation of goods.

2. Taxable base

The taxable base is the price charged or, in case of importation, the customs value, excluding the VAT.

3. Rates

Standard rate	:	17.6 percent
Reduced rate for essentials	:	7 percent
Luxury rate for certain sales and services deemed to have luxury character	:	33 1/3 percent

Reduced rates may also apply in special cases, for instance, 2.1 percent for daily newspapers.

VII. REGISTRATION TAXES

Some of the most significant registration taxes are:

A. Registration tax at the sale of real property

The sale of real property is normally subject to registration tax increased by a number of local surtaxes. However, the sale of new buildings is subject to VAT and exempt from registration tax.

1. Taxable base

The taxable base is generally the sales price of the sales value of the property whichever is higher.

2. Rate

The aggregate rate of the registration taxes varies between 16.6 and 18.2 percent depending on the region where the property is situated. A reduced rate varying between 5.4 and 7 percent applies to sales of dwelling houses.

B. Creation of a company

At the creation of a company a fixed registration tax of

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75 Fr.Frs. is due in addition to the registration tax which is due on the value of the contribution.

1. Taxable base

The amount of cash contributed or, in case of contribution in kind, the fair market value of the contribution.

2. Rates

Cash contributions are subject to a 1 percent rate whereas contributions in kind (real property, shares representing real property, good will, clientele, leasehold rights (or options thereon) and shares of "transparent" real estate companies) if made by a person not subject to corporate income tax are subject to 11.4 percent registration tax. However, if such contributions are made by an entity subject to corporate income tax the rate will also be 1 percent.

C. Succession and gift tax

When an individual domiciled in France (see for the concept of "domicile" the discussion of the individual income tax, supra) dies, his total estate wherever situated is subject to succession tax. The tax is imposed on the share each inheritor receives. Similarly, where a person domiciled in France donates property wherever situated, such donation is subject to gift tax. Persons domiciled abroad are only subject to French succession or gift duty with respect to French-situs property. Donations for which there is no need of registration (hand to hand gifts of cash) are not subject to gift tax but will become taxable at a later registration or eventually on the death of the donor.

1. Taxable base

Generally the fair market value of any property except cash. An exemption of 175,000 Fr.Frs. applies between spouses and between persons in the direct line of consanguinity.

2. Rates

Table 1
Transfers in the direct line of consanguinity except inter vivos gifts to descendants (donations-partages)

Value received (Fr.Frs.)	*Rate of tax (%)*
0 - 50,000	5
50,000 - 75,000	10
75,000 - 100,000	15
in excess of 100,000	20

Table II
Inter vivos gifts to descendants (donations-partages) and transfers between spouses

Value received (Fr.Frs.)	*Rate of tax (%)*
0 - 50,000	5
50,000 - 100,000	10
100,000 - 200,000	15
in excess of 200,000	20

Table III
Other transfers

Degree of consanguinity Transfer between:	*Rate of tax (%)*
Brothers and sisters	
0 - 150,000 Fr.Frs.	35
in excess of 150,000 Fr.Frs.	45
Persons up to and including the fourth degree	55
Others	60

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LIST OF ABBREVIATIONS

A	Archiv für Abgabenrecht – monthly – Genossenschafts-Buchdruckerei, Habsburgerstrasse 19, 3000 Bern 16, Switzerland.
AG	Aktiengesellschaft – monthly – Verlag Dr. Otto Schmidt KG., 5 Köln 51, Ulmenallee 96-98, West-Germany.
AWD	Aussenwirtschaftsdienst des Betriebs-Beraters (changed to: Recht der Internationales Wirtschaft – RIW) – monthly – Verlagsgesellschaft Recht und Wirtschaft mbH., 6900 Heidelberg 1, Häusserstrasse 14, Postfach 105960, West Germany.
B	Der Betrieb – weekly – Verlag Handelsblatt GmbH., Düsseldorf 1, Kreuzstrasse 21, Postfach 1102, West Germany.
BDPID	Bulletin de Documentation Pratique des Impôts Directs et des Droit d'Enregistrement – monthly – Editions Francis Lefebvre, 44 rue de Villiers, 92300 Levallois, France.
BIFD	Bulletin for International Fiscal Documentation – monthly – International Bureau of Fiscal Documentation, P.O. Box 20237, 1000 HE Amsterdam, the Netherlands.
BMIS	Bulletin Mensuel d'Information des Sociétés – monthly – Dictionnaires Joly, 26 Cours Albert 1-er, 75008 Paris, France.
CFE	Fiscalité Européenne – Revue – quarterly – Les Cahiers Fiscaux Européens, 51 Avenue Victoria, 06000 Nice, France.
ET	European Taxation – monthly – International Bureau of Fiscal Documentation, P.O. Box 20237, 1000 HE Amsterdam, the Netherlands.
EuMTR	European and Middle East Tax Report – Fortnightly – Institute for International Research, Ltd., 70 Warren Street, London W1P 5PA, United Kingdom.
INTR	International Tax Report – fortnightly – Institute for International Research, Ltd., 70 Warren Street, London W1P 5PA, United Kingdom
IWB	Internationale Wirtschafts-Briefe – fortnightly – Verlag Neue Wirtschafts-Briefe GmbH, Herne (Westfalen), Postfach 1620, West Germany.
JCPCI	La Semaine Juridique – Juris Classeur Périodique – Commerce et Industrie – weekly. Editions Techniques, 123, rue d'Alésia, 75014 Paris, France.
RF	La Revue Fiduciaire – monthly – Service Abonnement Revue Fidiciaire, 54 rue de Chabrol, 75480 Paris, France.

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Legislation in Latin American Countries and Criteria Applicable for the Taxation of Income

by Edison Gnazzo*(Uruguay) and Enrique Piedrabuena**(Chile)



(Paper to be delivered at the 34th Congress of the International Fiscal Association (IFA), Paris, September 14 to 19, 1980.)

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By Ramón Valdés Costa

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Foreword

The report we here introduce has the great interest of offering a complete and up to date view of the legislative situation in the 18 Latin American countries. It is fundamental for considering Subject II of the 34th IFA Congress, to which it is closely related. In the Scientific Committee, and taking into account the interest that a single report about the Latin American position implied, I proposed to assign it an official character and subsequently to include it in the CAHIERS. Because of regulations, especially with regard to the national character the reports submitted to the IFA Congress must have and the concern it would not follow the Instructions, it was decided to publish it in the BULLETIN FOR INTERNATIONAL FISCAL DOCUMENTATION, accepting Prof. J. van Hoorn's kind proposal.

The report shows the significant heterogeneity of Latin American domestic law and the resulting differences with (i) the continental doctrine, (ii) the solutions so radically held in the Model Treaties and — even more important — (iii) the treaties signed to date with the developed countries which do not follow these positions.

The doctrine, through several meetings of the Latin American Tax Law Institute which took place from 1956 (Montevideo) up to 1975 (Caracas), was to diminish and adjust the traditional concept of the source, as an exclusive criterion of taxing power. The conclusion reached in the last meeting constitutes the most authoritative expression of this Doctrine. It notes the source principle, but as a priority criterion and not as an exclusive one; it settles rules for the location of the income; it admits that taxation must be imposed on the basis of the net income and that tax treatment of linked enterprises must follow the general rules applied to independent corporations. [1]

The Model Tax Conventions drafted in Latin America, carefully analyzed in these last years at the international, non-European level, [2] *establish the traditional concept of the source as an exclusive criterion of taxation, making them (the Model Treaties) inapplicable in practice, even as a basis or starting point in the negotiation of the few treaties signed to date. The most eloquent example of a rejection of the above Model Treaties is shown by the treaty signed by Ecuador and Germany on July 22, 1977 — not yet ratified — which follows the OECD Model, leaving aside the Andean Pact Model, which was officially passed by Ecuador in 1971, effective from January 1, 1979.*

The other treaties follow the same trend, accepting the concept of permanent establishment, so resisted in Latin America, co-participation in the taxation of dividends, interest and royalties, and, what is worst for the source theory, accepting a limitation in the rates which is not applicable for the co-contracting countries.

The domestic legislation, as stated above and also clearly shown in the report, has a great heterogeneity and differences with the mentioned precepts. Some points must be noted, for example, the fact that eight countries adopted world income as a taxation criterion, which means a broadening of the source concept which approaches the domicile concept. Colombia, Chile, Honduras, Mexico and Peru adopted it, either for corporations or for individuals; Brazil, El Salvador and Uruguay, when individual income tax was the rule in that country, only applied the concept for this last income tax; Mexico, wholly leaving aside the source principle, also adopts the nationality criterion. From another point of view, Uruguay, in 1974, largely abandoned the source principle, as dividends and interest earned in the country and paid to persons domiciled outside the country are not taxed and royalties are

1. The text of this conclusion, substantially in agreement with that of the 29th IFA Congress which took place later on at London, is published in English, in *30 Bulletin for International Fiscal Documentation* (1976), p. 16, and in Spanish in the official publication of the Meeting (Caracas, 1976, p. 15) and in *Revista Tributaria* (Montevideo, T.II, p. 36).

2. The subject was thoroughly discussed at the XIX Technical Conference of CIAT at Curaçao (Netherlands Antilles) in September 1977. The reports submitted to the meeting may be read in *Documents and Reports* (Costa Rica 1977). The reports we submitted, "Criteria for the allocation of the power of taxation among the different tax jurisdictions according to the type of income, assets, and taxable goods (OECD, UN Experts Group, Andean Pact and LAFTA solutions)" and "Current Status of Studies and Work on Tax Treaties", were reproduced in *32 Bulletin for International Fiscal Documentation* (1978), p. 12 and 453 and in *Estudios de Derecho Tributario Internacional*, Montevideo, 1978, p. 175 and 193.
The Andean Pact Model was especially studied in the Seminar held at the IFA Congress in Mexico in 1974, under Prof. Stanley Surrey's direction. The reports submitted were published by the International Bureau of Fiscal Documentation, in a volume entitled *Fiscal Harmonization in the Andean Countries* (Amsterdam, 1975). Our report is reproduced in Spanish: "Régimen Impositivo de las Rentas derivadas de inversiones de capital en el Modelo de Tratado del Pacto Andino", in *Rev. Derecho Fiscal* (B. Aires), t.XXIV, p. 818; in *Rev. Tributaria* (Montevideo), T.I. p. 19; and in *Estudios . . .*, op. cit. p. 117; and under the title "The treatment of investment income under the Andean Pact Model Convention. The Andean view", in *29 Bulletin for International Fiscal Documentation* (1975) T. XXIX, p. 91.
The Model of the "Basin of the River Plate" (formed by Argentina, Bolivia, Brazil, Paraguay and Uruguay) was passed at the Foreign Affairs Minister's level in December 1978 and published in *Rev. Tributaria* (Montevideo) T.V., p. 513, with the notes of a member of the working committee, D. Dentone.

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partially taxed. Nine countries, Uruguay included, in opposition to the source principle, consider that know-how (technical assistance) received from outside is taxable for mere fiscal reasons. Thus, they follow the heterodox criterion of the "paying source" which assimilates the source to the place where the payment is made, as established in LAFTA meetings, as a result of a Brazilian suggestion but, according to the report, also followed by Mexico. In conclusion, some countries, like Chile and Ecuador, have to an extent accepted the concept of permanent establishment.

This panorama allows one to declare that the source principle — sustained by Latin America at the international level as an exclusive tax criterion since the meeting of the Fiscal Committee of the League of Nations at Mexico in 1943, and emphatically ratified in the Models of the Andean Pact in 1971, in the "Criteria" passed by LAFTA in 1977 and lately in the Model of the "Basin of the River Plate" in 1978 — is in crisis.

It has been lessened and adjusted by the most authoritative continental doctrine, rejected in the Treaties approved — even by countries of the Andean Pact — with the developed countries and broken by domestic legislation which presents heterogeneous solutions without other fundamentals in view than fiscal interests, leading to the conclusion that, at present, there is no Latin American position, unless at the level of the laws in force. Thus, a question is raised about the new treaties in which the developed countries seem to be so interested.

Ramón Valdés Costa

INTRODUCTION

Through the analysis of legislation in 18 countries, the present document attempts to summarize the current Latin American tax situation concerning the criteria of taxation applicable in each region.

For a better presentation of the study, it has been structured in the following way:

A. Summary of the legislation in the countries included in the contents, giving details in each case:
  I. Structure of the income tax.
  II. Binding criteria applied, i.e. the elements or characteristics that the tax regulations take into consideration to define its scope of application.
  III. General considerations on the admission of deductible expenses to determine the taxable income of taxpayers, with special emphasis on the expenses incurred abroad and services rendered abroad.

B. General conclusions on each of the points mentioned in A. above (with additional information in Tables 1, 2, 3 and 4).

C. Conclusions regarding the treatment of income derived from international activities (transport, insurance, news, films). See Tables 5 and 6.

In each case, information has been obtained from the legislation in force as of November 30, 1979.

A. SUMMARY OF INCOME TAX LEGISLATION IN 18 LATIN AMERICAN COUNTRIES

ARGENTINA

I. TAX STRUCTURE

The "Impuesto a las ganancias" is imposed on the total annual income of individuals and companies. Companies are taxed at a fixed rate of 33 percent and individuals on a progressive scale between 7 and 45 percent. Permanent establishments, whether commercial, industrial or of any other type, belonging to companies or entities constituted abroad, or to individuals resident abroad, pay 45 percent. When dividends are remitted to beneficiaries abroad, a final tax of 17.5 percent is paid. This tax is also applicable to beneficiaries resident in the country unless they disclose their identity, in which case they must then compute the dividends in their personal return; otherwise a final withholding of 17.5 percent is applied.

II. BINDING CRITERIA

The tax is applied to earnings of Argentinian source.

The law determines that in general "income of Argentinian source is that derived from assets located, placed

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or utilized economically in the Republic, from carrying out in the territory any act or activity susceptible to profitability, or acts performed within the country, not taking into consideration nationality, domicile or residence of the owner or of the parties intervening in the operations, nor of the place in which the contract is agreed upon". Notwithstanding the aforementioned, the legislation taxes "income derived from activities carried out occasionally abroad by persons resident in the country", adding that these persons "shall compute as payment, in advance of the tax, the amounts effectively paid in the place where such activities are carried out. This credit can only be computed up to the amount of the tax on the income incorporated from abroad."

At the same time the law qualifies as income of Argentinian source the profit derived from guaranteed loans "in rem" when the respective assets are located in the Argentine Republic. However, interest derived from debentures is fully considered of Argentinian source when the issuing entity has been incorporated or located in the Argentine Republic.

In addition, the compensation paid to members of company boards and other entities incorporated in Argentina, even for work performed abroad, is considered of Argentinian source, as well as the fees and other remuneration derived from technical, financial or other assistance provided from abroad.

In connection with the exemptions granted by the Argentinian legislation and the treatment of these exemptions in the legislation of other countries (mainly in relation to the "tax sparing" clause), the law establishes that these exemptions will not be effective as long as they are not recognized in the country of origin of the investment to the extent that a transfer of revenue to foreign treasuries could arise from these exemptions. This provision is not applicable in cases which are expressly governed by tax treaties. In this respect, it is convenient to point out that the network of tax treaties to which Argentina is a signatory has been extended since 1976, the following treaties existing to avoid double taxation on income and capital:

- Bolivia, approved in 1976, to be ratified shortly;
- Chile, signed in 1976, not yet ratified;
- Germany, Federal Republic, signed in 1978, already ratified, only the exchange of ratification documents is still missing;
- France, agreed on in 1979, not yet ratified;
- Sweden, agreed on in 1962, not yet ratified;
- Austria, Belgium, Canada, Italy, Russia, Spain, the United States, Finland and the Netherlands, negotiations are in course.

The regulations establish that expenses incurred abroad are deemed to have originated in profits of foreign source, but the Tax Administration is empowered to authorize the deduction if the taxpayer proves that these expenses have been made in order to obtain profits of Argentinian source.

In the case of permanent establishments of foreign entities, the local accounting must be kept separately from head office accounting. In addition the law states that the contract agreed upon between a foreign-owned local entity and entities domiciled abroad, controlling directly or indirectly the local company, will be considered as a transaction made between independent parties, when the economic considerations and conditions are in accordance with the normal practices of the market between independent entities (arm's length principle) with the following limitations:

- Loans: Provided that the transaction has not been rejected by the Central Bank, which must occur within 30 days of the communication of the transaction.
- Contracts governed by the law of technological transfer: In accordance with Law 21,167 of 1977, in contracts between a foreign-owned local entity and the foreign company that controls it directly or indirectly, royalty payments will not be admitted for the utilization of trademarks, and the payments made by the local entity cannot be expressed in lump sums; in addition, the payments will be deemed to accrue in annual periods coinciding with the end of the financial year and will have to be paid after such date.

In addition it is established that the compensation or salary paid to the members of the Board of Directors of a company or other entities abroad, as well as fees and other compensations paid for technical assistance from abroad, will be deductible provided these compensations do not exceed the following limits:

- 3 percent of the sales or receipts, established as the payment in the contract;
- 5 percent of the amount of the investment actually made on the basis of the technical assistance.

On the other hand, the deduction on compensation paid to a member of the Board of Directors, or to other entities incorporated or domiciled abroad who rendered the services abroad, cannot exceed the following limits:

- up to 2.5 percent of the trading profits of the entity provided that such profits have been distributed as a dividend;
- up to 2.5 percent of the trading profits of the entity when dividends are not distributed. This percentage will be increased in proportion to any distribution made, up to a limit of 12.5 percent.

The Tax Administration is empowered to determine other percentages in special cases.

BOLIVIA

I. TAX STRUCTURE

The income tax is applied on the basis of progressive rates (between 4 and 48 percent) in the case of individuals and a flat rate of 30 percent in the case of companies; the tax rate can be reduced by 30, 40 and 50 percent on profits that the companies reinvest in certain priority activities established by the law.

Companies have the obligation to withhold in the case of payments to beneficiaries domiciled abroad:

a) 30 percent as the only and final tax on the gross income in the case of remittance of profits, dividends of nominative shares, interest on loans, and from other securities;
b) in the case of individuals, the withholding is made in accordance with the progressive scale rates as the only and final tax.
In the special case of rents and other income from movables and in the case of professional fees, the withholding is made on 85 percent of the amount paid.

II. BINDING CRITERIA

The tax is applied to Bolivian-source earnings obtained by the taxpayers, independently of the place of domicile or incorporation. In addition, and as an extension of the source principle, the following profits are considered of Bolivian source:

- interest on loans utilized in the country, granted by creditors from abroad to persons or entities domiciled in the country;
- interest on loans guaranteed by assets placed or registered in Bolivia;

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— compensation received by members of the Board of Directors performing activities abroad in relation to enterprises domiciled in Bolivia;
— fees or compensation received or accrued for technical assistance or any other similar assistance rendered from abroad when the assistance relates to assets situated in Bolivia or profits from Bolivian source;
— interest on bonds or debentures when the issuing entity is domiciled in the country.

Profits derived from exports are fully considered as Bolivian-source income whilst profits from imports are considered to be foreign-source income.

The law establishes special rules for rectifying the value of exports or imports when a substantial difference with the market value is evident. In such a case an economic tie is deemed to exist between buyer and seller or vice versa.

As regards permanent establishments of foreign entities, the Internal Revenue Service is empowered to determine the net profit of these on the basis of separate accounting.

III. DEDUCTIBLE EXPENSES

As a general principle, the law establishes that expenses incurred abroad are for the production of income of foreign source, unless it is proved that these expenses are related to the production of Bolivian income. In the case of royalties, whatever the name given by the parties, including technical assistance, as well as in the case of fees and other compensation for advice, management or services rendered in the country or abroad, the deduction of the expense is authorized.

BRAZIL

I. TAX STRUCTURE

Individuals are subject to tax based on progressive rates applicable to the total income. Legal entities are subject to a flat rate of 35 percent on the effective income. An additional tax rate of 5 percent is also applied during the fiscal years 1979-1981 on profits exceeding 30 million cruzeiros a year. However, there are lower rates for public utility companies (6 percent and 17 percent), for agricultural enterprises (6 percent), and others. On the other hand, there is a notional income system ("lucro presumido") applicable to small and medium size enterprises.

Taxation of dividends and profits distributed by companies domiciled or incorporated in Brazil is, briefly, as follows:

Dividends and profits of corporations distributed to individuals domiciled in the country.

Bearer shares without identification of the recipient; final withholding (25 percent: SACC — closed corporation; 15 percent: SACA — open corporation).

Nominative shares and bearer shares when the shareholder is disclosed; the beneficiary can opt between no withholding and incorporate the dividend in his personal tax return or he can have tax withheld (25 percent SACC and 15 percent SACA) and then include the dividends in his personal tax return, either taking the withholding as a credit or not including such dividends in which case the withholding becomes final.

Dividends and profits remitted to beneficiaries domiciled abroad.

A final withholding of 25 percent which may be reduced to 15 percent if the beneficiaries reinvest the profits in Brazil in industrial equipment of the enterprise. In addition a final withholding of 12 percent is applied on the profits and dividends remitted abroad if the average of remittances over three years exceeds 12 percent of capital and reserves invested in Brazil.[1]

II. BINDING CRITERIA

In the case of individuals resident or domiciled in the country, the tax is applied on world-wide income, with a credit for the income tax paid abroad, subject to reciprocity. Legal entities and individuals not resident in the country are subject to tax only on Brazilian-source income, but the distribution is subject to the tax on dividends.

III. DEDUCTIBLE EXPENSES

In general only costs and expenses incurred in the country can be deducted. Depreciation of fixed assets is only admitted in relation to assets located in the country; as regards provisions, only those related to activities located in Brazil can be constituted.

In connection with the payment made abroad of royalties, trademark licenses, and fees for technical assistance, it must be pointed out that the technological transfer regime has been regulated by Law No. 15 of September 11, 1975, which establishes the obligation to register all contracts of this nature with the National Institute of Industrial Property (Instituto Nacional de la Propiedad Industrial), as a basic requirement for fiscal purposes. Following this line, the payment of royalties, trademark licenses or fees for technical assistance can be accepted as a deductible expense if the following conditions and limits are fulfilled:

— there is sufficient proof of the respective expenses;
— the deductions are made during the first five years of operations of the company or when the introduction of a special production process occurs;
— registration of the contract with the INPI;
— these expenses cannot exceed 5 percent of the gross[2] income of the manufactured products or of the proceeds of the products sold;
— the expenses cannot exceed the percentage coefficients given by the Finance Ministry in relation to the respective type of product.

Payments are subject to a final withholding of 25 percent on the gross amount paid. It must be added that royalties and technical assistance payments made by a subsidiary or a branch to its home office are not deductible. However, the treaties to avoid double taxation to which Brazil is a signatory establish a maximum withholding rate of 15 and 10 percent in certain cases, while on the other hand the country of residence of the recipient establishes a matching credit between 20 and 25 percent.

CHILE

I. TAX STRUCTURE

The income tax is applied on a schedular basis and there is also a surtax. The structure of the system is as follows:

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1. According to a recent Law, No. 1725, of December 7, 1979, the reduction of tax in the case of interest, commission, expenses and discounts remitted abroad is now 95 percent of the 25 percent tax rate. This change reduces the effective rate of 12.5 percent at present (50 percent of 25 percent) to 1.25 percent (5 percent of 25 percent).
2. In accordance with a recent Decree-Law, No. 1730 of December 14, 1979, this percentage will be applied in the future on the net proceeds.

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Schedular taxes

First category: It comprises income from capital and from mercantile, manufacturing, mining and other enterprises. There is a normal general tax rate of 10 percent, whilst corporations and joint stock companies incorporated in the country pay in addition a tax rate of 40 percent. Lottery prizes are only subject to a tax of 15 percent.

Second category: It comprises all compensation for personal services at progressive rates between 3.5 and 60 percent. The scale brackets are expressed in monthly tax units (which are readjusted periodically). In the case of compensation of members of the Board of Directors and university professionals, the tax is 7 percent. Income obtained by non-resident foreign individuals is exempt from this tax but an additional tax is applied instead.

Additional tax: A 40 percent additional tax is applied on Chilean-source income received or accrued in favour of individuals, whether nationals or foreigners, without residence or domicile in the country and by legal entities incorporated abroad with a permanent establishment in the country.

If certain royalties and technical assistance are considered unproductive or not necessary for the economic development of the country, the President of the Republic, based on a report of the "Corporación de Fomento de la Producción" and of the "Comité Ejecutivo del Banco Central de Chile", is empowered to increase the rate from 40 percent up to 80 percent.

The amounts remitted abroad to foreign producers or distributors in respect of film and television material will be subject to this tax at the rate of 20 percent. Compensation for personal services received by foreign individuals connected with scientific, technical, cultural and sport activities, when the service is carried out in Chile, will also be taxed at the rate of 20 percent.

Payments made by national airline companies to persons not domiciled or resident in Chile are exempt if they are made for technical assistance, services, interest or any other reason related to the normal activities of the company and if certain conditions are fulfilled.

Surtax: This tax is applicable to individuals resident or domiciled in Chile according to a progressive scale of rates between 3.5 and 60 percent of the net income determined on the basis of annual tax units (readjusted periodically). The gross income is arrived at by adding the taxable income of the different categories; from this income can be deducted the schedular taxes and 40 percent of the amounts distributed by corporations and joint stock companies, as well as 10 percent of one annual tax unit.

As a consequence, dividends and profits of corporations are distributed to nationals or foreign beneficiaries without any withholding. When the recipients are domiciled in the country, they must include the dividends in the surtax return, but they have a right to credit against the tax 40 percent of the dividends incorporated in the income.

It is important to point out that first category tax is fully subject to an annual monetary correction through the adjustment of the assets, liabilities and capital. Income and monthly expenses of professionals and independent workers who are subject to the second category tax are also adjustable.

II. BINDING CRITERIA

As a general principle, all persons domiciled or resident in Chile pay income tax on a world-wide basis whether the source of income is located within the country or abroad, but persons not resident in Chile are subject only to tax on Chilean-source income. However, the foreigner who becomes domiciled or resident in the country for the first time will be subject to tax on Chilean-source income only for the first three years of permanency in the country. This period can be extended in special cases.

Income is considered to be of Chilean source if derived from assets located in the country or from activities performed in Chile wherever the domicile or residence of the taxpayer may be. Royalties, payments for the utilization of trademarks and other similar compensation derived from the exploitation in Chile of industrial or intellectual property are also considered to be Chilean-source income. The shares of a company incorporated in Chile are deemed to be located in Chile. In the case of loans, the source of the interest is deemed to be located in the domicile of the debtor.

When foreign-source income has to be computed, only net profits will be subject, excluding those that are not available for reasons of force majeure or act of God or by legal provisions of the country of origin.

The Chilean-source income of agencies, branches or other forms of permanent establishments of foreign enterprises doing business in Chile will be determined on the basis of the actual results obtained in the country. When such results cannot be determined from the accounting records, the Regional Tax Bureau is empowered to determine the taxable income on the basis of applying to the gross receipts of the agency the proportion between the net world income and the gross world income of the head office. The net income may also be determined by applying to the total assets of the agency the proportion existing between the world net income and the total assets of the head office.

III. DEDUCTIBLE EXPENSES

The following rules are applied:

(a) Compensation for personal services rendered abroad is accepted as expenses provided that it is supported with sufficient documentation and when, in the judgement of the Regional Tax Bureau, its amount and nature are necessary and convenient for producting the income in Chile.

(b) Remittance abroad of royalties and technical assistance are deductible but the corresponding additional tax must have been paid.

It is important to point out, finally, that the President of the Republic is empowered to enact legislation according to international agreements and international provisions in order to avoid international double taxation or to diminish its implications,

COLOMBIA

I. TAX STRUCTURE

The "Impuesto sobre la Renta y Complementarios" covers the following taxes:

- Income tax on individuals, death duties and corporate tax;
- Supplementary tax on occasional gains of individuals;
- Wealth tax on individuals;
- Tax on transfers abroad of income, applicable to individuals and legal entities.

The income tax on individuals is applied on the basis of progressive rates between 10 and 56 percent. A 40 percent tax rate is applied on Colombian-source income obtained by foreign individuals without residence in the country and who are not obliged to appoint a representative in Colombia.

The tax rate applicable to corporations and companies in general is 40 percent. Foreign corporations also pay this 40 percent on taxable income. Limited liability companies and the like pay a tax rate of 20 percent.

Dividends and profits distributed to individual beneficiaries domi-

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ciled in the country are subject to a withholding on account of the final personal income tax applicable. It must be added that individuals whose wealth does not exceed 4 million pesos (approximately US$ 95,000) have the right to discount against the tax a special credit of 20 percent of the first 10,000 pesos paid as dividends. The withholding on account of the general tax is 5 percent in the case of interest paid by corporations.

The income and wealth tax rates are readjusted annually.

Occasional gains are taxed at half the rate applicable to ordinary income and if the tax so calculated is lower than 10 percent, tax will be assessed at the rate of 10 percent.

On dividends and profit transfers to home offices abroad two taxes are applied: the normal income tax and the supplementary tax on remittances, both being provisional and susceptible to reassessment. The regime is as follows:

1. Income tax

— The tax rate on dividends received by companies and other foreign entities is 20 percent. However, when the country under which legislation the foreign company was incorporated taxes dividends at a rate lower than 30 percent and when more than 25 percent of the total stock of the company receiving the dividends is owned by individuals resident in Colombia, whether nationals or foreigners, the applicable tax rate is 40 percent.

— Tax rate applicable to other profits, 40 percent.

2. Supplementary tax on remittances abroad

— Taxes applicable on the nominal amount of the remittance:
  - general rate, 12 percent;
  - special rate, 20 percent on the profits obtained by companies and other foreign legal entities without a permanent establishment in Colombia.

  Exemption: Dividends and interest on short term loans for imports or exports of merchandise, capital assets or raw materials, and other loans registered with the exchange authorities are exempted from this tax.

— Remittances for the payment of technical assistance rendered abroad are only subject to the supplementary tax on remittances if the following conditions apply:
  - that the beneficiary of the payment is not resident or domiciled in the country, and that he is not obliged to appoint a representative in Colombia;
  - that the technical assistance services are not available in the country;
  - that the technical assistance services are rendered only at the preoperating stage of a project.

  The General Directorate of National Taxes (Dirección General de Impuesto Nacionales), with the prior authorization of the Royalty Committee referred to in Article 6 of Decree-Law 688 of 1967, will determine in each case the technical assistance services that are not available in the country.

II. BINDING CRITERIA

Individuals resident in the country, whether nationals or foreigners, are subject to tax on their ordinary income and on occasional gains on a world-wide basis, but in the case of the wealth tax only on the wealth located within the country.

Foreign individuals resident in Colombia are only subject to tax on foreign-source income after four years of residence in the country. Individuals, whether nationals or foreigners, without residence in the country are only subject to tax on income and occasional gains of Colombian source and only on wealth located within the country.

Companies incorporated in Colombia are taxed on a world-wide basis whilst companies incorporated abroad are taxed only on Colombian-source income.

Income deemed to be Columbian-source is, inter alia:
— interest produced by local loans or economically connected with the country (interest on temporary loans for the import of merchandise and bank overdrafts is exempted);
— profits from the rendering of technical assistance services, whether rendered abroad or in the country;
— dividends and participations derived from Colombian companies domiciled in the country;
— dividends and participations received by Colombian residents, derived from companies or foreign legal entities which have business or investment in Colombia, directly or indirectly.

The Colombian taxpayer who receives foreign-source income and who is subject to income tax in the country of origin of the income has a right to credit against the Colombian tax the tax paid abroad on such profit, up to the limit of the Colombian tax applicable.

III. DEDUCTIBLE EXPENSES

Expenses incurred abroad are deductible as long as they are related to the production of Colombian-source income, provided that the taxpayer can support with documentary evidence the expenses and the withholding of taxes in Colombia when applicable. The deduction of expenses incurred abroad for the production of income of Colombian source cannot exceed, in general, ten percent of the net income with the sole exception of expenses subject to withholding and other cases expressly determined by the law.

Payments made by corporations to individuals economically connected to them will be considered to be a distribution of profits except in the case of salaries, as well as rents and interest within certain limits.

COSTA RICA

I. TAX STRUCTURE

Tax is applied on the total income on the basis of progressive rates for both individuals (between 5 and 50 percent) and legal entities (between 5 and 45 percent).

Distribution of dividends and profits is subject to the following withholding, applicable on the gross amount.

(a) Distribution of dividends and profits from companies to beneficiaries situated in the country is subject to withholding on the gross amount distributed:
  — 5 percent as final tax in the case of individuals domiciled in the country (except in the case of stock dividends);
  — 5 percent on account of the general tax when paid to companies incorporared in the country (except stock dividends).

(b) Distribution of dividends and income in general to beneficiaries domiciled abroad is subject to withholding tax as follows:
  — 10 percent on payment of certain Costa Rican-source interest to legal entities domiciled abroad (e.g. on bank loans);
  — 10 percent on payments connected with the production or distribution of films (except for certain special cases) made to individuals or legal entities domiciled abroad;

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— 10 percent on payments for personal services made to individuals or legal entities domiciled abroad;
— 15 percent on dividends and profits distributed to persons domiciled abroad (except stock dividends);
— 20 percent on payments to persons abroad for news and audiovisual programs and on patents, trademarks and royalties;
— 30 percent on compensation to members of Boards of Directors acting abroad, for technical assistance rendered abroad or to persons not domiciled in the country and for interest in general.

In the case of dividends, company participations and personal compensation, the Tax Administration is empowered to grant total or partial exemption from the withholding tax when it is proved that the beneficiaries are not granted a credit or deduction for the tax withheld in Costa Rica or when the credit granted is lower than the tax applicable in Costa Rica, in which case only the difference will be exempt. Corporations with bearer shares will pay annually a tax of 3 percent on the net capital, which tax cannot exceed 20,000 colones (approximately US$ 2,200).

II. BINDING CRITERIA

The taxes are applied according to the source principle, the income obtained within the country whether by a taxpayer domiciled in the country or abroad being taxed.

III. DEDUCTIBLE EXPENSES

In general, all the expenses necessary to produce the income can be deducted, including payment for technical assistance rendered abroad and fees for the utilization of patents and royalties paid to persons domiciled abroad.

DOMINICAN REPUBLIC

I. TAX STRUCTURE

The Dominican Republic is one of the few countries where a schedular tax is applied according to the origin of the income and then a surtax with progressive rates between 3 and 70 percent on the total annual income of individuals. The schedular tax is applied as follows:

— *First category:* income from real estate, 6 percent.
— *Second category:* income from movable capital (royalties, interest, etc.), 8 percent; when the income is remitted or credited to a foreign person, a final tax of 18 percent.
— *Third category:* profits of legal entities, progressive rates between 10 and 38 percent; when the profits are remitted or credited to a foreign person a final withholding tax of 18 percent is payable.
— *Fourth category:* income from independent services, 2 percent.
— *Fifth category:* income from dependent services, 2 percent.

Dividends are subject to second category tax at the rate of 8 percent and then are subject to surtax, but the tax withheld under the second category may be credited against the surtax.

Individuals are not subject to third category tax but they have to compute these profits, as well as any from participations in companies, in their surtax.

II. BINDING CRITERIA

The Dominican Republic only follows the territoriality principle. For these purposes the law states, in general, that Dominican-source income is that derived from capital, assets or rights situated, placed or economically utilized in the country, that obtained from carrying out commercial, industrial, agricultural, mining and similar activities or from personal services, the exercise of any profession as well as income from loans and rentals, without taking into consideration nationality, domicile or residence of the parties intervening in the transaction or the place of entering into contracts.

Income derived from occasional activities carried out in the country and that derived from occasional activities performed abroad by Dominican residents is also subject to tax.

Compensation paid to teachers, public speakers, scientists, artists and the like, staying in the country not more than 12 months on cultural programs, educational or technical exchange, with international bodies, other Governments, universities or private institutions, is exempted.

There are special regimes for determining the source of income and the tax applicable in the case of exports and imports, insurance, transport and communications.

Income derived from exports and imports is determined as follows:

(a) Income derived from the export of merchandise produced, manufactured, wholly or partially, or bought in the country is deemed to be of Dominican source, even though such transactions are carried out by means of subsidiaries, branches, representatives, purchase agents or other intermediaries of individuals or legal entities resident abroad. The income is determined by deducting from the wholesale price at the place of destination the cost of the merchandise, transport and insurance expenses, commissions and sale expenses, as well as those incurred in the Republic as necessary for obtaining the income subject to tax. When no price is fixed or the declared price is lower than the wholesale price effective at the place of destination, it will be deemed, except if proved to the contrary, that there is an economic connection between the parties. In this case the wholesale price at the place of destination will be taken as the basis for determining the value of the products exported.

(b) Income obtained by foreign exporters on the mere introduction of the products into the Republic is deemed to be of foreign source.

However, when the sale price in the Republic is higher than the effective wholesale price at the place of origin, plus insurance and transport expenses, it will be deemed, except if proved to the contrary, that there is an economic connection between the parties. In this case, the difference between both prices will be considered Dominican-source income and both parties will be responsible for the respective tax.

When applying the previous ruling, if the wholesale price in the country of origin is not known or if a doubt exists that this price corresponds to the same or similar imported merchandise or there is any other circumstance that makes the comparison difficult, the determination of the income of Dominican-source will be based on the margins obtained by independent entities devoted to the same or similar activity.

In the absence of such identical or similar activity the Tax Administration will establish a net percentage on the basis of businesses that are analogous with the tested case.

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III. DEDUCTIBLE EXPENSES

As a general rule, all necessary expenses for obtaining, maintaining and keeping the income or the source are deductible.

For these purposes, the following considerations apply:

(a) All expenses incurred in the country are deductible and those incurred abroad only if they are incurred to obtain, maintain or keep the income or the source of income in the country.

(b) Royalties are defined as compensation whether in cash or in kind for the transfer of ownership, use of assets or for the transfer of rights when the value is determined in relation to production, sale, exploitation or similar units, whatever the denomination given. Royalties paid abroad can be deducted as expenses if they fulfill the general rules and the beneficiaries are empowered to deduct additionally 20 percent as expenses, but the Tax Administration can apply a different percentage and even not admit any expense at all.

(c) Financial statements of branches and subsidiaries of foreign entities will be determined for tax purposes on the basis of separate accounting records, the Tax Administration being empowered to introduce the necessary corrections in order to reflect the actual effective profits of Dominican source. When from the accounting records of the entity the profit obtained in the country cannot be determined easily and accurately, the net income of Dominican source will be determined on the basis of results of independent entities devoted to the same or similar activities. The Tax Administration is empowered to adopt other indices for tax purposes when circumstances so require, and consider that the branch or subsidiary constitutes, with the head office, an economic unit. Based on this assumption they may determine the net taxable income.

The Tax Administration is empowered to request the necessary details or statements, duly certified, which may be necessary to clarify the commercial relations between the local entity and the foreign head office, as well as to determine reciprocal purchase and sale prices, values of fixed assets and any other data that they may require.

In the cases required by the Tax Administration, branches, agents and representatives of foreign entities in the country are obliged to file the following documents with the tax return:

— a copy of the balance sheet and of the profit and loss statement of the head office in accordance with the requirements in the country of origin for tax purposes or for distribution of dividends in the case of corporations;

— a certified copy of the contract between the head office and its representative in the country permitting the latter to intervene as such and of any other document establishing the procedure to determine the income participation of the agent or representative;

— a detailed account of original costs of products or merchandise imported into the country;

— any other document necessary to determine the taxable income or to expedite in any way the tax audit.

All pages of the above-mentioned documents have to be signed by authorized persons. The signatures have to be legalized before the respective Dominican Consul.

ECUADOR

I. TAX STRUCTURE

The tax on individuals is applicable on the basis (1) of progressive rates on global income, (2) a flat rate on certain categories of income as well as (3) a tax on business profits. There are also several additional taxes applicable to certain legal entities.

The progressive tax rates range between 10 and 50 percent. Earned income, whether of employees or from the exercise of a profession, in excess of 120,000 sucres annually (approximately US$ 4,000) is subject to a tax of 6 percent. Earned income obtained with the investment of capital also is subject to a 6 percent tax and profits derived from capital without personal work are subject to a tax of 18 percent.

Companies incorporated in Ecuador pay 20 percent on their profits. Permanent establishments of foreign companies pay 40 percent on the Ecuadorian-source profits.

Companies distributing dividends to individuals or to legal entities, whether nationals or foreigners, resident or non-resident in the country, have to withhold as follows:

— 20 percent on the dividends of shares (nominative shares according to a decision of the Andean Pact);
— 40 percent on dividends of nominative shares remitted to foreign shareholders resident abroad.

Profits obtained in the country by companies incorporated abroad and remitted to their head office are subject to a final tax of 40 percent.

Interest, royalties and other profits remitted abroad are subject to a final tax of 40 percent on the income considered to be Ecuadorian-source.

There is a special regime applicable to hydrocarbon companies.

II. BINDING CRITERIA

The tax is applicable to Ecuadorian-source income and to foreign-source income in special cases established by law.

Profits derived from independent professional activities by foreign individuals or legal entities resident abroad who occasionally work in Ecuador are taxed; the tax is applied on 60 percent of the total gross amount received or credited to them, provided that they are in the country less than one year. If they are in the country for more than one year the tax is computed on 100 percent of the amount received or credited, but in this case normal rules are applied for the determination of taxable income. Also considered Ecuadorian-source income is 80 percent of compensation received for professional services rendered abroad by individuals or legal entities, whether nationals or foreigners.

In general, technical assistance expenses are deductible providing the services are rendered directly, not through third parties, and that the services are actually rendered. Rentals paid for equipment, machinery, ships, or any type of transport vehicle utilized in economic activities in the country, belonging to individuals or legal entities resident abroad whether the contracts are entered into within or outside of the country, are considered to be income of Ecuadorian source.

A permanent establishment of a foreign enterprise is deemed to exist if there is a fixed place for carrying out the business activities of the enterprise in Ecuador, whether total or partially, including research and consulting, and other establishments of a productive nature. In this sense the law refers expressly to branches, agencies, offices, warehouses, mines, oil wells, plantations, forests, factories, workshops, research establishments, consulting agencies and other permanent places of business of the foreign enterprise. On the other hand the regulations establish that a permanent establishment is deemed to exist when the foreign enterprise maintains in the country a fixed place of business or has for more than 12 months a place to carry out technical services and when its agent has the power to conclude contracts on behalf of the foreign enterprise or when he is under a labour

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contract and habitually carries out commercial transactions on behalf of the enterprise, has usually in deposit assets for sale and delivery, and principally if the administrative expenses (in particular the rental of the offices) are paid for by the foreign company.

The income will also be considered to be of Ecuadorian source if it is:

- compensation obtained by Ecuadorians or foreigners resident in Ecuador from international bodies or foreign bodies and Governments;
- compensation received by Ecuadorians or by foreigners living abroad and working for the Government or for national bodies or enterprises or for foreign enterprises domiciled in Ecuador;
- compensation of Ecuadorians and foreigners for occasional services rendered abroad provided they are paid by public national bodies or by enterprises domiciled in Ecuador.

In the three above-mentioned instances a credit is granted for the tax paid abroad according to the certificates of the respective tax authorities.

- compensation received by foreigners who are working in Ecuador for foreign enterprises when they remain in the country for more than six months;
- fees and compensation paid to Ecuadorian professionals by national or foreign bodies or individuals or legal entities, domiciled or not in the country;
- in the case of compensation paid to professionals for services rendered abroad to national bodies or enterprises or to permanent establishments of foreign enterprises, 80 percent of the compensation is considered to be Ecuadorian-source income.

For foreign-source profits which are not subject to tax based on the source principle or in the case of exempt income, a tax credit according to the regulations will be granted.

When foreign enterprises distribute dividends from foreign-source profits to companies incorporated in the courntry, a tax credit is granted subject to reciprocity, but the credit so granted cannot exceed the amount of the Ecuadorian tax on such dividends.

III. DEDUCTIBLE EXPENSES

Commissions and other expenses paid abroad can be deducted as expenses under certain conditions, as well as fees for professional services provided abroad. Commissions and other expenses will be determined according to the contract; in the absence of this, it is deemed that the expenses do not exceed 2 percent of the income obtained from export or sales abroad.

EL SALVADOR

. TAX STRUCTURE

There is a general income tax based on progressive rates (between 2.5 and 15 percent for legal entities and between 2.85 and 60 percent for individuals).

There are also two special taxes on the profits of companies ncorporated in the country: on profits which are capitalized (as a final tax and on the basis of progressive rates between 5 and 12 percent), and on retained earnings (a provisional tax applied on the basis of progressive rates between 4 and 13 percent).

Finally there is a wealth tax ("De Vialidad Seria A") applicable on the capital of individuals and legal entities on the basis of progressive rates.

A 20 percent tax is applied on individuals and legal entities not domiciled in El Salvador and the same tax is applicable as a final withholding on dividends remitted abroad. In relation to the profits distributed by companies incorporated in the country to shareholders domiciled in El Salvador, the amounts distributed or accrued are not subject to withholding but they must be taken up in the personal tax return.

II. BINDING CRITERIA

Individuals domiciled in El Salvador, whether nationals or foreigners, pay income tax on a world-wide basis. Individuals not domiciled in El Salvador, whether nationals or foreigners, only pay tax on national-source income.

Legal entities, whether national or foreign, domiciled or not in the country, pay tax on the total income obtained within the national territory.

Income is deemed to be obtained in El Salvador if it is derived from assets located or from activities carried out in the country even though it is received or paid abroad and also includes compensation paid by the Government, municipalities or official bodies to their employees abroad. For these purposes:

- loans are deemed to be located in the domicile of the debtor;
- industrial and intellectual property and similar rights of an economic nature that authorize the carrying out of certain activities according to the law are deemed to be located where they are officially registered;
- concessions are deemed to be located where they have been legally granted.

Regulations define royalties as any amount paid whether in cash or in kind, determined in relation to a unit of production, sale or exploitation, whatever the denomination given in the contract may be; they are deemed to be of national source when they are derived from assets located in the country.

Taxpayers who have to include income of foreign source in their tax return can credit against their income tax the tax of a similar nature paid abroad.

The amount of the credit will be computed on a country by country basis. The credit against the national tax, in relation to any income tax paid in any Central American country, will not exceed the proportion existing between the net income of the taxpayer derived from such country and the total net income of the taxpayer in the same tax year. Income of foreign source cannot exceed the total net income. In relation to any other foreign country, the credit will not exceed 85 percent of the amount computed or explained in this paragraph for the purpose of calculating the limit of the credit and the net income will be determined without any deduction for personal consideration or children. Any amount of credit not utilized in a given year can be used in others.

When in accordance with the legislation of a Central American country persons domiciled in one of these countries are not obliged to pay tax on the income of Salvadorian source, the persons domiciled in El Salvador do not have to include in their tax return the income obtained in these other countries.

The taxpayer who applies this reciprocity principle must prove the existence and application of the respective foreign legislation, justifying its text, duration and sense by means of a certficate of two lawyers in professional exercise in the respective country, which certificate must be presented duly legalized.

III. DEDUCTIBLE EXPENSES

As a general principle the net income is determined by deducting from the gross income the necessary expenses for producing and maintaining the income; as a special rule, branches may deduct up to 5 percent of the income as well as a proportion of the general expenses of the head office.

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GUATEMALA

I. TAX STRUCTURE

An annual tax is applied on the total income obtained by individuals and legal entities. For these purposes there is a progressive scale between 5 and 48 percent applied to all taxpayers. There is in addition a 10 percent surcharge if the total taxable income exceeds 10,000 quetzales (same value as American dollars).

In addition there is the "Impuesto masivo" on remittances abroad. Under this tax, royalties, rents, commissions, interest and fees are taxed at a general rate of 12.1 percent by means of withholding when the remittances during the tax year exceed 10,000 quetzales and 11 percent if lower than this figure in which case it is a final tax.

Dividends are not taxed when distributed by companies incorporated in the country to beneficiaries domiciled in Guatemala; when remitted abroad, they are subject to a final withholding of 10 percent.

II. BINDING CRITERIA

Income of Guatemalan source is taxed whatever may be the nationality, residence or domicile of the recipient or of the parties intervening in the transaction or wherever the place of agreement of the contract. In general income is deemed to be of Guatemalan source if it is derived from tangible or intangible assets located, utilized or situated in the country, or derived from any activities carried out in the Republic. Compensation derived from personal work performed occasionally abroad by persons resident in the country which are paid from the Republic are also deemed to be income of Guatemalan source. Interest derived from loans from abroad is also considered to be of Guatemalan source, wherever the contract, the domicile of the parties or place of payment of interest or of the principal may take place.

Pensions from abroad, received in Guatemala by foreign residents not carrying out in the country any profitable activity, are not considered income of Guatemalan source.

In the case of branches and subsidiaries of foreign entities, the tax will be assessed on the basis of the accounting records of such branches or subsidiaries and the Tax Administration will make the necessary reassessment in order that the above-mentioned enterprises pay taxes on actual profits of Guatemalan source.

Compensation paid by international bodies to their employees who come to the country to render services on behalf of such bodies will not be subject to tax, except when the employee resides in Guatemala for more than six months prior to his recruitment and also when the employees are of Guatemalan nationality.

Interest on loans from abroad is exempt when the obligation to repay the loan is originally agreed and effectively repaid after 18 months (this provision does not cover loans granted by a bank operating in Guatemala through an agency or branch).

III. DEDUCTIBLE EXPENSES

In general, expenses incurred abroad are deductible from gross income under certain conditions which are as follows:

(a) Payments for technological research will be deductible provided that they are connected with the activity of the taxpayer and do not exceed 20 percent of paid-up capital and reserves at the beginning of the tax period, and they can be amortized during a period of up to five years.

(b) Payments for advice of foreign professionals rendered in the country are deductible provided that the taxpayer has obtained authorization of the Ministry of Labour to contract such services and it is proved to the Tax Administration that the foreign advice is connected with the activity of the taxpayer and its amount is less than 1 percent of the gross receipts of the taxpayer, except when they are considered start-up expenses.

(c) Commissions and consulting fees paid to head offices by branches or subsidiaries domiciled in Guatemala are deductible up to an amount of 1 percent of the gross receipts of the tax period; salary and compensation paid as participations or expenses for controlling or supervising branches are not deductible except in the case of salaries paid from abroad to employees working in the country and subject to Guatemalan income tax.

(d) Royalties will be deductible provided they have been authorized by the Ministry of Economy and do not exceed 15 percent of the annual gross sales connected with such royalties.

(e) All expenses incurred in travelling abroad are deductible in the case of legal entities but within certain limits and conditions determined by regulations.

HONDURAS

I. TAX STRUCTURE

The tax is applied on the total net income obtained during the tax year by individuals and legal entities based on a progressive scale between 3 and 40 percent, applicable for both individuals and legal entities. Dividends distributed by companies incorporated in the country are subject to a final withholding of 10 percent and those distributed as stock dividends, 5 percent. Profits and dividends remitted abroad are subject to a final withholding of 15 percent.

II. BINDING CRITERIA

The tax is applied on a world-wide basis in the case of individuals and legal entities whatever their nationality may be, when they are domiciled or resident in Honduras, independently of the place where income is distributed or paid. Persons not resident or domiciled in Honduras are subject to tax on income of Honduran source, derived from assets situated in Honduras, from services rendered in the national territory or from business carried out by persons domiciled or resident in the Republic, even though the payments are made or credited to the recipient by persons resident or domiciled in the country or abroad.

For the purposes of determining the tax on Honduran-source income applicable to non-resident or non-domiciled persons, the tax will accrue at the moment of the remittance abroad or when the payment is credited or made available to the beneficiary and the tax will be calculated according to the type of income as follows:

— Royalties	10 percent
— Interest	5 percent
— Personal compensation, in general	15 percent
— Dividends and profits	15 percent
— Rentals of movables or real estate	10 percent

For the purposes of the source concept and in the case of income derived from capital, it will be deemed that the income is of Honduran source when the assets constituting the capital are situated in Honduras. In the same way gains derived from the

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transfer of shares or securities issued by companies constituted under Honduran law are deemed to be of Honduran source. In the case of earned income it will be deemed that it is of Honduran source when the services are rendered or the work is performed in Honduras. However, when the services are rendered abroad, the source of income will be deemed to be of Honduran source if it is paid from Honduras. When the income is obtained by the joint use of capital and personal services, the location of the source will be determined in the same way as for income derived from capital, already explained.

Income derived from export is totally of Honduran source. When there is no value assigned or when the export value is lower than the wholesale price in the place of destination it will be deemed, except if proved to the contrary, that there is an economic connection between the exporter and the importer; in this case the wholesale price at the place of destination will be taken for purposes of determining the value of the exported products and the corresponding final profits.

Persons who are temporarily in the Republic and carry out activities of any nature or render services producing taxable income have the right to file a tax return before leaving the country and to ask for the corresponding assessment.

Merchant ships are also subject to tax under the following conditions:

— that they operate under Honduran license or flag;
— that they habitually navigate in territorial waters or receive income of Honduran source.

III. DEDUCTIBLE EXPENSES

The law and regulations allow, in general, the deduction of all expenses duly proved and that have been paid or incurred for the production of the income.

MEXICO

I. TAX STRUCTURE

There are two general income taxes:

— tax on corporate income
— tax on individual income

Tax on corporate income

The law taxes all types of income, whether in cash or in kind or merely accrued, derived from commercial, industrial, agricultural, stock raising or fishing activities, obtained by individuals or legal entities. For purposes of the tax, the law distinguishes the "causantes menores", that is, individuals earning less than 1,500,000 pesos a year (approximately US$ 68,000), and the "causantes mayores", that is, all the remainder of individuals and legal entities.

(a) The progressive scale of rates ranges between 5 and 42 percent and applies:
   — on the total annual income of the "causantes mayores", with special rates for agricultural, industrial and publishing activities;
   — on the total income of the "causantes menores" assessed on the basis of profitability coefficients according to the type of activity.

(b) The tax is also applied on the gross income of foreign individuals resident abroad and foreign enterprises domiciled abroad who earn the following income of Mexican source:
   — Rentals from movables, and under certain conditions interest paid by persons resident in the country, dividends or profits paid by foreign enterprises resident abroad if the recipient receives them as a partner or shareholder and opts not to accumulate the dividends ..... 21 percent
   — Interest in certain cases, profit on distribution of foreign publication and technical assistance and royalties if the taxpayer opts not to accumulate them ..... 10 percent
   — Reinsurance premiums or reguarantees transferred by Mexican companies if in the country of the residence of the reinsurers or reguarantors reciprocity does not exist, and income from public spectacle enterprises acting in a given place less than a month ..... 4 percent
   — Interest in certain cases ..... 42 percent

(c) In the case of royalties paid by persons resident in the country for publicity or for exploitation of patents, industrial or commercial designs, technical assistance or technological transfer and for professional services, the tax will be applied to the gross income but on the basis of the progressive scale of rates mentioned above.

Tax on income of individuals

A tax is applied on the annual income of all individuals on the basis of progressive rates ranging between 3.1 and 55 percent. During the tax year the taxpayers pay taxes on account of the final tax or by means of a withholding, as follows:

— withholding on salaries and for the rendering of dependent personal services	progressive scale ranging between 3.1 and 55 percent
— fees and compensations for rendering of independent personal services	fixed rates and 20 percent as a general rate
— real estate rentals	idem
— capital gains	general scale, on 30 or 40 percent of the gains depending on the cases
— acquisition of assets (donations, etc.)	20 percent on the gross
— profits of business enterprise	tax on corporate income
— dividends and distributions of profits	the recipients can credit certain percentages on a part of the tax paid by the company
— interest	21 percent on the gross as a final tax and a provisional 15 percent in respect of residents holding nominative securities

II. BINDING CRITERIA

(a) The following taxpayers pay tax on world-wide income:
   — individuals and legal entities of Mexican nationality;
   — foreign individuals resident in Mexico and legal entities of foreign nationality established in the country;
   — agencies and branches of foreign companies established in Mexico.

(b) The following taxpayers pay tax only on income of Mexican source:
   — foreign individuals resident abroad and legal entities of foreign nationality incorporated and established abroad.

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In general, income is deemed Mexican source when it is obtained from persons resident in the country. In the case of transfer of shares, bonds, certificates of financial institutions, loans, mortgage bonds, and certificates of participation (mutual funds) it is deemed to be Mexican-source when the securities have been issued in Mexico.

In the case of compensation paid to members of Boards of Directors and similar bodies, it is deemed to be Mexican-source when these compensations are paid in the country or abroad by resident companies.

In the case of interest derived from transactions with registered foreign financial institutions, the source is deemed to be located abroad when that interest is paid by financial institutions or by branches of foreign banks authorized to carry out business in Mexico.

In all the previous cases, when it is foreign-source income, the taxpayer can credit against the Mexican tax the tax paid abroad but up to the limit of the tax that would have been paid in Mexico. For these purposes tax exemptions granted abroad are included in the credit against Mexican tax as if they had been paid (tax sparing).

III. DEDUCTIBLE EXPENSES

In determining the net taxable income of companies, it is possible to deduct the necessary expenses connected with the business, provided they are in reasonable proportion with the transactions of the taxpayer.

In the case of payments for technical assistance to persons resident abroad, it must be proved to the Tax Administration that the services are rendered directly and not through third parties, that the services are actually provided and that the contract is duly registered in the "Registro Nacional de Transferencia de Tecnología".

Legal entities of foreign nationality resident abroad that carry out business occasionally in the country must account for the taxable profit in respect of each operation by deducting from the gross income the cost and the necessary expenses incurred in the operation. In these cases, the purchaser has to withhold provisionally 20 percent of the total proceeds but the Tax Administration is empowered to authorize a lower withholding based on a justified petition of the seller.

NICARAGUA

I. TAX STRUCTURE

The total net income obtained in the tax year by individuals and legal entities is subject to tax. For these purposes a scale based on progressive rates is applied to both individuals and legal entities, ranging between 6 and 50 percent but in no case may the total payable exceed 40 percent of taxable income. In the case of legal entities, only the entity is subject to tax and therefore the partners or shareholders do not include in their tax return dividends and profits received; neither is a withholding tax applied to such income whether paid to beneficiaries domiciled in the country or abroad.

II. BINDING CRITERIA

The tax is applied only to income of Nicaraguan source which is income derived from assets located in the country, services rendered in the territory or business carried out or producing effects in the Republic, whatever the place of payment of the income may be.

Profits derived from the export of goods produced, manufactured, processed or bought in the country are of Nicaraguan source.

Any remittance abroad of goods produced, manufactured, processed or bought in the country, done through subsidiaries, branches, representatives, purchase agents or other intermediaries of individuals or foreign legal entities, is considered to be an export.

Profits obtained by foreign exporters, by merely introducing the goods into the Republic, are of foreign source. However, when the sale price is higher than the wholesale price in the place of origin of the merchandise, plus transport and insurance costs, it will be deemed, except if proved to the contrary, that the parties involved are economically connected, the difference being considered income of Nicaraguan source and both parties are jointly liable for the payment of the tax.

III. DEDUCTIBLE EXPENSES

All the expenses effectively paid and necessary or proper for the production or for the maintenance of the source of income are deductible. However, the law establishes that the amounts paid or credited to persons not domiciled in Nicaragua will not be deductible, unless the payer has withheld and paid the corresponding tax.

PANAMA

I. TAX STRUCTURE

A general tax is applicable on the income of individuals and legal entities. The progressive scale for legal entities ranges between 20 and 50 percent, and in the case of individuals, between 2.5 and 56 percent. In the case of legal entities only the entity is subject to tax and the partners or shareholders do not have to include dividends or profit participations in their tax return. However, the distributions, whether to beneficiaries domiciled or not in the country, are subject to a final withholding tax of 10 percent.

Remittances abroad of other Panamanian-source income are subject to the progressive scale of rates for individual(for individuals or legal entities as the case may be) on:
- 100 percent of payments for personal services;
- 50 percent of royalties, rentals and any other payments.

II. BINDING CRITERIA

The tax is applied on the total net annual income of Panamanian source, notwithstanding the nationality, domicile or residence of the taxpayer or the place of entering into the contract, including, inter alia, income derived from real estate located in the country, profits produced by assets, capital, securities or rights situated, invested or economically utilized in the Republic and those originated by civil, commercial, industrial or similar activities and for the exercise of any profession and for the performance of any service within the territory. However, income derived from the following is not deemed to be of Panamanian source:

- invoicing for a higher value than that invoiced to Panama from an office established in Panama for the sale of merchandise, provided that such merchandise does not enter into Panama;
- directing, from an office established in Panama, transactions to be implemented or which have effect abroad;
- distributing dividends or profit participations from legal entities, when such distributions do not derive from income of Panamanian source;

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— interest, financial commissions and the like, derived from loans and financial transactions carried out with legal entities, independently of the place of domicile or incorporation, provided that those entities receive or accrue only income of foreign source.

Income derived from exports, carried out by companies established in Free Zones within the Republic, has a special treatment and is exempted from the 10 percent tax on dividends and profits distributed by such companies provided it proceeds from export transactions.

III. DEDUCTIBLE EXPENSES

As a general rule, all the expenses incurred for the production of the income or for the maintenance of the source of income are deductible. As regards expenses incurred abroad, they are deductible if it is proved that they were actually incurred and fulfill the previously mentioned rule.

PARAGUAY

I. TAX STRUCTURE

Tax is applied on the total net income obtained by taxpayers. There is a progressive scale ranging between 5 and 30 percent in the case of individuals, and between 25 and 30 percent in the case of legal entities.

As a general rule, income from personal services and from agricultural activities is not subject (in the latter case a substitutive tax on the transfer of cattle is applicable). Neither is a tax applied on the distribution of dividends or profits to beneficiaries domiciled in the country.

II. BINDING CRITERIA

The tax is applied only on income of Paraguayan source.

When any income of Paraguayan source is paid or credited to persons not domiciled in the country, a withholding tax will be applied as an only and final tax at the following rates:

(1) Dividends and profits, 10 percent on the gross amount. However, dividends and profits reinvested in enterprises of the country are exempted from this tax.
(2) Compensation or salaries of members of Boards of Directors or similar bodies acting abroad, 30 percent on the total gross payments.
(3) Fees, commissions, interest, rentals and any other income not mentioned under (1) and (2), 30 percent on 85 percent of the gross amount (on 90 percent in the case of royalties).

Domicile

For the purposes of withholding, persons will be considered domiciled in the country in the following cases:

— individuals whether nationals or foreigners who have stayed in Paraguay more than 180 days, continuously or not, during the tax year or in the last 12 months;
— branches, agencies, subsidiaries, correspondent agencies and any other form of representation in Paraguay of individuals or legal entities not domiciled in the country, if they are registered with the Tax Administration;
— legal entities incorporated in Paraguay with the sole exception of their agencies or branches established abroad.

III. DEDUCTIBLE EXPENSES

All expenses and payments made abroad, duly justified and approved by the Tax Administration, may be deducted from gross income if they are connected with the activity of the taxpayer provided they do not exceed 5 percent of the annual taxable income.

In the case of interest remitted abroad, payments made to the head office are not a deductible expense.

Enterprises or legal entities are subject to tax on all income of Paraguayan source. The Tax Administration will assess the taxable income of branches, agencies and subsidiaries of foreign enterprises on the basis of separate accounting records but they are empowered to introduce the necessary corrections to determine the actual results of Paraguayan source. In the absence of sufficient accounting records or when these do not show accurately the net profit of Paraguayan source, the Tax Administration may consider that the subsidiary or the branch and the head office constitute one economic unit in order to assess the net income.

PERU

I. TAX STRUCTURE

The total net income obtained by the taxpayer is subject to tax. In the case of individuals a progressive scale is applicable, the rates ranging between 5 and 65 percent. In the case of legal entities the progressive scale ranges between 20 and 55 percent. The tax applicable on individuals domiciled in the country cannot exceed 40 percent on taxable income from dividends. As a general rule, legal entities have to withhold 25 percent on dividends distributed to beneficiaries in the country. The shareholders compute the dividends in their tax returns and take as a credit against the final tax the 25 percent withheld.

Individuals not domiciled in the country are subject to the following rates:

— dividends ..... 30 percent
— profits of branches and agencies in the country available for remittance abroad ..... 30 percent
— compensation for personal services rendered in the country (the general progressive rates for individuals are applicable) .....
— compensation for personal services rendered abroad and other income ..... 40 percent

Legal entities not domiciled in the country are subject to the following rates:

— dividends, general rate ..... 40 percent
— profits of branches available for remittance abroad .. 30 percent
— interest ..... 10 percent
(However, tax at the rate of 40 percent is applicable in the case of enterprises economically connected.)
— royalties
(They are subject to the progressive scale of rates applicable to legal entities, plus a 30 percent tax on the income available for remittance abroad.)

II. BINDING CRITERIA

Persons domiciled in the country are subject to tax on a worldwide basis. Persons not domiciled in the country are subject only on income of Peruvian source.

Income of Peruvian source

In general and whatever the nationality or domicile of the parties

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to the transaction and the place of agreement or fulfillment of the contract, income will be considered of Peruvian source on:

(a) profits derived from properties located in the territory;

(b) profits derived from capital, assets or rights located or economically placed in the country; and

(c) profits derived from personal services and from civil and commercial activities of any nature carried out in the territory.

In addition, the law also considers as income of Peruvian source:

(a) interest derived from loans granted abroad to individuals or legal entities domiciled in Peru, even though the payment of the interest or the amortization of the capital is made abroad (for the application of this provision it does not matter where the contract is entered into);

(b) interest from loans guaranteed in rem when the assets guaranteeing the transaction are located in the country;

(c) interest from bonds, when the issuing entity is domiciled in the country wherever the bonds may be issued or the assets guaranteeing the transaction are located;

(d) salaries or any kind of compensation paid by enterprises domiciled or incorporated in the country to members of Boards of Directors or similar bodies acting abroad;

(e) fees or compensation for technical advice or similar assistance provided from abroad to individuals and legal entities domiciled in the country; however, fees and compensation for technical, economic, financial or similar assistance provided from abroad by governmental entities or international or financial institutions are not subject to tax.

According to the general rule, compensation for personal services fully rendered abroad is not considered income of Peruvian source, and therefore the respective payments are not subject to withholding.

The cases mentioned under (d) and (e) above are exceptions to this provision. We would point out that the expression "similar assistance" in paragraph (e) does not refer to the compensation. That is, the provision does not affect any payment for services rendered abroad but only technical assistance or the like. This has been confirmed by regulations when they point out indirectly that the assistance can be of an economic or financial nature.

Activities rendered partially in the country and partially abroad

There is a presumption "juris et de jure" that is not rebuttable that net profits obtained by taxpayers domiciled abroad, for activities carried out partially in the country and partially abroad, are arrived at by deducting from the gross profits the percentages established by law. When the activities are carried out by taxpayers domiciled in the country it is presumed "juris et de jure" that the income obtained is all of Peruvian source, except in the case of branches and agencies of foreign enterprises whose profits will be determined according to the rules already mentioned.

The previous provisions include transport and communication activities between the Republic and other countries, providing of news by international agencies, insurance, reinsurance and retrocession transactions, and the rental or any other form of exploitation of films, magnetophonic tapes, master copies and other equipment used for projecting or reproducing images and sounds.

Taxpayers domiciled in the country will add the profits and losses of Peruvian source obtained from different activities. They will treat foreign-source profits in the same way, but only if such transactions abroad give a positive result will they be added to the net income of Peruvian source. Net losses of foreign source cannot be set off for purposes of determining the taxable income.

III. DEDUCTIBLE EXPENSES

The following principles apply as regards deductible expenses:

(a) As a general rule all expenses necessary for the production or maintenance of the source of income of the business or activity subject to tax are deductible, unless there is an express prohibition by law.

(b) Royalties are defined as any compensation in cash or in kind derived from the transfer of ownership, use of movables or for the transfer of rights, whether definitive or temporary, when the amount is established in relation to production, sale, exploitation or any other units used as reference. Royalties, fees and other compensation for assistance, directing or for services rendered abroad can be deducted. As regards fees and other compensation for assistance, the deduction is admissible provided that the payments do not exceed 1 percent of income or 3 percent of the amounts invested; however, in special cases higher percentages may be accepted. Beneficiaries of royalties domiciled abroad who habitually perform research and incur expenses to obtain assets which can produce such royalties can deduct 5 percent from the gross royalties.

(c) As regards expenses incurred abroad it is presumed, unless it can be proved to the contrary, that such expenses have been incurred for the production of income of foreign source.

(d) Commissions originated abroad for purchase or sale of merchandise or any kind of goods can be deducted but only up to the percentage usually paid for such commissions in the country where they originate.

(e) Interest paid to foreign entities economically connected with the debtor as a general rule is not deductible in the amount that the rate exceeds the limits established by regulations in relation to the type of transaction, nor is interest on credits or loans deductible if it exceeds four times the paid-up capital of the debtor.

URUGUAY

I. TAX STRUCTURE

The "Impuesto a las Rentas de la Industria y el Comercio" is applied on profits derived from industrial, commercial and similar activities carried out by individuals and legal entities. Individuals are not subject in general to income tax except when they obtain profits from commercial, industrial or similar activities, produced by the joint utilization of capital and personal services in normal profitable activities. The rate of the tax is 25 percent.

In addition, individuals and legal entities domiciled abroad are taxed on rentals, transfer of ownership or the use of trademarks and patents, payments for technical assistance rendered abroad and distributions of profits of companies and branches remitted abroad, except dividends. Profits obtained in Uruguay by persons resident abroad are subject to two cumulative taxes:

— 25 percent;
— 20 percent on profits remitted abroad.

A wealth tax is also applicable on individuals and legal entities.

II. BINDING CRITERIA

Only income of Uruguayan source is taxed, i.e. income derived from activities carried out in Uruguay, from assets situated or rights utilized in the country, whatever the nationality, domicile or residence of the parties intervening in the transactions or the

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lace of entering into the contract. As an exception, payments or technical assistance rendered abroad are also taxed.

As regards withholding applicable to income remitted abroad, the ules are as follows:

- rentals, transfer of ownership or of the use of trademarks, patents, models, secret formulae or processes, exclusive information or technical assistance, 25 percent on the gross income;
- profits of commercial enterprises, 25 percent plus 20 percent on the income remitted abroad;
- other income, 25 percent on 30 percent of the income.

II. DEDUCTIBLE EXPENSES

The following rules apply to deductible expenses:

a) As a general principle, all necessary expenses for producing and maintaining the income are admissible if duly justified.

b) Expenses incurred abroad are deductible as long as they are necessary to obtain the income of Uruguayan source, providing the amounts are judged reasonable by the Tax Administration.

c) Net income of Uruguayan source of branches or agencies of foreign entities is determined on the basis of separate accounting records, the Tax Administration being authorized to introduce the necessary corrections to appraise the actual profits of such establishments. When the accounting records do not accurately reflect the net profits of Uruguayan source, the Tax Administration will determine the taxable income on the basis of the volume of business and adequate indices for these purposes.

The Tax Administration is empowered to request the necessary details or statements, duly certified, which may be necessary to clarify commercial relations between the local entity and the foreign head office and to determine reciprocal purchase and sale prices, values of fixed assets and other data which could be considered necessary.

d) Expenses incurred by the head office to produce and maintain income of Uruguayan source are always accepted provided that their origin and nature are duly proved. For these purposes it will be necessary to file documentation certified by independent auditors of the country of origin, duly translated and legalized, certifying the amounts and including a breakdown of the ratio of expenses between the different agencies and branches and the head office, in order to appraise the amount incurred for the production of income of Uruguayan source. The above-mentioned certificate must establish that expenses attributed to the branch in Uruguay have not been deducted in any other foreign tax assessment.

e) The deduction for interest paid or credited cannot exceed the rate applicable by the Central Bank according to Law 14,095 of November 7, 1972. In the case of interest on loans granted abroad, the rate will also be limited to the current rate used in the borrower's market.

VENEZUELA

. TAX STRUCTURE

Different progressive rates of tax are applied on legal entities and oint ownerships on one hand and individuals on the other. Additional taxes are applied to taxpayers obtaining profits deved from extractive, mining and hydrocarbon industries, and there is a 32 percent tax on occasional gains derived from lottery premiums, race courses and such.

Applicable rates are as follows:

1. **Mining**

Enterprises devoted to the exploitation of mines and connected activities, such as refining, purchase and transport, are taxed at a rate of 60 percent on the profits obtained.

2. **Hydrocarbon enterprises**

Enterprises devoted to the exploitation of hydrocarbons and connected activities such as refining, transport or acquisition of hydrocarbons and their derivative products for export purposes pay tax at the rate of 67.7 percent.

3. **Individuals**

The total annual income of individuals carrying out any activity other than mining is taxed at a progressive rate scale between 4.5 and 45 percent.

In the case of individuals not resident in the country, the tax applicable is as follows:

- compensation derived from dependent services..... 20 percent
- professional fees derived from independent non-commercial services..... 30 percent
- dividends distributed, including stock dividends.....20 percent

4. **Corporations**

Corporations carrying out any activity other than mining and hydrocarbon exploitation are taxed at progressive rates between 18 and 50 percent.

5. **Special tax rates**

They are applied in the following cases:

- limited liability companies;
- interest from loans granted by foreign financial institutions not domiciled in the country is taxed at the rate of 10 percent;
- lottery prizes, racecourse winnings and similar gains, obtained by any person or joint ownership, are taxed at the rate of 32 percent, which can be reduced in certain cases to 16 percent.

Dividends are taxed on distribution by a withholding of 7 percent and then incorporated in the personal tax return; on the other hand, dividends distributed to foreign persons are taxed by means of a final withholding of 20 percent and the same tax is applicable in general to any remittance of profits abroad made by branches to their head offices.

II. BINDING CRITERIA

The tax is applied on income of Venezuelan source, that is, on profits derived from economic activities carried out in the country or assets situated in the territory.

Profits are those arising from econmic activities performed in Venezuela or from assets situated in the country, when any of the factors giving rise to the income occurs within the national territory, whether these refer to the exploitation of the soil or of the sub-soil, the transfer, exchange or ceding of the use or possession of movables or inmovables, tangibles or intangibles, or services rendered by persons domiciled, resident or transitorily in Venezuela, as well as compensation, fees or payments for techni-

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cal assistance or technological services utilized within the country.

Official activities abroad of public servants of the National Administration, States or municipalities, as well as representatives of autonomous official bodies or from State enterprises to whom functions or research are entrusted outside the country, are deemed to be performed within the territory provided that the respective income is exempted in the place of accrual.

The Executive is empowered to exempt from the tax, inter alia, fees, salaries and other compensation paid to technicians or experts sent by foreign non-profitable institutions or foundations to render technical assistance in relation to projects previously approved by the National Government, as well as compensation and similar payments for technical assistance or technological services utilized in the country for the benefit of the public or private sector. However, income subject to tax abroad will only be exempted in the country as long as it means an effective advantage to the taxpayer.

- Income obtained by taxpayers rendering technical assistance or technological services from abroad to persons or joint ownerships that utilize them in the country or transfer them to third parties will be taxed at a percentage determined by regulations, whatever the method of payment or denomination may be. The percentage will be fixed taking into account the nature and complexity of the technical process contributed.

  When, as agreed by the parties, the income is derived from technical activities developed partly abroad and partly in the country, the Venezuelan-source income will be deemed, on the basis of the percentage fixed by Regulations, and this will be taxed after deducting costs and expenses permitted by Law.
- Net profits of taxpayers importing to the country merchandise on consignment will be 25 percent of gross receipts. These receipts will be based on the proceeds of the sales in Venezuela.
- Net profits of taxpayers not resident or domiciled in the country derived from professional non-commercial activities will be based on 90 percent of gross receipts.
- The transportation expenses of exported merchandise up to the foreign port of destination will be deductible, when the taxpayer computes as gross income the effective price of the exported merchandise in the foreign port of destination.
- In the case of exports of goods manufactured in the country or the rendering of services abroad of Venezuelan source, all the normal and necessary expenses incurred abroad with reference to these exports or activities may be deducted, such as travelling expenses, advertising, office expenses, exhibitions or fairs, including the transportation of the goods to be exhibited in such events.

III. DEDUCTIBLE EXPENSES

For determining profits the law allows the deduction from gross income, as a general rule, of all the normal and necessary expenses incurred in the country.

Among the deductions accepted, royalties and similar payments are allowed, as well as compensation, fees and similar payments for technical assistance or technological services utilized within the country; for this purpose the withholding will be applied on 90 percent of the respective payments.

B. GENERAL CONCLUSIONS ON THE STRUCTURE OF INCOME TAX IN 18 LATIN AMERICAN COUNTRIES

B.1. Conclusions concerning the structure of income tax effective in 18 Latin American countries

Table 1, on the tax structure of 18 Latin American countries, gives rise to the following conclusions:

1. There are 14 countries applying a tax on the income of taxpayers (basically individuals and legal entities). Among them, there is one country (Paraguay) in which the major part of income derived from personal services and from agriculture is not subject. El Salvador applies, in addition, taxes on capitalized profits or on retained earnings of corporations.
2. There are three countries (Chile, the Dominican Republic and Ecuador) maintaining a mixed system, under which a schedular tax is applied on certain categories of income and then a progressive surtax on the total income of individuals.
3. There is one country (Uruguay) that does not apply income tax on individuals, except if they carry out commercial or industrial activities employing jointly capital and personal services. However, a tax is applied on the potential income of land (agriculture).
4. Eleven of the 14 countries mentioned above apply a global tax, with different rates on both legal entities and individuals, whilst in only three countries (Guatemala, Honduras and Nicaragua) is there a common progressive scale applicable to both taxpayers.
5. According to Table 2, there are seven countries applying a flat rate on companies, whilst the remaining 11 countries apply progressive rates.
6. Among the 18 countries under study, it can be seen that:
   - *four countries* (Guatemala, Nicaragua, Paraguay and Uruguay) tax only profits of the entity without taxing distributed dividends. Among them, there are two countries (Nicaragua and Uruguay) that also do not tax dividends remitted abroad (see Table 3);
   - *two countries* (Chile and Mexico) tax the profit of the entity and not dividends distributed but it is obligatory to include them in the total income of the beneficiary and a credit is granted for the tax already paid by the company. In addition, Chile also does not apply tax on dividends remitted abroad (see Table 3);
   - the other countries apply the traditional system of taxing at the same time the profit of the entity and the distributed dividends under various methods of a provisional or final withholding.
7. There are six countries applying different types of wealth tax (Argentina, Colombia, Costa Rica, El Salvador, Peru and Uruguay).

B.2. Conclusions concerning the binding criteria applied by Latin American countries

According to Table 4:

1. All the countries concerned, without exception, tax the income obtained in the country by individuals or legal entities, domiciled or incorporated in the country.
2. All the countries concerned tax the income of national source in the case of individuals or legal entities domiciled or incorporated abroad; among them, Mexico also taxes the

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income obtained by Mexicans wherever the income may be obtained.

3. There are five countries (Colombia, Chile, Honduras, Mexico, and Peru) that basically apply the world-wide income principle to taxpayers (legal entities and individuals) domiciled or resident in the country (in other words, to these taxpayers they apply in addition to the source principle the domicile principle); on the other hand, Mexico applies additionally the nationality principle and taxes Mexican taxpayers domiciled abroad within certain limits. As a general rule, Mexico follows the principle of the source of payment as a criterion to establish the Mexican source of income.

   There are two countries (Brazil and El Salvador) that apply the world-wide income criteria only in respect of individual taxpayers domiciled in the country.

4. All the previously mentioned seven countries that apply the world-wide income criteria, except Honduras, have regulations for taking the tax paid abroad as a credit against the tax to be paid in the country and there is also one country — Mexico — which accepts the credit of the tax exempted abroad (tax sparing) except in the case of capital gains tax.

5. The remaining 11 countries basically apply the source principle or territoriality and some special circumstances can be noted:

   (a) Uruguay only taxes income of individuals when derived from industrial, commercial or similar activities, whilst Paraguay does not tax, in general, income from personal or professional services even if they are dependent services, or agricultural income.

   (b) Some countries (Argentina, Bolivia, the Dominican Republic and Guatemala for instance) tax occasional profits obtained abroad by persons domiciled in the country.

   (c) Some countries (Argentina, Bolivia, the Dominican Republic, Honduras and Nicaragua, for instance) regulate or limit the concept of foreign source in the case of imports, with the purpose of protecting the tax interests of the country.

   (d) Various countries (Argentina, Bolivia, Colombia, Ecuador, Honduras, Costa Rica, Guatemala, Uruguay and Peru, for instance) consider as national source income payments for technical assistance provided from abroad (principle of payments source).

   (e) Some countries (Bolivia, Costa Rica, Mexico, Paraguay and Peru, for instance) consider as national-source income compensation paid to members of Boards of Directors resident abroad, and in the case of Bolivia, also interest paid to persons domiciled abroad.

   (f) In the case of Ecuador, income obtained in the country by persons who have stayed less than six months in the country is not considered to be of national source and if they have stayed between six months and one year only 80 percent of the income is considered of Ecuadorian source. In addition, the income obtained by foreigners domiciled in Ecuador in respect of compensation paid from abroad by foreign bodies or enterprises is considered to be income of Ecuadorian source.

   (g) Panama adheres to a strict concept of income that is limited or restricted in certain special cases.

   (h) In practice all the countries concerned exempt the income obtained in the country by foreign diplomats derived from the exercise of their official function. In the majority of the cases reciprocity is required.

   (i) In order to determine income of national source of agencies and branches of foreign enterprises, Argentina, Bolivia, Chile, Guatemala, Paraguay and Uruguay, for instance, require the maintenance of separate accounting records.

   (j) The concept of "permanent establishment" is applied to enterprises domiciled abroad, in the case of Chile and Ecuador, for instance.

Regarding this particular matter, one must remember that the member countries of the Cartagena Agreement, commonly known as the Andean Pact (at present: Bolivia, Colombia, Ecuador, Peru and Venezuela) approved, in 1971, Decision No. 40, under which Model Conventions to avoid double taxation on income and wealth taxes were approved, among the member countries and in relation to countries outside the Region.

The Agreement has been ratified by all the member countries and became fully effective as from January 1, 1979.

The Agreement admits, as a general principle, taxation at source, which has been covered in Article 4 as follows: "Independent of the nationality or domicile of persons, income of any nature obtained by them will only be taxed in the member country in which such income has its productive source, except in the exceptional cases foreseen in this Agreement."

In the following provisions the concept of productive source is determined for different types of income and certain exceptions are made under which persons domiciled in a member country are not taxed on:

— income derived from the rendering of personal services or from the exercise of professional activities and technical assistance in other Contracting States of the Andean Pact;

— income such as dividends, interest, royalties and rentals from other Contracting States of the Andean Pact.

In the same way, it is established that transport enterprises of one Contracting State are not subject in any other Contracting State.

As regards taxation criteria, it must be pointed out that in the Latin American area ample doctrine has been produced by the Latin American Tax Institute and by the group of experts of the Latin American Association of Free Trade (ALALC). In both cases, the prevailing tendency has been to claim the right to apply the jurisdictional criterion of the territorial source as taxation criterion, which fits more with the reality of international business and with the sovereignty principle. In this respect, the member countries of ALALC (Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Mexico, Paraguay, Peru, Uruguay and Venezuela) have agreed at the expert level and as a recommendation, on a set of provisions or guides to orient the eventual negotiation of tax treaties among the member countries and among them and other countries. The recommendation, which is not yet obligatory and has not been approved officially by the Governments of member countries, follows substantially the rules established in the Andean Pact Models, containing, however, certain innovations in order to make the application of the source principle more flexible.

B.3. Conclusions concerning deductible expenses

As a general rule, all the pertinent legislation admits the deduction of expenses incurred, duly supported, necessary to produce or to maintain the source. There are, however, certain provisions which are worthwhile to cite in relation to expenses incurred abroad and to certain types of remittances abroad which are as follows:

1. It is deemed that expenses incurred abroad are made for the

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production of income of foreign source (Argentina, Bolivia, Brazil, the Dominican Republic and Peru), but this assumption is not absolute and admits proof to the contrary. In all the other cases, deduction of such expenses is allowed, as a general rule, if they fulfill the general principle of "necessity" and the quantitative limits established in certain legislations (for example, Colombia, El Salvador, Paraguay and Peru).

2. Expenses for royalties and technological transfers are deductible if they fulfill the various express requisites in the case of Argentina, Brazil, Guatemala and México. The payment of royalties from branches to the head office is not allowed by Brazil. There is wide scope for the payment of these items in the case of Bolivia, Chile, Costa Rica, Honduras, Nicaragua, Panama, Uruguay and Venezuela.

As regards deductible expenses, it may be added as a matter of interest that the member countries of the Cartagena Agreement (Bolivia, Colombia, Ecuador, Peru and Venezuela) approved in 1970 Decision No. 24 which establishes a common regime for the treatment of foreign capital and for trademarks, patents, licenses and royalties, determining, inter alia, that:

"*Article 2* — All foreign investors that want to invest in any of the Contracting States have to file an application before the competent national body, which, based on a prior evaluation, will authorize it if it complies with the priorities of development of the recipient country. The application must observe guidelines contained in Annex 1 of the regime. The Commission, at the request of the 'Junta', can approve common criteria for the evaluation of foreign investment in the member countries.

. . . . . .

Article 5 — All direct foreign investment will be registered with the competent national body together with the Agreement determining the conditions of the authorization. The amount of the investment will be registered in freely convertible currency.

. . . . . .

Article 14 — External loans require prior authorization from the competent body and must be registered with them.

Global limits of external borrowing may be authorized for specific periods. Loan contracts within such global limits must be registered before the competent body.

. . . . . .

Article 16 — Remittances by enterprises in payment of the principal and interest of external credit, will be authorized based on the terms of the registered contract.

In the case of contracts for external credit between subsidiaries and their parent or with other subsidiaries, the effective annual rate of interest cannot exceed by more than three points the rate of interest effective for blue chip securities in the financial market of the country of origin of the currency in which the transaction has been registered. For contracts for external credit other than those already mentioned, the effective rate of interest payable by enterprises will be determined by the competent national body, the rate having to be closely related with the rate prevailing in the financial market of the country where the financing has been obtained.

For the purposes of this Article, the effective interest will be the total cost payable by the debtor for the utilization of the loan, including commissions and any kind of expenses.

. . . . . .

Article 18 — All contracts for import of technology and for patents or trademarks must be examined and submitted for the approval of the competent body of the respective member country, which body must evaluate the effective contribution of the imported technology by estimating the probable profits, the price of the goods incorporating such technology and other specific methods for quantifying the effects of the imported technology.

. . . . . .

Article 21 — Intangible technological contributions give the right to the payment of royalties, if previously authorized by the competent national body, but they cannot be contributed as capital.

When these contributions are provided to the enterprise by its parent or by other subsidiaries of the same parent, payments of royalties will not be authorized and deduction for tax purposes will not be allowed.

. . . . . .

Article 45 — The capital of corporations must be represented by nominative shares.

The bearer shares existing at present shall be converted into nominative shares within a term of one year as from when this regime becomes effective."

C. CONCLUSIONS CONCERNING THE TREATMENT OF INCOME DERIVED FROM INTERNATIONAL ACTIVITIES

The great majority of Latin American countries have established express provisions to determine the taxable income of enterprises domiciled or incorporated abroad and carrying out activities in each national territory. The well known cases are transport and communication enterprises, news agencies, insurance and reinsurance companies, and companies exhibiting or distributing cinematographic films and the like.

As mentioned when referring to the binding criteria, the great majority of the countries apply the tax on income of national source in the case of taxpayers domiciled abroad. In the case of enterprises devoted to international activities as those already mentioned, formulae have been established in each country to determine first the income of national source and then income subject to tax. Table No. 5 has been prepared on this basis, giving rise to the following conclusions:

1. As regards transport enterprises and as may be seen from the summary in Table No. 6, there are six countries in which the taxable income can be determined on the basis of percentages of gross income from transportation between the country and another (however, in Uruguay and the Dominican Republic there is the option of proving the effective income). There are four countries where taxable income may be determined on the basis of percentages of operations or sales within the country and there are two countries which allow taxable income to be determined on the basis of percentages of operations between countries (notwithstanding, Panama gives the option to determine the income on an effective basis). Finally, five countries authorize other formulae (basically on the basis of a proportion of world-wide income to local income).

2. In the case of insurance, in practice all the countries take as national-source income the revenue from transactions covering risks in the country, while in various countries a percentage of the income of national source is taken as taxable income.

3. In the case of international news agencies and the exhibiting and distributing of films, the gross amount received by the beneficiaries is taken as income of national source and the taxable income is fixed, also as a general rule, by applying percentages on such income (between 15 and 80 percent depending on the country).

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TABLE NO. 1
Latin American countries and the type of tax applied

Country	Type		Observations
	Global	Schedular	
Argentina	x		
Bolivia	x		
Brazil	x		
Chile	x	x	
Colombia	x		
Costa Rica	x		
Dominican Rep.	x	x	
Ecuador	x	x	
El Salvador	x		
Guatemala	x		
Honduras	x		
Mexico	x		
Nicaragua	x		
Panama	x		
Paraguay	x		(Individual and agricultural income are, in general, not taxed)
Peru	x		
Uruguay			(Individual income is not taxed; there is a tax only on industrial and commercial activities and special taxes on agricultural activities and others)
Venezuela	x		

TABLE NO. 2
Income tax rates applicable to companies incorporated in the country

Country	Flat rate (%)	Progressive rates (%)	
		Maximum	Minimum
Argentina	33		
Bolivia	30		
Brazil	35		
Chile	50		
Colombia	40		
Costa Rica		45	5
Dominican Rep.		38	10
Ecuador	20		
El Salvador		15	2.5
Guatemala		48	5
Honduras		40	3
Mexico		42	5
Nicaragua		50	6
Panama		50	20
Paraguay		30	25
Peru		55	20
Uruguay	25		
Venezuela		50	18

TABLE NO. 3
Tax on dividends and on profits remitted to head office or beneficiaries domiciled abroad

Country	Withholding Tax (%)	Type		Observations
		Final	Provisional	
Argentina	17.50	x		
Bolivia	30	x		
Brazil	25	x		15 percent if profits are reinvested in industrial equipment.
Chile	Non-existent			Companies or subsidiaries in the country are taxed at the rate of 40 percent; in addition to the 1st category of 10 percent and the 5 percent dwelling tax.
Colombia	20		x	40 percent in certain cases and also a supplementary tax of 12 or 20 percent as a general rule.
Costa Rica	15	x		A credit is granted for the tax paid abroad.
Dominican Rep.	18	x		
Ecuador	40	x		
El Salvador	28	x		
Guatemala	10	x		
Honduras	15	x		
Mexico	21	x		
Nicaragua	Non-existent			Profits of corporations only are taxed.
Panama	10	x		
Paraguay	30	x		40 percent in the case of legal entities.
Peru	40	x		30 percent in certain cases.
Uruguay	Non-existent			Dividends are exempted. Profits distributed by a branch or agency are subject to a 20 percent final tax.
Venezuela	20	x		

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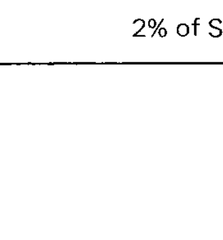
TABLE NO. 4
Comparative summary of binding criteria applied by Latin American countries

Countries	*Individuals domiciled in the country*	*Legal entities incorporated in the country*
Argentina	S	S
Bolivia	S	S
Brazil	D	S
Chile	D	D
Colombia	D	D
Costa Rica	S	S
Dominican Rep.	S	S
Ecuador	S	S
El Salvador	D	S
Guatemala	S	S
Honduras	D	D
Mexico	D-N	D
Nicaragua	S	S
Panama	S	S
Paraguay	S	S
Peru	D	D
Uruguay	S	S
Venezuela	S	S

Codes:
S = Source criterion or territoriality
D = Domicile criterion
N = Nationality criterion

Corporate Taxation in Latin America

- Taxation of Income
- Taxation of Dividends, Interest, Royalties and Branch Profits
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TABLE NO. 5
Determination of the source of income taxable in the case of companies engaged in international transport and communications, insurance, news, exhibiting and distributing films, not incorporated or domiciled in the country

Notes: SI (Determination of national-source income)
TI (Determination of taxable income)

Country		*Transport and communications*	*Insurance*	*International news agencies*	*Exhibiting and distributing films*
Argentina	SI	Gross amounts between Argentina and abroad. Absolute presumption.	Gross income on transactions covering risks in the country. Absolute presumption.	Gross income received. Absolute presumption.	Price paid. Absolute presumption.
	TI	10% of SI (15% in the case of containers)	Effective income with deduction of expenses.	10% of SI	50% of SI
Bolivia	SI	Gross amounts between Bolivia and abroad. Absolute presumption.	Gross income on transactions covering risks in the country. Absolute presumption.	Gross income received Absolute presumption.	Price paid. Absolute presumption.
	TI	2% of SI	2% of SI	2% of SI	15% of SI
Brazil	SI	Gross income of Brazilian source.			
	TI	20% or option of determination on an effective basis.			

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Notes: SI (Determination of national-source income)
TI (Determination of taxable income)

Country		*Transport and communications*	*Insurance*	*International news agencies*	*Exhibiting and distributing films*
Colombia	SI	Proportion of effective income considering relationship between national gross receipts and world-wide receipts.			Price paid.
	TI	SI less expenses			60% of SI
Costa Rica		Administrative resolutions considering a percentage of world-wide income.			
Dominican Rep.	SI	Income between the Dominican Rep. and the other country	Income on transactions covering risks in the country		Gross income received.
	TI	Option between 10% of SI or effective income	Option between 10% of SI or effective income		15% of SI
Ecuador	SI	Total proceeds of sales in the country through permanent establishments	Effective profit or based on coefficients provided by the tax administration		Effective profit in the country through permanent establishment
	TI	2% of SI			
El Salvador	SI	Proportion of world-wide income based on gross receipts	Idem	Idem	Idem
	TI	SI less expenses	SI less expenses	SI less expenses	SI less expenses
Guatemala	SI	Gross amounts between Guatemala and abroad.	Income on transactions covering risks in the country		Gross income received
	TI	10% of SI			80% of SI
Honduras	SI	Proceeds from sales in the country	Income on transactions covering risks in the country	Gross income	Gross income received
	TI	20% of SI	10% of SI		
Mexico	SI	Proportion between local and world-wide profits			
Nicaragua	SI	Income in the country	Income on transactions covering risks in the country		Gross income received
	TI	Between 5 and 10% of SI	Between 2 and 10% according to the type of insurance		30% of SI
Panama	SI	Gross income between Panama and the other country and vice versa	Effective income on transactions covering risks in the country		Gross income received
	TI	Option between 10% of SI or effective income	Effective income (reinsurances are exempted)		15, 50 or 75% of SI depending on the case

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Notes: SI (Determination of national-source income)
TI (Determination of taxable income)

Country		*Transport and communications*	*Insurance*	*International news agencies*	*Exhibiting and distributing films*
Paraguay	SI	Income on contracts in the country	Income on transactions covering risks in the country		Gross income received
	TI	10% of SI	10% of SI (8% on re-insurance)		60% of SI
Peru	SI	Income between Peru and the other country		Gross income received	Gross income received
	TI	Between 1 and 5% of SI, depending on the case		10% of SI	20% of SI
Uruguay	SI	Income on transactions between Uruguay and the other country	Income on transactions covering risks in the country	Gross income received	Gross income received
	TI	Option between 10% of SI or effective income	Option between 2 and 10% of SI per type of insurance or effective income	Option between 10% of SI or effective income	Option between 30% of SI or effective income
Venezuela	SI	50% of gross receipts between Venezuela and abroad and vice versa	Income on transactions covering risks in the country	Gross income received	Gross income received
	TI	10% of SI	30% of SI	15% of SI	25% of SI

TABLE NO. 6
Summary of the application of income tax on international transport enterprises

Country	*Taxable income determined (percentage)*			*Effective taxable income of national source*	*Others*
	From the country to abroad	*From the country to abroad and vice versa*	*From sales in the country*		
Argentina	10				
Bolivia	2				
Brazil				20	
Colombia					x
Costa Rica					x
Dominican Rep.	10				
Ecuador			2		
El Salvador					x
Guatemala	10				
Honduras			20		
Mexico					x
Nicaragua			5 to 10		
Panama		10			
Paraguay			10		
Peru	1 to 5				
Uruguay	10				
Venzuela		5			

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ISRAEL:

The Gabbay Report

A proposal for inflation-adjusted taxation of income in Israel

By Dr. J.F. Pick

The dilemma of choosing between accuracy and practicability continually accompanies the discussion about tax adjustments for inflation.

A comprehensive inflation adjustment of the taxable income in any of its possible versions may be theoretically the best solution for taking inflation into account in the collection of income tax in high inflation countries. But those trying to work out a good system of such adjustment and to put it into practice will soon become aware of the difficulties involved. Because of these difficulties the majority of countries which have decided to make some adjustment for inflation in their income tax system have restricted themselves first of all to relatively simple ad hoc measures, in most cases in the field of inventory relief or accelerated depreciation. These measures almost always grant relief which is not in proportion to the loss suffered from inflation because the loss depends also on the way of financing; except for some South American countries, tax relief for effects of inflation has not been accompanied by a "monetary adjustment", i.e. an allowance for the loss of the creditor and the gain of the debtor from inflation. That so-called monetary adjustment appears to be the most important element in a system of full inflation adjustment.

The committee of exports appointed by the Israeli Minister of Finance in August 1979 (when the annual rate of inflation in Israel approached 100 percent) to recommend methods for solving the taxation problems connected with inflation and especially those concerning:

(a) the real value of depreciation allowances for tax purposes
(b) the impact of inflation on inventories in the different economic branches; and
(c) the treatment of the effect of inflation on the own funds of the business;

proposed in its report submitted to the Minister of Finance in March 1980 to go the hard way of full inflation adjustment. It expressed the view that Israel has reached a rate of inflation which demands such adjustment, among other reasons, because the distortions which partial adjustments for inflation by way of ad hoc measures would create are acceptable only at much lower rates of inflation.

The report of the committee refers expressly to the incentive to invest in real assets and the encouragement to work with borrowed capital which are inherent in a tax system based on nominal value and which adversely affect the economic system.

The main point in the proposal of the GABBAY Committee, named after its chairman *Joseph Gabbay*, the deputy director of inland revenue, is the creation of a "capital maintenance reserve" deductible from taxable income.

The amount to be transferred to the maintenance reserve has to be calculated once a year and is composed of five elements:

(1) The main element is an extended monetary adjustment. It consists of the adjustment by the rate of inflation of the current year on the net sum of "erosible assets" at the beginning of the year. "Erosible assets" is the surplus of monetary claims with the addition of inventories, most machinery and some securities over monetary liabilities. The report explains in detail the inclusion of machinery in that item. Because of the high allowance given under this method in the first two years — a full inflation adjustment for the cost of machinery in addition to depreciation at historical cost — the total tax allowance is granted more quickly than by an adjustment of the annual depreciation allowance; although over the life time of the machinery almost the same allowance — in real terms — is granted.

(2) The second element is an adjustment of depreciation on "non-erosible" assets, especially factory and hotel buildings. That adjustment is in addition to historical cost depreciation based on the rise of the cost of living index from the time the building was acquired or erected until the end of the current year of business. The "non-erosible" assets group also includes securities not traded on a stock exchange, patents, prepaid expenses, loans granted and tax payments. However, buildings seem to be the main item in this group calling for an adjustment of depreciation.

(3) The "erosible assets" group includes securities traded on the Tel Aviv stock exchange. The third element in the calculation of the transfer to the capital maintenance reserve is the deduction from that transfer of the sum of book profits and realised profits on those traded securities. Profits on traded securities are tax free and the deduction of these profits is necessary for reasons of symmetry because the inclusion of traded securities in the non-erosible assets group would otherwise give holders of such securities twofold tax relief, by way of deduction of the profits from those securities from the taxable income and by an allowance, within the capital maintenance reserve, for the loss of value of the amount invested in traded securities.

(4) The calculation of the first element on the basis of the position at the beginning of the business year would in many cases result in a distortion of the amount transferred to the capital maintenance reserve unless there is an adjustment for changes in the amount of capital employed and in the composition of assets during the year. Therefore, the fourth element contains an adjustment for changes during the year, among them the inflow of new share capital, distribution of cash dividends, the acquisition or erection of buildings, the purchase of patent rights or non-traded shares or the sale of "non-erosible assets".

(5) By an adjustment for the effects of inflation on the value at the end of the year of the "real profits" of the

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year the fourth element is somehow supplemented. Just as monetary assets available at the start of the business year lose value in the course of the year, profits made at the beginning of the year lose at almost the same rate. The fifth element of adjustment is an allowance for the effect of inflation on the profits made during the year. That adjustment amounts to 20 percent of the "real profits" of the year multiplied by the rise of the index. The calculation is based on the assumption that the profit is made gradually during the year (arriving at 50 percent); tax at a rate of 60 percent is deducted from 50 percent of the profit. A negative "real profit" is not taken into account in the calculation of the transfer to the capital maintenance reserve.

In the view of the authors of the report the transfer from profit to the capital maintenance reserve achieves fairly correctly the aim of a changeover from nominal to real profits.

In case the transfer as calculated by summing up the five elements arrives at a negative balance the authors propose the deduction of that balance from the finance costs allowed for tax purposes. In case the negative balance exceeds the amount of finance costs the excess should be deducted from the (tax free) inflationary element of a capital gain made during the same year or from the transfer to the capital maintenance reserve of a related enterprise or should be set off against past losses. Negative balances which cannot be used for one of the above mentioned purposes have to be carried forward to the next year and will be considered a monetary liability in the calculation of next year's transfer to the capital maintenance reserve.

Except for industrial enterprises, the committee proposes the calculation of the capital maintenance reserve on the basis of only 90 percent of the rise of the cost of living index or that part of the rise which exceeds 10 percent (the lower of the two).

Somehow in contrast to the exact method of calculating the transfer to the capital maintenance reserve, the committee proposes a further device for reducing the cost of inflation adjustment by restricting the transfer to the capital maintenance reserve to 50 percent of the profit subject to tax before that transfer. Any excess over that 50 percent has to be carried forward of the following year as an "erosible asset".

Regarding the application of the new system, the committee suggests its introduction for a limited period of three years.

The system should be compulsory for all taxpayers who must then keep a complete set of books of account on accrual basis, with special regulations for taxpayers reporting on cash basis.

The calculation of the capital maintenance reserve by corporate bodies has to be examined by auditors.

The report deals to some extent also with specific problems of certain economic branches, e.g. livestock in agriculture and the stock of land held by building contractors. Going into these details would exceed the framework of this report. But it appears important to mention that the report refers to the specific problems of inflation adjustment in the tax accounts of financial institutions. Dealing with these problems has been entrusted to a subcommittee which has not yet submitted its report.

Although in Israel a few hundred industrial companies with foreign participation are already entitled to submit an inflation adjusted tax calculation on the basis of the RONAL Amendment (Amendment 15 to the Law for the Encouragement of Capital Investment) of March 1977, the proposal of the GABBAY committee is the most far-reaching plan prepared in Israel, and probably one of the most far-reaching plans anywhere, for an adjustment of tax accounts for inflations. The system appears logical and comprehensive and though various details may require change or improvement, the proposals form a complete and symmetric entity. The members of the committee deserve much credit for their work.

The GABBAY proposals aim to move as far as possible from the taxation of nominal profits to the taxation of real profits. In fact, the tax account model worked out in the proposals is based on historical cost accounts adjusted for general price level changes.

Inflation adjustment as such would not require a changeover of accounting methods to current costs but without it accounts do not show real values. The relationship between price level adjusted accounts based on historical cost and accounts based on replacement cost or current values depends on the different trends of price changes for different materials and goods and also on technological changes.

The GABBAY committee rightly restricted itself to price level changes. It would appear almost impossible to achieve a changeover to current cost accounting for the large number of small and medium sized enterprises in Israel. Even if achievable, such an adjustment may be considered unnecessary within an inflation adjustment of the income liable to tax.

In December 1979 the Institute of Public Accountants in Israel adopted Opinion 23 requiring all firms the turnover of which exceeded in 1979 IL 300 million and all companies the shares or bonds of which are traded at the Tel Aviv Stock Exchange to add to the notes to their financial statements from 1980 onward a statement on the effect of inflation on the profit and loss account. That statement on the effect of inflation calculates those effects on the basis of general price level changes and in the main on a general concept similar to that of the proposals of the GABBAY committee but there are many differences of detail. It would appear that in case the GABBAY proposals are to be put into effect a harmonisation of the accounting principles between financial accounts and inflation adjusted tax accounts would be of great assistance.

There appear to be three main problems involved in the decision concerning a possible implementation of the proposals:

(1) *the administrative difficulties;*

(2) *the restriction of the tax advantage presently enjoyed by certain economic branches, mainly manufacturing;*

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(3) *the choice of the methods for restricting the effect of inflation adjustments on total tax collection.*

(1) An examination of the proposals from the point of view of their administrative implementation is bound to reveal the most difficult problem. It would require a large degree of imagination to envisage the adjustment of all changes during the year (element 4) — in capital employed and in the distribution between "erosible" and "non-erosible" assets — of the large number of small and medium sized firms or companies covered by the proposal.

Even the RONAL Amendment, which was tailored for a few hundred companies only, provides for an easier method of calculating the transfer to the capital maintenance reserve than the GABBAY proposals which are intended for application to some hundred thousand taxpayers.

It would appear that similar to the RONAL adjustment method the calculation of the transfer to the capital maintenance reserve should be based on only two elements — the adjustment of the effect of inflation on the balance of erosible assets at the beginning of the year and the adjustment of depreciation on the non-erosible assets. Even such an adjustment would strain to the hilt the professional manpower in the tax administration and in the economy.

Some adjustments for changes during the year may be kept in reserve as a right of the tax administration to ask for more details and to demand adjustments for such changes in cases of execessive tax planning or special circumstances. The adjustment of the real profit becomes less important if the adjustment for changes during the year is dispensed with and traded securities may be transferred to the "non-erosible assets" group if only for the sake of saving administrative work.

(2) During most of the period of the existence of the State of Israel special tax advantages and other incentives have been granted to certain economic branches, mainly to manufacturing industries. These incentives have been part of a policy aiming to achieve economic independence by fostering industrial exports. Though the aim has not been fully achieved because of the great security requirements of Israel, the substantial increase of industrial exports can certainly to some extent be ascribed to these incentives.

The GABBAY report proposes on the whole a neutral application of the new measures retaining only very slight advantages for industry by adjusting for 100 percent (instead of 90 percent) of the rise of the index and by treating machinery as "erosible assets" which has a certain pro-industry bias. Against that, the accelerated depreciation and the inventory relief granted in the tax years 1978 to 1980 which gave manufacturing industry considerable tax incentives are to be abolished.

While the move towards more "neutrality" in tax laws would in principle be a highly desirable development, legislators would have to ask themselves whether a reduction of incentives to industry would hamper the achievement of the goal of increasing industrial exports.

(3) The letter of appointment of the committee by the Minister of Finance of 14 August 1979 aked the members to take into account the "fiscal limitations" which would affect the implementation of their recommendations. Out of these considerations the committee proposed:

(a) *to adjust "erosible assets" for 90 percent only of the rise of the index;*
(b) *to deduct any negative balance of the equity maintenance allowance from finance expenses allowed for tax purposes;*
(c) *to restrict the transfer to the capital maintenance reserve in any year to 50 percent of the taxable profit before that allowance.*

(a) The restriction of the adjustment to the excess of the rate of inflation over 10 percent seems the most reasonable of these measures. Taxpayers in other countries with inflation at an annual rate of around 10 percent also suffer taxation of inflationary profits at that rate.
Furthermore, if full tax relief for the effect of inflation cannot be granted, an equal proportional reduction of the relief to all taxpayers appears the most appropriate way for reducing the cost to government.

(b) The deduction of a negative capital maintenance reserve balance from finance expenses appears reasonable and logical because such negative balance represents generally a debtor's gain from the decline of the value of his debts in times of inflation.
There may be certain problems related to the proposed treatment of that item. Because long term credit in Israel is extremely restricted the main cases of a negative capital maintenance reserve (an excess of monetary liabilities over the sum of monetary assets, inventories and machinery) are probably manufacturers and hotels which financed their buildings with direct credits which they obtained as an incentive for increasing exports (including tourist trade treated as export). These enterprises will now be charged with the full debtor's gain on their long term debt, i.e. its decline in value due to inflation while in respect of the building acquired with that loan they will obtain tax relief by way of an adjustment of the amount of depreciation at a much slower pace. The GABBAY report explains that this disadvantage is in fact taking away an advantage that until now existed in these cases because the enterprises concerned can presently write off linking differences on their loans currently as they accrue and more quickly than the loans are repaid, thus resulting in a certain tax deferment. Nevertheless, their suggestion that the above problem should be solved in the field of financing and not by fiscal methods may be difficult to achieve. It would appear that the disadvantage of an immediate full charge for the debtor's gain as against the very gradual adjustment of depreciation of the assets financed by those debts should be partly cured by a certain tax deferment. Otherwise the inflation adjusted tax system would, in view of the financing problems prevailing under conditions of high-rate inflation, create an anti-investment bias which may be as harmful as the present pro-investment bias referred to in the GABBAY

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report which, however, in recent years did not prove strong enough to maintain productive investment at the desired level.

(c) The restriction of the transfer to the capital maintenance reserve to 50 percent of the taxable profits before that transfer appears to be the main flaw in the GABBAY committee proposals. It is surprising that such an unbalanced and regressive adjustment device found its way into the report which in most of its other parts is highly consistent and careful to maintain maximum symmetry. If the annual rate of inflation amounts to 80 percent an enterprise earning 200 percent on its own funds would, under the 50 percent rule, pay tax only on its very substantial real profit but no tax on its nominal inflationary profit. Another enterprise which earned only 50 percent on its own funds, which at that rate of inflation means a real loss, would nevertheless have to bear tax on 50 percent of its unreal profit. In that way the restriction of the transfer of the capital maintenance reserve to 50 percent of the profit before that transfer would hit hardest taxpayers with real losses or with relatively small real profits, while those with high real profits remain unaffected.

From all points of view it would appear preferable to achieve a reduction of the tax relief granted by way of an equal abatement of the relief granted instead of applying the regressive 50 percent rule which hits hardest those taxpayers with real losses.

If the proposal can be changed in the directions here indicated the GABBAY report could form the basis for an experiment in inflation-adjusted taxation of income which should be studied with interest also outside the State of Israel.

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Nathan Boidman:*

INTERPRETATION OF TAX TREATIES IN CANADA

A. AN OVERVIEW OF THE PROBLEMS OF INTERPRETATION

One might expect to glean profound wisdom from the following comments on treaty interpretation because they are based on an extensive review of most reported income tax treaty cases in Canada to date and a fair number of cases in other countries. [1] *Presumably, they reflect a coherent body of interpretative principles, developed and applied on a consistently evolving basis, and providing, therefore, sound guidelines as to the manner in which we might expect a treaty to be interpreted and applied and as to how treaty cases will be dcided in the future. However, there are two reasons why one may well be disappointed if such are one's expectations.*

AUTHOR'S NOTE

This Article is an edited version of the text of a paper presented to the International Fiscal Association, U.S.A. Branch, at its Fourth Annual Meeting in Philadelphia, 17 - 18 January 1980, on "New Developments In Tax Treaties". The paper focuses on the manner in which Canadian Courts interpret tax treaty cases, seeking to identify the extent, if any, to which there is a consistent and/or coherent body of rules of interpretation, with comparative comment respecting the approach of the judiciary in other countries, particularly the U.S. The underlying research was carried out for purposes of a book on treaty interpretation in Canada, scheduled to be published by the Canadian Tax Foundation.

1. The mix between domestic and international rules

First, Courts often tend to interpret treaties in much the same manner as they would domestic tax statutes, only hesitantly bringing into play rules which are particularly apt for a treaty issue. The result is an unpredictable mix between the use of purely domestic rules of interpretation in some cases and a blend of domestic and treaty rules in other cases, making it difficult to foresee the resolution of a future treaty issue.

The problem is accentuated by the predilection of Courts to conscientiously propound the need to adopt broader rules of interpretation while in fact failing to wrest themselves from the more restrictive framework in which domestic tax issues are resolved.

The basic principle of treaty interpretation in Canada was stated by the Tax Appeal Board in *Saunders* v. *M.N.R.:*

> *"The accepted principle is to be that a taxing act must be construed either against the Crown or the person sought to be charged, with perfect strictness, so far as the intention of Parliament is discoverable. Where a tax Convention is involved, however, the situation is different and the liberal interpretation is usual in the interest of the comity of nations. Tax Conventions are negotiated primarily to remedy a subject's tax position by the avoidance of double taxation rather than to make it more burdensome. This fact is indicated in the preamble to the Convention. Accordingly, it is undesirable to look beyond the four corners of the Convention and Protocol in seeking to ascertain the exact meaning of a particular phrase or word therein."* [2,3]

On the other hand, Mr. Justice Cattenach in the Federal Court, Trial Division wrote in *Stickel* v. *Her Majesty The Queen:*

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1. This research was carried out for purposes of a book on treaty interpretation in Canada, scheduled to be published by the Canadian Tax Foundation. It reflects court decisions to Janaury 15, 1980.
to January 15, 1980.
2. 54 DC 524, at 526.
3. This statement of judicial policy has been referred to in several subsequent decisions, such as, *Canadian Pacific Limited* v. *Her Majesty the Queen* 76 DTC 6120, *Vauban Productions* v. *Her Majesty The Queen*, 75 DTC 5371 and *Shahmoon* v. *M.N.R.* 75 DTC 275.

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"The consensus of all writers is that treaties are to be construed in the most liberal spirit provided, however, that the sense is not wrested from its plain and obvious meaning.

In my view, the duty of the Court is to construe a treaty as it would construe any other instrument public or private, that is, to ascertain the true intent and meaning of the contracting States collected from the nature of the subject matter and from the words employed by them in their context. In this I am assisted by the preamble of this particular Treaty which states that two of the overall aims are the avoidance of double taxation and the prevention of fiscal evasion in the case of income tax." [4]

It is seen that Mr. Justice Cattenach would substantially restrict the object of liberal interpretation of treaties by conventional rules of interpretation, and his decision in *Stickel* [5] could fairly be considered to be within the constraints of domestic revenue law interpretation.

2. Inconsistency of application

Secondly, there is the old domestic problem of inconsistency of selection or application of conflicting or competing rules or methods of interpretation. This problem is a recurring theme in this paper (see, in particular, section B).

As one cynic (so self described), an eminent international tax lawyer who will grace our podium at this meeting, said in a letter to me, commenting on the first draft of my book: [6]

> "I have completed reading your Treatise on interpreting Canada's income tax treaties and feel that you are undertaking an impossible task. I am quite cynical about the Court's analysis. I believe that in most cases, the Courts decide an answer to the problem and then adopt the appropriate rationale."

(a) The U.S. experience in treaty abuse cases

Perhaps our cynic had in mind the difficulty of reconciling some of the more renowned U.S. treaty cases: the decisions in *Perry Bass* v. *C.I.R.*, [7] on the one hand, and as a group those in *Compagnie Financière de Suez et de l'Union Parisienne* v. *U.S.*, [8] *Johansson et al* v. *U.S.* [9] and *Aiken Industries Inc.* v. *C.I.R.* [10] The latter cases suggest that the U.S. Courts are quite prepared to disregard a taxpayer's compliance with formalism and adherence to specific requirements of a treaty exemption or to seek out defects in documentation or formal inadequacy in order to give effect to an overriding principle that a treaty should be interpreted such as to assure its prime purpose of avoiding double taxation and the converse thereof, that it not be interpreted so as to allow the avoidance of all taxation (or taxes in more than one country) or what can be preceived as an undue, abusive or unintended avoidance of taxes which might otherwise become due. On the other hand, *Perry Bass* [11] can reasonably be regarded as standing for the proposition that attention to detail, formal adequacy or observation of the legal niceties can provide success in a treaty case regardless of the rupture of the underlying purposes of double tax agreements. As you well know, in *Perry Bass* [12] the taxpayer effectively reduced his overall tax burden by interposing a Swiss corporation between himself and various investments in the United States, succeeding on the basis of the "viability" principle, that is, the company looked and acted like a real corporation having been very carefully adorned with all

4. 72 DTC 6178, at 6182, 3.
5. Supra note 4, reversed by the Supreme Court of Canada, 74 DTC 6268.
6. Supra note 1.
7. 50 T.C. 595.
8. 492 F. 2d 798; or 74-1 USTC, 83505.
9. 336 F. 2d 809; or 64-2 USTC 93907.
10. 56 T.C. 925.
11. Supra note 7.
12. Supra note 7.

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the accoutrements of an ongoing enterprise. The Court was of the view that it ought to disregard "the personal purpose of a taxpayer in creating a corporation", provided that substantive business functions are carried out. Compare, however, *Johansson* [13] and *Suez.* [14]

In *Johansson*, [15] the Court, in holding the taxpayer's scheme to be untenable, stated:

> *"The primary objective of our Treaty with Switzerland, as well as those with more than 20 other countries, is the elimination of the impediments to international commerce resulting from the double taxation of international transactions."* [16]

The Court went on to find that the attempt by Johansson to shelter the prize money he would earn from his heavyweight championship boxing match with Floyd Patterson by utilizing a Swiss company should not succeed for the reason, inter alia, that such tax relief was not necessary for the purpose of eliminating impediments to international commerce.

> *"Scanart, S.A. had no legitimate business purpose but was a device which was used by Ingemar Johansson as a controlled depository and conduit by which he attempted to divert, temporarily, his personal income, earned in the United States, so as to exempt taxation thereon by the United States."* [17]

The Court rejected strict or mechanical interpretation and cited *Maximov* v. *U.S.:* [18]

> *"In determining whether the taxpayer in a given case is protected by the terms of a treaty, abstract and desultory definitions of such terms as 'residence' and 'legitimate business purposes' are of limited, if any, assistance. 'To give the strict word of the treaty a meaning consistent with a genuine shared expectation of the contracting parties, it is necessary to examine not only the language but the entire context of the agreement.'"* [19]

Then, dealing with the proper locus of taxation in relation to the purpose and operation of a double tax agreement:

> *"Thus, as a general rule, the income from services is taxable when the services are rendered . . . Where, as here, services are performed in the United States, and the compensation for them is drawn from the wealth of the United States, this is the country of primary economic impact and consequently, the appropriate taxing locus. There are, however, a number of potential exceptions in the general 'economic impact' rules. Among them is a view that a business enterprise engaged in international commerce ought not to be subject to taxation in every country in which he may transact some business. Although such an enterprise does draw upon the wealth of the various countries with which he comes into contact, the overall objective of encouraging international commerce, as well as the practical necessities of business planning are better satisfied by a centralized regime of taxation at the enterprise's business seat or permanent establishment. The business seat exception is found in Article III of the Swiss Treaty. Elements of this exception are also found in Article X. Typical of what have become known as "commercial traveller provisions" in the international tax conventions, the Article is designed to assure business establishments in each of the contracting States that they may freely send their agents and employees into the other Contracting State without thereby subjecting those employees to the latter's taxes. Like Article III, it is an exception to the 'economic impact' rule, carved out in the interest of facilitating international trade. Where the practical reasons for the exception do not obtain, however, the general rule must apply. Thus, while Johansson may have brought himself within the words of the Swiss Treaty by his 'residence' in Switzerland and his 'employment by a Swiss enterprise', he has failed to establish any substantial reasons for deviating from the treaty's basic rule that the income from services is taxable where the services are rendered. International trade will not be seriously encumbered by a refusal to grant special tax treatment to one only marginally if at all Swiss resident and only technically if at all employed by a paper Swiss corporation."* [20]

In *Suez* [21] the Court expressed its views on the proper and improper use of treaty provisions in the following words:

> *"Ultimately this case also turns on the intent and purpose of the Convention as agreed upon by the signatories. The purpose and intention of the tax Convention between the U.S. and France was to avoid double taxation and to alleviate the problems arising from it. The parties, to a bilateral agreement, are 'primarily' concerned with removing an obstacle to a flow of trade and investment between the two countries. . . . The fact is that the plaintiff is not confronted with the problem of double or burdensome taxation that the Treaty is designed to alleviate or eliminate. There is no double tax on the income of the plaintiff since it is not taxed in France. There is no obstacle to trade or commercial intercourse in the context of this case."* [22]

The Court dealt with "unintended" treaty benefits:

> *"We cannot read the Treaty to accord unintended benefits inconsistent with its words and not compellingly indicated by its invocation. Our interpretation affords every benefit negotiated for by the parties to the Convention on behalf of their respective residents and prevents an intended tax default to a private party."* [23]

The Court also considered the issue in terms of allocation of jurisdiction to levy tax:

> *"The plaintiff claims based on the Treaty that an adverse decision would violate the rules of comity. This is not so because the only tax authority involved*

13. Supra note 9.
14. Supra note 8.
15. Supra note 9.
16. Supra note 9, at 93910.
17. Supra note 9, at 93909, 10.
18. Infra note 46.
19. Supra note 9, at 93910.
20. Supra note 9, at 93910.
21. Supra note 8.
22. Supra note 8, at 83514, 5.
23. Supra note 8, at 83515.

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is that of the United States. If the United States surrendered its authority in accordance with the plaintiff's claim, it would gain nothing for which it negotiated under this Treaty. Also, France has no interest in this matter because its authority to tax is not in dispute. France disclaimed its right to tax the income in dispute. United States' interests and benefits are the only ones involved relative to the Convention, therefore a result unacceptable to the plaintiff, either based on the Convention or indirectly structured to it, an unfavorable choice of law in no way violates the principle of comity. The decision merely protects the principle of the Convention, avoidance of double taxation." [24]

B. The problem of inductive versus deductive processes of interpretation and broadly stated canons of interpretation

I encountered two particularly thorny problems in trying to identify a coherent theory and underlying body of rules of interpretation for tax statutes and treaties, problems which are probably inherent in any legal analysis.

1. Inductive v. deductive analysis

Tax Courts tend to vacillate between, on the one hand, the desire to methodically apply in a purley deductive manner prevailing principles and rules of interpretation and, on the other hand, the tendency to inductively (or perhaps intuitively) draw conclusions from a maze of available data (the facts, the law and the rules of interpretation and application), hopefully factoring in the deductive analysis required.

The latter approach appears to be a natural response to the difficulties raised in tax avoidance cases, such as the U.S. cases noted earlier where the judicial concern is to avoid decisions which ignore or overlook underlying purposes of the relevant statute or treaty.

It is my own view that the inductive approach gives rise to inconsistency and incompleteness of reasoning and that the problem is accentuated by broadly worded canons or dicta of interpretation (more on the latter below).

(a) The deductive approach

The deductive approach should involve a two-step process:

- First, the transaction at issue should be characterized or qualified as to its true or substantive nature for tax assessment purposes—
- Then, the relevant law or statute can be applied or interpreted in relation thereto.

(i) Characterizing or qualifying the transaction

The first issue is whether we are dealing with a transaction which is carried out without regard to tax law, including treaties; or is it one which was structured with tax law in mind, for example, *Johansson*; [25] or, is it one which had no purpose other than to yield a tax benefit,[26] such as *Aiken*,[27] where an existing debt relationship between a Bahamian and U.S. corporation was restructured to obtain advantage of the then existing Honduras-U.S. Treaty.

In the first category we simply have the question of applying or interpreting the treaty provision in relation to the factual situation. In the second category we must make an initial determination (before interpreting or applying the treaty provision) of the true substance or commercial effect of the particular transaction, overall, bringing into play doctrines of step transaction, substance over form, etc. In the third category the question of categorization and qualification of the transaction becomes all important with the ultimate sanction that the transaction will be ignored in its entirety on the basis of sham or lack of business purpose, or that the alleged taxpayer is a mere agent, as was the reasoning in *Aiken*.[28]

The point is, that the interpretative process is one-dimensional in the first type of situation and multi-dimensional in the second and third categories.

If there is a failure to recognize the necessity of first qualififying the true substance of a transaction, the objective of consistent interpretation (particularly where there are competing, alternative rules of interpretation) may be compromised. For example in Canada, as I will comment on in more detail below, there still remains an uncertainty as to whether a revenue statute should be interpreted strictly (literally) or broadly bringing into play the intent of the legislator and other (extraneous) factors.[29] Such a determination should not be made by reference to the particular nuance or circumstances surrounding the issue at hand; however, where the Court has failed to first deal specifically with the question of categorization, it may tend to use an interpretation rule based not on a consistent policy within that country or Court in relation to the particular law under consideration, but, rather, one which provides a desirable or equitable result in the particular case. For example, if it is common ground that a treaty provision is to be interpreted contextually a Court should not apply a strict or literal reading simply because the result thereof would accord more with the apparent policy or purpose of the

24. Supra note 8, at 83515.
25. Supra note 9.
26. These three different types of transactions or issues are referred to below as "categories".
27. Supra note 10.
28. Supra note 10.
29. In the 1930s, the United States abandoned the strict rule of interpretation, in *White* v. *U.S.*; (1938) 305 U.S., 281 and adopted the "business purpose test" in *v. Helvering* v. *Gregory*, 60 F. 2d 809, aff'd (1935), 293 U.S. 465 and *Wellard* v. *Commissioner*. The doctrines of "agency" and "sham" can be seen in *Barthel* v. *Birmingham*, 332 U.S. 126 (1947, 1847-2 C.B. 174); *Ringling Brothers, Barnum & Bailey* v. *Higgins*, 189 F. 2d 864 (2nd Circuit) 1950; *Filipidis* v. *United States*, 71-1 U.S. c. 85 828 (M.D.) 1970 (confirmed); Curin, 71-2 U.S. T.C. 87 830 (4th Circuit 1970) 14; *Richard Rubin*, 56 T.C. 1155, 1159-60 (1970), affirmed 46 DF 2D 1216 (2nd Circuit) 1972; *Moline Properties Inc.* v. *Commissioner*, 319 U.S. 436, 438-439 (1943), 1943 C.B. 1011; *Floyd Patterson* T.C. 1966-329, affirmed 1968 - 2 U.S. T.C. 87, 623 (2nd Circuit 1968).

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particular treaty provision. Rather, the task of negating matters such as a lack of business purpose in a transaction should be left to the initial characterization process; the animus of the transaction should not influence or compromise consistent and logical selection and application of rules of interpretation.

Treaty cases in Canada have yet to involve the second and third category situations. The main reason is that until 1976 there was no difference between treaty rates and domestic rates on most forms of passive investment withholding tax levies, being perhaps the area most prone to abusive planning. In addition, for whatever reason, perhaps lack of detection, issue has not been made of situations where certain treaty countries have been utilized as a base for carrying on business in Canada without permanent establishments, claiming business profit treaty exemption in circumstances where the substantive aspect of the activity was foreign to the base (treaty) country used.

There is a tendency, of course, for modern treaties to contain specific anti-abuse provisions which effectively codify or formalize what I perceive as the first process otherwise necessary in a treaty issue determination. For example, under Article XXVII (2) of the yet to be ratified, renegotiated, Canada-United Kingdom Treaty:

> *"Where under any provision of this Convention any person is relieved from tax in a Contracting State on certain income and, under the law in force in the other Contracting State, that person is subject to tax in that other State in respect of that income by reference to the amount thereof which is remitted to or received in that other State, the relief from tax to be allowed under this Convention in the first-mentioned State shall apply only to the amounts so remitted or received."*

This, of course, is meant to deal with non-domiciled U.K. residents who can avoid U.K. tax on unremitted foreign source income.

(ii) Applying principles or rules of tax treaty interpretation

Once the transaction has been characterized (as well as applying or perhaps ignoring the principle enunciated in *Suez* [30] and *Johansson* [31] that a treaty cannot be simply utilized at the discretion of a taxpayer) consideration can then be given to what I prefer to consider the true or strict questions of interpreting tax treaties. The following is a brief summary of how Canadian and some other Courts have used the possible principles or rules of interpretation.

(A) *A treaty should not expand the ambit of taxation*

In Canada the dicta in *Saunders* [32] cited above have been construed to extend or expand the liability for tax which would arise in the absence of the treaty. I believe this is a fairly universal rule with the exception of France, where a treaty can apparently serve to increase the ambit of taxation (Article 4 bis-2, 165 bis and 209 G.C.I.). Another possible exception to this rule may be discerned in a decision under the Germany-Luxembourg Treaty referred to in the *International Tax Treaty Service* [33] at page 11 of the section on Article XIV.

(B) *Eliminating double taxation*

Hopefully a treaty is to be interpreted in light of the purpose of avoiding double tax. This is the third of the three schools of tax treaty interpretation identified by Fitzmaurice: the "aims and objects" school.[34]

However the majority of cases indicates that this rule of interpretation is usually subordinated to the first two schools of interpretation identified by Fitzmaurice: the "Founding Fathers School" or the "Ordinary Meaning of the Words School".[35]

Cases where the purposes of treaties have been manifestly observed include *Appleby* v. *M.N.R.*,[36] *Reeder* v. *M.N.R.*[37] [38] On the other hand, there are far more cases where the basic purposes of treaties are not determinative in the decisions: *Stickel* v. *M.N.R.*,[39] *Fletcher* v. *M.N.R.*,[40] *A.G. Munich (Jr.)* v. *M.N.R.*,[41] *C.J. Crawford* v. *M.N.R.*,[42] *Furness Pacific Ltd.* v. *M.N.R.*,[43] *Joe Snell* v. *M.N.R.*,[44] *A.P. Hilton* v. *M.N.R.*,[45] *Maximov* v. *U.S.*,[46] *Mathewson* v. *M.N.R.*,[47] *Hurd* v. *M.N.R.*[48]

Lord Donovan of the House of Lords in *Imperial Chemical Industries Ltd.* v. *Caro*[49] expressed this rule this way:

> *"It is true that this may produce an anomaly. . . but in this particular appeal which deals with different*

30. Supra note 8.
31. Supra note 9.
32. Supra note 3.
33. Michael Edwardes-Ker, *The International Tax Treaties Service*, In-Depth Publishing Ltd., Dublin, 1978. Another example is the 1979 decision of the Privy Council in *Hock Heng Co. (1979)* STC 291 as reported in *The International Tax Strategy Service*, In-Depth Publishing Ltd., Dublin, 1978, in 1979 Bulletin No. 5, page 7. The Council rejected an attempt by the Malaysian tax authorities to deny a deduction to a Malaysian company for losses of a Singapore branch, as is permitted under Malaysian domestic tax law, on the basis that the treaty between Malaysia and Singapore would have exempted the Malaysian company from tax on such profits and therefore losses therefrom should be denied. A finding to this effect would have permitted a treaty to expand the ambit of taxation and the decision is therefore consistent with the general rule noted.
34. As summarized by David Ward in *Principles To Be Applied In Interpreting Tax Treaties* (1977) 25 Can. Tax. J., 263.
35. The first school is also referred to as the "intentions of the parties school", the second school as the "textual" school and the third as the "teleological" school. Fitzmaurice's first school can also be thought of as the liberal or contextual approach while the second school is closer to the strict or literal approach dealt with below. It would seem that the "aims and objects" school plays an important role only in abuse of treaty cases such as the four U.S. cases dealt with earlier.
36. 79 DTC 172.
37. 75 DTC 17.
38. See also, the Internal Revenue Services' interpretation of *The Estate of Tait* v. *The Commissioner*, 11 T.C. 731.
39. Supra notes 4 and 5.
40. 77 DTC 185.
41. 51 DTC 115.
42. 51 DTC 99.
43. 52 DTC 1048.
44. 68 DTC 745.
45. 63 DTC 336.
46. 2. Cir., 1962 299 F. 2d 565, aff'd. 373 U.S. 49 (1968).
47. 63 DTC 490.
48. 79 DTC 5369.
49. 39 T.C. 374 (CA).

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taxes levied in different countries on different lines, protection in any system of double taxation relief must almost be impossible to achieve."

Lord Upjohn said:

"It very frequently happens, owing to the complexity of modern taxation, that anomalies and hardship do arise. There is only one safeguard, and that is, to give effect to the plain meaning of the words which Parliament has thought fit to use." [50]

(C) *Counteracting tax evasion or avoidance*

Should a treaty be interpreted in light of the purpose of combating tax evasion or avoidance? This certainly seems to be the view of the U.S. Courts in *Burbank* [51] where the exchange of information article of the U.S.-Canada Convention was given broad application in respect to co-operation between the taxing authorities, in contrast to many European, particularly Swiss, decisions.

(D) *Achieving reciprocity of taxation*

Should a treaty be interpreted in light of the purpose of providing reciprocity of taxation between the two taxing jurisdictions? This principle, in part, underlay the dicision in *Johansson:*

"The primary objective of our Treaty with Switzerland, as well as those with more than 20 other countries, is the elimination of the impediments to international commerce resulting from the double taxation of international transactions. The basic mechanism of these treaty arrangements is the establishment of standards for determining the single most appropriate locus of the taxation of any given transaction. *Although some treaty provisions are inevitably the result of political compromise, the dominant criterion for determining the appropriate taxing locus is economic impact" (emphasis added).* [52]

A similar objective can also be seen as underlying the permanent establishment and enterprise cases under the U.S.-Canada Convention, in *Rutenberg* v. *M.N.R.,* [53] *Abed* v. *M.N.R.,* [54] *Consolidated Premium Iron Ores Ltd.* v. *Commissioner of Internal Revenue,* [55] *Number 473* v. *M.N.R.,* [56] *McMahon* v. *M.N.R.,* [57] *Number 630* v. *M.N.R.,* [58] *Donroy Ltd.* v. *U.S.,* [59] and *Johnston* v. *C.I.R.,* [60] all referred to below.

(E) *Avoiding abuse of treaties*

Should a treaty be interpreted so as to prevent it from being a means of avoiding tax? This idea was dealt with in the opening portion of the paper, being an issue which has come up before the U.S. Courts but not yet before the Canadian Courts.

(F) *The use of extrinsic aids*

In interpreting treaties may reference be had to extrinsic aids? Canada has traditionally been more conservative in this area than, I believe, the U.S. The basic rule in Canada is that "travaux préparatoires" and legislative history of a statute are not admissible as evidence in the interpretation of a statute *(Attorney General of Canada* v. *Readers Digest Association).* [61] I understand the contrary rule was adopted in 1896 in the *United States* v. *Freight Association.* [62] Perhaps Article XXXII of the *Vienna Convention on Treaties*, 1969, which advocates the admissibility of "travaux préparatoires", will eventually be followed by Courts in Canada. Similarly, it remains to be seen whether commentaries on the OECD Model would be referred to by a Canadian Court, as was the procedure adopted by the U.S. Court in *Burbank.* [63]

(G) *Interpretation as a contract*

The question of interpreting a treaty as a contract and not as a statute is considered separately below with particular reference to the propriety of unilateral acts of interpretation by administrative officials and the effect thereof before the Courts.

(H) *The influence of international law*

What is the influence of rules of international law, relations and concepts on the interpretation of treaty cases? As seen above, the Canadian Courts generally refer to the desirability of more liberal interpretations in a treaty issue. Consideration is given elsewhere to the

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50. In a recent New Zealand case, D1 (1979 4 NZ TC, Taxation Review Authority, February 19, 1979) as reported in *International Tax Strategy 1979*, Bulletin No. 3, page 14, a U.S. citizen, retired in New Zealand, failed in his attempt to invoke the New Zealand-U.S. Income Tax Treaty to avoid paying New Zealand tax on pension benefits under the U.S. Social Security Program. The gist of the taxpayer's argument was that Article 18 should be construed to avoid double taxation, being the result, in a sense, of the pension having been derived from contributions which had been made on a non-deductible basis. Article 18 provided as follows:
"When a person shows proof that the action of the revenue authorities of the Contracting Governments has resulted or may result in double taxation in his case in respect of any of the taxes to which the present Convention relates, he shall be impelled to lodge a claim with the Government of which he is a citizen or in whose territory he is resident. If the claim should be deemed worthy of consideration, the taxation authorities of such Government may consult with the taxation authorities of the other Government to determine whether the double taxation in question may be avoided."
In rejecting this argument, the court said:
"There is no mandatory provision that double taxation must be avoided. The terms of the Agreement are permissive only and confer no absolute right on a taxpayer to insist that such consultation be held. In equity, however, I have no doubt that in appropriate cases proper consultation would be had between the revenue authorities of the two countries."
51. 36. AFTR 2D 75, 6227, Cert. denied, 96 S.CT 2647 (1976).
52. Supra note 9, at 93910.
53. 79 DTC 5394.
54. 78 DTC 6007.
55. Court of Appeals, 6th Circuit, reported, inter alia 59 DTC 1112; See also, 57 DTC 1146 for the decision of the Tax Court.
56. 57 DTC 300.
57. 59 DTC 1109.
58. 59 DTC 300.
59. 301 F 2d 200.
60. (1955) T.C. 920.
61. 61 DTC 1273.
62. (1896) 166 USR, 290.
63. Supra note 51.

OECD Model and commentaries and the Vienna Convention on treaties. In a Rhodesian case,[64] the Chief Justice, Beadle, spoke of "an international language" requiring wide and broad interpretation in order that the purposes of tax treaties be achieved. The Federal Court of Canada in *Canadian Pacific* [65] was prepared to accept an administrative interpretation (of the U.S. Treasury) to achieve avoidance of the double tax while the Tax Review Board in *Number 630* [66] referred to the persuasive influence of the U.S. decision in *Johnston* [67] in deciding a permanent establishment case under the U.S.-Canada Convention. These instances of the Canadian Courts looking to foreign decisions augur well for an international approach to treaty interpretation in Canada. In the U.S. the reliance in *Burbank*[68] on the OECD commentary is an important breakthrough in internationalizing the interpretation of treaty issues.[69] [70]

(I) *The question of strict v. liberal interpretation*

This is considered separately below.

(b) The inductive approach

There are times when the deductive approach considered above is short circuited and fused into what I have labelled the inductive approach in the sense that either the transaction is not fully characterized or qualified, as a first step, or consideration is not given to the full range of rules or principles of interpretation.

Ideally, the Court should consider the full range of interpretative principles which may be relevant to applying a treaty provision and apply them consistently within a reasonable overall theory of treaty, as opposed to domestic tax statute, interpretation.

2. The problem of broadly stated canons or dicta of interpretation

Uncertainty sometimes is created by broadly worded canons or dicta of interpretation: Consider the words of Domoulin, J. in *Western Electric Company Inc.* v. *M.N.R.*

> "*... dealing, as I must, with a measure of exception, expressly enacted by the contracting parties to limit the extent of their own national laws and to devise special rules governing special cases of mutual interest, I feel bound to adhere closely to the current and ordinary meaning of the Treaty terms, ever more so than to provisions of any other statute.*" [71]

Is this in the spirit of the broad rule of interpretation advocated in *Saunders*,[72] or does it suggest a restrictive approach to granting alleviation under tax treaties. It would appear that either view is possible, the former on the basis that the second part of the statement is merely reformulation of the statement in *Saunders* that:

> "*Accordingly, it is undesirable to look beyond the four corners of the Convention and Protocol when seeking to ascertain the exact meaning of a particular phrase or word therein.*"

The latter view can be argued on the basis that the first part of the statement contemplates that the extent to which the contracting parties intend to limit the extent of their own national laws is to be narrowly construed.

The point is that the Courts as well as the legislator or treaty negotiator should speak as clearly and unambiguously as possible.

C. THE PROBLEM OF STRICT VERSUS LIBERAL INTERPRETATION

1. Overview: Canada v. U.S.

It is important to point out that my observations of the Canadian experience in treaty interpretation are probably not too helpful a guide to treaty interpretation in the United States. This is because of the substantial difference between the two countries in basic domestic revenue statute interpretation. As far back as 1938 the United States rejected the concept of strict or literal interpretation of revenue statutes adopting the liberal or contextual intent of the legislator doctrine (see *White* v. *U.S.*[73]).

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64. Aktiebolaget Tetra Pak, Appellante Division, (1966) S.A. 198. Reported at page 17 under Article VII of the *International Tax Treaties Service*, supra.
65. *Canadian Pacific Limited* v. *The Queen*, 76 DTC 6120, Walsh, J. at page 6135: "*While it is true that this Court has the right to interpret the U.K.-Canada Tax Convention and Protocol itself and is in no way bound by the interpretation given it by the United States Treasury, the result would be unfortunate if it were interpreted differently in the two countries when this would lead to double taxation. Unless, therefore, it can be concluded that the interpretation given in the United States is manifestly erroneous it is not desirable to reach a different conclusion and I find no compelling reason for doing so.*"
66. Supra note 58.
67. Supra note 60.
68. Supra note 51.
69. Canadian Courts have rarely relied specifically on international instrumentalities or rules of interpretation in treaty cases although the underlying interpretative process often is the same. For example, the reasoning in *Tara Exploration and Company Limited* v. *M.N.R.* 72 DTC 6288 respecting the meaning to be given "permanent establishment" (see below) and the commentary to Article IV of the OECD Model Treaty which advocates that the objective is to determine a "degree of permanence" in the activity carries on and to this end "factors should be examined first, singly and then as a whole, and whether examined in the latter fashion or in the former fashion, the ultimate test of permanency is to be kept in mind as well as the related criteria of whether the activities carried on are of a profit making nature or are, instead, of an auxiliary or preparatory nature."
70. See also the recent development in *Hunter Douglas* v. *The Queen* 79 DTC 5340 where reference is made to the Vienna Convention on the Law of Treaties. In the 1979 decision in *Fothergill* v. *Monarch Airlines Ltd.* (1979) 3 WLR 491 (C.A.), the English Court of Appeal in a case involving an international convention on law respecting carriage by air objected to the use of "travaux préparatoires" with a strong dissent by Lord Denning. However, the influence of an international approach was seen in the decision of the Supreme Court of the Netherlands, BNB 1979/116, March 14, 1979 (as reported in *International Tax Strategy 1979* Bulletin No. 6, page 10) which involved references to the Commentary of the OECD 1977 Model and decisions in other European countries.
71. 79 DTC 5204, at 5210.
72. Supra note 2.
73. Supra note 29.

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In *Helvering* v. *Gregory*,[74] Judge L. Hand advocated that the Court should be given discretion to, in effect, round out the law as it would in a decision or issue involving a private contract.

Such an approach more readily accommodates the more progressive rules of interpreting treaties described above.

For example, in *London Display Company NV* v *U.S.*,[75] a case under the Netherlands Antilles-U.S. Tax Treaty, the Court had little difficulty in deciding that the provision in the Treaty dealing with industrial and commercial profits should prevail over the provision dealing with the leasing of artistic works in relation to a contract of lease, in respect of wax figures, by a company specializing in provision of display materials and props to a U.S. enterprise to be used in commercial display.[76]

2. The Canadian situation

On the other hand, in Canada, we have yet to resolve in a definitive fashion the conflict between strict and liberal interpretation in revenue statutes generally. This notwithstanding that section 11 of the *Interpretation Act of Canada* which governs the manner in which all Canadian statutes are to be interpreted specifically provides for liberal interpretation:

> *"Every enactment shall be deemed remedial and shall be given such fair, large and liberal construction and interpretation as best insures the attainment of its object."*[77]

For example, the Supreme Court of Canada in *Stickel*[78] held that a visiting American professor was eligible for an exemption under Article VIII A on earnings derived from teaching on a temporary basis in Canada notwithstanding that the Court had noted that the taxpayer had, in all probability, not paid any tax in the U.S. and thereby would benefit unduly from the decision by avoiding all tax. However, because Mr. Stickel came within the four corners of the exemption, his application was upheld.

That the Supreme Court of Canada came to its decision by reference to the words of the Convention, strictly construed, rather than perhaps its manifest purpose, may be demonstrated as follows:

> *"I am not overlooking the fact that the respondent paid no tax in the United States on the income in question here. There is evidence that the United States tax authority has treated him as a non-resident in respect to this income. Although the evidence is scanty, I am prepared to infer that this might have been the result of some representation made by the respondent to the United States tax authority. Our problem is whether he comes within the treaty giving him exception from Canadian tax on his Canadian income and on this issue I agree with the Federal Court of Appeal that he does and on both grounds given by the Courts."*[79]

The decision of the Federal Court, Trial Division in 1979 in *British Columbia Railway Co.* v. *The Queen*[80] is a recent illustration of strict interpretation. In that case a federal sales tax was held to have no effect because of absence of certainty as to when the tax was to be levied.

The problem is particularly acute in cases of relatively clear, unambiguous statutory language (more on this below).

Often the result is that Canadian judges, conditioned by such an ambiguous and ambivalent approach to domestic tax cases, bring a mixed bat of strict versus liberal interpretation to treaty cases. This is so notwithstanding the expressed preference for "liberal" interpretation in treaty cases (see *Saunders*, etc. supra).

The underlying conflict is further complicated by a real dichotomy in the manner in which the strict versus liberal principle is applied in cases of clear statutory language as opposed to ambiguous, unclear provisions. In the latter circumstances the approach has tended to be more towards that adopted in the U.S. since the 1930s, with the Courts tending to accept the responsibility of seeking out the legislative intent;[81] accordingly, in treaty cases involving ambiguous or conflicting provisions there is a better chance that the decision will be grounded in a suitable application of relevant underlying rules of interpretation.

The problem is substantial in the former category (that is, situations of apparently straightforward and clear statutory language) where the Canadian Courts in treaty

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74. Supra note 29.
75. 46 T.C. 511.
76. The principle of liberal interpretation in tax treaty cases in the U.S. was stated as follows by the Supreme Court of the United States in *Geofroy* v. *Riggs* (1890 133 U.S. 642 at 646):
"It is a general principle of construction with respect to treaties that they should be liberally construed so as to carry out the apparent intention of the parties to secure equality and reciprocity between them. As they are contracts between independent nations, in their construction words are to be taken in their ordinary meaning, as understood in the public law of nations and not in any artificial or special sense impressed upon them by local law, unless such restricted sense is clearly intended. And it has been held by this court that where a treaty admits of two constructions, one restrictive of the rights which may be claimed under it and the other favourable to them, the latter is to be preferred."
77. The theory of literal or strict interpretation in Canada sprang from a famous U.K. decision in the 19th century, *Partington* v. *The Attorney General* (1869) LR HL 100, at page 122; *"As I understand the principle of all fiscal legislation it is this: If the person sought to be taxed comes within the letter of the law he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be. In other words, if there be admissible in any statute, what is called an equitable construction, certainly such a construction is not admissible in a taxing statute, where you can simply adhere to the words of the statute."*
78. Supra note 6.
79. Supra note 6, at 6269.
80. 79 DTC 5020.
81. However, as recently as last year, in a domestic case, the Federal Court, Trial Division, in *Harmon* v. *M.N.R.* 79 DTC 5037, chose, in the case of an ambiguous statutory provision, to rely on a strict rule of construction, namely, that an ambiguity in a taxing provision is to be construed against the tax collector.

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as well as domestic cases show a propensity to interpreting on a liberal or strict application of the words regardless of the apparent conflict with interpretations which would be derived from a balanced application of the overall body of interpretation suitable for double tax treaties.

3. Examples of strict interpretation

As noted in *Stickel*,[82] Article VIII A of the U.S.-Canada Treaty was at issue and the Supreme Court of Canada found that its terms clearly required only that the purpose and intention at the time of coming into Canada be to stay for only two years in a teaching capacity. Provided this requirement could be considered factually to have been met the professor was entitled to the exemption regardless of actual subsequent events and, as noted, regardless of other ancillary considerations such as taxation in the U.S.

The 1977 decision of the Tax Review Board in *Sydney S. Fletcher* v. *M.N.R.*[83] is a good, recent example of the strict interpretation in treaty manners. The startling aspect in this case is that the Canadian taxpayer was able to claim reduction of Canadian tax by invoking a provision of the U.K.-Canada Treaty (Article IX, dealing with dividends paid by a Canadian company) which one would have thought was available only for the benefit of residents of the U.K. The language of Article IX, literally construed, had direct application to the Canadian taxpayer but only, apparently, as an anomalous result.

For examples of strict interpretation in the U.K. see *Nothman* v. *Cooper*[84] and *Oppenheimer* v. *Cattermole*.[85]

In the United States the U.S. Supreme Court decision in *Maximov*[86] may also be considered to be of a restrictive type. In that case, a U.K. resident did not qualify for the exemption granted under the U.S.-U.K. Treaty with respect to capital gains derived in the U.S. by a U.K. resident for the reason that the interest of the U.K. resident was held in a trust, the trustees of which were resident in the U.S. with the capital gains being accumulated. The reasoning was that the scheme of the Internal Revenue Code was to treat a trust as a separate person and that the claim by the taxpayer was "too remote" and would require an unwarranted rewriting or refashioning of the provisions of the domestic U.S. law in order to grant the exemption. This would seem to sacrifice the objects of a tax treaty to formalities of domestic law construction.[87]

4. Examples of liberal interpretation

In contrast to these examples of strict interpretation is a recent decision of the Tax Treaty Board of Canada in *Appleby* v. *M.N.R.*[88] where the language of the U.K.-Canada Treaty was liberally stretched in order to grant relief against an apparant case of double tax as between the payer and the recipient of alimony payments.

Tara Exploration and Company Limited v. *M.N.R.*[89] and *Consolidated Premium Ores Ltd.*[90] are good examples of contextual-liberal interpretations in Canada and the U.S., respectively, in the case of the rather clear words of a treaty. In each case, the taxpayer corporation had maintained a relatively inactive, norminal office in another country, did not carry on any substantial business activities in or as a result of that office and was held not to have a permanent establishment, notwithstanding the plain words of the treaty involved. *Tara* involved the Canada-Ireland Treaty and *Consolidated Premium* the Canada-U.S. Income Tax Convention. In both cases the Courts decided that the intent clearly was to identify as "permanent establishments" places where real and continuous business activities were carried out. In *Tara* the Supreme Court of Canada stated:

> *"Although the respondent maintained a bank account in Toronto, most decisions with regard to the writing of cheques on this account emanated from the president of the respondent who was resident and domiciled in Ireland at all material times. An employee of the respondent's accountant in Toronto, in charge of accounts payable, had authority to co-sign cheques without obtaining approval from Ireland for routine administrative accounts. On such occasions, approval was obtained from the respondent's solicitor in Toronto, who in turn obtained the requisite approvals from Ireland. I doubt whether the office in Toronto was a "permanent establishment" within the definition of that term contained in the Treaty. It seems to have been little more than an office maintained to enable the respondent to comply with the requirements of the Corporations' Act."*[91]

In *Consolidated Premium* the Sixth Circuit Court approved the judgement of Judge Van Fossan of the Tax Court of the United States which included the following passage:

> *"Premium had no real office in the United States; no officers, directors or employees here; no bank account or books of account; no telephone listing; its name did not appear on any door or office; it had no employee or agent established here who had 'general authority to contract for the employer or principal', such authorization being one of the definitive tests of a 'permanent establishment' under the Treaty.*
>
> *The term 'permanent establishment' and the term 'engaged in trade or business' both imply a place for*

82. Supra notes 4 and 6.
83. 77 DTC 185.
84. (1975) 1 All E.R. 538.
85. 50 T.C. 159.
86. Supra note 46.
87. *Hunter Douglas Ltd.* v. *The Queen*, supra note 70, where a Canadian company which had moved its central management to the Netherlands was held to be exempt from Canadian withholding tax on dividend payments made by it to shareholders in various countries, pursuant to the specific language of Article IV(5), is another decision of the strict interpretation variety. Clearly, there can be some doubt as to whether such third country shareholders, in the circumstances of the case, were intended to benefit from the Netherlands-Canada Treaty.
88. 79 DTC 172.
89. 72 DTC 6288, supra note 69.
90. Supra note 55.
91. Supra note 69, at 6290.

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carrying on a trade or business in the United States. Although the two terms are not synonymous, both relate to the same concept and apply the same general conditions . . . . Respondent contends, in effect, that the procuring of a license from the State of Ohio and the printing of a letterhead with the same address as Otis and Company, coupled with certain isolated acts of Eaton and Aly, demonstrated that the petitioner had a 'permanent establishment' in the United States. The fact is that the petitioner made returns to the State of Ohio each year, stating that it had not done ultimately, surrendered the license. It is also clear that there was no agent or officer at such address authorized to do business for the petitioner: . . . the term 'permanent establishment' normally interpreted suggests something more substantial than a license, a letterhead and isolated activities. It implies the existence of an office, staffed and capable of carrying on the day to day business of a corporation and its use for such purpose or it suggests the existence of a plant or facilities equipped to carry on the ordinary routine of such business activity. The descriptive word 'permanent' in the characterization 'permanent establishment' is vital in analyzing the treaty provisions. It is the antithesis of temporary or tentative, it indicates permanence and stability."[92] [93]

There will be times where departures from strict interpretation are justified by the so called "golden rule of interpretation", comprising the concept that departure from literal interpretation is justified in circumstances where the results of the latter would be manifestly absurd and occasionally on the wider grounds of the "intention" of Parliament. (See for example, *Home Oil Company Ltd.* v. *M.N.R.*,[94] *Allied Farm Equipment Ltd.* v. *M.N.R.*[95] and *Sunbeam Corporation (Canada) Ltd.* v. *M.N.R.*[96]). There really is no basis to predict which of these obviously conflicting rules of interpretation will be invoked by the Canadian Courts, either in a domestic or treaty context — leaving the predictability of results highly uncertain.

D. THE QUEST FOR CLEAR TREATY PROVISIONS - AND SOME COMMENTS ON THE BUSINESS PROFIT EXEMPTION ARTICLE IN TREATIES

1. General considerations

The inherent difficulty in tax treaty interpretation was aptly expressed as follows by D.P. O'Connell:

"It is said that where a treaty clause is clear and unambiguous it is not required to be interpreted. However, it may be doubted if a clear and unambiguous cause has ever been divised."[97]

I think what he was saying is simply that no particular sentence or article in a tax treaty can alone import to the reader all that is required in determining whether or the manner in which it will apply to a particular transaction.[98] And I say this in really two respects. First, I have in mind the problem of categorization or qualifying of a transaction of the category two or three type I referred to above, that is, where all formal requirements of the particular treaty exemption sought have been complied with, but where the overall substance of the matter is that the taxpayer was not intended to benefit from the treaty, considered from an intuitive approach. Secondly, I have in mind the issues which will arise when due weight is given to each particular word of a seemingly straightforward provision. Consider, for example, Article 1 of the Canada-U.S. Convention which reads as follows.

"An enterprise of one of the contracting States is not subject to taxation by the other contracting State in respect of its industrial and commercial profits except in respect of such profits allocable in accordance with the Articles of this Convention to its permanent establishment in the latter State."

2. Problems of interpreting Article I of the U.S.-Canada Convention

Certainly the concept, purpose and generally intended operation of Article I are straightforward. However, just about each word gives rise to definitional problems which cause much uncertainty as to the overall applicability. We are all used to the question of when does a permanent establishment exist and the excellent judgments on that issue in cases such as *Consolidated Premium*[99] and *Tara*.[100]

92. Supra note 55, at 1161, 2.
93. A decision of the Lower Court of Amsterdam (No. 1106/76 M11) June 20, 1978, as reported in *International Tax Strategy 1979*, Bulletin No. 9, page 7 is a good example of a decision consistent with *Consolidated Premium* and *Tara*. The substance of the arrangement was an ongoing permanent representation and precense of a Swiss company in the Netherlands which was held to be a permanent establishment notwithstanding that the arrangement apparently skirted the strict language of the treaty. In other words, the real substance of the arrangements in relation to the basic purpose of the treaty provision prevailed.
94. 55 DTC 1148.
95. 73 DTC 5036.
96. 62 DTC 1390.
97. D.P. O'Connell, *International Law*, Second Edition (1970), page 253 as quoted in the *International Tax Treaties Service*, supra.
98. The problem is, of course, magnified when there is an apparent obscurity or conflict within the terms of the treaty. For example, it is understood that the Japanese are now considering the case of whether a German bank can charge a profit on financing its Japanese branch banking operation with the uncertainty stemming from the conflict between the applicable treaty provison based on Article 7, Paragraph 2, and Article 7, Paragraph 3, of the OECD Model. Paragraph 2 provides that the operations of a branch are to be accounted for on an arm's length basis, thereby imparting the notion of profit margins on intra-company transactions. On the other hand, Paragraph 3 suggests that deductions in computing the profit of a branch are restricted to an allocation of actual direct or indirect head office expenses. A similar type of dispute could arise under some of Canada's treaties aside from those under the OECD Model; consider for example, Article III of the Canada-U.S. Convention.
99. Supra note 55.
100. Supra note 46.

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(a) What are industrial and commercial profits?

The question of industrial and commercial profits brings into operation the restrictions inherent in Article II, [101] giving rise to conceptionally difficult questions of reconciling the resulting strict limitations of Article I with the overall substance of certain situations.

(i) *Bank loan interest*

For example, bank loan interest income earned in the other country is strictly speaking ruled out by the exclusion of the Article II type. Although we have seen no jurisprudence, to my knowledge, under the Canada-U.S. Convention with respect to a bank interest situation, the similar issues in cases like *Western Electric* [102] and *Canadian Pacific* [103] and the restrictive interpretation in the Australian bank loan interest case of *E.J. and A. Bank Ltd.* [104] does not augur well for how Canadian Courts, at least, would view such an issue.

In *Western Electric* [105] the U.S. taxpayer supplied know-how to a Canadian manufacturer and was denied the protection of Article I because the arrangement was excluded by Article II and instead governed by the royalty provisions of the Convention. The issues in *Western Electric* were twofold:

- Were payments made by Northern Electric Company Ltd. of Canada to Western Electric Company Inc. of the U.S. as fees for technical information (with the fees computed as a percentage of sales of Northern) to be included as "royalties" within the meaning of paragraph 6(a) of the Protocol?
  and
- If they were so included would the rule of Article II, that royalties are excluded from the exempt income contemplated by Article I (industrial and commercial profits), prevail so that withholding tax of 15 percent could arise under provisions of the treaty?

The findings with respect to the second issue are of particular interest for these purposes. It was held that since it could properly be said that the payments were "royalties", that the provisions of Article II were mandatory and, therefore, the payments could not qualify as industrial and commercial profits for the exemptive provisions of Article I. The question which arises is whether, in the context of the purposes and overall scheme of the treaty, Article I should in certain circumstances override the express provisions of Article II? Although the finding in relation to the facts in *Western Electric* [106] would appear to be within the spirit of the treaty (which was strictly applied), it is the absence of any examination of the interaction of Articles I and II which may be open to question.

The application of the decision in *Western Electric* [107] to the question of bank loan interest would, on the basis of the similar exclusion in Article II of "interest" as "industrial and commercial profits" (for the purpose of Article I), require a finding that a bank does not qualify for the exemption contemplated by Article I. Although, as noted, this issue has not come before either the U.S. or Canadian courts, it is the express position of the tax authorities in both countries.

However, where it was to the advantage of Revenue Canada, as in the case of *Canadian Pacific Ltd.*, [108] the converse was argued. That case involved a claim by Canadian Pacific for credit under section 126 of the Income Tax Act for taxes paid in the U.S. on rentals ("per diem") received on railway cars temporarily on U.S. rail tracks where the U.S. authorities had adopted the interpretation of Articles I and II in *Western Electric* [109] and had claimed and exacted a tax on that basis. The Canadian authorities sought to deny a credit on the basis that taxes should not have been paid in the U.S. because of Article I. The Federal Court found for Canadian Pacific (and this in accordance with the *Western Electric* interpretation) but primarily on the ground that, in the circumstances, consistency by the tax authorities on both sides would be more in keeping with the spirit of the treaty.[110]

The Court did in passing raise the possibility that a strict reading of Articles I and II could be derogated from if it could be shown that the activities of Canadian Pacific with respect to earning those rentals had been of an active nature; however, this point was not pursued by the Court but raised merely as a possibility. It would be interesting to see whether the comment by Walsh, J. at page 6135, that:

> *"While these receipts have certain aspects of both — industrial and commercial profits — as already stated, Canadian Pacific Ltd. did nothing to advance or promote this source of revenue which is the usual badge of a commercial or industrial enterprise"*

would serve as a basis for a claim by a bank, in the circumstances postulated for an Article I exemption.

It should be noted that in the Australian case of *E.S. and A. Bank Ltd.* [111] where there was a genuine ambiguity in that the expression "industrial and commercial profits" referred to activities of banking while the same term was defined not to include interest, the Australian Court held that the claimant bank did not qualify for exemption; if this approach were to be employed by the Canadian Court in respect to Articles I and II of the U.S.-Canada Treaty where the words are clear and, against the bank, strictly construed, then there would not be much hope for a departure from a literal construction. It is to be hoped that the courts would be more inclined to follow the opening provided

101. "(Rentals, royalties, interest, dividends, management charges and capital gains.) For the purpose of this Convention, the term 'industrial and commercial profits' shall not include income in the form of rentals and royalties, interest, dividends, management charges, or gains derived from the sale or exchange of capital assets.
Subject to the provisions of this Convention such items of income shall be taxed separately or together with industrial and commercial profits in accordance with the laws of the Contracting States."
102. Supra note 71.
103. Supra note 3.
104. 69 A.T.C. 4069.
105. Supra note 71.
106. Supra note 71.
107. Supra note 71.
108. Supra note 3.
109. Supra note 71.
110. Supra note 65.
111. Supra note 104.

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by Walsh, J. in *Canadian Pacific* [112] in resolving the issues. It should be noted that a viable solution to the problem arises under the provisions of the Model OECD treaty, which by virtue of the inter-connected wordings of Articles 7 and 11 should serve to eliminate the type of problem that now exists under treaties featuring the type of wording in Articles I and II of the Canada-U.S. Convention.

The somewhat arbitrary results which arise in these types of international transactions, turning on particular and perhaps unintended differences in wording in treaties, can be seen by comparing the decision in *E.S. and A. Bank* [113] to that of *Twentieth Century Banking Ltd.* [114] involving the same issue under the U.K.-Jersey tax treaty. Because in that treaty the term "industrial and commercial profits" was not restricted by the type of definition in Article II of the U.S.-Canada Treaty, the Court had little difficulty in concluding that interest earned in the context of an ongoing banking operation was clearly industrial and commercial profit and thereby eligible for the usual permanent establishment — industrial and commercial profit exemption.

The *Rhodesian case* [115] held similarly with respect to rentals received on moveable property being leased in the ordinary course of a leading business. There seems to be little conceptual difference between these conflicting cases, challenging the Courts to seek common determinations regardless of the differences in which similar treaty provisions are worded.

(ii) *Recent developments respecting loan guarantee fees*

In *Associates Corporation of North American* v. *Her Majesty The Queen*, [116] a case heard before the Federal Court, Trial Division in early 1980, Revenue Canada went so far as to contend that loan guarantee fees are not eligible for Article I on the basis that they are really part of interest for the purposes of Article II, notwithstanding:

(1) that only specific deeming provisions in the Canadian Income Tax Act (section 214(15)) provide for such an assimilation;
(2) that the terms of the U.S.-Canada Convention are not required to be interpreted by reference to the law of the country claiming tax; and
(3) the very real difference between the earning of interest and the nature of a guarantee fee.

The Federal Court decided for the taxpayer.

(b) Enterprise for the purpose of Article I

Article I can have other surprises for the unwary, as straightforward as it may seem on a quick reading. Last November the Federal Court of Canada upheld a decision of the Trial Division in the case of *Rutenberg* [117] where a U.S. individual was denied the protection of Article I in respect of certain land trading activities in Canada although not necessarily carried out through a permanent establishment. The grounds for disqualification were that Rutenberg's activities did not comprise an "enterprise of one of the contracting States" within the meaning thereof in the protocol. The protocol definitions were construed to require that not only must the business be carried on by a person resident of the United States but, in addition, the activities in some substantial part must be carried on in the United States (see the requirement of "American enterprise" within paragraph 3(d) for the purposes of being considered "an enterprise of one of the Contracting States" within the meaning of paragraph 3(c) of the Protocol).

I take no issue at all with the decision in *Rutenberg* [118] but, having regard to a contrary finding by the Federal Court, Trial Division in *Masri* [119] in similar circumstances, I merely wish to make the point that it is difficult to disagree with D.P. O'Connell that there are very few treaty provisions which can be applied without the possibility of interpretative controversy. [120]

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112. Supra note 3.
113. Supra note 104.
114. *International Tax Treaties Service*, p. 15 under the section on Article VII.
115. Supra note 64.
116. 80 DTC 6049.
117. Supra note 53.
118. Supra note 53.
119. 73 DTC 5367; see also *Abed* v. *M.N.R.* 78 DTC 6007. For a full discussion of these cases see Nathan Boidman, *The Concept of Real Estate Enterprise Under the U.S.-Canada Treaty: A Case Study*, Tax Management International, May 1978, 22.
120. The Canadian decision of *Number 473*, supra note 56, *Number 630*, supra note 58 and the U.S. decisions in *Johnston*, supra note 60, and *Donroy Ltd.*, supra note 59, are excellent examples of the uncertainties which can arise where a provision like Article I and related definitions suggest results on its plain words which are out of context with the domestic tax law which the treaty has been negotiated to modify. In each of these cases the taxpayer was a member of a partnership carrying on business in the other country and sought exemption from tax either in his own country or the country where the activities took place on the theory that the U.S.-Canada Convention establishes separate status for partnerships, thereby providing a shield for the partners against the domestic tax law otherwise applicable. In both the U.S. and Canada the tax treatment of partnerships is the same, with the activities and income of the partnership being effectively attributed to the partners who are then liable for tax on their distributive or proportionate share. The U.S. and Canadian courts in these cases had little difficulty in piercing the partnership veil sought to be created, rejecting the claim for Article I exemption which would have been clearly unwarranted in the circumstances — definitely good examples of contextual interpretations of treaty provisions, unfettered by the precise language employed in the treaty. For example, in *Number 630* a resident of the U.S., a partner in a Canadian partnership, had sought exemption from Canadian tax on the basis of Article I. The Tax Review Board stated:
"What he (the taxpayer) did submit, however, was that under the Convention, already referred to, a partnership was an 'enterprise', therefore, by virtue of the Convention alone, could be regarded as an entity separate and distinct from the various partners. This argument is interesting and ingenious, but I do not think it can prevail. . . . in my comprehension and the meaning of this paragraph, 'enterprise' refers primarily to the work, endeavour, contract and task undertaken by some entity rather than to the entity itself. True, the word 'enterprise' is used rather loosely, perhaps not always consistently in paragraph 3(f) for instance, but all in all I think it was intended to have the meaning I have indicated. Furthermore, I do not think that the Convention nor Protocol is to be interpreted as though in conflict with the basic law of either of the contracting States by which the Convention was ratified."
The case of *Number 630* (as well as that of *W.C. Johnston*

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E. THE INTERPRETATION OF A TREATY AS A CONTRACT; COMMENT RESPECTING UNILATERAL INTERPRETATION

I wish to conclude my remarks by dealing briefly with the question of interpreting a treaty as a statute as opposed to a contract or vice versa and I would like to look in particular at the very real difference between the Canadian and U.S. judicial approaches in respect of the effectiveness and relevancy of unilateral acts of interpretation or administration by the competent authorities of each country.

In Canada the judiciary jealously guards its right to interpret law and certainly in that context a tax treaty agreement is considered as much law as any other domestic tax statute. [121] For example, the Courts regularly dismiss out of hand any reference by a tax collector or taxpayer to Governmental interpretation of tax law in Interpretation Bulletins, Information Circulars or published tax rulings.[122]

Secondly, Canada, unlike the U.S., has only one type of regulation; in U.S. terms these would be called "legislative regulations". That is, the Government may make regulations where specifically authorized by statute and then within constraints of the principle that the regulation may not exceed the scope of the authority granted. The result of these particular features of our judicial and legislative system is that it is quite difficult for Revenue Canada or any administrative body to effectively change the provisions of Canada's tax treaties on a unilateral basis — which could be considered consonant with the requisites or principles of a contract.

On the other hand, it appears that the Treasury or the I.R.S. finds more sympethatic reception in the U.S. Courts for its interpretations of tax law generally including double tax agreements. For example, interpretative regulations (resting on the general authority granted by the Internal Revenue Code) are usually upheld on the grounds of presumptive validity unless the particular Court has sympathies to the contrary, in which case it might suddenly lose its presumptive validity. At one time there was a series of Treasury regulations made to assist in the interpretation or application of U.S. double tax treaties; such regulations are no longer issued. These regulations, even if outside the specific authority granted by the treaty, have frequently been accepted by U.S. Courts. For example, in *Jules Samann* v. *The Commisioner*, [123] a case involving the authority to be given a U.S. Treasury regulation respecting the Swiss-U.S. Treaty under the authority of Article 19 of the Treaty (whereby, "The two contracting States may prescribe regulations necessary to carry into effect the present Convention within the respective States"), the United States had made an interpretation of Article 8 which at the request of the Swiss Government had been submitted to Switzerland before being proclaimed in the U.S. As no objection was raised, it was thus considered by the Court that the Swiss Confederation had, at least tacitly, approved the regulation and acquiesced in it. The Court stated:

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and *Donroy)* confirm the rule that a permanent establishment of a partnership is attributed to a partner for the purposes of Article I:

"It appears to me that the four partners of which the appellant was one, had set up a head quarter, or whatever one may wish to term it, in Ontario, where the office premiums used by the partnership were to be found. I have the greatest difficulty in considering that office not to be the office of the appellant also and, in fact, cannot do so. It appears to me that the office premises of the partners collectively, were also the office premises of any one partner."

121. A tax treaty has no effect in Canada until it has been enacted by Parliament, in the same fashion as any other statute.

In both Canada and the U.K. there is strong jurisprudence tending to view a treaty as a statute at least in respect of the right of the Sovereign Parliament of a Contracting State to unilaterally change its terms. See, for example, The House of Lords decision in *I.R.C.* v. *Colloco* 39 TC 509 (HL) where Viscount Simonds stated at page 548:

". . . neither comity nor rule of international law can be invoked to prevent the Sovereign State from taking what steps it thinks fit to protect its own revenue laws . . . ."

Section 34(1) in the Interpretation Act RSC 1970, C.I-23, of Canada, provides that:

"Every Act shall be so construed so as to reserve to Parliament the power of repealing or amending it and of evoking, restricting or modifying any power, privilege or advantage thereby vested in or granted to any person."

Section 34(1) must be read having regard to the fundamental rule that a tax treaty in Canada does not have force of law unless enacted by statute: See *Attorney General for Canada* v. *Attorney General for Ontario* (1937) AC326, at page 346:

"Within the British Empire there is a well established rule that the making of a treaty is an executive act, while the performance of its obligations, if they entail alteration of the existing domestic law, requires legislative action. Unlike some other countries, the stipulations of a treaty duly ratified do not within the Empire, by virtue of the treaty alone, have the force of law. If the national executive, the Government of the day, decides to incur the obligations of a treaty which involves alteration of law they have to run the risk of obtaining the assent of Parliament to the necessary statute or statutes."

See also J.G. Castel, *International Law Chiefly As Interpreted And Applied In Canada, Toronto, Butterworths,* 1976, at page 938:

"There are two situations which require Parliament's intervention before an agreement can be ratified. First, when the agreement itself provides that it must be submitted to the legislative authority of each of the contracting powers. Secondly, when the provisions of the agreement run counter to the statutes of Canada and when its implementation within the country necessitates an amendment to our statutory laws. Only the Parliament of Canada can amend any statutes and bring them into harmony with provisions of the agreement involved."

Finally, in this respect it should be noted that a statute enacting a tax treaty generally has a conflict rule which provides that the provisions of the tax treaty will render inoperative any competing or conflicting domestic tax rule. However, such a constraint is itself the creature of Parliament and can be amended.

The U.S. situation is presumable the same. See, for example, the pending legislation respecting foreign investment in U.S. real estate which would nullify conflicting treaty provisions after a five-year renegotiation delay.

122. Such interpretation will be given no greater weight than other knowledgeable (but non-binding) commentary on the law; see *Harmon*, supra note 81, *B.C. Railway*, supra note 80, *Bruster* v. *The Queen*, 76 DTC 6046, *Stickel*, supra note 4 and *Canadian Pacific*, supra note 3. However, see the Supreme Court decision in *Harel* v. *Deputy Minister of Revenue of Quebec* 77 DTC 5438 where federal tax administrative practice was held to be persuasive in interpreting a provincial taxing statute.

123. 313 F. 2d 461; 36 T.C. 1011.

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"A regulation . . . is endowed with the presumption of validity . . . . No offense is done our understanding with the Swiss when, with their consent, we imbue the terms of the exemption with the meaning they import in the tax language of the U.S. . . . ."

See also *Maximov*, [124] *Lewenhaupt* v. *Commissioner* [125] and *Simenon* v. *Commissioner* [126] where the U.S. Court said:

"It is well settled that a regulation of long standing . . . promulgated by the Department charged with the enforcement of a statute, is entitled to great weight and will be followed unless unreasonable or inconsistent with the statute involved."

F. CONCLUDING COMMENT

If there is a message to be extracted from the foregoing and the other papers presented at this meeting, it is that there are sufficient problems in the tax treaty area to keep us coming to I.F.A. meetings for the foreseeable future.

124. Supra note 46.
125. 20 T.C. 151.
126. 44 T.C. 820.

Conference Diary

SEPTEMBER 1980

Business International Institute/Asia: Doing business in and with Thailand (Seminar) (including taxation), Bangkok (Thailand), September 1-2 (English).

International Tax Institute, Inc.: ITI Tax Seminar (including: How to maximize the foreign tax credit; intercompany pricing of sales to foreign subsidiaries; U.S. taxation of foreign nationals employed in the U.S.), Stamford (U.S.A.), September 9-10 (English).

Business International Institute/Asia: Doing business in and with Korea (Seminar) (including taxation), Seoul (Republic of Korea), September 15-16 (English).

IXth Luso-Hispano-Americanas Meeting of Tax Studies: Influence of taxation on the financing of enterprises; the family unit as taxable subject, Porto (Portugal), September 28-October 3 (Portuguese, Spanish).

34th Annual Congress of I.F.A.: I. The dialogue between the tax administration and taxpayer up to the filing of the tax return: II. The determination of the source of income. For the seminar the subject is the flight to tax havens, their use and abuse, Paris (France), September 14-19 (English, French German, Spanish).

OCTOBER 1980

Seminar Services International: The 4th Multi-Choice International Corporate Finance Conference (including: Tax aspects of international financing operations), London (United Kingdom), October 29-30 (English).

NOVEMBER 1980

Confédération Fiscale Européenne (C.F.E.): Second Congress of European Tax Consultants (subject: "La pratique de la Fiscalité en Europe"), Rome (Italy), November 6 and 7 (English, French, German).

Management Centre Europe: International Tax Management Seminar (Discussion of tax problems in today's multinational environment), Munich (German Federal Republic), November 10-11 (English).

Management Centre Europe: Managing and developing foreign subsidiaries (including: Tax in international operations), Munich (German Federal Republic), November 12-14 (English).

Management Centre Europe: Leasing Seminar (including: Tax aspects of leasing), Brussels (Belgium), November 26-28 (English).

DECEMBER 1980

Management Centre Europe: International cash management (including: International tax aspects in cash management), London (United Kingdom), December 8-10 (English).

APRIL 1981

Management Centre Europe: Fourth MCE International Tax Conference. Chairman: Prof. J. van Hoorn Jr., Co-Chairman: A.G. Davies C.B.E. Main subjects: Transfer pricing; Government and business views on tax avoidance; Taxation of international leasing; small meeting groups directed by members of the faculty, Munich (German Federal Republic), April 8-10 (English).

SEPTEMBER 1981

35th Annual Congress of I.F.A.: I. Mutual agreement procedure and practice; II. Unilateral measures to prevent double taxation, Berlin (German Federal Republic), September 21-25 (English, French, German, Spanish).

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International Fiscal Association (I.F.A.): General Secretariat, Woudenstein, Burgemeester Oudlaan 50, P.O. Box 1738, 3000 DR Rotterdam (the Netherlands).

International Tax Institute, Inc., 17 Danbury Road, Ridgefield, Connecticut 06877, U.S.A.

Management Centre Europe, Avenue des Arts 4, B-1040 Brussels (Belgium).

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TAX GLOSSARY

by H.W.T. PEPPER *

TAX BURDEN — The tax burden, or tax ratio, in a country is computed by taking the total tax payments for a particular fiscal year as a fraction or percentage of the G.N.P. or national income for that year.

TAX CLEARANCE CERTIFICATES — In some countries "tax clearance" certificates have to be obtained from the income tax department to indicate that the individual has no income tax arrears. The certificate must be shown to the Emigration or Customs authorities on leaving a country. Without it the individual may be prevented from leaving. In a few countries such a certificate has to be obtained for other purposes, e.g., as pre-requisite to tendering for a government contract, or obtaining a driving licence.

TAX COMPLIANCE — The term refers to the degree to which taxpayers respond to their statutory duty to declare their incomes and provide the information required for the calculation of their income tax, sales tax, etc., and pay on time the tax due from them.

TAX-COMPOUNDED — A system whereby Building Societies in Britain pay interest to their depositors in "tax-compounded" from is described under BUILDING SOCIETY ARRANGEMENT (q.v.). Interest and other income paid in this form do not normally involve the recipient in further tax liability (although in Britain the compounding relates only to the standard rate of income tax and the recipient incurs a liability to higher tax rates if his total income is above certain limits). The tax payable by the recipients as a body is accounted for by the body or organisation which pays out the income in tax-compounded form.

TAX CONSCIOUSNESS — The degree to which an individual is aware of his duties under taxing laws and/or of the amount of tax he eventually bears in one form or another. (See, by contrast, UNMERKLICHKEIT.)

TAX CREDITS — Where, under an income tax system, a taxpayer has borne tax by deduction or withholding on certain items of income which are included in his aggregate assessment, a credit may be due on such tax against the tax computed on the aggregated income. In the case of value added taxation, a credit may be due for tax charged to a trader by other traders from whom he has obtained his supplies. In a transition from one type of sales tax to another where old tax has been borne by goods in hand at the commencement of the new tax, a credit may be due, when computing the new tax on disposal of the stock in hand at its commencement. (See, however, BUFFER RULE.)

TAX DECLARATION — See DECLARATION, TAX.

TAX DEPOSIT ACCOUNT — An account held by a U.K. company to accumulate cash with which to pay MAINSTREAM CORPORATION TAX (q.v.). Interest is credited by the Inland Revenue Department, but where cash is withdrawn from the account for a purpose other than tax payment the rate of interest allowable is reduced.

TAX EFFICIENCY — There are often various different ways of undertaking commercial transactions and the tax treatment may vary according to the manner in which things are done.
For example, it may be a marginal decision whether or not to incorporate a small business, whether to rent premises and equipment or purchase them. A company has to decide what proportions of its working capital requirements should be in equity, fixed interest debentures, bank overdraft; etc.
Other factors are, of course, involved in making the decision but if other things are equal, the decision producing the most favourable tax position will be the most "tax-efficient" one.

TAX EQUALITY — See EQUITY, DOMESTIC TAX EQUALITY, and GRADUATION.

TAX EVASION — See EVASION.

TAX-EXCLUSIVE BASE — See TAX-INCLUSIVE BASE.

TAX-EXCLUSIVE PRICE — See TAX-INCLUSIVE PRICE.

TAX EXIT CERTIFICATE — See TAX CLEARANCE CERTIFICATE.

TAX "FARMING" — The system of appointing persons to collect a tax imposed by the monarch or the central government, often by the establishing of a series of quotas or sums required in total yield from different regions, the tax farmers being given discretion as to how they achieve the quota or target set. The system has many drawbacks, the chief among which is that tax farmers normally collect excessive amounts from those that they are able successfully to dun and retain an undue proportion of the gross yield. The system was used in Roman times, to some extent in medieval Britain, and in many other countries in other epochs, but is not nowadays regarded as an equitable method of tax administration.

TAX FINANCE — A term sometimes used to refer to the process by which provision is made by a business for payment of tax liabilities of which it must take account, e.g., in its balance sheet and in cash flow computations.

TAX FORMS — See FORMS, TAX.

TAX-FREE — The term "tax-free" is sometimes used, when strictly, the term "tax-exempt" should be applied, to mean that an item of income or a transaction is *exempt* from tax. The term is also used to mean that someone else is paying the tax and the recipient is thus "free" of any liability to *pay tax* although the tax is borne by him. See also TAX-FREE PAY.

TAX-FREE PAY — In the calculation of the amounts to be deducted or withheld by way of income tax on employees' remuneration under P.A.Y.E. schemes, it is usual to supply official tables which, under some systems, enable the tax to be ascertained at a glance after deducting from total pay the "tax-free" pay, i.e., the various deductions and personal reliefs to which the tax-payer is entitled for the

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period of the deduction. The tables apply the operative graduated rates to the (taxable) balance of the income.

TAX-FREE SHOPS — Shops which are usually situated within the boundaries of an airport or sea-port from which outgoing passengers may purchase goods which are free of sales taxes and other indirect taxation, since the purchases are clearly destined for export. In some countries *incoming* tourists may acquire a personal allocation of liquor or tobacco from duty-free shops before entering the Customs area of the country in which the airport is situated.

TAX-FREE ZONE — An area within the territory of a country may be designated a "tax-free zone" in which customs duties and other indirect taxation are not applied, partly because the area may be used in connection with entrepot trade or export industries based on imported raw materials where, if indirect taxation were applied, it would mostly have to be refunded. Sometimes income tax exemptions or abatements are also allowed in respect of profits from activities within the zones. Where goods pass from the zone into the remainder of the country the normal duties and taxes are usually applied. Examples of tax-or-duty-free zones include the Kaohsiung "export processing zone" in Taiwan, the Shannon airport zone in Eire, and designated areas in many of the world's large ports within which goods may be imported and re-exported without entering the general customs area of the country as a whole.

TAX FROM TAX — This term is sometimes applied to the "invoice system" of V.A.T., under which the trader who is liable to pay value added tax on his sales may deduct therefrom the tax charged to him by his suppliers. The term also applies in income tax systems where double tax relief in respect of tax paid in other countries on the income assessed in the taxing country takes the form of a deduction for the foreign tax against the local tax.

TAX HAVEN — A country with low tax rates on income (or no direct taxes at all). The term also includes countries with normal tax systems but whose income tax codes provide some "shelter" (see TAX SHELTER) or exemption for particular types of income which makes them attractive to non-residents. The relief from income tax is normally partly offset by sundry initial and annual registration fees which form an important source of revenue for the tax haven country.

Because of ever more tortuous and artificial devices being contrived by tax advisers to avoid taxation in countries with high tax levels, tax havens have tended to fall into disrepute. They are tending to seek respectability by exercising a little more control over the type of person operating therein and the nature of the business (including offshore banking) conducted. See also FINANCIAL CENTRE, OFFSHORE BANKS, COMPANIES, TRUSTS, SHIPPING CENTRE.

TAX HAVEN, ART — A tax measure, unique to the Republic of Ireland, exempts from income tax earnings from original and creative work, having cultural or artistic merit, by established writers, artists, etc. Introduced in 1969 to halt the "intellectual drain", or "brain drain" from Ireland, the exemption has attracted foreign writers, artists and others to set up residence in the country, which for other taxpayers has an orthodox fiscal system.

TAX HOLIDAY — A tax holiday is generally understood as the period of exemption from income tax for new industries, granted by certain countries, as a method of trying to develop or diversify their industries. The exemption is usually given for a term of years to "pioneer" or "infant" industries (see also PIONEER INDUSTRY). Countries which tax all income for income tax purposes in the year after it accrues, or is received, are sometimes said to operate a "one year tax holiday" system although, of course, the "holiday" merely defers the tax liability which deferral nevertheless provides a welcome benefit in cash flow terms.

TAX-INCLUSIVE BASE — Under a sales tax regime the tax may be calculated on the actual sale prices of goods and services. Since the entrepreneur has to charge prices to consumers which include the sales tax element, to charge tax on the total sales proceeds not only involves taxing the tax-exclusive prices of the goods but also the tax element in their prices, so that there is a levy of "tax on tax". The levy of sales tax on the tax-inclusive price is fairly normal for a retail tax (the State retail taxes in the U.S. are an exception, being charged on tax-exclusive prices), but with manufacturers' and wholesalers' taxes it is more usual to levy the tax on a price or value which excludes tax — this is the position, for example, with regard to the Canadian manufacturers' tax. As regards V.A.T., some systems tax the tax-inclusive price but the current trend is to charge the tax on the tax-exclusive price. At least in theory, application of sales taxes to the tax-exclusive price should be less likely to involve price ESCALATION (q.v.) or pyramiding since the price of the goods and the tax element are separately indentifiable. See also TAXABLE BASE.

TAX-INCLUSIVE PRICE — The price of goods or services which includes indirect taxation thereon. Where such tax is excluded from the price quoted, that price is said to be the tax-exclusive price (see also TAX-INCLUSIVE BASE).

TAX INVOICE — See INVOICE, STATUTORY.

TAX LAW — Apart from the statute by which a tax or duty is imposed, the law which is relevant to the incidence and computation of tax includes decisions of tax tribunals set up under the tax legislation, and also the decisions of the Courts where matters of interpretation, etc., have been taken for rulings. In addition, there may be statutory rules and orders made by the legislature in a manner less formal than the amendment or extension of the basic statute law. The incidence of the tax may be partly regulated also by double tax treaties with other countries. In addition, agreements, particularly between governments and concerns exploiting mineral or forests, or providing public utilities, such as cable, wireless and telephone services, the production of electricity, etc., are sometimes made which contain clauses governing the application of taxation to the entrepreneur, which may wholly or partially supersede some of the tax laws.

TAX-LOSS COMPANY — Where a company has been making losses in its trade which have not been allowed for income tax purposes, the losses may have attractions for another company which is in a position to take over the unsuccessful company because the former may be able to put the losing company on a profitable basis and thus obtain the benefit of the losses, which will reduce or eliminate the tax liability in the early years of profitability. Accordingly, a tax-loss company may have a value in respect of its accumulated losses which may even exceed the value of its more tangible assets. To prevent tax avoidance through "trafficking" in tax losses, the tax law will commonly have some provision that the losses cannot be allowed on a change of ownership

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unless the original business is continued in identifiable form.

TAX LOTTERY — See LOTTERIES for CONSUMERS.

TAX, MAXIMUM — See MAXIMUM TAX.

TAX, MINIMUM — See MINIMUM TAX, TAX PREFERENCES.

TAX NEUTRALITY — See NEUTRALITY.

TAX ON TAX — Tax may be levied on tax in an income tax context where an employer undertakes to pay an employee's remuneration "tax-free". The term usually means that the employer will be responsible for the tax in this instance and that the remuneration which the employee receives will represent his "take-home pay" as far as income tax is concerned. The employer then has to account for tax on a figure for gross remuneration which, after being subjected to income tax, would leave a net payment equal to the tax-free remuneration. To compute this gross figure, however, it is clearly not sufficient to calculate tax on the net remuneration and then add these two figures together, because the tax on a gross figure thus obtained would clearly be greater than the tax on the net remuneration. Accordingly, a GROSSING-UP (q.v.) operation is required in order to determine tax not only on the net remuneration but on the tax which the employer is to pay. As regards sales tax, "tax on tax" relates to the charging of tax on TAX-INCLUSIVE PRICES (q.v.).

TAX-OPTION CORPORATION — Under U.S. Internal Revenue legislation, a tax-option corporation is a corporation (company) which is entitled to opt for various forms of special tax treatment under Sub. Chapter 5 (Sections 1371-1377) of the Code. (See also SMALL BUSINESS CORPORATION.)

TAX PERFORMANCE — This term, which is equivalent to "tax burden" and "tax ratio", refers to the "performance" of the Government in mobilising a country's resources for defraying government expenditure by taxation and is usually expressed as a percentage which total tax receipts bear to G.N.P. or national income.

TAX PERIOD, STAGGERING OF — See PAYMENTS, SPREADING OF.

TAX PLANNING — The term may in some cases be merely a euphemism for tax avoidance, but may also be more than that. It is important for a business to take tax into account when making decisions on how it shall conduct its affairs, and hence that it should try to find the most tax-efficient way of doing things. See TAX EFFICIENCY.

TAX POINT — This term refers to the point or stage at which indirect taxes are levied; for example, in V.A.T. schemes the tax usually arises upon delivery of the goods or the issue of the invoice, whichever event is earlier. In the Brazilian V.A.T. scheme (I.C.M.), the tax is payable when goods are moved from the premises of the seller (see also TAXABLE EVENT).

TAX PREFERENCES — A term used in the U.S.A. in connection with MINIMUM TAX (q.v.) which is levied at the rate of 10 percent (previously 15 percent) on the amount by which the preferences exceed $30,000 plus the income tax for the year. "Preference" items in the case of a corporation include such things as:

(a) excess of accelerated depreciation over straight-line depreciation;

(b) excess of percentage depletion over adjusted cost basis depreciation.

There are broadly similar provisions in respect of tax preferences granted to individuals.

TAX, PREFERENTIAL STATUS OF DEBTS FOR — Because taxes are a debt to the State and thus, in a sense, to the general public, it is usual to provide in tax laws or commercial codes that debts for tax should take preference over other debts, for example, in a bankruptcy of an individual, or the winding up of a company, as well as in the administration of the estate of a deceased person.

TAX PUSH — One of the causes of monetary inflation is the increase of prices occasioned by an increase in the cost of factors of production, e.g., labour. Inflation cuased by increased wages and salaries is sometimes known as "Wage-push" inflation. Where the cause is increased taxation (especially indirect taxation on commodities and services) the term "tax push" inflation is used.

TAX RATES — The rate of tax is usually expressed either as a percentage, or in terms of currency, e.g., as so many pence in the pound, cents in the dollar, as far as taxes on capital and income are concerned. As regards indirect taxation, ad valorem duties and taxes are also usually charged at a percentage rate on the sale of goods and services. Graduated rates are commonly applied where the capital or income of individuals in being taxed, and flat rates are used in applying indirect taxes. (See also CORPORATION TAX, GRADUATION, SCHEDULAR TAXES, and, by contrast, SPECIFIC DUTIES.)

TAX RATIO — The ratio which the total tax yield of a country bears to G.N.P. or national income. (See also TAX BURDEN.)

TAX, REGULATOR — See REGULATOR, TAX.

TAX RESERVE CERTIFICATES — Certificates which were formerly on sale in the U.K. as a means of prepaying income tax, etc. The certificates bore tax-free interest and could be bought in advance of the due date of taxes and then presented in payment therefor. See, also, TAX DEPOSIT ACCOUNTS.

TAX, RESOURCE — See RESOURCE TAX.

TAX SECURITY — See SECURITY FOR TAX.

TAX SHADOWING — The term applied to the process of the "matching", by one country the tax imposed in another country, on income which is taxable in both, so as to avoid the frustration of double taxation relief which could arise where income is computed on different bases by the two countries concerned. The term also covers the TAX-SPARING PRINCIPLE (q.v.) whereby one country gives relief for PHANTOM TAX (q.v.) resulting from tax holiday legislation in the other.

TAX SHELTER — The term is used in the U.S.A. to mean tax relief or exemptions generally, and includes items such as oil depletion allowances, the exemption from tax of the interest on certain municipal bonds, relief for large charitable donations.

TAX SHIFTING — See SHIFTING OF TAXES.

[to be continued]

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Zambia: Tax Changes in the Budget for 1980

by A.B.C. Emmanuel

As far as Income Tax is concerned the 1980 Budget brought no significant changes except for two concessions in regard to capital allowances. The Minister of Finance had promised to make some changes to some of the taxes imposed in the 1979 Budget and these have now been implemented by the Income Tax Admendment Act No. 6 of 1980.

Rates of tax

(a) The rates of tax on individuals and companies remain the same.
(b) The rates of tax for withholding taxes also remain the same.

The changes

1. Capital allowances

(a) The limitation of the allowable cost of vehicles for capital allowances purposes to K 4,000 has now been increased to K 6,000.
(b) The ceiling allowed for the purpose of capital allowance on low cost housing has been raised from K 4,000 to K 8,000.

2. Donations

Section 41 of the Income Tax Act has been amended to include donations to "funds of a public character wholly and inclusively established for the use of the Republic".

Donations to the Bridges Reconstruction Fund would come into this category.

3. Undistributed profits tax

Under the provisions of Section 95(1) of the Income Tax Act 1966 (as amended) the Commissioner of Taxes had the power to treat a company's profits or a proportion thereof as distributed to its shareholders. This deeming was applicable to certain classes of companies and it was left to the discretion of the Commissioner to deem the amount of the distribution without causing detriment to the company's business.

In the 1979 Budget this section was repealed and replaced by a new Section 95. Under this regulation the Commissioner would not deem a distribution but would charge a tax of 35 percent on the undistributed profits of a company in addition to the corporate tax of 48 percent.

This tax would be charged on all companies except those which are controlled directly or indirectly by:

(a) the Government, i.e. mostly companies controlled by ZIMCO Ltd.;
(b) quoted companies, i.e. companies whose ordinary share capital may be bought or sold on a stock exchange market.

The Commissioner then imposes the tax using a formula to decide the quantum of the undistributed profits. The formula is A — (B + C + D) in which:

A = the amount of the profits
B = (i) 30% of the *industrial profits*
(ii) 20% of the *trading profits*
(iii) 10% of *rent* or *income in respect of professional services*
C = the amount of tax charged for the year
D = the amount distributed as dividends within the "specified period"

"Industrial profits", "trading profits", "specified period", "profits" have all been defined for the purposes of this section.

This regulation did not come into force due to criticisms made by various bodies on the grounds chiefly that:

(a) the section has been badly drafted; some of the definitions were very vague and left the taxpayer in a state of uncertainty as to what was to be included or excluded in the calculation of the undistributed profits;
(b) the formula was too rigid and left no room for expansion and reinvestment, and did not consider the liquidity position of the companies;
(c) the Commissioner has been given too much discretion and wide powers and the concept of detriment was no longer applicable now, unlike in the previous section.

The International Bureau of Fiscal Documentation is pleased to publish an article on the Zambian Budget for 1980 by its correspondent for Zambia, Mr. A.B.C. Emmanuel.

Mr. Emmanuel, who is currently Tax Manager of Price Waterhouse & Co. in Lusaka (Zambia), graduated in 1945 from the University of Ceylon where he received his B.A. (Hons) Econ. In 1946 he joined the Income Tax Department (now Inland Revenue Department) of Sri Lanka where, after a scholarship in 1961 to the United Kingdom to study taxation at Somerset House, he was in 1963 promoted to Assistant Commissioner. In 1973 he joined the Department of Taxes of Zambia where he was in charge of the Withholding Tax District through 1978. In 1979 he joined Price Waterhouse & Co.

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The Minister did not do away with this regulation but in his 1980 budget speech promised to bring about changes that would make it more flexible and allow for more expansion in business, keeping in mind reinvestments, reasonable reserve levels and other safeguards for the business.

The Minister's proposals have now been put into effect by the Income Tax Amendment Act No. 6 of 1980. Sec. 95 states "Sec. 95 of the Principal Act is amended by the deletion of subsections (1), (2) and (3) and the substitute thereof of the following subsections:

"(1) For the purposes of this section:
'taxed profits' means the balance of a company's trading and profit and loss accounts after any adjustments thereto as determined by the Commissioner and after subtraction therefrom of the tax charged under the other provisions of this Act;
'Undistributed profits' means such part of the taxed profits of a company as remains undistributed as dividends after nine months starting from the end of the charge year or, as the case may be, from the end of the period for which the accounts prepared by such company are accepted by the Commissioner in accordance with the provisions of Section 62.

(2) Subject to the provisions of subsection (3) a company shall be charged additional tax at the rate of 35 percent of the amount of its undistributed profits.

(3) In determining the amount of undistributed profits of a company for the purposes of this section, the Commissioner may take into account such of the company's expansion or other needs as, to his satisfaction, are normal business practice and reasonable in the particular circumstances."

This new amendment does not clear the debts and uncertainties that arose in the 1979 amendment. The number of definitions has of course been reduced but the two new ones still leave the taxpayer in a state of uncertainty. Besides, there is now no formula for the Commissioner to determine the quantum of the undistributed profits and it is left to the discretion of the Commissioner who is given wide powers. The successful implementation of this new regulation will depend on the good intentions of the officials of the Department of Taxes, because in trying to find out what are "taxed profits" one has to see what the "adjustments" are which the Commissioner would make and in quantifying the amount of "undistributed profits" one has to see that the Commissioner in his *discretion* takes into account "such of the company's expansion or other needs as, to his satisfaction, are normal business practice and reasonable in the particular circumstances".

The Commissioner of Taxes has fortunately now issued a *Practice Note* laying down the Department's interpretation of this Section and also outlining the Department's practice in relation to this Section. The Department "recognises that the paramount considerations in determining distribution of profits as dividends, that might be made by companies, is the financial requirements of the business." But it is also aware that there are some companies which do not plough back some of their profits into the business for expansion purposes, nor distribute them adequately to their shareholders. This new regulation will therefore be used by the Commissioner, in his discretion, as a regulatory measure keeping in mind the welfare growth and expansion of the business.

In arriving at the "taxed profits" the Commissioner of Taxes would make the "adjustments" that are normally made for income tax purposes under the Income Tax Act 1966 (as amended). As a preliminary basis the Department will consider using the following formula to determine the amount of undistributed profits.

Profits as per accounts			A
Add Disallowable items such as Depreciation of capital expenditure and expenditure specifically prohibited as deductions			B
			C
Deduct			
Capital allowances and items specifically allowable	D		
Tax charged	E		
Dividend declared	F		G
Undistributed Profit			H

However the amount at H may be further reduced, completely or partially, provided the taxpayer can submit a detailed expansion or reinvestment plan supported by documentary evidence as acceptable to the Commissioner. To help the taxpayer who may be liable to this tax, the following "allowances" on their own *or in conjunction* with detailed expansion and reinvestment requirements, as mentioned above, may be used to reduce the amount arrived at as "H". These are:

(a) in the case of *industrial profits*, the maximum amount of the allowance may be equal to 30 percent of such net profits;
(b) in the case of *trading profits*, the maximum amount of the allowances may be equal to 20 percent of such profits;
(c) in the case of profits falling in neither of the abovementioned two categories, the maximum aount of the allowance may be equal to 10 percent of such net profits.

For the purposes of calculating these "allowances" the Department has decided that *industrial profits* "would include so much of the profits of a company adjusted for income tax purposes as is attributed to:

(i) the construction of buildings, plant and machinery, roads, bridges, water conservation or other operations deemed by the Commissioner to be of a like nature; or
(ii) farming; or
(iii) mining; or
(iv) manufacturing; or
(v) the carriage of passengers or goods; or
(vi) hotel keeping; and the

Trading profits would include so much of the profits of a company as adjusted for income tax purposes as are not attributed to:

(i) industrial profits; or

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SUMMARY OF SOME IMPORTANT TAX RATES

Income tax on companies	48 percent
Income tax on individuals:	
First K 1,000	5 percent
Next K 1,000	10 percent
Next K 2,000	20 percent
Next K 2,000	30 percent
Next K 2,000	45 percent
Next K 2,000	55 percent
Next K 2,000	65 percent
Balance	70 percent
Withholding taxes on payments to non-residents:	
– dividends	20 percent
– interest	30 percent
– royalties	30 percent
– public entertainment fees	30 percent
– management and consultancy fees	30 percent
– real property rentals	30 percent
– payments to contractors for construction or haulage operations (transportation of persons or merchandise)	25 percent

See for a comprehensive description of the Zambian tax system our publication: *African Tax Systems/Systèmes fiscaux africains.*

(ii) rents; or
(iii) professional services.

Once the amount of undistributed profits has been determined by the Commissioner, he would then issue an assessment in the form of a directive stating the amount of the undistributed profits and the tax thereon. The provisions in Part viii and xi of the Income Tax Act 1966 (as amended) relating to collections, recovery of refunds, objections and appeals will apply to all such directions.

The Commissioner has also decided that where the *pre-tax* adjusted profits of a company are K 3,000 or less, an Undistributed Profits Tax assessment would not be made. This decision, purely for administrative reasons, is to relieve the department of spending time on small cases.

It should be noted that most of the concessions given in the Commissioner's Practice Note were in fact part of the law in the 1979 budget. These open the door for negotiations with the Commissioner since each company now has to put up its case for expansion and reinvestment in order to avoid the necessity of paying this tax. But before putting its case, in arriving at 'H' the Commissioner states that "expenditure" specifically prohibited will be added back and only items specifically allowable would be deducted. "Expenditure incurred in the production of income" is allowed for tax purposes under Sec. 29, but then what of losses which are dealt with in Section 30 of the Income Tax Act? It would appear unfair for a company which has large carry forward losses, but a profit in a particular year, to be liable to U.P.T. Many companies have repayments of outstanding loans which tend to eat into their liquidity position. Such repayments are not "allowable expenditure" in computing profits. It is hoped that the Commissioner of Taxes will consider these when looking into the detailed expansion and reinvestment plan and granting the "allowances" to each company.

Another fear is whether the Department is sufficiently equipped and geared to deal with each case without causing hardships and delay in determining each case. With so much "discretion" being given to the tax officials it is hoped that they will consider the welfare of the company and use this provision as a regulatory measure rather then a penal one.

Job credits

This concession which was introduced but not put into effect in 1979 has now been changed by the Income Tax Amendment Act No. 6 of 1980. The former Sec. 90 A has been repealed and replaced by the new one which states that the Minister "may by a statutory order provide for the granting of job credits in such amounts, for such periods and for such employees of such business as may be prescribed therein."

We now await the publishing of the statutory order.

Industrial Development Act

Frequent reference has been made in recent months by the Minister of Finance to the Industrial Development Act. This Act was passed in 1977 to supersede the Pioneer Industries (Relief from Income Tax) Act 1965. The purpose of the Pioneer Industries Act was to encourage the establishment of new industries, to strengthen and diversify the economy of the country, provide additional avenues of employment of labour and act as an incentive for the investment of capital.

The nature of the incentive was relief from income tax for a period of two to five years depending on the amount of capital put into the new project. It is important to note that the relief was limited to new industries or to those which are not being carried on at present on substantial commercial fashion.

The new Industrial Development Act was intended to go further than the Pioneer Act. The Act was to "provide for the licencing and control of manufacturing enterprises to provide incentives for investment, to regulate the making of contracts relating to the transfer of foreign technology and expertise to enterprises operating in Zambia and to provide for matters connected with or incidental to the foregoing".

Although it was passed in 1977 it has not proved helpful to industry and investment. The Minister has therefore agreed to pass regulations which will provide clear guide-

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lines for investors and also provide fuller details of the incentives that are available to them.

The Industrial Development Act does not specify any period for or time limit to the reliefs but states that "relief from Income Tax, Sales Tax, S.E.T. for *such period, and in such manner* as the Minister responsible for the administrative thereof may prescribe". Similarly for customs duties, tariffs, import licences, rebates, etc., all such reliefs depend on the Minister responsible provided certain stipulated conditions are fulfilled.

It is now hoped that regulations will be passed specifying the actual working of the reliefs and the conditions to be fulfilled.

These regulations, it is hoped, will provide clear guidelines for investors and with the added incentives offered by the job credits facility, the Minister of Finance hopes that the business community would help in expanding the economy of the country.

SERVE THE LORD AND SAVE TAXES -- THE ULTIMATE TAX H(E)AVEN

(from our ecclesiastical correspondent)

A few months ago, the Financial Times reported that the export of Bibles from Britain had suffered a serious cut. U.K. publishers may well find an enlarged market in the United States if a new project develops well.

Religion has always been considered a serious matter in that country. As was, not so very long ago, taxation. It was, until recently, only the Bible where the relationship between religion and taxes was set out (e.g. "Render unto Caesar what is Caesar's etc."). This relationship has now received a new momentum as a result of the activities of a new profession: tax advising ministers. The following is an extract from an advertisement which appeared in the December 1979 issue of SIE — Sophisticated Investor, page 118, and of an article in the Western Law Journal, January/February 1980, page 1.

Assembly of Hope

This organisation, appropriately located at One Chapel *Road, Helmetta, N.J. makes an offer to the reader — at a* very *low cost — to become a Minister ($10) and/or to start one's own Church (also $10). The advantages are not small. Not only can one conduct "Holy Rites, Sacraments and Rituals. . . Advise, Treat, Inspire, Marry, Bury. . . Exorcise, Pardon, Bless. . .", BUT one benefits from tax exemption on a large scale. The advertisement gives a detailed example which we shall not reproduce here. It ends with the slogan* Become a Minister and start your own Church now! *The lower part of this full page ad. is a registration form to apply for one's "own personal ID card that will command instant recognition and respect for your new responsibilities".*

Universal Life Church, Inc.

This competing organisation is located at Modesto, *California. Mr. Steve Goolian, a journalist, reports on it under the title:* How do you spell tax relief? — C-H-U-R-C-H. *One can, also for not more than $20, become a minister of this church provided that one "follows the church's only tenet: Do that which is right". Apparently, the promoters of this tax avoidance scheme think that it is right to set up a mail order system to sell their ministries for the purpose of avoiding tax. As one of the promoters according to Mr. Goolian has said — "a large market probably existed for such church-financial planning". Together with a friend he established his own "Church of Universal Harmony" which belongs to the Universal Life Church. They claim to have ordained "more than seven million" (!) ministers into the church.*

This seems a good business at $20 each. No wonder the Internal Revenue Service are trying to stop this, unsuccessfully as they lost a case in 1973. "The IRS never appealed and refuses to say why", writes Mr. Goolian.

Indeed, there seems to be great reluctance to interpret such sections of the Internal Revenue Code as 107, 170 and 501 in a sense which would sustain their original spirit without introducing a new spiritual aspect. One may well wonder why other tax avoidance schemes are more easily contested (or, even, recognized as such) and whether in other countries tax (avoidance) and religious ideas would be so generously treated.

Over the years there have been serious discussions and fierce debates between priests on the question of whether it is ethical or moral to dodge taxes which are imposed on the basis of regular laws. As far as we know, the arguments used never included profit-making mail order schemes. In Mr. Goolian's article, the United States Commissioner of the Internal Revenue Service, Mr. Jerome Kurtz, is quoted as having said: "Those interested in protecting the preferences for churches must agree that the IRS has an obligation to be vigorous in stopping such schemes. The protection of church preferences requires that such preferences not be distorted". There will be few besides the promoters of new "ministers" and "churches", be they tax collectors or taxpayers, who will not wholeheartedly agree. On the other hand, one wonders whether all this is not a "mene tekel" in a world where more and more people are trying to get out of the increasing burden of taxes and other public charges. The many ways in which they do so show that they become desperate to a degree which is frightening. With regard to this "ultimate (tax) h(e)aven" the sky seems to be the limit. . .

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Développements Fiscaux en Afrique

Activités de la Commission Economique des Nations Unies pour l'Afrique

Tax Developments in Africa

Activities of the U.N. Economic Commission for Africa

J. van Hoorn Jr.

La Commission Economique des Nations Unies pour l'Afrique (C.E.A.) dont le siège se trouve à Addis Abéba avait déjà, en 1965, organisé une conférence fiscale à laquelle participaient des personnalités de haut rang appartenant à un grand nombre de pays africains. La réunion était bilingue (anglais et français) offrant ainsi, pour la première fois, la possibilité aux responsables fiscaux, anglophones ou francophones, de se rencontrer et d'être confrontés aux autres systèmes fiscaux et politiques de développement économique. La préoccupation principale de la conférence concernait la politique et l'administration fiscales. Des rapports nationaux servaient de base à la discussion.

As early as 1965 the United Nations Economic Comission for Africa (E.C.A.), with headquarters in Addis Ababa, convened a tax conference in which top-ranking officials from a large group of African countries participated. The meeting was bilingual (English and French) and thus offered for the first time the possibility to English and French speaking tax officials of meeting each other and becoming acquainted with each other's tax systems and policies for economic development. The main emphasis was on tax policy and tax administration. Country reports served as a basis for discussion.

Il est apparu au cours de cette réunion que l'on connaissait très peu des systèmes fiscaux nationaux des autres pays d'Afrique et que ce manque de connaissance et d'information n'était pas dû, du moins essentiellement, à une barrière linguistique. Il était intéressant de noter avec combien d'attention les participants écoutaient et discutaient les expériences de leurs collègues. Il n'est donc pas surprenant qu'il y ait eu un sentiment unanime en faveur d'une propagation d'informations concernant les développements fiscaux en Afrique.

During the meeting it became apparent that little was known about national tax systems in other African countries and that this lack of knowledge and information was not, at least, not primarily, due to language barriers. It was interesting to note with how much attention the participants listened to and discussed the experiences of their colleagues. It is not surprising, therefore, that there was a unanimous feeling that more should be done to disseminate information concerning tax developments throughout Africa.

La première conséquence de la conférence a été la demande, par la C.E.A., au Bureau International de Documentation Fiscale de rassembler une documentation complète sur la législation fiscale des pays d'Afrique. Le résultat a non seulement été la réunion unique, dans la bibliothèque, de matériaux classés systématiquement sur la quasi totalité de cet immense continent africain mais aussi la publication, par le Bureau, d'un ouvrage sur feuilles mobiles intitulé *Systèmes Fiscaux Africains*, accompagné de son édition parallèle en anglais: *African Tax Systems*; ces deux ouvrages étant régulièrement mis à jour. Ces ouvrages servent de base à une coopération plus profonde dans le contexte africain.

The first action undertaken by E.C.A. was to request the International Bureau of Fiscal Documentation to prepare a comprehensive documentation on the tax legislation of African countries. The result has been, not only that the Bureau's library contains a unique set of systematically arranged materials on practically every country in the huge African continent, but also that the Bureau published a large loose-leaf work under the title *African Tax Systems* with a parallel edition in French: *Systèmes Fiscaux Africains*, regularly updated. This work serves as the foundation for further cooperation within the African context.

Au cours de la décade suivante, la C.E.A. a organisé d'autres conférences importantes ainsi qu'un grand nombre de cours et groupes de travail, certains couvrant une région ou une sub-région. L'un des résultats de ces activités a été la formulation d'un certain nombre de principes et d'obstacles liés à la participation sans cesse grandissante de l'Afrique dans l'économie mondiale. Ceci a même conduit à un projet non-officiel d'une convention multilatérale tendant à éviter les doubles impositions accompagnée de notes explicatives se rapportant aux différentes dispositions.

In the following decade or so, E.C.A. organised other large conferences as well as numerous training courses and workshops, some of which covered a region or a sub-region. One of the results of these activities has been the formulation of a number of principles for, and pitfalls in connection with, Africa's increasing participation in the world economy. This even led to an unofficial draft for a multilateral tax treaty together with explanatory notes to the various provisions of it.

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LES ACTIVITES CONSULTATIVES ET DE RECHERCHE DE LA C.E.A.

Pendant de nombreuses années la C.E.A. a aidé des pays membres sous la forme d'envoi de missions consultatives et de conduite de groupes de travail locaux dans des domaines tels que *la politique, la législation et l'administration fiscales* aussi bien que celui de *la gestion budgétaire et financière* — tout ceci étant réalisé à la demande des états intéressés.

Les membres de la C.E.A. ont en outre effectué des études et rapports divers. Les études traitant de *l'utilisation des techniques d'imposition forfaitaire dans le régime fiscal des petits commerçants et des professionnels en Afrique* ainsi que *le contrôle des dépenses publiques* ont été entreprises récemment; les deux sujets présentent un intérêt tout particulier pour les pays en voie de développement.

La C.E.A. se penche spécialement sur le manque de possibilités de formation professionnelle et de recherche en Afrique. Actuellement, un projet sur la création et le développement de centres régionaux pour la formation professionnelle et la recherche en matière fiscale est en progrès. Ce projet est à mettre en parallèle avec des idées similaires qui ont cours dans d'autres parties du tiers-monde et surtout dans l'Asie du Sud-Est. Bien que l'assistance d'experts étrangers soit vraisemblablement nécessaire, du moins dans un premier stade, il est important de constater que des initiatives ont été prises dans des régions où les pays en voie de développement sont majoritaires et que le travail est tout d'abord entrepris par des experts locaux connaissant mieux que personne quels sont les problèmes posés dans des pays en voie de développement ayant une base culturelle souvent très particulière.

L'un des plus récents groupes de travail, traitant de la politique, législation et administration fiscales, a eu lieu en Eté 1979. A cette occasion les premières mesures ont été prises pour achever la création d'une association d'administrateurs fiscaux africains.

L'ASSOCIATION D'ADMINISTRATEURS FISCAUX AFRICAINS

La réunion d'Addis Abéba a été suivie de celle de Février 1980 qui s'est tenue à Monrovia. La réunion inaugurale de l'A.A.F.A. a eu lieu dans cette ville en la présence du Ministre des Finances libérien, Son Excellence, l'Honorable Ellen Johnson-Sirleaf, et présidé par M. Philip T. Bowen, Secrétaire d'Etat pour les recettes du Libéria.

La Constitution de l'Association a été adoptée au cours de cette réunion; il a également été décidé que des comités sub-régionaux seraient établis comme suit:

Afrique du Nord: Algérie, Egypte, Jamahiriya Arabe Lybienne, Maroc, Soudan, Tunisie.

Afrique de l'Ouest: Bénin, Côte d'Ivoire, Gambie, Ghana, Guinée, Guinée-Bissau, Haute Volta, Libéria, Mali, Mauritanie,

E.C.A.'S ADVISORY AND RESEARCH ACTIVITIES

For may years E.C.A. has been busy assisting member countries in the form of sending advisory missions and conducting local training workshops on such areas as *Tax Policy, Legislation and Administration* as well as on *Budgetary and Financial Management.* All this was done at the request of the countries involved.

In addition, E.C.A.'s staff carried on various studies and surveys. Recently, a start was made with studies on *Use of Presumptive Tax Assessment Techniques in Taxation of Small Traders and Professionals in Africa* and on *Expenditure Control,* both subjects which are of particular interest to developing countries.

E.C.A. is especially concerned about lack of training and research possibilities in Africa. Currently, a project on the creation and development of regional centres for tax training and research is in progress. This project runs parallel to similar ideas in other parts of the "Third World", above all, in South East Asia. Though assistance of outside experts is likely to be required, at least in the first stage, it is significant that initiatives are being taken within the regions where developing countries are in the majority and the work is to be primarily undertaken by indigenous experts who know better than anyone else what the problems in developing countries, with their often very special cultural background, are.

One of the most recent workshops, dealing with tax policy, legislation and administration, was conducted in the Summer of 1979. On that occasion, the first steps were taken to achieve the creation of an association of African tax administrators.

ASSOCIATION OF AFRICAN TAX ADMINISTRATORS

The Addis Ababa meeting was followed up in Monrovia in February 1980. In this city the inaugural meeting of the A.A.T.A. took place in the presence of the Liberian Minister of Finance, Her Excellency, the Honourable Ellen Johnson-Sirleaf, and chaired by Mr. Philip T. Bowen, Deputy Minister for Revenues of Liberia.

During the meeting the Constitution of the Association was adopted. It was also decided that sub-regional committees be established as follows:

North Africa: Algeria, Egypt, Libyan Arab Jamahiriya, Morocco, Sudan, Tunisia.

West Africa: Benin, The Gambia, Ghana, Guinea, Guinea Bissau, Ivory Coast, Liberia, Mali, Mauritania, Niger, Nigeria, Senegal, Sier-

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Niger, Nigéria, Sénégal, Sierra Léone, Togo.

Afrique du Centre: Angola, Cameroun, République Centrafricaine, Congo, Guinée Equatoriale, Gabon, Tchad, Zaïre.

Afrique de l'Est: Botswana, Comores, Djibouti, Ethiopie, Kenya, Lesotho, Madagascar, Malawi, Ile Maurice, Mozambique, Ouganda, Seychelles, Somalie, Swaziland, République Unie de Tanzanie, Zambie.

Il faut remarquer que la compisition de ces comités est fondée sur la situation géographique des pays et non pas linguistique.

Un Comité Exécutif provisoire a été nommé et comprend six membres, y compris les représentants des comités sub-régionaux. Le Président de l'Association est M. Bowen, son Vice-président M. Soulémane Abdoulaye, Directeur Général des Impôts au Togo.

Les membres de l'Association sont les pays membres de la Commission Economique des Nations Unies pour l'Afrique (C.E.A.) et de l'Organisation de l'Unité Africaine (O.U.A.). Chaque membre a droit à un vote mais est représenté par 2 personnes désignées par le Ministre des Finances. L'Association sera financée par les contributions des pays membres en fonction de leur capacité économique avec un minimum de 0,5 pour cent et un maximum de 10 pour cent; il a été décidé d'adopter l'index de l'O.U.A. à cet effet.

PROGRAMME DE L'ASSOCIATION

Les sujets suivants ont été retenus pour être étudiés à la réunion de l'Assemblée Générale qui aura lieu en Février 1982:

- Evasion et fraude fiscale
- Information sur la conscience fiscale
- Fiscalité et développement
- Techniques de législation fiscale
- Amélioration et consolidation de l'organisation et gestion fiscales.

On s'est par ailleurs mis d'accord sur le fait que les comités sub-régionaux établiraient leur propre programme et que chaque comité organiserait au moins un cours de formation professionnelle ou un séminaire en 1981.

L'Assemblée Générale [1] a accepté de demander à la C.E.A. de préparer à la demande de l'Association une liste des experts fiscaux africains. L'Assemblée Générale a également demandé à l'E.C.A. "d'écrire aux pays membres pour que ceux-ci soumettent régulièrement des copies de leurs codes fiscaux au Bureau International de Documentation Fiscale à Amsterdam". [2]

1. D'après l'article 20 de la constitution, ce document entrera en vigueur dès que 10 pays auront accepté d'être membre et signé la constitution. Ceci ayant été le cas, l'Assemblée Générale de l'Association a été déclarée établie.
2. Rapport de la Réunion Inaugurale de l'Association des Administrateurs Fiscaux Africains et d'un Groupe de travail sur la politique, la législation et l'administration fiscales, Monrovia 11-19 Février 1980, Para. 26, p. 8.

ra Leone, Togo, Upper Volta.

Central Africa: Angola, Cameroon, Rep. of Central Africa, Congo, Equatorial Guinea, Gabon, Chad, Zaire.

East Africa: Botswana, Comoros, Djibouti, Ethiopia, Kenya, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Seychelles, Somalia, Swaziland, Tanzania United Republic, Uganda, Zambia.

It is worth noting that the composition of these committees is based upon the geographical situation of the countries and not at all on language.

A provisional Executive Committee was nominated consisting of six members including representatives of the sub-regional committees. The chairman of the Association is Mr. Bowen, its vice-chairman Mr. Soulémane Abdoulaye, Director-General of Taxation of Togo.

The Association's members are the countries which are members of the U.N. Economic Commission for Africa (E.C.A.) and of the Organisation of African Unity (O.A.U.). Each member has one vote but is represented by two persons designated by the Minister of Finance. The Association is financed by contributions from the member countries established according to their economic capability with a minimum of 0.5 and a maximum of 10 percent; it was decided to adopt the O.A.U. index for this purpose.

PROGRAMME OF THE ASSOCIATION

The following subjects were selected for discussion in the General Assembly meeting to be held in February, 1982:

- Tax fraud and evasion
- Information on tax awareness
- Taxation and development
- Techniques of tax legislation
- Improvement and strengthening of tax organisation and management.

Furthermore it was agreed that the sub-regional committees should draw up their own programme and that each committee should organise at least one training course or seminar in 1981.

The General Assembly [1] agreed to request the E.C.A. to prepare on behalf of the Association a roster of qualified African tax experts. The General Assembly also "requested E.C.A. to write to member countries to submit copies of their tax codes to the International Bureau of Fiscal Documentation in Amsterdam on a regular basis". [2]

1. According to Article 20 of the Constitution, this document becomes effective as soon as ten countries have accepted membership and signed the Constitution. This being the case, the General Assembly of the Association was declared established.
2. Draft Report of the Inaugural Meeting of the Association of African Tax Administrators and a Workshop on Tax Policy, Legislation and Administration, Monrovia, 11-19 February 1980, Para. 26 at p. 8.

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GROUPE DE TRAVAIL SUR LA POLITIQUE, LA LEGISLATION ET L'ADMINISTRATION FISCALES

A l'occasion de la création de l'Association des Administrateurs Fiscaux Africains, un group de travail s'est penché sur cette matière. Six sujets principaux ont été discuté à Monrovia, à savoir:

(i) imposition des sociétés multinationales et transnationales;
(ii) les causes de la double imposition internationale et les mesures pouvant l'éviter;
(iii) directives pour la négociation de conventions tendant à éviter les doubles impositions, avec une référence particulière au modèle de conventions de double imposition entre les pays en voie de développement d'Afrique et les gouvernements des pays du siège des investisseurs étrangers;
(iv) le régime fiscal du secteur agricole avec une référence particulière aux pays africains en voie de développement;
(v) planification de réforme fiscale; et
(vi) considérations essentielles liées à l'organisation et à la gestion des Sections responsables de l'Impôt sur le revenu.

Le document mentionné à la note 2 reprend certains points des discussions rapportées comme ayant été conduites à un haut niveau permettant "au groupe de travail de reconnaître les points essentiels et atteindre une majorité d'opinion sur des solutions proposées ou soumettre ultérieurement à l'étude certains de ces points". [3] Le manque de place ne nous permet pas de donner ici plus d'informations. Les personnes intéressées peuvent demander (gratuitement) une copie du résumé préparé par la C.E.A. sur ses sujets.

NOTE:
Le *Bulletin* a déjà rapporté, dans le passé, des développements fiscaux ayant eu lieu dans un grand nombre de pays, y compris différentes parties du monde en voie de développement. Ces rapports contiennent des informations sur des activités exercéès par des organisations internationales.

La Rédaction a l'intention de publier régulièrement des rapports sur ces organisations afin de permettre à la communauté fiscale internationale d'être systématiquement informée de l'actualité.

3. Rapport (note 2, supra), appendice rose, p. 1.

WORKSHOP ON TAX POLICY, LEGISLATION AND ADMINISTRATION

On the occasion of the creation of the Association of African Tax Administrators, a workshop was conducted under this title. Six main topics were discussed in Monrovia, viz.:

(i) Taxation of multinational and transnational corporations;
(ii) The reason for international double taxation and measures for its avoidance;
(iii) Guidelines for negotiation of tax treaties especially with reference to the model on double taxation treaties between African developing countries and the governments of foreign investors' home countries;
(iv) Taxation of agricultural sector especially with reference to African developing countries;
(v) Tax reform planning; and
(vi) Vital considerations involved in organization and management of Income Tax Departments.

The document referred to in note 2, contains a review of the discussions which are reported as having been conducted at a high level enabling " the workshop to identify major issues and to reach a consensus of opinion on solutions or further consideration to be given to these issues". [3] Space limitations prevent the giving of details here. Those interested are invited to request (free of charge) a photocopy of the summary prepared by E.C.A. on these subjects.

NOTE:
In the past, the *Bulletin* reported on tax developments in a large number of countries, also in various parts of the developing world. These reports included information on activities carried on by international organisations.

It is the intention of the Editors to publish reports on these organisations on a regular basis so as to keep the international tax community systematically informed on what is going on.

3. Draft Report (note 2, supra), pink appendix, p. 1.

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The Commonwealth Association of Tax Administrators (C.A.T.A.)

TECHNICAL MEETING ON THE COLLECTION OF TAXES AND TRAINING OF COLLECTION PERSONNEL

Elsewhere in this issue mention is made of the establishment of the Association of African Tax Administrators earlier this year. In several respects it was modelled on another intergovernmental organisation established as long ago as 1967: CIAT — the Interamerican Centre of Tax Administrators, with headquarters in Panama City.

C.A.T.A. is an organisation of a similar nature, but it is not restricted to a specific region or continent. It was conceived in 1976 and was formalized by a constitution adopted in 1978. C.A.T.A., with headquarters in London, England, currently links the tax administrators in 31 Commonwealth states and dependencies. They are: Australia - Bahamas - Bangladesh - Barbados - Botswana - Canada - Cook Islands - Cyprus - Fiji - The Gambia - Ghana - Grenada - India - Jamaica - Kenya - Malawi - Malaysia - Malta - Mauritius - New Zealand - Nigeria - Papua New Guinea - Singapore - Sri Lanka - Swaziland - Tanzania - Tonga - Trinidad & Tobago - United Kingdom - Western Samoa - Zambia.

The basic objective of C.A.T.A. is to promote the improvement of tax administration in all its aspects within the Commonwealth with particular emphasis on developing countries. This is accomplished by promoting the improvement of tax administration of members through the exchange of experiences and the dissemination of information and technical knowledge. In complying with these objectives, C.A.T.A. periodically convenes conferences on specific aspects of tax administration and holds a triennial general meeting in which its members participate.

From April 14 to 18, 1980 a Technical Meeting of C.A.T.A. took place in Swaziland. It was attended by tax officials of the rank of Commissioner or Deputy-Commissioner of the following 19 countries: Bangladesh, Botswana, Canada, Cook Islands, Cyprus, Jamaica, Kenya, Malawi, Malaysia, New Zealand, Nigeria, Papua New Guinea, Sierra Leone, Sri Lanka, Swaziland, Tanzania, United Kingdom, Western Samoa and Zambia.

Responsible for coordinating this Technical Meeting was Mr. W.A. Stoneham from Canada.

The following is a report of the proceedings of this Technical Meeting.

The second technical meeting of C.A.T.A. member states took place at the Yen San Hotel in Mbabane, Swaziland during the week of April 14 to April 18, 1980. The meeting was hosted by the Kingdom of Swaziland and the technical co-ordination for content as well as conduct of the proceedings was the responsibility of the Canadian delegation.

In order to identify areas of primary concern to the member countries intending to participate in the conference, all members were asked several months prior to the meeting to submit papers covering the following 3 aspects:

1. The most serious problems affecting collection of taxes in their country.
2. Details on any formalized tax collection training program administered by them.
3. Description of any significant strengths in their system which provide assistance in the collection of taxes.

From the submissions received from 19 of the member-countries, seven major areas were identified as being of interest to all.

These main topics were each addressed by 1 or 2 speakers in terms of how these matters affect the tax collection operation in their country and how their respective administrations handle them. The presentations were followed by either workshops or round table discussions, which expanded these topics or aspects thereof, as they applied to the other countries represented at the conference. Topics of slightly lesser importance although of considerable interest to all were allocated to the last day of the conference for round table discussions. Time permitting, the round table discussions were to be extended to any other topics raised from the conference floor. All conference participants were informed in advance of all the agenda topics selected and were requested to come prepared to contribute to the workshop and round table discussions.

The conference opened on schedule on the morning of April 14 with 33 delegates from 18 countries in attendance. After the opening exercises, Mr. J.A.R. Felix, Commissioner General of Inland Revenue,



Mr. W.A. STONEHAM

Mr. Stoneham joined the Canadian Department of National Revenue, Taxation in 1965 following a career in the private sector and presently is the Assistant Director, Policy and Enforcement, Accounting and Collections Division.

Sri Lanka addressed the conference on the first topic: Tax Delinquency: Causes and effects today; setting out the theme and indeed the principal reasons for which this conference of Commonwealth Tax Administrators had been convened.

I. Tax delinquency: Causes and effects today

In his opening remarks the speaker stressed the importance for every government of building public confidence in its programs in general and its ability to collect taxes to finance such programs as an important factor in curbing tax delinquency.

Mr. Felix broke down the problem of tax delinquency into three different areas:

a. under reporting of income and tax,
b. non-reporting of income,
c. non-payment of tax on declared or assessed income,

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indicating that all three are a direct result of the public attitude toward compliance and that the latter is influenced by such items as:

1. Fairness of the tax system.
2. Fairness and impartiality of administration.
3. Efficiency and thoroughness of tax administration.
4. Chances of delinquency being detected.
5. Severity of penal action upon detection and frequency of application of penal action.
6. The taxpayer's confidence in and loyalty to the Government and his sense of duty to pay the correct amount of tax.
7. Degree of taxpayer's understanding of his duties and obligations.
8. Degree of public information available to create tax consciousness.
9. Number of administrative measures used to withhold tax at source such as on dividends, interest, and employment earnings.
10. "Red tape" and physical difficulties involved in making payments.

Mr. Felix further referred to the effect of economic conditions such as: Commercial interest rates being substantially higher than penalty payable for non-payment, lack of cash-flow in a stagnant economy, government policies which adversely affect taxpayer's sources of income and lack of or slowness in compensation, and payment of prior year taxes out of current income subject to current economic influences.

He recommended that tax administrators orchestrate legislation and procedures beginning with preventative aspects like withholding taxes and ending with an arsenal of legal sanctions to encourage compliance in filing returns and paying taxes assessed. Publicity via all available media should be used to indoctrinate taxpayers with such requirements and the possible consequences of not complying.

The speaker advocated the use of Electronic Data Processing equipment as an effective means to identify and categorize nonfilers as well as to provide an up-to-date collection accounting system, which would allow early compliance action and thus serve to create a better tax consciousness by dispelling public lethargy in this area. Additionally he recommended publicity seminars and consultations with tax practitioners to clarify apparent difficulties in public understanding of certain complicated taxing provisions.

Mr. Felix cited the intelligent use of estimated assessments, of tax clearances as well as the acceptance of arrangements from taxpayers to pay their tax arrears over a period of time in line with their verified ability to pay, as useful compliance tools. He emphasized the importance of controlling tax delinquency in regard to the nations's economy by relating delay in collection to increased losses to the the government treasury which in turn result into greater budget deficits and increased government borrowing. Tax delinquency further has an inflationary effect in that these tax monies, not available to the Treasury, are being diverted to purchase of consumer goods. This further creates serious inequities for the compliant taxpayer, who, besides not having their tax money to spend are carrying the total tax burden, while the tax evaders enjoy all the benefits provided by the state without paying their share.

In subsequent round table discussions the plenary expressed general agreement with Mr. Felix's observations. On the topics of tax amnesty and tax clearances raised, there appeared to be agreement on the former's overall negative effect and that it thus is rarely used, while the latter procedure is used selectively by many member countries with good results. Further, while there are presently few or no tax collection treaties in existence, substantial compliance benefits were envisioned by the delegates from the existance of such treaties in the future.

II. The Department's collection organization, the purpose, the activities and the relation with other work areas of the Revenue Department

Two papers were presented on this topic, the first by Mrs. Eugene Heather, Technical Officer, Inland Revenue Department, Western Samoa, and the second by Mr. M.U. Ahmad, First Secretary (Taxes) National Board of Revenue of the People's Republic of Bangladesh.

The organizational structure of the Samoan Revenue Department provided for a distinctly separate Collection (or Accounts) Section responsible for the collection and collection accounting functions only. The section's staff is supplemented periodically by assessing staff to provide extra manpower for ledger balancing exercises, etc. but in all other aspects the two functions are totally separate.

This contrasted sharply with the approach taken by the National Revenue Board of Bangladesh which has combined the assessment and collection recovery functions under the Deputy Commissioner of Taxes (formerly Income Tax Officer). While separation of these two functions has been recommended staffing constraints up to this point have not allowed such separation.

Subsequent discussions by the plenary indicated that the majority of delegates favoured a separate collection function for better results. Instances of close cooperation by both audit and collection sections in exacting payment of taxes assessed at time of assessment or shortly thereafter were illustrated by two of the member states. This pertained especially to situations where prompt action appeared necessary to avoid losses. In the subsequent workshops the three groups arrived at the following observations and recommendations:

Separating collections from other functions provides the following advantages:

1. Better collection results due to greater concentration of effort in a single area.
2. Staff obtains greater in-depth knowledge of collection procedures.
3. Speedier recovery of delinquent taxes reducing likelihood of potential losses.
4. Less likelihood of employee becoming susceptible to offers for collusion.
5. Less training time required to make employee effective in one function.
6. Staff will progress from handling simple accounts to handling more complex accounts with additional experience and training.
7. This sytem still allows for rotation of staff into other areas such as assessing and audit to provide opportunities for career development and job satisfaction.

The integrated system (staff working in 2 or more functions simultaneously) also has certain advantages:

1. Provides greater all round experience and knowledge to staff.
2. Permits rapid shifting of staff resources into areas of greatest need.
3. Staff has a better overview of the entire operation, resulting in less unproductive work. (e.g. assessments which are uncollectible at time of assessment etc.)
4. May provide greater job satisfaction and opportunity for promotion.

The consensus appeared to lean toward the non-integrated approach with provision for staff rotation, as being the most desirable, although many of the participants operated under an integrated system.

III. Enforced collection of delinquent taxes, judicial vs. administrative procedures

This topic was addressed by the delegates of 2 countries Mr. J.B. Sweeting, Director, Collection Procedures, of the Board of Inland Revenue for the United Kingdom, and Mr. H.W. Ramien, programs officer, Accounting and Collections Division, Revenue Canada.

Mr. Sweeting after briefly outlining the responsibility areas of the Inland Revenue Department in respect to the collection of all direct taxes on income and capital as well as the National Insurance contributions, indicated that all enforced collection work is initiated in the 250 local collection offices under the supervision of the local Collector in Charge. Their collectors most frequently use the administrative distraint procedure, available under authority of the tax statute, which permits

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seizure and sale of goods of the defaulter. The simple initiation of this process is in the majority of cases sufficient to motivate delinquent taxpayers to comply (in 1979 only .2 percent of all distraint calls resulted into eventual sale of assets). Care and discretion is utilized in the application of this procedure to avoid potential abuse.

Mr. Sweeting then referred to the judicial processes available. Depending on the amount of the tax debt, the Department uses the Magistrate's Court or County Court, with only debts over £2000 being brought before the High Court. The courts upon granting judgement can provide enforcement instruments for seizure of goods and monies, as well as such measures as enforced as bankruptcy or liquidation. The only disadvantage to these processes arises from the invariable delays encountered in the two higher courts.

The speaker stated, that these processes, coupled with department's policy of collecting taxes promptly, with the least amount of friction and through efficient use of personal visits and telephone calls has brought good results.

Canada also uses administrative procedures extensively, with its collectors issuing Demands on Third Parties under authority of the Income Tax Act to intercept incomes or seize bank accounts of the defaulting taxpayer. If this procedure proves ineffective, Mr. Ramien stated that Senior Head Office officials can issue a certificate under the Act which upon registration in the Federal Court of Canada has the same force and effect as a judgement. Based on this certificate writs and other enforcement instruments to seize and sell goods, lands as well as monies and securities can be obtained promptly.

Another provision under the Act allows the Canadian Income Tax Department to assess and collect from a transferred spouse the tax owing by the transferror spouse up to the value of the property transferred. The transferree is subject to all collection actions possible under the Act.

The speaker emphasized that there is a constant awareness by management and staff of the formidable extent of these available powers and that continual guidance and control is exercised by supervisory and management staff to prevent any possible abuse of these powers.

In the subsequent workshops the delegates selected the following administrative provisions as particularly successful and desirable:

1. Interest and penalty provisions.
2. Instalment provisions.
3. Withholding provisions on income from employment, dividends, royalties, and any other sources possible.
4. Interception or attachment of incomes and bank accounts.
5. Tax clearance certificates for individuals leaving the country or other specific situations.
6. Distraint procedures.
7. Right to offset tax refunds against prior year tax debts.
8. Right to offset funds payable by other Crown Departments to the delinquent taxpayer.
9. Making directors and managers of companies personally responsible for company tax arrears.

The need for judicial processes would still exist, but with most or all the provisions above adapted where necessary to the particular needs of each country, the frequency for using such judicial processes would be considerably reduced.

IV. Identification of training needs and the design and implementation of a training package to meet those needs

Mr. R. Adair, District Commissioner of the Department of Inland Revenue for New Zealand provided the delegates with an overview on how his Department came to develop its present comprehensive Training Program.

He commenced with an outline of the qualities required in senior revenue staff, such as the need to be effective communicators, the ability to interpret complex legislation competently, as well as being well versed in accounting and commercial practices. Additionally they must have the capacity to adapt to continually changing conditions.

Training, therefore, is considered an ongoing process, and must be geared to the employees present duties as well as toward potential future management positions.

A major review of his Department's training system in 1970 revealed that training at the district level was dependent on the degree of enthusiasm of local management and that it varied considerably between offices. Planned programs were often discontinued due to workloads or if training was given it was frequently poorly prepared. The review committee also recognized the need for finding or developing replacements for the majority of senior managers over the next decade and that well coordinated training plans were needed to accomplish this.

These findings resulted in establishment of the centralized Staff Training Council comprised of the Department's senior functional managers. This council approves the National Training Program, as well as the priorities for all courses, both district and centralized, including all financial and other requirements for the latter.

The council is assisted by the Head Office Training Section, which is responsible for conducting centralized courses as well as the evaluation of training results nationwide and the review of course content, as well as the maintenance of up-to-date personal training records for all staff.

Mr. Adair stated that district office level training is conducted by a local Staff Training Officer who spends at least 60 percent of his time in this function and is usually in this function for a 2 year period. The districts are further provided with programmed learning training manuals and centralized courses are made available to the district office staff.

The speaker emphasized that training programs must be continuously evaluated in order that they can meet the needs of both staff and management, and he suggested that this be done, by having employee and management evaluate the course material and the employee's performance respectively on an on-going basis. Only constant involvement by management in providing feed-back on how the training measures up to what they want or expect from the program, will ensure the success of such programs.

In discussions following his presentation Mr. Adair indicated that his department uses the employee's overall performance and competence as recorded in the annual performance review together with related work experience as a basis for promotion. He also indicated that in his opinion the fully trained employees leaving the department for the private sector may actually benefit the department in the long run by promoting better communications with the private sector.

From the workshop groups, the following observations and recommendations were raised:

1. Specialized training for collection officers was with few exceptions deficient or non-existent. Generally such training consisted of on-the-job training only.
2. The groups agreed on the need for strong support from top management for training programs. Such programs should be centrally controlled and directed to ensure uniform application of the law country-wide.
3. Smaller countries, in as far as their different systems allowed, might pool their resources and set-up a central training facility.

V. Initial collection procedures

Mr. Charles Mwangi, Principal Collector of Income Taxes for Kenya addressed this topic, giving considerable background on the manual accounting procedures employed by his department.

He indicated that one central collection office collects all assessments raised in

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Kenya's 9 Assessing Districts. After assessments are outstanding beyond the due date and no payment is received, penalty and interest are added to the amount and an Overdue Notice is sent to the taxpayer requesting the total amount by a specific date. If the taxpayer agains fails to pay, enforced collection action is commenced after the due date has elapsed. The only exception arises in cases where the taxpayer appeals and the responsible assessor issues a "Stand Over Order". In such cases collection action ceases until the appeal has been dealt with.

In the subsequent round table discussions various procedures were brought out by the delegates, ranging from a series of notices and letters issued either manually or by computers, the use of telephones, as well as the use of partial payment procedures controlled by collection personnel or computers. Although there appeared to be a great variance in procedures, it was felt that an efficient approach at this early stage can eliminate many future collection enforcement problems.

VI. Publicity programs, a means of raising the public's social conscience and of promoting taxpayer education in an effort to encourage compliance with the law

Mr. W.A. Stoneham, Assistant Director, Enforcement and Policy, Accounting and Collections Division, Revenue Canada, presented this topic.

In an effort to make the public aware of the taxation process and to gain the public's confidence and voluntary compliance Mr. Stoneham referred the delegates to Canadian Taxpayer Education Programs, such as the "Teaching Taxes" manual used in schools, as well as to taxpayer assistance programs implemented through public relations officers, toll-free telephone service available to taxpayers for assessing inquiries, the issuance of Tax Information Pamphlets, as well as the ongoing serialized publications such as the Interpretation Bulletins, Information Circulars and Income Tax Rulings.

The foregoing provides the general public and especially the tax practitioners in the private sector with essentially the same large body of technical and practical information on departmental interpretations and procedures, as is available to Departmental staff. Revenue Canada further trains community volunteers to assist taxpayers who are in any way incapacitated to file their own returns.

These programs, coupled with periodic media campaigns and a limited number of high quality films shown in movie-houses across Canada have achieved an effective two-way communication between the Department and the public. The resultant confidence of the taxpayers in the fairness of the tax system is reflected in the highest degree of voluntary compliance which exists in Canada today.

In discussions following the delegates agreed with Mr. Stoneham that under the self-assessment system more information must be made available to the public to gain the desirable degree of compliance. At the same time, they agreed that certain procedural processes or information contained in internal manuals on assessment or write-off procedures must not be made public.

The workshops' objectives on Publicity efforts and methodologies to be used to support such effort were, on the delegates' request, expanded to also include recommendations in regard to implementation of training programs.

The workshop findings and recommendations on the publicity objectives were as follows:

1. Publicity on the role and purpose of the tax department, to create better public understanding of its role, is essential to reducing the Department's administrative workload.
2. Publicity efforts should be directed at school children in progressive steps to generate an early understanding of taxation and the creation of a future tax conscience. Children in turn can also educate their parents in tax matters.
3. Mass media such as Radio, T.V., newspapers and publications as well as public speakers should be used to provide publicity on the Department's programs, including filing and payment and instalment requirements etc.
4. Public Relations Officers should be trained and used to provide information to the press on high-profile situations creating positive publicity for the Department. (Investigations, prosecutions, interviews on filing of returns etc.)
5. In remote areas politicians or other individuals such as chiefs of tribal councils etc. could be used to provide basic tax information to the populace in their area.
6. Departmental staff must display proper conduct at all times, must be courteous and well groomed, and their mode of living must be exemplary as often a single employee forms the taxpayer's concept of what the tax department is like.
7. Use of questionnaires was advocated to obtain feed-back from the public on what areas, of interest to them, were not sufficiently covered by existing publications.
8. The delegates advocated the use of simple language in all publications aimed at the general public.
9. One country is in the process of creating a central one-stop centre providing information on all government services, which will include the tax department.
10. It was suggested that C.A.T.A. should assist on the technical side in the creation of a film which would highlight the various positive aspects of taxation, and which could be distributed to C.A.T.A. member countries for public showings.
11. During peak seasons temporary offices can be set up to provide public information to taxpayers in their home areas.

The workshop findings on the Establishment of Training Programs provided the following:

1. There is, in the majority of member countries, a distinct lack of resources for training programs, especially for collection personnel.
2. To alleviate this condition, it was suggested that the countries pool their resources, and attempt to standardize their training programs to the extent possible. The delegates further recommended that central training centres should be created under the auspices of C.A.T.A. where all general training is given to staff of participating members.
3. If financial restraint did not permit sending all the staff to such a centre, senior personnel should be sent, who upon their return home, could pass this training on to more junior staff and at the same time amend it as necessary for local conditions.
4. It was suggested that C.A.T.A. set up a systematic training program for training senior collection personnel, and that this course be periodically improved on the basis of evaluation questionnaires completed by course participants.
5. If the foregoing suggestion was not feasible, C.A.T.A. could prepare a general staff training manual for use by member countries, which could be adapted to local requirements.
6. Lack of training in enforcement procedures and especially court action constitutes a serious problem in a number of the member countries.

There was consensus among the delegates that while training presented a considerable expense, it nevertheless also presented the key to succcessful execution of the departmental programs. The long term benefits derived, therefore, return value worth many times the expense incurred in training staff.

Similarly, it was felt that, if the taxpaying public gains a better understanding of the role of the tax department in relation to the nation's economy, and each taxpayer becomes aware of, or can be made to feel part of, a nationwide effort to create or maintain a country in which he can be happy and proud to live, the effort and expense of publicity programs is returned many-fold.

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VII. Policies and procedures dealing with the deletion of uncollectible debts and small accounts

Presentations on this topic were given by Mr. S. Sivalingam, Deputy Director General Department of Inland Revenue, Malaysia and Mr. H.W. Ramien, Programs Officer, Accounting and Collections Division, Revenue Canada.

Mr. Sivalingam emphasized the importance of tax administrators examining the causes for write-offs and taking steps to eliminate such uncollectible amounts promptly from the Department's Receivables.

He detailed various causes for accounts becoming uncollectible among them extended payment arrangments, poor collection follow-up, unrealistic estimated assessments and disappearance of taxpayer's assets, and he stated that his Department's policy of reviewing uncollectibles with a view toward improving its policies and procedures has been effective and has resulted into only a fraction of 1 percent of the taxes assessed being written off.

While both remission and write-off procedures are available to delete assessed amounts very few situations qualify for the former and the majority of deletions takes place in the form of Write-off of Irrecoverable Tax in accordance with General Treasury Instructions.

Once it can be proven that all reasonable attempts for recovery have been made and the balance cannot be collected and there is no evidence of departmental negligence, the accounts so identified are submitted to the Secretary-General Treasury with full explanation for write-off approval. Upon approval the accounts are deleted from the ledger.

Canada while using very similar criteria uses its computer facilities to remove accounts of nominal size and accounts with poor collection potential from the collector's workload. These accounts are monitored by computer for several years and any activity such as returns filed, changes of address or refunds becoming available will either return these accounts to the collector or will result into refunds being offset or both. In cases of continued inactivity for several years the accounts will eventually be written off.

Accounts qualifying for write-off either after having gone through the foregoing procedure or meeting pre-set write-off criteria are reviewed by a committee of Senior Head Office and District Office officials, who will approve or reject such accounts based on the facts provided. This committee also examines the accounts to determine whether they are uncollectible because of particular departmental programs or procedures.

The write-offs are finally examined and approved at 3 different levels depending on amounts, ranging from the Minister to Treasury Board or Parliament, and only after such final approval are they deleted from the ledger.

In the subsequent round table discussion all delegates agreed on the importance of removing uncollectible accounts from the Department's receivable ledger as soon as their uncollectibility is established, so that Revenue receivables are reflected realistically.

The Plenary raised the point that the amount of work required to substantiate a write-off often discourages staff, who will rather turn their attention to accounts which can still be collected.

Artbitrary (provisional) assessments were cited as a frequent cause for write-off, with the assessments often being unreasonably high and for that reason being impossible to collect. The delegates favoured New Zealand's approach which requires their assessors to substantiate all default assessments as being reasonable.

Several delegates indicated that their departments wrote off the tax balance only, and simply reversed interest and penalty.

The round table discussions following the final presentation were subject to close time constraints and resulted into the comments and recommendations recorded below on the following topics.

1. *Appeals and the effect on collection*

This presented a problem in several, if not most, of the member-countries. While many of the tax statutes required payment in full despite any appeal or objection, in many cases collection action on the amount under dispute was curtailed. This delay in collection in some countries increased the total taxes outstanding considerably and resulted into losses to Treasury when such amounts became irrecoverable because of changes in the taxpayer's financial circumstances. The Canadian approach of requiring the taxpayer appealing his assessment to pledge realizeable security in lieu of payment, was noted with some interest as an alternative which could eliminate such losses.

2. *Ways and means of improving compliance in remote areas*

The delegates advocated the use of radio programs to improve public understanding and acceptance of taxation.

Some countries indicated that setting up local workshops or group discussions, as well as training classes on basic business procedures and bookeeping has had a positive impact, but that it was a slow process to change the population's generally negative attitude in regard to taxation.

Requiring tax clearances for renewal of business licenses, administered locally by village leaders or police, has resulted into improved compliance in several countries.

3. *Recruitment and retention of trained collection personnel*

The consensus was that it was difficult to attract personnel to the collection function, as the career possibilities are relatively narrow within this area. To improve this, the delegates recommended that rotation into other areas should be made available to the staff. Also an appropriate payscale must exist for collectors' jobs to attract individuals with the proper motivation and personality. Such individuals must be self-motivated, conscientious and resourceful in performing their duties. The delegates agreed on the importance of providing the employees with a detailed job description, to ensure they are aware of the scope of their duties, and also to allow proper evaluation of their performance by management.

Discussion arose on the aspect of evaluation and the various approaches used, which varied from "on-the-job" praise or criticism to self-assessment by an employee of his performance with subsequent in-depth discussion with supervisor of specific performance areas, as well as the employee's future aspirations and potential for advancement. In the latter procedure the results are recorded and are reviewed by different levels of management to identify potential candidates for future senior position.

Several countries indicated, that much time and resources had been allocated to the development of an efficient system of staff evaluations, as the latter constitutes an important factor in motivating staff, providing specific training, as well as identifying future potential which can be developed to the administration's and the employee's benefit.

4. *Computer application to tax collection*

It was pointed out by the delegates of countries using computers on a larger scale, that computers do not present the solution to all problems. They stated that a computer system must be preceded by an effective manual system, which can then be adapted. A number of member-countries are presently using computers and have done so for some time, others (a total of 12 countries) are in the process of setting up taxpayer master records, accounts receivable and other accounting processes, with such programs as the issuance of assessments and initial collection follow-up procedures to follow at a later state.

Several of the countries indicated difficulties in developing such programs, and it was suggested that in order to develop a system which will meet the needs for a particular administration, it is essential that the administration's management be well versed in the systems area. Only with such knowledge can the "computer people" be directed into developing programs and systems which will effectively handle specific functions and procedures.

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Kailash C. Khanna:

INDIAN BUDGET 1980/81

Expectations of a major corrective exercise in the direct tax structure were built around the Indian Budget for the year 1980/81, particularly because in the immediately preceding year there had been an estimated drop of 3 percent in GNP at 1970/71 prices, a rise in the price level of about 16.8 percent and a general deceleration in industrial capacity utilisation with an expected cost escalation. Regrettably, the Finance Minister, Mr. Venkataraman, has suggested only minor adjustments with crumbs of tax relief thrown here and there. The surcharge on personal income-tax will be reduced from 20 to 10 percent, thereby lowering the maximum marginal rate from 72 to 66 percent. The tax benefit will be insignificant having regard to the prevalent inflation. The eminent Jurist, and until recently India's Ambassador to the United States of America, Mr. N.A. Palkhivala, has strongly advocated indexation of the tax rates to counter inflationary trends.

In the sphere of corporate taxation, the Finance Minister has suggested a continuance of the "tax holiday" with a change in the basis of computation of the taxable income. In the case of companies, 25 percent of the taxable income derived from a new industrial undertaking will be exempt from tax for a period of seven years. However, in computing the quantum of "tax holiday" profits, the losses, depreciation and investment allowance of earlier years in respect of the new industrial undertaking will be taken into account even though these might have been set off against the profits of the taxpayer from other sources. The Finance Minister's reasoning for the proposed change is that the existing "tax holiday" benefit favours capital intensive industry whereas the need is to stimulate investment in labour intensive industry. The proposed quantum of tax-free profits is lower than the existing benefit, and it may not be feasible for a new undertaking to earn adequate profits in its formative years. There is no provision for carry forward of the unabsorbed tax benefit and in many cases the proposed "tax holiday" may be a still-born incentive. It has been suggested that the percentage figure should be raised to 45 and the holiday period extended to ten years.

An otherwise innocuous Budget, it has generated considerable heat and controversy because of suggested retroactive changes in legislation especially in two areas of importance to the corporate sector, a short reference to which has been made in paragraph 85 of the Budget speech. The existing "tax holiday" profits are determined with reference to the capital employed. In 1972 the Central Board of Direct Taxes notified a rule saying that borrowed funds would not be included in the computation of capital employed. The taxpayers contended that since the Income-tax Act used the words "capital employed" without any restriction or limitation, the expression must be understood in its general or commercial sense and that the exclusion of borrowed funds from capital through a notification was beyond the rule-making powers of the Central Board. Several High Courts have decided in favour of the taxpayer. In order to nullify the effect of the Court rulings, the Finance Minister has suggested an amendment of law with retroactive effect as of the year 1972. Another proposal seeks to give retroactive effect as of the year 1968/69 to a change in law to counter a ruling of the Supreme Court. Under an existing provision, barring few cases, 60 percent of intercorporate dividend income is exempt from tax. The relevant provision states that where a domestic company receives "any income by way of dividends", a deduction of 60 percent shall be allowed from such income. Taxpayers contended that the deduction of 60 percent should be calculated with reference to the gross income from dividends and not the net. To clarify, if a company received a dividend of 100 it would straightaway deduct therefrom 60, leaving a dividend income of 40, from which it would further deduct expenses, interest and bank charges, if any, and pay tax only on the balance. The tax authorities, on the other hand, argued that the deduction of 60 percent should be calculated with reference to the net dividend income arrived at after subtracting interest and expenses from the total dividend received. The matter was taken up to the Supreme Court which held that the expression "income by way of dividends" described only the nature of the income and did not relate to the quantification thereof. In order to negate the effect of the Supreme Court's judgement, the Finance Minister has now proposed retroactive legislation stretching back to the year 1968/69.

Chambers of Commerce and other associate bodies have strongly represented against the proposed retroactive amendments on the ground that these are unethical and against the generally accepted principle of retroactive legislation; moreover, these will detract from the sanctity of court judgments and erode the taxpayer's confidence in the stability and finality of tax assessments. If implemented, the changes will upset innumerable completed assessments, both of companies and their shareholders. During the current debate in Parliament, a Member described the proposed retroactive legislation as an attempt to collect taxes "more by crook than by hook". The Finance Minister has not relented so far but his proposed action raised the important question, whether, in the absence of an emergency or exceptional situation, retroactive legislation to remove ambiguities resulting from bad drafting and bureaucratic ineptitude can be justified as a matter of sound fiscal policy.

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HIGHLIGHTS OF THE INDIAN CENTRAL BUDGET FOR 1980-81

The following are the main proposals of the 1980 Budget presented by the Union Minister, Mr. R. Venkataraman, on June 18, 1980 before the Lok Sabha:

A. INCOME TAX

1. CORPORATE TAXATION

a) *Rate of tax*

No change is proposed in the existing corporate tax rate structure.

b) *Tax holiday on profits of a new industrial undertaking*

Under the present law five-year tax holiday is available on new industrial undertakings set up before 1st April, 1981, and this relief is calculated at 7.5 percent of the capital employed in the undertaking. It has now been proposed that this tax holiday will be extended upto March 31, 1985, but the calculation of this tax holiday will not be on the capital employed in the undertaking but on the profits of the new industrial undertaking as under:

In case of companies
— 25 percent of the profits derived from the new industrial undertaking during the relevant year.
In other cases
— 20 percent of the profits derived from the new industrial undertaking during the relevant year.

This tax holiday will be available for a period of seven years and will apply to those undertakings which qualify for the tax holiday under the existing law.

It has also been proposed that the profits of the new industrial undertaking for the purpose of this claim will be computed after taking into account losses, depreciation and investment allowance if any of earlier years in respect of the new industrial undertaking.

The basis of computation of the capital employed in the new industrial undertaking for determining the tax holiday available upto March 31, 1981 is proposed to be incorporated in the Income Tax Act itself (instead of the Income Tax Rules) wherein it has been made clear that in computing such capital borrowings will not be included. This amendment will be applicable with retrospective effect from 1972/73 assessment onwards, if approved.

c) *Additional depreciation on plant & machinery in certain cases*

It has been proposed that additional depreciation at 50 percent of the normal depreciation allowance (excluding extra shift allowance) will be available on new plant and machinery installed after March 31, 1980 but before April 1, 1984. This will be available only in the year of installation.

Additional depreciation will be taken into account in calculating the written down value of the plant and machinery.

Additional depreciation will not be available on ships, aircraft, road transport vehicles, office appliances, machinery or plants installed in any office premises or in residential accommodation or in guest houses etc.

Additional depreciation will also not be allowed on any plant and machinery the whole of the actual cost of which is allowed as deduction.

d) *Expenditure on scientific research*

To encourage in-house research and development activities it has been proposed to allow a weighted deduction equal to 1 1/4 times of the expenditure incurred in approved in-house research and development or carrying out any research programme approved by the prescribed authority. The proposed deduction will not be allowed on expenditure incurred in acquiring land or construction of buildings.

e) *Expenditure on advertisement, publicity and sales promotion*

Under the existing law there are certain restrictions on advertisement, publicity and sales promotion expenses; it has been proposed to withdraw the restrictions.

f) *Export market development allowance*

It has been proposed to amend the Income Tax Act to clarify that the weighted deduction for export market development allowance will be available only on the following expenditure:

(i) advertisement or publicity outside India in respect of the goods, services or facilities dealt in or provided by the taxpayer in the course of his business;
(ii) maintenance outside India of a branch, office or agency for the promotion of the sale outside India of such goods, services or facilities;
(iii) travelling outside India for the promotion of the sale outside India of such goods, services or facilities, including travelling outward from and return to India.

2. PERSONAL TAXATION

a) *Surcharge*

The rate of surcharge on income-tax has been reduced from 20 percent to 10 percent. This will mean that the top slab rate will now come down from 72 to 66 percent.

b) *Raising of exemption limit*

The exemption limit in the case of individuals is proposed to be raised from Rs. 10,000 to Rs. 12,000. However, there has been no change in the slab rates.

c) *Deduction in respect of Life Insurance Premium, contributions to Provident Fund etc.*

The existing rates at which deduction is allowed is:

On	first Rs. 5000	100%
	next Rs. 5000	35%
	balance	20%

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It has been proposed to increase the rates as under:

On	first Rs. 5000	100%
	next Rs. 5000	50%
	balance	40%

d) *Interest credited to member's account in the Provident Fund*

Under the existing law interest credited to a member's account in a recognised Provident Fund in excess of 8.25 percent or in excess of 1/3rd of his salary is liable to be taxed in his hands.

It has been proposed in this budget that the second condition that is interest exceeding 1/3rd of the salary being liable to tax in the hands of the employee should be abolished.

e) *Standard deduction to pensioners*

Under the existing law standard deduction in respect of expenses incidental to employment is allowed against salary income of an employee. The standard deduction is allowed at the rate of 20 percent of the salary upto Rs. 10,000 and 10 percent of the salary in excess thereof, subject to a maximum of Rs. 3,500,—. This deduction is allowed irrespective of whether any expenditure incidental to employment is actually incurred by the employee or not.

It has been proposed that the standard deduction will also be allowed on pensions.

B. WEALTH TAX

(i) It has been proposed to raise the exemption limit for wealth tax purposes from Rs. 100,000 to Rs. 150,000.
(ii) There is no change in the rates of tax.

C. INDIRECT TAXATION

1. CUSTOMS DUTY

Revision in the rates of import duty has been proposed in some cases. A few examples are given below:

a. on all dutiable articles imported as personal baggage the rate is increased from 120 percent ad valorem to 150 percent;
b. on computers and computer peripheral units rate increased from 10 percent ad valorem to 20 percent;
c. on cinematograph films rate increased from 50 paise to Re 1/- per liner metre;
d. full exemption from import duty has been proposed for steel tubes imported for use in the manufacture of industrial gas cylinders of certain specifications;
e. reduction in the import duty has been proposed on certain machineries and testing instrument for printing industry; also for certain other items of machinery and testing instruments.

2. EXCISE DUTY

It is proposed to revise the rates on the following items as under:

a. soda ash raised from 10 to 15 percent ad valorem;
b. caustic soda and caustic potash raised from 10 to 15 percent ad valorem;
c. acids raised from 10 to 15 percent ad valorem;
d. synthetic rubber raised from 5 to 10 percent;
e. on cheaper varieties of toilet soaps reduced from 10 to 5 percent, on toothpaste from 20 to 10 percent;
f. cigarettes which are at present exempt from special excise duty will be levied duty at the rate of 1/10th of the basic duty;
g. excise duty on cheaper television sets reduced from 15 to 10 percent and duty on other television sets reduced from 30 to 25 percent;
h. licence fees abolished on single and two-band radio sets and transistors;
i. cycles and cycle parts as well as sewing machines totally exempted from excise duty;
j. duty on pressure cookers reduced from 15 to 10 percent;
k. it has been proposed that 30 specified life saving drugs will be fully exempted from excise duty;
l. it has been proposed to raise the special excise duty from 1/20th to 1/10th of the basic excise duty on specified items. It has been also proposed to levy special excise duty at the rate of 1/20th of basic duty on some items which are now exempt from such levy.

3. POSTAL TARIFF

a) Postal tariff on letters increased from 30 p to 35 p. but no increase is proposed on inland letters and postcards; postal parcel increased from Rs. 1.50 to Rs. 2 per 500 gms; and
b) Higher charges will be made for shifting and installing telephones. Local telephone calls beyond 5000 in a quarter to be charged at 50 p. per call against 40 p. at present.

D. OTHERS

The Finance Minister has indicated that a Bill will be introduced in the current session of the Parliament to levy a new tax at 15 percent on gross receipts of hotels in which the minimum tariff for a single room is Rs. 75/- per day. This new levy is proposed to be made effective from 1st September, 1980.

It is proposed to levy a tax at 7 percent on interest income of banks and financial institutions which will be allowed to be passed on to the borrowers thereby raising the cost of borrowed funds.

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INDIA:

Budget Speech 1980

Extracts from the Budget Speech 1980 pronounced on June 18, 1980 by the Finance Minister Mr. R. Venkataraman.

With respect to the taxation proposals the Finance Minister said the following:

I now turn to my proposals in the field of direct taxes. In framing these proposals, I have borne in mind certain broad considerations, namely, that the rates of direct taxes should be such as to promote voluntary compliance, that the farmers, workers and the middle class should be afforded some relief in pursuance of the commitment in our party's manifesto and some stimulus should be provided for raising the level of savings and investment in the national economy. At the same time, a concerned attempt should be made to counter certain widely prevalent devices for tax avoidance through fragmentation of income and wealth.

The middle class is among the worst hit by the rise in prices in recent years. As hon'ble members are aware, even skilled workers in the organised sector are now liable to income-tax, at the present level of exemption. In order to afford a measure of relief to this class of persons I propose to raise the exemption limit for income-tax on personal incomes from Rs. 10,000 to Rs. 12,000. With a view to keeping the sacrifice of revenue within management limits, the nil rate slab of income is being retained at Rs. 8,000. As a result, in cases where the taxable income exceeds Rs. 12,000 the incidence of income-tax, excluding surcharge, will remain at the existing levels, subject to the grant of marginal relief in cases where the taxable income exceeds the exemption limit by a small margin. This proposal will benefit more than six lakhs * of income-tax payers.

Reduction of surcharge

Hon'ble members will recall that the rates of income-tax on the personal incomes were reduced in 1974 on the basis of a recommendation of the Direct Taxes Enquiry Committee and this process was taken one step further in 1976 when these rates were again lowered. The reduction in rates had largely fulfilled the expectation that it would lead to better tax compliance. Unfortunately, the movement in this direction was reversed under the Janata government and the rates of income-tax were increased in stages. I am of the view that the position in this regard should be set right. I accordingly propose to reduce the surcharge on personal incomes in the case of all categories of non-corporate tax payers from 20 percent to 10 percent. This will not only bring down the maximum marginal rate of tax from 72 percent to 66 percent but will benefit tax payers in all slabs of income.

Reduction of wealth tax

In view of the somewhat steep rise in prices of assets, I also propose to raise the exemption limit for wealth tax from Rs. 1 lakh to Rs. 1.5 lakhs with effect from the current assessment year. In cases where the taxable wealth exceeds this limit, the tax burden will, however, be retained at existing levels, subject to the usual marginal relief.

Government hopes that these concessions will provide the necessary inducement to the vast majority of our tax payers for current declaration of their incomes and wealth.

I propose to counter some of the more commonly used devices for tax avoidance.

Hindu undivided family

As hon'ble members are aware, the separate treatment accorded to Hindu undivided family in tax laws has been widely used for avoidance of proper tax liabilities. I accordingly propose to de-recognise partial partitions of Hindu undivided families both for income and wealth taxation. Partial partitions made on or after 1st January, 1979, will not be recognised for tax purposes and taxes will continue to be levied on the basis that the existing Hindu undivided family had continued to remain joint.

At present, Hindu undivided families having one or more members with independent income exceeding the exemption limit are charged to income-tax at rates which are somewhat higher than those applicable in the case of individuals. In order to further restrict the use of Hindu undivided family for the purposes of tax avoidance, I propose to raise the rates of income-tax in the case of such Hindu undivided families. The maximum marginal rate of 66 percent will now apply on the slab of income over Rs. 50,000 and rates on some of the lower slabs will also be raised to somewhat higher levels. With these two changes in regard to tax treatment of Hindu undivided families, hope that the urge for forming multiple Hindu undivided families merely for the fragmentation of income and reduction of tax liability will be weakened.

Discretionary trusts

Hon'ble members will recall that the government had in 1970 taken several measures to prevent the use of private discretionary trusts as a device for tax avoidance. Experience, however, shows that these measures have not been fully effective and the proliferation of such trusts has not been curbed to the desired extent. I, therefore, propose to tighten the provisions in respect of private trusts.

At present, discretionary trusts are taxed at a flat rate of 65 percent of their income and 1.5 percent of their wealth, or at the rates applicable in the case of an individual, whichever is higher. Under my proposal, such trusts will be charged to income-tax at the maximum marginal rate and the wealth-tax at the flat rate of 3 percent or at the appropriate rate applicable in the case of an individual, whichever is higher. I also propose to make several other provisions in relation to taxation of private trusts with a view to plugging some loopholes which have come to the notice of government. All these provisions will take effect from the current assessment year.

Charities

Charitable and religious trusts are sometimes used for acquiring or maintaining control over business or industry for private ends. In 1975, we have laid down a pattern for investment of funds of charitable or religious trusts if they were to continue to enjoy the tax exemption. With a view to enabling such trusts to change over to the new pattern of investment in a smooth and gradual manner, the law provided that the new pattern may be adopted before 1st April, 1978. This date was subsequently extended to 1st April, 1981. Such trusts have, therefore, been given ample time to adjust to the new policy. I want to put them on notice that this time limit will not be extended.

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* One lakh = 100,000; one crore = 100 lakhs (10 million).

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Long-term savings

Our tax laws have always sought to encourage long-term savings through life insurance, provident funds and other similar instruments. Unfortunately, the efficacy of the provisions for encouraging savings was impaired last year when the incentives for savings were drastically reduced. Hon'ble members should be glad to know that I propose to restore incentives for such savings to the pre-1979 budget levels.

The taxpayers will thus be entitled to 100 percent deduction in respect of the first five thousand rupees of the qualifying savings, 50 percent in respect of the next five thousand rupees and 40 percent of the balance.

As further measure for promoting savings in the household sector, I propose to give an option to income-tax payers to retain moneys in their compulsory deposit accounts beyond the due dates on payment of interest at the existing rate applicable to such deposits. Further, I propose to liberalise the tax exemption in respect of interest on balances with recognised provident funds. At present, interest on such funds is exempt from income-tax to the extent it does not exceed one-third of the salary income of the employee. I propose to remove this ceiling limit.

Tax incentives

It is essential to promote new investment in industry. At the same time, the fiscal system should not lead to a bias in favour of capital-intensive techniques. Keeping these twin objectives in view, I propose to continue the tax holiday in respect of new industrial undertakings, ships and hotels but in a modified form.

Under my proposal, tax holiday will be available in respect of new industrial undertakings, ships or approved hotels with reference to a specified percentage of the income derived from these sources. In the case of companies, 25 percent of the profits derived from these sources will be exempted for a period of seven years. In the case of non-corporate taxpayers the percentage of exempted profits will be 20 percent.

In the case of co-operative societies, the tax holiday will be available for a period of ten years as against seven years in the case of other categories of taxpayers. This concession will be available in the case of all small-scale industrial undertakings which go into production after 31st March, 1981, but before 1st April, 1985, that is, till the end of the new five-year plan period. For other industrial undertakings, the concession will apply only where they do not produce articles or things listed in the Eleventh Schedule to the Income-Tax Act. The concession will also be available in the case of approved hotels which start functioning or new ships which are acquired during that period.

It is necessary to encourage new investment particularly in view of shortages in several key sectors of the economy. As a special stimulus for new investment, I propose to allow in the year of installation, an additional depreciation in an amount equal to 50 percent of the normal depreciation on new machinery or plant installed during the new plan period. The proposed additional depreciation will not be admissible in respect of ships, aircraft, road transport vehicles, office appliances or machinery or plant installed in office premises or residential accommodation.

There is a widespread feeling of frustration among the scientific community. This government is keenly aware of the contribution which our scientists and technologists can make to the economic regeneration of India and is determined to promote research and development activities in a big way.

I, therefore, propose to allow a weighted deduction in an amount equal to 125 percent of the actual expenditure incurred on scientific research in any in-house R and D facility where such expenditure is incurred on a programme approved by the prescribed authority having regard to the social, economic and industrial needs of India. In addition, I propose to extend, the scope of the existing provision for a weighted deduction on the expenditure incurred in scientific research under sponsored programmes in approved laboratories so as to cover the expenditure similarly incurred in in-house R and D facilities of public sector companies. I have no doubt that the hon'ble members will welcome these concessions.

Advance tax

At present, income-tax payers are required to pay advance tax during the financial year on the basis of their own statements or estimates.

Where the estimated advance tax is likely to fall short of the tax on current income by more than 33-1/3 percent of the estimate, the taxpayers are required to make an upward revision of the estimates. I propose to reduce this margin from 33-1/3 percent to 20 percent in the case of companies. There will be no change for other taxpayers. This change will enable us to realise a larger share of the tax due as advance tax and thus have a favourable impact on government's ways and means position in 1980-81.

Employment of handicapped

In order to encourage the employment of blind and handicapped persons in business and industry, I propose to provide for a weighted deduction of one and one-third times the salary paid to such persons by employers where such salary does not exceed twenty thousand rupees in a year. Further, I propose to enhance the deduction currently available in computing the taxable income of blind and handicapped persons from five thousand rupees to ten thousand rupees.

Pensioners

At present, standard deduction in computing the salary income is not available in the case of pensioners. With a view to affording some relief to pensioners who are amongst the worst hit by the rise in prices, I propose to extend the benefit of standard deduction in their case as well.

Sportsmen

In order to encourage our sportsmen to compete in international events, I propose to allow a deduction, equal to 25 percent of their foreign earnings if these are brought into India in foreign exchange. This provision will apply in relation to the current assessment year and onwards. I also propose to allow higher deduction in respect of savings made by sportsmen through life-insurance and provident funds etc., as currently available in the case of authors, playwrights, artists, musicians and actors. Sportsmen will thus be entitled to deduct contributions made to life insurance and provident funds up to 40 percent of their professional income and 30 percent of the remaining income, subject to a maximum of Rs. 50,000.

Publicity

In 1978, certain restrictions were placed on the deductible amount of expenditure on advertisement, publicity and sales promotion. These restrictions have particularly hurt small and medium business. I, therefore, propose to do away with these restrictions.

Agriculture

At present, income from poultry and dairy farming and livestock breeding is exempt from income-tax up to 33-1/3 percent of such income or ten thousand rupees, whichever is higher. I feel that time has come when persons deriving income from these sources should also contribute a little more to the national exchequer. I accordingly propose to restrict the deduction in respect of such income to one-third of such income or fifteen thousand rupees, whichever is less.

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At present, agricultural property is included in the taxable wealth for the purposes of the levy of wealth-tax. At the time when agricultural property was brought within the tax net, it was hoped that it would be a potent instrument for mobilising resources from the affluent section of agriculturists. But our experience of over the last decade has been most disappointing. The amount realised as wealth-tax on agricultural property has generally been less than Rs. 1 crore per annum. The valuation of agricultural land has posed difficulties leading to complaints of harassment. As this tax has clearly failed to achieve its original objective, I propose to discontinue the levy of wealth-tax on agricultural property except in the case of owners of tea, coffee, rubber and cardamom plantations. I am sure that this measure will be widely welcomed by our farmers.

Other measures

I also propose to make certain amendments in the Income-Tax Act to counteract certain court decisions which have resulted in unintended benefit to taxpayers. The Finance Bill further contains certain proposals for the amendment of direct taxes which are of minor significance. I will not take the valuable time of the House in explaining the same.

The reduction in rates and other concessions in respect of direct taxes should ordinarily involve loss of revenue. However, I am of the view that reduction in rates will lead to significantly improved compliance with tax laws. The legislative amendments made for countering tax avoidance devices and the changes in the provisions in regard to advance tax should result in larger accretion of revenue. On a broad judgement of the overall impact of all the proposals relating to income-tax and wealth-tax, I am not assuming any loss of revenue. I recognise, however, that there may be need for some adjustment in the inter-se shares of Centre and states under income tax. Such adjustments will be made in the course of the year in the light of trends in collections.

An upward adjustment of leading rates should moderate the inflationary pressures in the economy. I accordingly propose to revive interest-tax in relation to interest earned by scheduled commercial banks after 30th June, 1980. The scope of the levy is being extended to cover also interest received by the larger all-India industrial finance institutions, namely, IDBI, ICICI, IFCI and IRCI. The tax will be levied at the rate of 7 percent on the chargeable amount of interest as in the past. This measure will yield Rs. 217 crores in a full year and about Rs. 108.5 crores in the year 1980-81.

With a view to checking lavish expenditure incurred on accommodation and entertainment in luxury hotels, I propose to introduce a bill in the current session to levy a new tax at 15 percent on gross receipts of hotels in which the minimum tariff for a single room is 75 rupees per day. The new levy is proposed to be made effective from 1st September 1980. This will yield about Rs. 12 crores in a full year and the revenue during 1980-81 will be of the order of Rs. 5 crores.

Indirect taxes

I shall now turn to my proposals on indirect taxes. In framing my proposal I have kept in view the following objectives: to the extent additional resource mobilisation is inescapable, this should be done in such a way as not to enhance the burden on any commodity significantly. Subject to this consideration, the small segment of our industry should be encouraged. Industries with significant employment and export potential should be provided encouragement through suitable adjustment of duty structure. The duty burden on some articles of common consumption should be reduced or totally removed.

At the outset I would like to put the hon'ble members at ease by pointing out that my proposals are modest. I have tried to avoid the usual device of picking out selected items for new or increased levies at relatively high rates.

For this year, I have sought to spread the effect of the additional taxation thinly on a wide range of products, taking care to leave out articles of common consumption. I propose to achieve this objective through the special excise duty which is even now leviable on all excisable goods at 1/20th of the basic excise duty, but from which a number of commodities have been exempted.

Under my proposal, the special excise duty will be levied on those items which are at present exempt from the levy, at the rate of 1/20th of the effective basic excise duty rates applicable. Certain commodities will, however, continue to be totally exempt from the levy. Thus there will be no special duty on motor spirit including naphtha, kerosene, high speed diesel oil, light diesel oil and liquefied petroleum gas or on coal or electricity.

Again, the special excise duty will not be levied on matches, or on vanaspati, or on goods falling under tariff item 68. Where special excise is already leviable at 1/20th of the effective basic duty, I propose to increase this to 1/10th of the effective basic duty.

This increase will not, however, apply to furnace oil, asphalt, bitumen and tar, petroleum products not otherwise specified and calcined petroleum coke. Sugar and processed vegetable non-essential oils will also not be subjected to the increased levy.

Cigarettes, which are at present totally exempt from special excise duty, will be subjected to special excise duty at 1/10th of the basic excise duty rates. These proposals would yield a revenue of Rs. 197.71 crores in a full year. The impact of these proposals relating to special excise duties will also yield sum of Rs. 16.75 crores in the shape of countervailing duties on imported goods.

Soda ash and caustic soda command a sizable premium in the market on account of persistent shortages. I propose to mop up a part of this premium by raising the excise duty on these products from ten percent to fifteen percent ad valorem. I also propose to increase the excise duty on starch from ten percent to fifteen percent ad valorem.

This step will bring these chemical products on a par with other chemical products, which, in general, bear excise duty at 15 percent ad valorem. Synthetic rubber at present bears duty at the very low level of five percent ad valorem.

As a revenue measure, I propose to raise the excise duty on synthetic rubber from five percent to ten percent ad valorem. Similarly, the rate of excise duty on specified acids is being raised from ten percent to fifteen percent ad valorem. These measures would fetch in a full year, additional revenue of Rs. 18.93 crores.

On revenue considerations, I propose to subject molasses to a specific duty of Rs. 30 per metric tonne under a separate item in the central excise tariff instead of eight percent under item 68 of the central excise tariff as at present. The levy is, however, proposed to be restricted to molasses produced in vacuum pan sugar factories. Molasses produced in khandsari sugar units, which go inter alia for edible purposes, are proposed to be exempted. The revenue yield as a result of this proposal is estimated to be Rs. 4.24 crores in a year.

Protection of industry

I now come to proposals which are designed to provide a higher degree of protection to certain sectors of indigenous industry. The first proposal related to audio frequency amplifiers, an item reserved for the small-scale sector.

In view of the adverse effect of imports of this item, I propose to increase the customs duty on imports from 75 percent to 120 percent ad valorem.

My other proposal relates to imported unexposed colour positive cinematograph films, in respect of which the basic customs

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duty is proposed to be raised from 50 paise to Rs. 1 per linear metre to enable the indigenous public sector unit to withstand competition from imports. I also propose to increase the countervailing duty on imported computers from ten percent to 20 percent ad valorem as a measure of affording protection to the indigenous computer industry.

These measures are designed to yield additional revenue of about Rs. 1.83 crores in a full year.

I have only one more revenue proposal in the field of indirect taxes. This relates to passengers' baggage. As hon'ble members are aware, baggage allowances were substantially liberalised in 1978 and, for the generality of Indian passengers going abroad for short visits, the allowances consist of Rs. 1,000 worth of duty-free goods and Rs. 2,000 worth of goods on payment of duty. Despite this liberalisation, goods in the nature of baggage continue to be imported by many passengers in quantitites substantially higher than the permissible limits.

This is mainly due to the prevailing craze for foreign goods and the high margin of profits on the sale of these goods in India. Such cases of import of baggage items in excess of the permissible limits necessitate initiation of adjudication proceedings which generally have the effect of slowing down the tempo of passenger clearance in out international airports.

I have given thought to this problem and I am making two proposals in this regard. The first is a pure revenue measure of increasing the effective rate of duty on baggage articles in excess of the free allowances from 120 percent ad valorem to 150 percent ad valorem. This measure is to come into force immediately and is expected to yield an additional Rs. 20 crores in a full year.

The second measure to be brought into force shortly, provides for the levy of duty at a flat rate of 320 percent on baggage imported in excess of the permissible limits, that is, in excess of what can be passed free or on a duty of 150 percent.

At present, such articles would be treated as unlicensed imports, resulting in confiscations, fines and penalties, designed to wipe out any profit on their sale.

The increased rate of duty is intended to replace these fines and penalties, without having to go through the time-consuming process of adjudication. Goods which are obviously in the nature of trade goods will, however, still attract penal action.

Rationalisation measures

I have a few other proposals which are essentially in the nature of rationalisation measures.

The first one relates to aerated waters. In the interest of simplification, it is proposed to do away with the existing distinction between aerated waters containing caffeine and those not containing caffeine for the purpose of excise duty.

Instead, it is proposed to levy on all flavoured aerated waters a uniform duty at 40 percent ad valorem. The revenue effect of the proposal is expected to be negligible.

I have given considerable thought to the problems thrown up as a result of the changes made in the 1979 budget in the excise duty structure applicable to the match industry.

While the duty advantage enjoyed by the cottage sector obviously needs to be maintained, the non-mechanised middle sector should not be allowed to make inroads into the cottage sector.

In order to ensure that the benefit of the lower rate of duty accrues only to the genuine cottage sector units, I propose to confine the duty concession to match boxed bearing approved labels and sold to or marketed through the KVIC, state agencies and registered cooperative societies.

At the same time, I do not find justification for the continuance of the existing limits placed on the clearances of matches by the cottage sector at the concessional rate of duty. I, therefore, propose to abolish the existing limit on production by the cottage sector units. I am confident that this package of measures will result in accelerated growth of the cottage sector of the match industry.

There have been complaints of malpractices in the biri industry by manufacturers who have been taking advantage of the liberal exemption limit applicable to the unbranded sector which is at present 60 lakhs of biris per manufacturer per year.

With a view to reducing the possibilities of malpractices, I propose to lower this exemption limit to 30 lakhs of unbranded biris per manufacturer per year, which will still leave out of the excise net the really small manufacturer and the self-employed manufacturer. This is not designed as a revenue measure.

Some of the provisions in the Finance Bill are aimed at rationalisation or clearer definition of certain central excise tariff items to remove doubts or difficulties which have come to notice. The details of these measures may be found in the budget papers.

Concessions

I shall now turn to concessions in the area of indirect taxes. The small manufacturer plays a significant role in our economy. I would like to improve his competitive position vis-a-vis the large manufacturer and thus widen the entrepreneurial base of our economy.

Only in this way can we check concentration of economic power. There is already a scheme of excise duty concessions applicable to manufacturers of 70 excisable commodities, under which clearances upto Rs. 5 lakhs in value in a year have been exempted from duty.

I now propose to liberalise this concession in two respects. First I propose to include two more groups of commodities under the scheme. These are chemicals, namely, sodium, bi-chromate, bleaching powder, calcium carbide and artificial and synthetic resins and plastic materials. Besides, the coverage is being widened in respect of paper and paper boards. But the second and more important concession which I propose to introduce is that in respect of all the commodities covered by the scheme, clearances between Rs. 5 lakhs and Rs. 15 lakhs will bear only three-fourths of the applicable rate of excise duty as against the normal duty at present. This measure should benefit a large number of small manufacturers. The revenue sacrifice will be of the order of Rs. 6.50 crores in a full year.

Last year's budget made a change which affected a substantial number of small manufacturers of goods falling under the residuary item 68 of the Central Excise Tariff. Hon'ble members will recall that the quantum of duty-free clearances was reduced from Rs. 30 lakhs to Rs. 15 lakhs. I had opposed this change then.

As a measure of undoing the hardship caused to such small manufacturers, I propose to provide for complete exemption from duty for clearances up to Rs. 30 lakhs per annum. In other words, small manufacturers of goods falling under item 68 of the Central Excise Tariff, whose capital investment on plant and machinery does not exceed Rs. 10 lakhs, will be eligible for complete exemption from duty on their first clearances of goods up to Rs. 30 lakhs in a financial year. The quantum of clearances eligible for full exemption from duty will be fixed at a correspondingly lower figure. This concession is expected to cost Rs. 2.4 crores in a full year.

Paper and allied products are in short supply in the country and new investment in this sector has not been readily forthcoming. Much can be done by smaller units to help in filling the production gap. To encourage them, I propose to extend a concessional rate of duty of 20 percent ad valorem as against the present rate of 30 percent to paper and paper board produced by small manufacturers whose clearances in

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the preceding financial year did not exceed 300 tonnes of paper and paper board. This concession will cost a little less than Rs. 1 crore in a full year.

The electronics industry has considerable employment and export potential. We have the necessary skills and expertise and these should be harnessed through appropriate fiscal incentives for development of the electronics industry in a big way.

This is a field which offers great scope to small-scale manufacturers. I am, therefore, proposing some duty concessions in respect of the industry.

There will be a reduction in customs duty on specified items of capital goods such as machines and instruments required by the electricals industry and not produced within the country. The customs duty on such items will be reduced from the present levels of duty (which in some cases are as high as 89 percent ad valorem) to a total of 25 percent ad valorem.

Similarly, I also propose to reduce the customs duty on specified raw materials and components required for the electronics industry from their present levels (which in some cases are higher than 200 percent ad valorem) to 45 percent ad valorem plus countervailing duty where an excise duty is leviable under item 68. These two concessions will cost the exchequer Rs. 4.7 crores in a full year.

The experience of other countries shows that the growth of consumer electronics facilitates in due course the development of other sophisticated lines of production in electronics.

Television is a powerful medium of communication and education. With a view to enabling a larger number of people to get the benefit of this medium, I propose to reduce the excise duty on cheaper priced TV sets from 15 percent to 10 percent ad valorem, and to effect a corresponding reduction in the duty on other TV sets from 30 percent to 25 percent ad valorem. These concessions would entail a revenue sacrifice of Rs. 1.5 crores in a year.

Radio is an equally powerful instrument of education and entertainment and is more widely in use. Government considers that single and two band radio sets should be popularised particularly in rural areas. The licence fee on such sets has proved to be irksome and inhibits purchase of radio sets by the rural folk. It is, therefore, proposed to abolish the fee in respect of single and two band radio sets including transistor sets. This measure, which I am sure will be widely welcomed, will cost government about Rs. 4 crores.

Our computer industry is still in its infancy, compared with those of other countries. In order to provide an additional incentive for indigenous production and improvement, I propose to reduce the excise duty on indigenously manufactured computers from 25 percent to 20 percent ad valorem.

Ship building

Ship building is a high priority industry and has an important part to play in promoting economic self-reliance. The Indian ship building industry is finding it increasingly difficult to face competition from foreign shipyards. I, therefore, propose to extend full exemption from excise duty to ocean going vessels built in Indian shipyards. This relief would cost about Rs. 5 crores in the current financial year.

Hon'ble members would be aware that government has been following the practice of bringing down the import duty on selected machinery items having no indigenous angle to 25 percent ad valorem as a measure of reducing capital costs in industries.

Other industries

Carrying this process further, I propose, this year, to reduce the import duty to 25 percent ad valorem on twelve more items of capital equipment. These include five items of machinery used in the printing industry, such as high speed letter press rotary and off-set rotary printing machines, mono lino type casting machines etc. These concessions would entail a revenue sacrifice of Rs. 1.84 crores in a full year.

The cost of high pressure gas cylinders constitutes a significant portion of the total capital outlay required by the glass industry. With a view to reducing, at least in part, this capital outlay, I propose to extend complete exemption from customs duty on steel tubes imported for fabrication of high pressure gas cylinders. I also propose to reduce the excise duty on such cylinders from the existing level of 15 percent to 8 percent ad valorem, which is the duty level applicable under item 68. These two measures, taken together, are estimated to cost Rs. 1.89 crores in a full year.

I have a proposal of general application, which is intended to facilitate manufacturers of excisable goods, using inputs on which excise duty is leviable. In order to give relief in such cases, two procedures are in vogue at present. One is what is called the set-off procedure. The other is the proforma credit procedure under Rule 56A of the Central Excise Rules.

The proforma credit procedure is generally recognised to be more beneficial and less irksome to the manufacturers. I, therefore, propose to replace the existing concessions based on the set-off procedure by similar concessions based on the proforma credit procedure. I am sure that this measure will be welcomed by industry.

Consumption goods

It is a little painful for me to remind hon'ble members that last year's budget had increased excise duty on a number of articles of common consumption to a significant extent. I propose to reverse this trend. Thus —

— specified life-saving drugs, 30 in number, will be fully exempted from excise duty. The list will be kept under periodical review with a view to adding more items as may be warranted.

— controlled cloth is meant for the weaker sections of society and its cost should be as low as possible. I, therefore, propose to exempt controlled cloth from excise duty.

— cotton and cotton-viscose blend hosiery consisting of items like banians are of relatively low value and these are now subject to excise duty at 8 percent. I propose to exempt them fully from excise duty.

— cycles are the poor man's conveyance. I, therefore, propose to totally exempt cycles and cycle parts falling under item 68 from excise duty.

— sewing machines, which are indispensable to the housewife and also enable the weaker sections to earn a living, will also be fully exempt from excise duty.

— pressure cookers which take the drudgery out of the housewife's daily tasks and save fuel now attract duty at 15 percent. I propose to reduce it to 10 percent.

I also propose to make substantial reductions in excise duty on some other items of everyday use, accordingly—

— excise duty on cheaper varieties of toilet soap will be reduced from 10 percent to 5 percent.

— excise duty on tooth paste will be reduced from 20 percent to 10 percent.

— vacuum and gas-filled bulbs not exceeding 60 watts will have the duty reduced from 15 percent to 10 percent.

I am sure these substantial concessions, which would cost the exchequer approximately Rs. 15 crores in a full year, will be welcomed by Parliament and by the public. I also hope that industry and trade will play fair by the consumer and pass on the benefit of these duty reductions to the consumer.

Transportation

Our party's election manifesto has referred to the need to encourage dieselisation of taxis. In fulfillment of this commitment and with a view of giving an incentive for taxi-owners to go in for dieselisation, I propose to extend full excise duty exemp-

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tion to diesel engines used for conversion of petrol-driven taxis.

My second proposal is aimed at giving relief to the cycle rickshaw drivers. Powered cycle rickshaws are already exempt from excise duty. To encourage motorisation of non-powered cycle rickshaws, I propose to extend full duty exemption for internal combustion engines used for this purpose. I am sure hon'ble members will welcome this measure, as a visible sign of our keenness to reduce physical strain and at the same time encourage this relatively cheap means of transport.

New tribunal

Before I leave the field of indirect taxes, I have a major decision of policy to announce. For the past couple of decades, there has been a persistent public demand for the setting up of an independent appellate tribunal for customs and Central Excise matters, somewhat similar to the set-up on the direct taxes side.

This demand has recently been endorsed by the Estimates Committee of Parliament. Government has, in the past, not been in favour of such a system, as it was felt that it would not be appropriate in the case of indirect taxes, and that the present departmental machinery was in fact adopting an objective approach.

I think a time has come when we should gracefully accept the common view, which is based on the dictum that justice should not only be done but should also seem to be done. It is in this spirit that provision has been made in the Finance Bill for setting up an appellate tribunal to hear appeals in respect of customs, Central Excise and gold control matters.

This tribunal will be independent of the executive machinery charged with the responsibility of day-to-day administration of revenue laws. I have no doubt that this measure will meet with the whole-hearted approval of Parliament and of trade and industry.

My taxation proposals will yield a sum of Rs. 223.22 crores in a full year in Central Excise duties and Rs. 39.58 crores in customs duties. The reliefs I have announced add up to Rs. 34.75 crores on the Central Excise side and Rs. 7.93 crores on the customs side.

The net yield is, therefore, Rs. 188.47 crores from Central excise duties and Rs. 31.65 crores from customs duties. The accrual to the Central exchequer in a full year will be Rs. 144.85 crores and the share of the states will be Rs. 75.27 crores.

Where changes are proposed to be made by notifications, effective from the 19th June, 1980, copies of such notifications will be laid on the table of the House in due course.

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BIAC'S response to the OECD's report on transfer pricing and multinational enterprises

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IFA

international fiscal association

TVA ET PRESTATIONS DE SERVICES

Journée d'études franco-belgo-luxembourgeoise
du 7 mars 1980

For an English translation of this Introduction and English summaries of the other French texts, see at the end of this Article.

INTRODUCTION

Par Prof. Dr. Paul Sibille

Plusieurs groupements nationaux de l'Association Internationale de Droit Fiscal (I.F.A.) entretiennent depuis plusieurs années l'excellente coutume de rencontres bilatérales au cours desquelles des rapports sont présentés et des discussions engagées sur des thèmes et des questions qui intéressent particulièrement leurs pays.

C'est ainsi que, pour faire pendant à la journée d'études tenue à Paris en mai 1978, le groupement français et le groupement belgo-luxembourgeois ont organisé une journée d'études à Bruxelles le 7 mars 1980.

Cette journée a été consacrée à l'étude des difficultés d'application de l'article 9 de la 6ème directive du Conseil des Communautés européennes du 17 mai 1977 relatif au lieu où une prestation de services est considéré comme exécutée et donne ouverture à la T.V.A. et des solutions qu'il y a lieu d'y apporter (compte tenu de la directive no. 8 relative aux modalités de remboursement de la taxe sur la valeur ajoutée aux assujettis non établis à l'intérieur du pays, qui vient d'être adoptée par le Conseil des Ministres de la Communauté européenne).

L'expérience acquise depuis le 1er janvier 1978, date à laquelle la directive no. 6 du Conseil des Communautés européennes est entrée en vigueur, au moins dans certains pays de la Communauté, fait en effet apparaître que l'article 9 de la directive pose des problèmes dont la solution est, dans l'état actuel de la législation des divers pays concernés et des instructions administratives correspondantes, lorsqu'il en existe, loin d'être evidente, quand elle ne varie pas de pays à pays.

Les problèmes qui ont été spécialement étudiés au cours de cette journée d'études furent les suivants:

a) définir de façon concrète les services énumérés à l'article 9 de la directive, qui sont soustraits par celle-ci au régime de la taxation dans le pays du domicile de l'auteur de la prestation;

b) comment le prestataire de services, débiteur d'une T.V.A. dans un pays où il n'est pas établi et n'a pas d'établissement, peut-il faire pour s'acquitter de ses obligations sans difficultés excessives *sur le plan administratif ou financier?*

c) comment l'utilisateur d'une prestation de services qui a supporté la charge afférente à ces services peut-il la récupérer sans difficultés excessives *lorsque, remplissant les conditions voulues pour obtenir cette récupération, il n'est pas établi dans le pays où la T.V.A. a été payée par le prestataire de services?*

Les séances de travail ont été présidées par M. Henri LEVY MORELLE, Président de la section belgo-luxembourgeoise de l'I.F.A., chargé de cours à L'U.L.B. La co-présidence était assurée par M. Georges EGRET, Secrétaire général du groupement français de l'I.F.A., en l'absence de son Président M. Max LAXAN.

L'organisation de cette journée d'études a pu être menée à bonne fin grâce, pour la partie scientifique, à MM. Jean de LONGUEVILLE et Guy van FRAYENHOVEN, respectivement Président et Membre du Comité scientifique du groupement belgo-luxembourgeois, et, pour la partie matérielle, à M. Jacques AUTENNE, Maître de conférences à l'U.C.L., Secrétaire du groupement belgo-luxembourgeois.

Le groupement belgo-luxembourgeois se félicite d'avoir trouvé auprès du Bureau International de Documentation Fiscale, à Amsterdam, l'occasion de publier les travaux de cette journée d'études, comportant les rapports, les parties essentielles des exposés et les résumés des débats.

Le rassemblement de ces matériaux a pu être réalisé grâce aux notes recueillies et retranscrites par Madame Marie-Cécile van GRIEKEN, assistante à l'Ecole Supérieure des Sciences Fiscales, sous la Direction du Professeur P. SIBILLE, Directeur de l'Ecole.

La présente publication constituera sans nul doute un guide précieux pour les juristes et experts fiscaux et pour les entreprises qui sont confrontées continuellement avec l'un des problèmes les plus complexes en matière de T.V.A. dans les relations internationales.

INCORPORATION DE LA SIXIEME DIRECTIVE SUR LA T.V.A. DANS LES LEGISLATIONS NATIONALES

Les pays membres des Communautés Européennes ont adapté leur législation relative à la T.V.A. en vertu de la 6ème directive. Les modifications ont pris effet aux dates suivantes:

Belgique	— le 1er janvier 1978
Danemark	— le 1er octobre 1978
France	— le 1er janvier 1979
Irlande	— le 1er mars 1979
Italie	— le 1er avril 1979
Luxembourg	— le 1er janvier 1980
Pays-Bas	— le 1er janvier 1979
République Fédérale Allemande	— le 1er janvier 1980
Royaume-Uni	— le 1er janvier 1978

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SUJET I: Lieu des prestations de services

Exposé

BELGIQUE: Localisation des opérations imposables*

par Jacques Malherbe **

LIVRAISONS DE BIENS

Aux termes de la directive (art. 8.1.b)) comme du Code belge, la livraison d'un bien a lieu à l'endroit où se trouve ce bien au moment de la livraison.

La directive prévoit que, si un bien est transporté ou expédié, la livraison a lieu au point de départ du transport. S'il fait l'objet d'une installation ou d'un montage, la livraison a lieu à l'endroit où ces travaux se font (art. 8.1.a)).

Le Code belge édicte les mêmes règles en situant au départ du transport ou à la fin de l'installation le moment de la livraison (art. 15, §1, al.2, 1o). Le lieu de celle-ci étant déterminé par la localisation du bien au moment de la livraison, le résultat est identique.

PRESTATIONS DE SERVICES

La 6ème directive situe le lieu d'une prestation de services au siège de l'activité économique du prestataire ou de l'établissement stable rendant la prestation et, subsidiairement, du domicile ou de la résidence du prestataire (art. 9.1). Il abandonne le critère du lieu d'utilisation du service, introduit par la 2ème directive (art. 6.3) et repris par la réglementation belge (Code, art. 21 ancien et arrêté royal no. 5 du 6 février 1970, relatif au lieu d'utilisation des prestations de services en matière de T.V.A.). L'article 21 nouveau du Code s'aligne sur la directive (§1).

Il adopte également les nombreuses exceptions au critère principal établi par la directive:

a) Les services se rattachant à un immeuble sont localisés au lieu de situation du bien (directive, art. 9.2.a) et Code, art. 21, §3, 1o). Ils comprennent non seulement les travaux immobiliers, mais:
   - les prestations des agents immobiliers comme intermédiaires et des experts;
   - les travaux d'étude ou de contrôle des architectes, géomètres et ingénieurs;

   comme prévu la directive, et en outre:
   - la mise à disposition d'emplacements de parcage de véhicules, d'entreposage de biens, de logements meublés, d'emplacements de camping;
   - la location d'immeubles ou de coffres-forts;
   - la gestion d'immeubles (Code, art. 21, 1o et arrêté royal no. 5 du 27 décembre 1977 concernant les services relatifs à un immeuble par nature en matière de T.V.A.).

b) Les prestations de transport sont rattachées au lieu de transport en fonction des distances parcourues (directive, art. 9.2.b) et Code, art. 21, §3, 3o).

c) L'endroit où les prestations sont matériellement exécutées sert à localiser:
   - les activités culturelles et assimilées, y compris celles de leurs organisateurs et les services accessoires;
   - les activités accessoires au transport, telles que chargement et manutention;
   - les travaux portant sur des biens meubles corporels, y compris les expertises (directive, art. 9.2.c)). En ce qui concerne ces derniers, le Code belge les localise à l'endroit où se situe le bien (art. 21, §3, 2o). Cet endroit coïncide normalement avec le lieu d'exécution du travail.

d) La location de biens meubles corporels, autres que des moyens de transport, est localisée à l'endroit de leur utilisation. Si le loueur est établi dans la CEE, encore faut-il que le bien soit exporté dans l'Etat d'utilisation (directive, art. 9.2.d); Code, art. 21, §3, 5o).

e) Le siège de l'activité économique du preneur ou de l'établissement stable pour lequel la prestation de services est rendue et, subsidiairement, le domicile ou la résidence du preneur, est considéré comme lieu de prestation des services suivants:
   - cession ou concession de droits intellectuels, auxquels le Code ajoute les monopoles de vente ou d'achat et le droit d'exercer une activité professionnelle;
   - publicité;
   - travaux intellectuels des conseillers, ingénieurs, bureaux d'études, experts comptables, à l'exclusion, en Belgique, pendant la période transitoire, des avocats;
   - l'engagement de ne pas exercer une activité professionnelle ou un droit intellectuel;
   - les opérations bancaires et financières, autres que la location de coffres-forts, les opérations d'assurance étant exonérées;
   - la mise à disposition de personnel;
   - les services des intermédiaires autres, précise le Code, que les commissionnaires qui sont réputés acheteurs ou vendeurs, intervenant dans la fourniture des prestations énumérées ici (directive, art. 9.2.e); Code, art. 21, §3, 7o).

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* Extrait de la Communication faite à l'Université des Sciences sociales de TOULOUSE, les 29/30 novembre 1979.

** Maître de conférences à l'Université de Louvain, Avocat au barreau de Bruxelles.

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FRANCE: Documentation

Lieu d'imposition des prestations de services et définition du contenu des prestations de services

La loi française: Code général des impôts (CGI), articles 259, 259A, 259B et 259C

I. *Rappel du cas général:*

Lieu de prestataire, Instruction administrative du 15 février 1979

II. *Les exceptions au cas général:*

A. Locations de biens meubles corporels
(CGI, Article 259 A-1°, Compte rendu du Comité Fiscal du 29 mars 1979, Instr. Adm. 3 A-19-79 du 10 décembre 1979, Article 24 Annexe I du CGI)

B. Prestations se rattachant à un immeuble
(CGI, Article 259 A-2°, Instr. Adm. du 15 février 1979)

C. Prestations de transport et prestations accessoires au transport
(CGI, Article 259 A-3°, Instr. Adm. du 15 février 1979, Document de base 3A 233, Annexe III du CGI)

D. Prestations imposables au lieu de leur exécution
(CGI, Article 259 A-4°, Instr. Adm. du 15 février 1979)

E. Prestations de caractère immatériel
(CGI, Articles 259 B et C, Instr. Adm. du 15 février 1979, Compte rendu du Comité fiscal du 29 mars 1979, Instr. Adm. 3A-17-79 du 13 novembre 1979, Article 24, Annexe I du CGI)

LUXEMBOURG: Le régime de la taxe sur la valeur ajoutée appliqué aux prestations de services suite aux modifications législatives intervenues en raison de la 6ème directive

par Rodolphe Gerbes * et Yves Prussen **

Sommaire

I. INTRODUCTION
II. DEFINITION DU LIEU DE LA PRESTATION
III. LES OBLIGATIONS DU PRESTATAIRE DES SERVICES
IV. PROCEDURE DE DEDUCTION DE LA TAXE EN AMONT ET PROCEDURE DE REMBOURSEMENT PREVUE PAR LA 8ème DIRECTIVE

I. INTRODUCTION

La sixième directive du Conseil des Communautés Européennes en matière de TVA s'est traduite au Grand Duché de Luxembourg par une loi du 12 février 1979, qui est entrée en vigueur le 1er janvier 1980.

En théorie cette modification législative a apporté des changements importants dans la taxation des prestations de services effectués par des assujettis à la TVA, les prestations de services étant définis par la loi comme opération ne constituant ni une livraison de biens ni une importation, et l'assujetti étant défini comme toute personne, résidente ou non, effectuant de façon indépendante et à titre habituel des opérations relevant d'une activité économique quelconque. Conformément à l'article 2 de la loi organique de la TVA, sont soumises à la taxe les prestations effectuées à titre onéreux à l'intérieur du pays.

En l'occurrence ces changements sont le résultat d'une optique fondamentalement différente que la sixième directive a imposée dans la définition du lieu d'une prestation de service. D'autres changements paraissent plutôt de nature pratique, les principes afférents étant comparables à ceux ayant déjà existé sous l'ancienne législation. Tel est notamment le cas pour certains des services énumérés à l'article 9 de la directive.

Le système antérieurement en vigueur a paru simple, mais son application donnait lieu à des difficultés notamment en raison des interprétations divergentes dans les différents pays-membres de la CEE.

En effet, conformément à l'article 17 (ancien) de la loi organique de la TVA, le lieu de la prestation de service était réputé se situer à l'endroit où le service rendu était utilisé ou exploité. Ce principe prévoyait en conséquence l'assujettissement à la taxe des prestations de service facturées par des étrangers à des résidents du Grand Duché, à moins qu'il ne pouvait être prouvé que ces services étaient effictivement utilisés ou exploités en dehors du territoire grand-ducal.

En ce qui concerne les assujettis établis dans le Grand-Duché de Luxembourg, il existait une exonération correspondante en ce que les prestations de service effectuées pour le compte des commettants étrangers pour les besoins de leur entreprise, se trouvaient exonérées.

La difficulté principale consistait à déterminer le lieu de l'utilisation, et la tendance de certaines administrations fiscales de localiser l'utilisation du service dans leur pays a entraîné des désavantages certains pour beaucoup de preneurs assujettis.

C'est pour atteindre une harmonisation plus poussée des législations et de leur interprétation que le critère du lieu d'utilisation du service a été abandonné.

En conformité avec la sixième directive, la loi du 12

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février 1979 a posé comme principe que, sauf exception, toutes les prestations exécutées ou réputées exécutées à l'interieur du territoire sont soumises à la TVA, étant entendu qu'en principe le lieu de la prestation du service est le lieu de l'établissement stable à partir duquel le service est rendu. La sixième directive est ainsi plus proche du principe retenu par la loi allemande aux termes duquel un service est presté à l'intérieur du pays si l'entrepreneur y déploit son activité de facon prépondérante (par. 3 al. 10 UStG.), mais elle a introduit la présomption irréfragable que, sauf exception, ce qu'elle prévoit, l'activité est exercée au siège économique ou dans l'établissement stable du prestataire. Au Grand-Duché, l'établissement stable n'est pas défini dans la loi organique de la TVA. Il faut donc se référer à la législation sur les impôts directs (loi d'adaptation fiscale paragraphe 16).

Les exceptions sont énumérées à l'article 9 de la directive qui prévoient un régime s'inspirant du principe de l'article 6 al. 3 de la seconde directive (lieu d'utilisation effectif du service) qui avait été repris par l'ancien article 17 de la loi, même si cela ne ressort pas des travaux préparatoires de la directive.

Il est toutefois indéniable que ces nouvelles dispositions considèrent des services effectivement prestés à l'intérieur du pays comme étant prestés à l'étranger, et d'autres services effectivement prestés à l'étranger comme ayant été prestés à l'intérieur du pays. La différence fondamentale entre la nouvelle et l'ancienne loi est en conséquence l'introduction de critères précis définissant le lieu où la TVA est à payer.

II. DEFINITION DE LIEU DE LA PRESTATION

Le lieu de la prestation d'un service pour les besoins de la législation sur la TVA n'est pas nécessairement le lieu où le travail est matériellement exécuté.

En effet, la loi pose des présomptions irréfragables (article 17 nouveau de loi) suivant lesquelles sont considérés comme lieu de la prestation de service:

a) en principe le siège ou l'établissement stable à partir duquel le service est rendu,
b) par dérogation les lieux définis par l'article 17.

Ces dérogations concernent les services énumérés à l'article 9 de la directive qui sont soustraits au régime de la taxation dans le pays du siège ou de l'établissement stable de l'auteur de la prestation:

A. Services se rattachant à un immeuble déterminé

Il importe de préciser que les prestations qui ne se rattachent pas à un immeuble déterminé, comme par exemple la confection de plans d'architecture standardisés, obéissent à la règle générale. Sont visés:

1. Les services tendant à préparer ou à coordonner l'exécution de travaux immobiliers, y compris ceux des architectes, des bureaux d'études et des bureaux de surveillance.
2. Les opérations d'entretien effectués à un immeuble, dans la mesure où elles ne constituent pas des livraisons de biens au sens de l'article 5 (par. 5.1) de la VIe Directive (art. 12f) de la loi luxembourgeoise du 12.2.1979.

Lieu de l'imposition
lieu de la situation de l'immeuble

Ce dernier assimile à une livraison la délivrance d'un travail immobilier, y compris celui comportant l'incorporation d'un bien meuble à un bien immeuble, à l'exclusion toutefois des opérations d'entretien courant. Constitueraient p.ex. des travaux immobiliers les réparations portant sur des immeubles.

3. Les prestations de services des agents immobiliers et des experts en immeubles.
4. Plus généralement tous les services en relation avec l'acquisition ou la cession d'immeubles, tels que ceux des notaires, autres services de conseils visés sous E ci-après, tels des services de publicité.
5. Les locations d'immeubles, de chambres d'hôtel, d'emplacements de parcage et de coffres-forts.
   Il y a lieu de noter que la règle s'applique à toutes les locations immobilières généralement quelconques, y comprises celles exclues de l'exonération prévue par la loi pour les locations immobilières telles que le logement passager de personnes, de stationnement passager de personnes, de stationnement passager de véhicules (v. art. 13, B, b) de la VIe Directive et art. 44.1. g) de la loi luxembourgeoise).
6. Le magasinage de biens dans un immeuble.

B. Les prestations de transport

Pour les transports internationaux ce lieu n'est réputé se situer à l'intérieur du pays que pour la partie du transport qui y est effectivement réalisée. Signalons qu'en règle générale, les transports internationaux sont des services exonérés.

Contrairement à l'ancienne législation cette exception ne concerne pas la location de moyens de transports auxquelles s'applique la règle générale.

Lieu d'imposition
lieu où s'effectue le transport

Toutefois dans le cas où une agence de voyage a contracté en son propre nom avec un voyageur pour l'organisation d'un voyage incluant une prestation de transport effectué par un autre assujetti, le service de l'agence, même dans la mesure où il constitue l'exécution d'un contrat de transport, est taxé au siège ou établissement de l'agence. En l'occurrence la prestation en question n'est plus considérée par la loi comme opération de transport, mais comme une partie d'une prestation sui generis.

C. Les prestations de services ayant pour objet:

1. Des activités culturelles, artistiques, scientifiques, sportives, enseignement, de divertissement ou des

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activités similaires, y compris les prestations de services des organisateurs de telles activités et les prestations de service accessoires à de telles activités.
2. Des activités accessoires au transport telles que le chargement, le déchargement et la manutention ainsi que des activités similaires.

Lieu d'imposition

lieu où la partie essentielle de chaque service est matériellement exécutée

3. Des expertises de biens meubles corporels.
4. Des travaux portant sur des biens meubles corporels.

Dont à comprendre parmi les prestations sous 3 et 4 entre autres les simples réparations de voitures automobiles et d'autres biens meubles ainsi que les expertises y relatives (p. ex. en cas de panne).

D. Les prestations de services ayant pour objet:

la location de biens meubles corporels que le prestataire, en vue de leur utilisation dans le pays de destination, a exportés ou importés d'un pays membre des C.E. vers un autre pays membre.

Il résulte du texte de loi que la dérogation n'est pas applicable:

a) lorsque c'est le preneur qui a exporté le bien loué d'un Etat membre vers un autre pour l'y utiliser;
b) lorsque soit le preneur soit le louer exportent le bien loué ou à louer à partir d'un pays tiers ou dans un pays tiers;
c) lorsque la location a pour objet un moyen de transport généralement quelconque dans ces trois hupothèses;

Lieu d'imposition

lieu où les biens sont utilisés

Dans ces quatre hypothèses le lieu de la location se détermine conformément à la règle générale (pays du loueur) sous réserve d'éventuelles mesures particulières à prendre sur base de l'habitation prévue à l'article 17 par. 3 de la loi luxembourgeoise.

En effet, cet article prévoit que le lieu de prestation pourra être fixé par référence au critère de l'utilisation ou de l'exploitation du service pour des cas où le régime décrit dans ce chapitre mène à des cas de double imposition, une non-imposition ou des distorsions de concurrence.

On constate que le texte en question ne reconnaît le critère du lieu d'utilisation que dans un cas particulier alors que dans des situations économiquement identiques le critère général reste curieusement applicable.

E. Les prestations de services ayant pour objet:

les activités énumérées ci-après, lorsque les prestations ne sont pas visées sous A et C ci-dessus, et qu'elles sont effectuées pour le siège d'activité d'un preneur assujetti (ou de son établissement stable) établi en dehors du pays du prestataire, que ce soit dans un Etat membre ou dans un pays tiers:

1. La cession ou la concession de droits d'auteurs, de brevets, de droits de licences, de marques de fabrique et de commerce et d'autres droits similaires;
2. la publicité, y compris les prestations de services des intermédiaires en publicité agissant en leur propre nom;
3. les activités d'avoué, d'avocat, de conseiller, d'expert comptable, d'ingénieur, d'un bureau d'études ou d'activités similaires;

Lieu d'imposition

lieu du siège d'activité économique du preneur (ou de son établissement stable)

4. le traitement de données et la transmission d'informations;
5. les opérations bancaires, financières, d'assurance et de réassurance à l'exception de la location de coffres-forts;
   Signalons que les opérations de banque et d'assurances proprement dites sont exonérées.
6. la mise à disposition de personnel;
7. les prestations de services consistant dans l'obligation de ne pas exercer, entièrement ou partiellement, une activité professionnelle ou un droit visé ci-dessus sous 5;
8. les prestations de services des intermédiaires qui agissent au nom et pour le compte d'autrui et qui interviennent dans les prestations de services visées ci-dessus sous 5.

F. Les prestations de services:

énumérées sous E ci-dessus, qui ne sont pas visées sous A et C et qui sont effectuées pour les besoins d'un preneur *non assujetti* domicilié ou résident habituellement *en dehors des C.E.*

Remarques quant aux positions 5 et 6 ci-dessus:

Il résulte implicitement du texte que:

1. les mesures dérogatoires énumérées sous 5 et 6 ci-dessus sont primées par celles figurant sous 1 et 3. Il y a lieu de signaler qu'elles peuvent être modifiées ou complétées par des dispositions particulières sur base de l'habilitation contenue dans la loi.
2. dans l'hypothèse où le prestataire et le preneur sont établis dans le même pays le lieu des prestations sous 5. est fixé d'après le principe général (lieu d'établissement du prestataire)
   Il en est de même lorsque le preneur non assujetti a son domicile ou sa résidence habituelle à l'intérieur des C.E.

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Lieu d'imposition
lieu du domicile ou de la résidence du preneur

3. En d'autres termes et en résumé:
   (a) C'est le lieu d'établissement du preneur qui détermine le lieu de la prestation
   (i) dans tous les cas où le preneur est établi dans un pays tiers
   (ii) en cas d'établissement à l'interieur des C.E., seulement lorsque le preneur est un assujetti et que le siège de son activité ou son établissement stable se trouve dans un pays-membre autre que celui du prestataire, peu importe que ses activités soient possibles ou non de la TVA.
   (b) Au contraire le lieu d'établissement (d'activité) du prestataire sera considéré comme lieu de la prestation lorsque
   (i) le preneur et la prestataire sont établis dans le même pays
   (ii) le preneur est un non assujetti ayant son domicile ou sa résidence dans un autre pays membre des C.E.

   Pour éviter les cas de non-imposition, le par. 3 de l'article 17 habilite le Gouvernement à déroger aux dispositions des par. 1er et 2 (positions 1 à 6 ci-dessus) en ce qui concerne la location de biens corporels, y compris les moyens de transport, et les prestations visées sous 5 et 6 ci-dessus, en fixant le lieu de ces prestations par référence au critère de l'utilisation ou de l'exploitation.

III. LES OBLIGATIONS DU PRESTATAIRE DES SERVICES

A. Services effectués au lieu du siège ou d'un établissement stable

Pour le prestataire dont les services sont réputés avoir été rendus à l'intérieur du pays, en raison de l'existence à l'intérieur du pays du siège d'activité ou d'un établissement stable, le régime d'importation n'a pas changé. Le prestataire devra être immatriculé auprès de l'administration compétente et déposer ses déclarations comme par le passé.

Il est indéniable que le principe de la taxation au lieu du siège ou de l'établissement, à partir duquel le service est presté, simplifie beaucoup la perception de la taxe en ce que les opérations ne seront désormais plus exonérées dans le pays du siège du prestataire et plus soumises à la TVA dans le pays où le service est utilisé.

B. Services énumérés à l'article 9 par. 2 sous (E) de la Directive

En ce qui concerne certains services énumérés plus spécialement à l'article 9 par. 2 sous (E) de la Directive, l'article 21 de celle-ci a prévu un système simplifié:

En effet, pour:
— les cessions ou concessions de droits d'auteurs, brevets, licences, marques de fabriques ou de commerce et droits similaires,
— la publicité,
— les activités d'avoué, d'avocat, de conseiller d'expert comptable, d'ingénieur, d'un bureau d'études et les activités similaires,
— le traitement de données et la transmission d'informations,
— les opérations bancaires, financières, d'assurance et de réassurance (excepté la location de coffre-forts),
— la mise à disposition de personnel,
— l'obligation de ne pas exercer une activité professionnelle ou un droit quelconque visé ci-dessus,
— les prestations d'intermédiaire agissant au nom et pour le compte d'autrui et intervenant dans les prestations ci-dessus,

la directive prévoit que le preneur de la prestation sera le débiteur de la taxe, tandis que le prestataire peut être rendu solidairement responsable.

Puisque le preneur en question doit nécessairement être assujetti à la taxe dans son pays, cette solution a le mérite de sembler pouvoir s'appliquer sans difficulté: en effet le preneur sera obligé de déclarer la prestation de service dans ses propres déclarations, et par voie de conséquence devrait normalement pouvoir procéder à la déduction de la taxe ainsi déclarée.

Toutefois, le degré de difficulté dans l'application de ce principe devient plus élevé lorsqu'il faut demander des déclarations à des milliers d'assujettis non immatriculés ne faisant que des prestations exonérées.

Au Grand-Duché, pareille obligation du preneur n'est pas encore inscrite dans un texte formel. En effet, l'article 26 de la loi nouvelle prévoit qu'un règlement grand-ducal pourra disposer que la taxe sera due par le preneur du service sous la responsabilité solidaire du prestataire. A ce jour aucun règlement n'a été pris en ce sens.

C. La pratique administrative

En pratique, à défaut de texte règlementaire pris sur base des habilitations prévues par la loi, rien n'est changé dans la procédure de taxation des services censés effectués au Grand-Duché par des assujettis étrangers par rapport à la taxation des services antérieurement effectués à l'étranger et utilisés au Grand-Duché.

La première obligation du prestataire est celle de la déclaration de l'opération. En principe une déclaration doit être faite dès le commencement de l'opération (article 61 al. 1 de la loi organique) et une autre déclaration indiquant le montant de la taxe due, doit être déposée dans les quinze jours du deuxième mois suivant celui lors duquel l'opération a été faite (où en cas de paiements de la rémunération par acomptes pour une opération prolongée dans les 15 jours du mois suivant l'établissement de la facture afférente à chaque acompte). Il y a lieu de signaler que par toute opération faite avec un contractant assujetti, le prestataire doit délivrer une facture mentionnant le montant de la taxe due dans les 25 jours du mois suivant celui où l'opération a été faite.

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La première déclaration est généralement faite par information écrite à l'Administration de l'Enregistrement à Luxembourg. Cette information est transmise au bureau d'imposition X chargé de la récupération des taxes dues par des prestataires étrangers. Le functionnaire compétent se met alors en rapport avec l'assujetti pour définir la façon appropriée de procéder. En cas de services purement occasionnels, l'assujetti étranger n'est pas immatriculé mais déclare le service par simple lettre. L'Administration peut aussi convenir avec lui de se mettre en rapport avec le preneur pour que celui-ci déclare à décharge du prestataire.

Après réception d'une déclaration pour service purement occasionnels, l'Administration établit un titre de recette sur base duquel la taxe est perçue.

En cas de services occasionnels, il arrive assez fréquemment que le preneur fasse la déclaration à décharge du prestataire et se charge lui-même de l'acquittement de la taxe. Le prestataire pourra également demander à son cocontractant de se charger de ces formalités, ce qui toutefois n'a un intérêt que si le preneur est effectivement tenu de déposer des déclarations, s'il fait donc lui-même des opérations non-exonérés. En effet, vis-à-vis de l'Administration le prestataire reste celui qui est personnellement tenu de déposer les déclarations, et en cas d'oubli du cocontractant, le prestataire s'expose aux sanctions.

Il appartient au receveur compétent de vérifier si la prestation a un caractère occasionnel. Dans le cas contraire, il procédera à l'immatriculation du prestataire. En cas de prestations de services importants et continuels, il demandera la nomination d'un représentant responsable (qui souvent est le preneur solidairement responsable) ou plus généralement un cautionnement.

Les obligations du représentant responsable sont celles d'établir les déclarations, de détenir aux fins de contrôle les copies des factures et toutes pièces nécessaires à cette fin. Par ailleurs, il garantit solidairement le paiement de la taxe et des amendes. Toutefois, c'est le prestataire qui établit les factures indiquant le montant de la taxe dont il devra transmettre une copie au représentant responsable.

Par arrêté grand-ducal du 22 décembre 1979 pris sur base de l'article 63 2 sous (E) de la loi organique, l'administration est autorisée à demander le dépôt d'un cautionnement auprès de la Caisse de Consignation ou une garantie bancaire destinée à assurer le paiement de la taxe. Les montants sont fixés par le préposé en fonction de l'importance présumée des opérations imposables et de la créance de l'Etat. Cette pratique est généralement préférée à celle de la nomination de représentant responsable.

IV. PROCEDURE DE DEDUCTION DE LA TAXE EN AMONT ET PROCEDURE DE REMBOURSEMENT PREVUE PAR LA 8E DIRECTIVE

La 8ième directive adoptée par le Conseil prévoit l'introduction par les Etats-membres d'un texte permettant le remboursement de la taxe à des preneurs de services assujettis non établis dans le pays qui a perçu la taxe.

Il y a d'abord lieu de signaler que le texte en question ne s'applique que dans le cas où l'assujetti concerné ne fait pas lui-même d'opération imposable dans le pays où la taxe a été prélevée. Dans le cas contraire, il pourra récupérer la taxe ayant grevé des services qui lui ont été rendus par le biais de la déduction de la taxe en amont et éventuellement la restitution de l'excédent de la taxe en amont. Il faut toutefois que l'assujetti ait lui-même fait la déclaration de ses propres prestations, et il ne pourra récupérer la taxe en amont s'il a demandé au preneur de déclarer à décharge. En pratique le texte nouveau ne visera donc que des cas exceptionnels. A cette fin, la loi organique a habilité le gouvernement à introduire cette procédure par voie de règlement.

Alors que la directive a défini le modèle de la demande de remboursement à remplir pour l'assujetti concerné et les pièces et attestations qui sont à joindre, et en raison de la centralisation des services de l'Administration au Grand Duché le nouveau texte devra pouvoir s'appliquer sans difficultés.

Il y a lieu de rappeler que la directive prévoit que l'assujetti étranger devra justifier sa qualité d'assujetti par une attestation de son administration locale et joindre les originaux des factures ou documents d'importation. La demande sera à adresser à l'Administration avec les pièces à l'appui définis ci-haut.

Eu égard aux expériences pratiques que l'on a pu faire dans les rapports avec l'Administration de l'Enregistrement, il est à prévoir que l'assujetti ayant rempli ces formalités simples, ne rencontrera pas de difficultés pratiques pour récupérer le montant de la taxe, qui lui sera viré normalement dans les quelques semaines suivant le dépôt de la déclaration.

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COMMUNAUTE EUROPEENNE:

Monsieur GUIEU

L'orateur commence par retracer la genèse des travaux de la Commission sur la taxation des prestations de services en disant que c'est une lourde tâche d'essayer d'indiquer tous les méandres des discussions qui ont abouti à ce texte de compromis de la 6ème directive qui a pu rallier l'adhésion de tous les Etats membres. Il s'agit bien d'un texte de compromis qui peut-être présente certaines difficultés d'application au plan national.

Dans le cas des prestations de services, il existait des situations fort différentes. Lorsqu'on a adopté la 2ème directive T.V.A. en avril 1967, on avait cru qu'au plan communautaire (six pays à l'époque), la solution idéale et uniforme avait été trouvée en prévoyant que le lieu de la taxation de services serait le lieu d'utilisation. On espérait pouvoir éviter les doubles impositions et les non-impositions qui s'étaient présentées dans les situations précédentes.

Malheureusement ce critère d'utilisation avait un champ très restreint puisqu'il ne s'appliquait que pour les prestations de services énoncées dans l'annexe B de cette deuxième directive et c'étaient les prestations de services qui théoriquement étaient le plus souvent incorporées dans le prix des marchandises, qui avaient donc les influences dans les relations internationales; d'autre part, les Etats membres avaient encore la possibilité d'exonérer ces prestations de services, bien que citées dans l'annexe B.

Il faut ajouter qu'en raison de situations différentes de pays à pays, il y avait aussi un correctif: l'annexe accordait aux Etats membres la possibilité de déroger à ce principe de la taxation dans le lieu de l'utilisation, mais sous réserve d'éviter les cas de double imposition.

Autre difficulté constatée: certains Etats membres ont interprété d'une façon différente la notion d'utilisation. Pour des raisons pratiques, certains pays ont estimé que le lieu d'utilisation était le lieu du prestataire de services: dès que le prestataire rendait sa prestation, il y avait commencement d'utilisation. D'autres pays, au contraire, se référaient au lieu du preneur, c'est-à-dire au lieu où le preneur recevait la prestation. Dans un troisième groupe de pays, ce n'étaient ni le lieu du preneur, ni le lieu du prestataire, mais le lieu d'utilisation réelle: là où le bien était réellement utilisé.

Il en résultait que l'application brutale de ces principes devait conduire à des cas de double, voire de triple imposition, ou à des cas de non-imposition.

Mais pour éviter ces inconvénients, chacun des Etats membres avaient établi toute une série de dérogations de sorte que les législations traitant notamment de la détermination du lieu de taxation des prestations de services étaient très compliquées et nullement comparables de pays à pays.

En fonction de cette situation de fait qui avait évolué sur un texte communautaire — et l'on pensait que la question était résolue — les services de la Commission se sont mis au travail. Après de longues discussions avec les experts, la Commission avait essayé dans sa proposition de 6ème directive d'écarter la notion d'utilisation pour se concentrer uniquement sur la notion du prestataire de services.

Dans les propositions présentées au Conseil, on avait demandé aux Etats membres de prévoir que le lieu de la prestation de services était, pour toutes les prestations de services, le lieu du prestataire de services.

Mais il fallait un correctif pour éviter des cas de double imposition si la prestation de services était utilisée par un preneur assujetti dans un autre Etat membre avec une notion d'exportation de services: à ce moment-là, bien que l'assujetti soit le prestataire, il y avait, comme pour les marchandises, une notion d'exportation et de taxation dans le lieu de l'obtention dans le chef du preneur.

On avait ainsi un système parallèle à celui existant pour les marchandises et, avantage le plus important, une unicité du lieu de la prestation de services quelle que soit la situation de l'utilisateur.

A ce critère du prestataire de services, il y avait malheureusement deux exceptions: l'une pour les immeubles, et c'était le lieu de la situation de l'immeuble, l'autre pour les transports, c'était le lieu de la prestation de services en fonction du parcours du transport.

Dans le texte retenu de la 6ème directive, on a toujours le principe général de l'art. 9/1, qui prévoit la taxation auprès du prestataire de services. Cela permet de régler déjà toutes les prestations de services rendues à des non assujettis ou à des particuliers. On est ainsi assuré d'un lieu unique de taxation, sans possibilité d'y échapper et en évitant toute double taxation.

Par contre, si les Etats membres ont accepté de conserver l'exception prévue pour les immeubles et les transports, ils ont ajouté de nouvelles dérogations à ce principe pour notamment les activités culturelles, les activités accessoires au transport, les expertises portant sur les biens meubles corporels et surtout sur les travaux portant sur les biens meubles corporels en prévoyant que pour ces prestations de services, le lieu de la prestation était l'endroit où était matériellement exécutée cette prestation de services.

C'était déjà là une dérogation assez substancielle au principe du lieu du prestataire de services.

Il y a eu enfin une autre dérogation qui aboutit dans les faits au résultat que l'on avait recherché dans la notion d'exportation de services, c'est l'art. 9/2 litt.e, où il est prévu que pour toutes les prestations de services, qui sont incorporées dans le prix des biens en principe, comme les concessions et droits d'auteur, les prestations de publicité; les obligations de ne pas exercer une activité, les opérations financières, etc..., le lieu de la prestation devenait le lieu du preneur lorsque le preneur dans la Communauté était un assujetti; il en était de même si le preneur était situé hors de la Communauté (assujetti ou non). De sorte que pour ces prestations de services nous risquons d'avoir deux lieux de la prestation de service selon la situation du preneur.

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En régime normal, à l'intérieur d'un Etat membre, pour ces prestations de services, le lieu de la prestation de services est toujours situé auprès du prestataire; c'est lui qui va facturer, c'est lui qui va transmettre la taxe à son preneur, et c'est lui qui est redevable de la taxe; par contre, si le preneur est un assujetti communautaire, mais qui est situé dans un autre pays, le prestataire se trouve hors du champ d'application de la T.V.A. et c'est le lieu du preneur qui prévaut. Ceci entraîne pour une même opération rendue par un prestataire de service deux lieux de la prestation de services.

Dommageable intellectuellement, cette situation est valable au point de vue économique, puisque ces prestations de services sont taxées auprès du preneur, au taux du preneur et permettent, surtout au preneur, de déduire la taxe pour éviter toute rémanence de taxe. On arrive ainsi à éviter des doubles impositions.

Cette conception dualiste des prestations de services énumérées à cette disposition a paru néanmoins fort regrettable aux instances communautaires.

Un correctif a cependant été apporté en ce qui concerne les prestations de services qui sont rendues à des assujettis hors communauté et dont le lieu de la prestation de services est situé auprès de ce preneur. La conception de l'utilisation a été introduite pour éviter prestations de services, les Etats membres peuvent demander qu'une autre personne soit également redevable de la taxe: un représentant fiscal ou le client preneur.

Par contre, pour toutes les prestations de services qui sont fixées à l'art. 9/2,e (toutes les opérations pour lesquelles le lieu de la prestation de services est le lieu du preneur), il n'y a qu'une seule personne qui est redevable de la taxe, c'est le preneur.

En ce qui concerne les moyens de récupérer ou de rembourser cette taxe, le mécanisme qui a été instauré par la 6ème directive aboutit pratiquement dans tous les cas à la récupération totale de la taxe. Ou bien le redevable de la taxe est le preneur et il est mis en cause comme redevable soit à titre subsidiaire, soit à titre principal. A ce moment-là, il est évident qu'il peut utiliser les dispositions de l'article 17 pour déduire la taxe qui a frappé la prestation de services et par conséquent, dans son chef, il ne peut pas y avoir de rémanence de taxe. Par contre, si le prestataire est également redevable de la taxe étant donné qu'il a des opérations imposables, il a le droit également de déduire la taxe qui a frappé ses opérations en amont.

Selon l'orateur, l'article 17/4, c'est-à-dire le remboursement de la taxe à un assujetti étranger et la 8ème directive ne sont valables que si le prestataire établi à l'étranger a recours à des fournisseurs dans le pays de la taxation pour sa propre prestation de services. Il estime que la 8ème directive ne joue pas pratiquement dans le contexte de la prestation de services et du lieu de la prestation de services tels que définis dans l'art. 9 de la 6ème directive.

Il conclut en disant que ce texte de la directive résulte d'un compromis, mais aboutit quand même au résultat recherché qui est d'éviter des cas de non-imposition et de double imposition. Il rend parfois les situations un peu complexes et mériterait qu'on réfléchisse par la suite pour essayer de regrouper sur la notion du lieu du prestataire de services certaines opérations qui sont à l'heure actuelle au lieu du preneur ou à l'endroit où les prestations sont matériellement exécutées.

Il convient de remarquer que si ces règles se sont, au fil des discussions, un peu compliquées, cela provient également de la différence du niveau de taxation des prestation de services. Certaines délégations, à juste titre parfois, ont eu la crainte de voir des détournements de prestations de service vers des pays qui avaient un niveau plus bas si on prévoyait uniquement la règle de la taxation dans le chef du prestataire de services.

BELGIQUE:

M. CAPPELLEMAN

Après les exposés très clairs de M. Guieu et de M. Le Brun, l'orateur essaiera de décrire les quelques problèmes que l'on a en matière d'application de l'article 9 de la 6ème directive en suivant la présentation qui est faite à ce sujet dans le Code belge de la T.V.A.

En Belgique, on a suivi d'assez près le libellé de la 6ème directive encore qu'avant le 1er janvier 1978 déjà, le critère selon lequel la taxe est perçue dans le pays du preneur (art. 21) ait connu de nombreuses applications.

Dans son paragraphe 1er, cet article précise qu'une prestation de services a lieu dans le pays lorsque le lieu où elle est réputée se situer conformément aux paragraphes qui suivent se trouve dans le pays, ce qui n'est peut-être pas des plus clair ou qui est peut-être trop clair mais qui en toute hypothèse en soi ne résoud rien.

Les critères, on les rencontre à partir du paragraphe 2, et ici se trouve le critère principal, le critère du lieu du prestataire.

En fait le lieu du prestataire, ce n'est peut-être pas nécessairement le lieu où est établi le prestataire mais en fait c'est l'endroit où le prestataire de services a établi le siège de son activité professionnelle ou un établissement stable à partir duquel la prestation de services est rendue. Dans la pratique, l'application de ce critère n'a pas donné lieu à des problèmes majeurs.

Dans le cas cité par M. Le Brun, on peut se demander où se situe le lieu à partir duquel la prestation de services est rendue: est-ce là où en fait le matériel est importé, est-ce là où le matériel est régulièrement donné en location à partir d'un lieu donné en France? On peut effectivement se demander si le lieu où le matériel se trouve ou le lieu où il rentre régulièrement en vue d'être donné en location ne peut pas constituer un lieu pour la prestataire de services qui y a établi un siège d'activité. C'est effectivement une question. Si la proposition de 10ème directive était réalisée, ce problème serait résolu mais cette proposition n'est pas réalisée, je n'oserais même pas dire qu'elle sera réalisée dans un proche avenir.

Voilà le critère principal: le lieu du prestataire.

Il y a une série d'exceptions: d'abord l'endroit où est situé l'immeuble lorsqu'il s'agit d'une service qui est

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relatif à une immeuble par nature, auquel cas le lieu du service est le lieu où se trouve l'immeuble.

Les cas d'application de ce critère sont fixés dans l'arrêté royal no. 5 et une énumération très rapide nous démontre qu'en fait il s'agit de tout travail immobilier, c'est-à-dire tout travail de construction, de démolition, d'entretien d'immeuble, etc., également tout travail d'étude et de contrôle qui relève de l'activité habituelle des architectes, des ingénieurs et des géomètres, toute expertise portant sur un immeuble par nature, toute mise à disposition d'emplacement ou parking, ou pour l'entreposage de biens, toute prestation d'hôtellerie en tant que mise à disposition d'une chambre, toute mise à disposition d'emplacement sur un terrain de camping. Il en est encore ainsi de toute location de coffres-forts qui sont immeubles par nature ou de toute location de biens immeubles par nature; on sait qu'en Belgique, uniquement ce qu'on appelle le leasing immobilier est soumis à la T.V.A., mais non les locations ordinaires d'immeubles.

Il existe une nouveauté par rapport à la situation qui existait auparavant: toute intervention comme intermédiaire lors de la constitution, de la cession d'un droit réel ou de jouissance sur un bien immeuble par nature, toute intervention d'une agence immobilière en tant que courtier dans la location ou de vente d'un immeuble est soumise à la T.V.A. en Belgique, dès que l'immeuble donné en location ou vendu se situe en Belgique.

Enfin toute gestion d'un bien immeuble par nature situé en Belgique est également soumise à la T.V.A.

Deuxième dérogation: l'endroit où se trouve le bien lorsqu'il s'agit d'un travail, y compris l'expertise, portant sur un bien meuble. Cela signifie que tous les travaux à effectuer sur des biens meubles se trouvant en Belgique sont soumis à la T.V.A. en Belgique.

Bien sûr, lorsqu'un bien est importé en Belgique en vue d'être travaillé à façon et ensuite réexporté (perfectionnement actif), en principe ce travail est soumis à la T.V.A. belge, sauf exonération lorsque le bien travaillé est réexporté ou est exporté par le travailleur à façon dans les conditions prévues pour l'exonération en cas d'exportation par le fournisseur du service.

Pour l'expertise, si elle est effectuée sur un bien meuble qui se trouve en Belgique, la T.V.A. est due en Belgique. On s'est déjà interrogé sur la question de savoir, quand on parle de travail, si on ne vise que les travaux matériels, ou également les travaux intellectuels. Quand on compare le texte belge avec la directive, on constate dans la directive qu'il est question de travaux, et l'orateur se pose la question de savoir si le mot travail veut dire travail matériel ou s'il a une signification plus large en fait.

La troisième dérogation concerne les transports, le lieu d'une prestation de transport et donc le lieu où le transport est effectué et en fonction des distances parcourues. Rien de particulier quant à cette dérogation.

La quatrième dérogation précise que le lieu du service c'est l'endroit où la prestation de services est matériellement exécutée lorsque cette prestation a pour objet des activités culturelles, artistiques, sportives, scientifiques, d'enseignement, de divertissements ou similaires. M. Le Brun, en ce qui concerne le lieu du service, a fait état d'une question relative à la taxation de prestations de services ayant pour objet la formation de personnel qui allait de pair avec une vente de matériel à exporter, enseignement qui est donné par le fournisseur de ce matériel. Selon l'orateur, il est clair que le lieu du service est le lieu où cet enseignement est donné et ce, sur base du texte; mais comme il y avait exportation du matériel, auquel cet enseignement se rapporte, on considère que cet enseignement est exonéré pour des raisons d'exportation. C'est une solution qui parait tout à fait compatible avec la 6ème directive encore qu'en Belgique on ne va pas aussi loin semble-t-il, étant donné que le texte en matière d'exportation énumère limitativement les prestations de services qui sont exonérées comme se rapportant à des biens exportés, texte dans l'énumération duquel on ne retrouve pas ce genre de prestations.

Selon M. Cappelleman, si une situation pareille devait se produire en Belgique, on devrait dire que la T.V.A. est due en Belgique. Mais ceci ne veut pas dire que si la T.V.A. belge est portée en compte par le fournisseur du bien prestataire d'enseignement à une société étrangère, que celle-ci doive supporter cette T.V.A. définitivement; la société étrangère peut récupérer la T.V.A. belge dans des conditions que l'on va pouvoir exposer dans le courant de l'après-midi.

Les prestations des restaurateurs, des cafetiers se situent également là où le cafetier et le restaurateur se trouvent. Lorsqu'il s'agit de prestations accessoires au transport, c'est également le lieu du service qui est le lieu où la prestation est matériellement exécutée.

On s'était interrogé au sujet de certaines prestations accessoires au transport, c'est-à-dire essentiellement des opérations de chargement et de déchargement; mais il y en a encore d'autres qui ont été citées par M. Le Brun, notamment le jaugeage et le pesage. Là aussi on applique le critère du lieu où la prestation est matériellement exécutée.

En Belgique, on s'était demandé s'il fallait suivre le même critère pour ce qu'on appelle la réception des marchandises, réception qui consiste assez souvent en un contrôle quantitatif ou qualitatif des marchandises, ou une prise d'échantillons, prestations confirmées par un bordereau de réception de marchandises. On a décidé, dans ce cas, qu'on doit appliquer le critère qui vaut pour la prestation accessoire au transport, mais il faut ajouter que dans ce domaine il y a généralement exonération lorsqu'il s'agit de prestations qui se rapportent à des marchandises exportées ou importées.

Le critère suivant est l'un des plus contesté, à savoir le critère concernant la location.

Lorsqu'il s'agit d'un bien meuble autre qu'un moyen de transport, le critère à suivre, c'est le lieu du prestataire sauf, selon le Code belge, lorsque le bien est donné en location par un loueur qui est établi dans la Communauté et qui exporte le bien dans un autre pays de la Communauté, où le bien sera utilisé. On voit bien apparaître ici la notion d'utilisation et cette disposition est tout à fait conforme à la 6ème directive; et, deuxième exception, ce n'est pas le lieu du prestataire, c'est le lieu de l'utilisation lorsque le bien est donné en location par un

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loueur qui est établi hors de la Communauté européenne.

En fait, le lieu du prestataire connaît une double exception: cas du bien exporté par le loueur dans un autre pays du Marché Commun où le bien serait utilisé, et cas où le loueur est établi hors de cette Communauté.

Quelques problèmes ont surgi en Belgique en raison de l'application de la 6ème directive. On est conscient de ce que le résultat obtenu n'est pas toujours équitable. Mais si on veut précisément éviter des doubles impositions ou des non impositions, il semble nécessaire d'appliquer pratiquement à la lettre les dispositions de la 6ème directive à ce sujet.

Cela peut parfois conduire à des situations assez curieuses. On a par exemple, en Belgique, un cas dans lequel une société néerlandaise achète aux Pays-Bas du matériel qu'elle donne en location à une société belge et dès lors ce matériel est exporté par le fournisseur du matériel à la demande du loueur directement des Pays-Bas en Belgique. Dans ce cas, le lieu de la prestation de services, ce n'est pas les Pays-Bas étant donné que le matériel est exporté par le loueur ou sur son ordre des Pays-Bas en Belgique, et la T.V.A. est due en Belgique. Mais malheureusement ce n'est pas tout. Ce même loueur achète également du matériel en Belgique qui sera donné en location en même temps que le matériel qui est importé des Pays-Bas, et pour compliquer les choses, la location se fait pour un prix unique.

Pour la première partie, à savoir pour le matériel qui est envoyé des Pays-Bas en Belgique, on l'a dit, le lieu du service est la Belgique, étant donné que l'on se trouve dans la première exception: matériel qui est exporté par le loueur à destination d'un autre pays du Marché Commun où le matériel sera utilisé. Pour la deuxième partie, il s'agit de marchandises qui sont achetées en Belgique et qui restent en Belgique: il n'y a donc pas de déplacement de la marchandise d'un pays vers un autre: dès lors il faut appliquer le critère normal, c'est le lieu du prestataire, et on devrait dire que la T.V.A. est due aux Pays-Bas.

L'orateur signale que la décision n'est pas sortie, mais croit savoir que si la Commission avait été consultée, la réponse aurait été que, compte tenu de la proposition de 10ème directive, la taxation devrait avoir lieu en Belgique. Mais tant qu'il s'agit d'une proposition de directive, il semble que l'on doive s'en tenir au texte pour le moment, même si le texte conduit à une solution baroque.

Autre exception à la règle: le critère relatif aux moyens de transport.

Selon la 6ème directive, le lieu du service est le lieu du prestataire, c'est-à-dire le lieu à partir duquel en fait la prestation de services est effectuée.

Mais la 6ème directive, notamment en ce qui concerne les locations de biens meubles, permet de déroger à cette règle fondamentale mais seulement dans deux cas: le premier cas, est celui dans lequel le lieu du service se situe à l'intérieur de la Communauté mais où l'utilisation du bien se fait en dehors de la Communauté: dans ce cas, on aura évidemment toute faculté de déroger à la règle principale; le deuxième cas, c'est exactement l'inverse: si, selon la règle principale de la directive, le lieu de la prestation se trouve en dehors de la Communauté et s'il y a en fait utilisation effective du bien dans la Communauté, les Etats membres ont la faculté de situer le lieu là où s'exerce l'utilisation.

En Belgique, le législateur a fait usage directement de cette faculté, en disposant que pour la location de moyens de transport, si la règle principale est le lieu du prestataire, il y a une double exception, savoir: (1) le lieu du service c'est le lieu d'utilisation lorsque le moyen de transport est donné en location par un loueur qui est établi dans le pays; et (2) le lieu du service est seulement situé là où s'exerce l'utilisation dans la mesure où le moyen de transport est utilisé en dehors du Marché Commun. Ce n'est d'ailleurs que dans ces limites là que les Etats membres peuvent faire usage de la faculté laissée par la 6ème directive.

Voici un exemple concret: si l'on prend en location en Belgique un véhicule pour faire un voyage en Europe, en principe la T.V.A. est due en Belgique sur le loyer total; mais dans la mesure où la voiture est utilisée en dehors du Marché Commun, le loyer n'est pas imposable en Belgique. Il n'est pas facile de dire au départ dans quelle mesure le véhicule sera utilisé à l'intérieur du Marché Commun ou à l'extérieur du Marché Commun.

Les Etats membres qui n'ont pas fait usage de cette faculté s'y retrouvent peut-être plus facilement, parce que dans ce cas le loyer peut être taxé intégralement.

D'autre part, si le véhicule est donné en location par un loueur établi hors de la Communauté, le lieu d'utilisation se situe là où le véhicule est utilisé. Si jamais un touriste qui a pris en location un véhicule en dehors du Marché Commun, pénètre avec ce véhicule en Belgique, il est probable que l'on aurait quelques problèmes pour percevoir la T.V.A. à concurrence de l'utilisation du véhicule dans le pays.

Revenons à une dernière exception à la règle principale (lieu du prestataire), exception selon laquelle le lieu du service est le lieu du preneur dans les cas déjà décrits par MM. Guieu et Le Brun, c'est-à-dire seulement lorsque le preneur est établi en dehors de la Communauté ou lorsqu'il est établi dans la Communauté, dans un autre pays que la Belgique, bien entendu, et lorsqu'il agit pour les besoins de son entreprise.

Ceci demande un mot d'explication: la directive parle d'un assujetti, à propos de la distinction entre le preneur établi en dehors de la Communauté et le preneur établi dans la Communauté mais qui a alors la qualité d'assujetti. Or dans le Code belge, on ne parle pas d'assujetti mais d'un preneur qui agit pour les besoins de son entreprise. La raison en est qu'en Belgique un assujetti est celui qui supporte effectivement le poids des formalités en matière de T.V.A.; dès l'introduction de la T.V.A., on a eu des réticences pour décider qu'une entreprise exonérée, par exemple, était assujettie à la T.V.A.

En Belgique, la qualité d'assujetti est donc réservée aux entreprises qui, effectivement, ont des obligations en matière de T.V.A., des obligations actives. Pour la directive, ce n'est pas le cas: une clinique, un institut d'enseignement, etc. sont des assujettis. Or l'expression contenue dans le texte belge "le preneur qui agit pour les besoins de son entreprise" doit se comprendre dans le

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sens d'assujetti selon la 6ème directive et c'est bien dans ce sens là que cette disposition est appliquée.

Le lieu des services est au lieu où est établi le preneur, lorsqu'il s'agit de concessions, droits d'auteur, concessions de clientèle, travaux de publicité. On interprète ceux-ci dans un sens très large en Belgique: on y comprend par exemple les annonces faites en vue de la vente d'un immeuble ou en vue de recrutement du personnel, on ne fait pas de distinction. Pour les annonces qui sont faites en vue de la vente d'un immeuble, on s'était bien demandé si on ne devrait pas dire qu'il s'agit d'une prestation de services se rapportant à un immeuble. C'est une question, mais puisque les travaux de publicité sont nommés expressément, on a estimé qu'il fallait les comprendre ici dans cette catégorie.

Il faut encore citer les travaux de nature intellectuelle fournis dans l'exercice de leur activité habituelle par les conseillers juridiques ou autres, les experts comptables, les ingénieurs, les bureaux d'études, etc. C'est une disposition qu'on applique d'une façon assez large également aux études de marché, par exemple à la communication de renseignements commerciaux tels la communication de listes de clients possibles. On applique cette disposition d'une manière assez large parce que normalement ce genre de services est commandé par des assujettis pour les besoins de l'entreprise. Si on ne devait pas appliquer ce critère et si on devait donc taxer dans le pays du prestataire il y aurait tout de même lieu à récupération de la T.V.A. par le biais de l'art. 17, 4°: un assujetti étranger peut toujours récupérer la T.V.A. en Belgique, du moment qu'il prouve qu'il a fait des dépenses pour l'exercice de son activité d'assujetti. Dans le doute, on préfère dire qu'on ne perçoit pas pour éviter la procédure de restitution qui peut être assez longue.

Enfin le lieu du preneur sert de critère pour les services des banques et des autres organismes financiers, toujours dans les mêmes limites quand il s'agit de prestations de services faites pour des preneurs établis en dehors du Marché Commun ou établis dans un autre pays du Marché Commun, mais qui agissent pour les besoins de leur entreprise. Il en est de même pour la mise à disposition de personnel ou pour les services fournis par les courtiers mandataires qui interviennent dans des opérations déjà énumérées, c'est-à-dire dans les concessions de brevet, dans la publicité, dans les travaux de nature intellectuelle, etc. Là aussi il y a en Belgique par rapport à la situation précédente un changement assez fondamental.

M. Cappelleman termine son exposé en disant qu'il croit ainsi avoir situé la question dans certains cas et qu'à sa connaissance on ne connaît pas trop de problèmes avec l'article 21 du Code belge.

FRANCE:

MONSIEUR LEBRUN

L'idée de base de la Commission est une idée née de la constatation des difficultés qui résultaient du concept d'utilisation des services. Il était en effet relativement satisfaisant pour l'esprit de se tourner vers une notion différente, vers une notion juridique, la notion du preneur ou la notion du prestataire.

L'inconvénient est que les notions juridiques collent parfois mal avec la réalité de ce que doit être un impôt sur la consommation. L'on ne doit jamais oublier qu'en la circonstance, les entreprises sont, certes, redevables de l'impôt mais que le poids final se porte sur le consommateur. C'est en quelque sorte cette approche réaliste et nécessairement fiscale — dans le sens de moyens de financement du budget — qui était la préoccupation des Etats.

En guise d'exposé introductif, l'orateur explique les raisons pour lesquelles les délégations n'ont pas toujours pu suivre la Commission dans son approche théorique et pourquoi elles ont contribué à ce que Monsieur GUIEU peut appeler un compromis.

L'on n'a pas toujours pu suivre la Commission dans les propositions dont la valeur et l'articulation ne sont pas contestables. D'autre part, on se trouvait en présence de difficultés dès lors que les prestations encourues sont des prestations qui peuvent non seulement être juridiquement établies au nom de prestataires ou de preneurs établis dans la Communauté, mais également au nom de prestataires ou de preneurs établis dans des pays hors Communauté. Cette préoccupation n'était pas négligeable.

Au plan pratique, comment les administrations ont-elles réagi devant un certain nombre de difficultés?

Le premier problème, c'est la définition de certains services énumérés à l'article 9 de la directive qui ne sont pas imposables à la taxe sur la valeur ajoutée dans le pays où le prestataire est établi.

Essentiellement, de quels services s'agit-il? Il s'agit des locations de biens meubles corporels, des services se rattachant aux immeubles, des services se rattachant aux transports, d'un certain nombre de prestations intellectuelles et des opérations portant sur les cessions ou concessions de droit d'auteur notamment.

En ce qui concerne les locations de moyens de transport, on n'a pas rencontré de difficultés fondamentales. On est peut-être en face, à l'heure actuelle, d'une difficulté qui est liée, elle, à la définition du domicile de l'assujetti, de l'établissement stable.

On est souvent interrogé et amené à s'interroger sur la situation dans laquelle une location de moyens de transport effectuée d'une manière définitive en France par une entreprise établie dans la Communauté doit être ou non imposable en France.

Les circonstances de fait qui caractérisent cette situation sont déterminantes: l'importation définitive du moyen

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de transport en France, son rattachement en permanence à un point situé sur le territoire français, sa location multiple et de courte durée à partir de ce point situé en France, et même la mise à la disposition du client par une société de gestion française.

En la circonstance, la notion d'établissement semble devoir être appréciée non seulement au sens juridique du terme mais également en tenant compte des circonstances de fait propres à la matière sur laquelle on est éventuellement interrogé.

Sur ce point des locations des moyens de transport et sous réserve de ce qu'a dit, à juste titre, Monsieur GUIEU, à propos des intentions dites de la 10ème directive, il ne semble pas que l'on ait rencontré des problèmes trop difficiles à résoudre et qui méritent de retenir l'attention de l'auditoire.

Ensuite, voici un deuxième cas d'exception: les prestations de services se rattachant à un immeuble se situant en France.

A cet égard, l'approche a été une approche de réalisme, une nouvelle fois, c'est-à-dire que l'on a considéré que les opérations taxables du chef des immeubles sont, non seulement, bien entendu, les travaux immobiliers et les prestations réalisées en vue de la construction de l'immeuble, mais ce que l'orateur appellerait toute la périphérie technique et commerciale, c'est-à-dire aussi bien les opérations techniques préalables à la construction que les commissions on honoraires de gestion par les promoteurs pendant la période de construction, ou les opérations des intermédiaires qui s'entremettent pour l'achat, la souscription ou la vente des immeubles et, bien entendu, les prestations des experts relatives aux travaux de construction.

C'est donc l'idée que toute ce qui se rattache à un immeuble est imposé dans les mêmes conditions que l'imposition afférente à cet immeuble; il est clair, en effet, que s'il n'en était pas ainsi, on aboutirait à des situations absurdes suivant lesquelles une partie des prestations serait taxée dans un pays et l'autre dans un autre: ce serait peu conforme à l'esprit même de simplification qu'a voulu la directive.

C'est un peu autour des mêmes notions qu'ont été traités les problèmes de transport et les prestations accessoires, c'est-à-dire qu'on ne limite pas la notion: on entend non seulement appréhender le transport lui-même mais également les operations qui l'entourent, c'est-à-dire le chargement et le déchargement, la manutention de la marchandise, ou son déchargement, son dosage, son pesage, enfin toutes les opérations qui peuvent être adjointes, y compris les locations de matériel pour le chargement et le déchargement, les gardiennages, les transbordements, les opérations d'assistance aux passagers.

La quatrième dérogation a trait aux opérations culturelles, artistiques, sportives, scientifiques, éducatives, récréatives et les prestations accessoires. Pour celles-ci, l'orateur estime qu'essentiellement la difficulté rencontrée est relative à la formation du personnel étranger, étant donné que dans un certain nombre de cas, les formations de personnel étranger sont liées à des opérations d'exportation: on exporte un matériel déterminé, et on envoie dans les pays producteurs de ce matériel le personnel destiné à utiliser cet appareil et à recevoir la formation ad hoc.

Il est tout à fait conforme, selon lui, et à la volonté de la Communauté et à la situation de fait qu'en la circonstance, cette formation de personnel étranger soit assimilée à une opération relevant d'une activité de conseil en formation et également fasse l'objet d'un traitement identique à celui des exportations.

Les prestations culturelles et autres pour l'essentiel sont le plus souvent exécutées par un assujetti établi dans le pays où la prestation est exercée. Cela est vrai dans un certain nombre de cas, mais cela peut poser des problèmes, non pas de principes, mais des problèmes d'administration, car il est clair que si quelqu'un vient rapidement effectuer une prestation de caractère culturel ou artistique même, il vient, il s'en va, il peut y avoir quelque difficulté pour l'appréhender. Déjà du côté des impôts directs, le même problème a été fréquemment rencontré. Mr. LEBRUN souligne à cet égard, simplement comme une incidente, que les problèmes qui se posent ne sont spécifiques ni à l'harmonisation, ni à la taxe sur la valeur ajoutée; ce sont purement et simplement des problèmes que l'on rencontre dès lors que des opérations sont susceptibles de s'effectuer à travers des frontières, sans perdre de vue que pour un certain nombre d'entre elles, il n'y a même pas de support matériel.

C'est la raison pour laquelle on doit dire que dans l'approche faite par les délégations sur ce sujet, chaque fois qu'il y avait la possibilité, en quelque sorte, d'appréhender ou de saisir physiquement une prestation de services, on a demandé qu'il soit fait retour au principe de l'utilisation; c'est le résultat auquel on aboutit dans la pratique.

Une deuxième catégorie de problèmes: ceux relatifs aux cessions et concessions de caractère intellectuel, aux droits d'auteur, aux prestations de publicité, aux prestations de conseillers. En cette circonstance, un certain nombre de difficultés ont surgi auxquelles on a apporté les premières réponses. On applique en France la directive depuis un an. Au passage, l'orateur félicite la délégation belge de la promptitude avec laquelle elle a mis en vigueur ce texte difficile et déclare battre sa coulpe devant le fait qu'il ait fallu un an de délai pour obtenir le même résultat en France. Il est persuadé que ses amis belges ont, dans un certain nombre de cas, des réponses beaucoup plus pertinentes aux problèmes qui se sont posés, en France.

Il y a eu quelques difficultés concernant les prestations de publicité. Il faut savoir où s'arrête en quelque sorte la notion de prestation de publicité et il est apparu, en la circonstance, que la fourniture des éléments nécessaires à la réalisation de l'opération de publicité devait être assimilée à celle-ci, mais que, en revanche, la distribution d'articles publicitaires, etc. . . , ne représente pas la même notion. Ce n'est pas très facile à délimiter; c'est un domaine dans lequel on sera appelé à plusieurs titres à se concerter davantage.

Pour les autres types de conseils, on a placé dans cette notion de conseils, aussi bien les conseils en brevet d'invention que les conseils en informatique, en recrute-

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ment, en organisation, en matière d'études de marchés, en ingéniérie. Il n'est pas certain, en définitive, que chacun d'eux ait spécifiquement toujours le titre de conseil mais il est évident que l'on se trouve bien dans un domaine où il y a fourniture par le prestataire de services d'un conseil où le bon sens l'entend, même si, dans un certain nombre de cas, il peut y avoir des arguties sur le sujet.

On a également été affronté avec le problème des fournitures d'information. La notion de fourniture d'information pose quelques difficultés, et voici comment on les a résolues, sans pour autant prétendre détenir la sagesse universelle. On a considéré que relevait du traitement de données, de la fourniture d'information, la prestation qui consistait en l'utilisation d'un ordinateur pour émettre des billets ou donner des informations touristiques, ou pour les terminaux des compagnies aériennes et des agences de voyage, la fourniture d'informations radiodiffusées on télévisées de programme culturel, la transmission d'émissions télévisées par satellite: c'est à peu près les problèmes sur lesquels on a été conduit à s'interroger.

Enfin, il y a quelques opérations relatives aux intermédiaires, de commissions étrangères pour le compte d'inventeurs français, par exemple, et en la circonstance, il est apparu que l'opération effectuée par le commissionnaire était imposable en France dès lors que le bénéficiare était un assujetti établi dans ce pays.

L'orateur déclare avoir fait ce panorama technique des problèmes qu'il a rencontrés en France parce qu'il croit que cela répond au souci de ce colloque et peut servir de base pour les échanges d'informations pratiques permettant de développer progressivement les applications communautaires du texte de la directive.

D'autres problèmes de caractère pratique se posent également: le premier, c'est la notion de siège de l'activité de l'établissement stable: l'orientation utilisée par l'Administration française en a été fournie déjà: à côté évidemment des concepts juridiques qui le définissent, il lui paraît que le réalisme fiscal impose que soit appréhendé comme tel tout centre d'activité où l'assujetti effectue de manière régulière des opérations.

Une deuxième notion qui peut causer des difficultés est la notion de bénéficiaire dans le cadre de l'article 9, 2c de la 6ème directive: il faut entendre par là le client direct du prestataire, sinon on risque d'entrer dans un mécanisme de sous-traitance.

Egalement le problème de la définition de l'assujetti est un cas d'application pratique entre les Etats mais qui, d'après l'orateur, devrait intéresser moins les membres de l'assemblée.

Enfin, on peut avoir des problèmes relatifs à la définition même de l'exécution d'une prestation, mais il n'y a rien de nouveau dans la directive par rapport à ce qui existait antérieurement.

LUXEMBOURG:

MAITRE PRUSSSEN

L'orateur déclare que n'étant pas un représentant de l'Administration fiscale luxembourgeoise, il a moins d'expérience sur la question d'autant plus que le texte légal luxembourgeois date seulement du 12 février 1979 et n'entre en vigueur que le 1er janvier 1980. L'expérience que l'Administration luxembourgeoise a pu avoir avec ce texte est donc relativement limitée. Il y a également beaucoup moins de règlementation qu'il y en a à l'heure actuelle en Belgique.

Le texte luxembourgeois contient de nombreuses délégations de pouvoirs au gouvernement en vue de prendre des mesures d'exécution.

En principe, le lieu de la prestation est le lieu du siège d'activité ou de l'établissement stable ou, à défaut, le domicile, car il se pourrait en effet qu'une personne accomplisse des prestations de services alors qu'elle n'a pas de véritable siège d'activité.

La notion d'établissement stable doit être interprétée selon la législation applicable en matière d'impôts directs, la loi sur la T.V.A. ne contenant pas de définition. Il est donc fait application de la loi d'adaptation fiscale, la définition de service tombant sous ce critère doit être recherchée par rapport aux services qui sont expressément énumérés dans la directive.

Pour ce qui est de la dérogation relative aux travaux immobiliers, l'orateur estime qu'il n'est pas toujours facile d'appliquer le critère sur lequel tout le monde s'accorde: il peut arriver en effet qu'un immeuble situé dans un pays déterminé donne lieu à des travaux exécutés dans un autre pays pour le compte d'un preneur localisé dans un troisième pays, et qu'en fin de compte, l'immeuble n'est pas acheté. Voici un exemple vécu: des consultants anglais ayant un bureau à Paris ou à Bruxelles, ont été amenés à donner un avis au sujet d'un immeuble situé à Francfort, pour le compte d'une firme japonaise établie à Londres. Si l'on imagine que l'immeuble n'est pas acheté, la T.V.A. sera due à Francfort.

Deuxième dérogation: le lieu où la partie essentielle du travail est matériellement exécutée d'après la législation luxembourgeoise.

Des difficultés pourront se présenter, car qu'entend-on exactement par la partie essentielle du travail. Ce peut être le cas notamment de l'expertise, celle-ci pouvant parfaitement se situer dans des pays différents: l'expert se rendra sur les lieux, puis rentrera dans son pays pour étudier le cas et rédiger son rapport: quel sera alors le lieu de la taxation? Le pays où le contrat aura été passé? Celui où est situé le bien qu'il aura examiné? Celui où il se sera entretenu avec son client? Ou enfin le pays dans lequel il aura le plus longuement réfléchi à l'affaire?

Ce deuxième critère concerne donc, outre les expertises sur biens meubles dont il vient d'être question, les activités culturelles, artistiques, scientifiques, sportives, d'enseignement, de divertissements, etc... L'orateur

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estime que la formation de personnel doit également rentrer dans cette catégorie. Il s'agit aussi d'une activité accessoire au transport, les travaux sur meubles corporels.

Le troisième critère est celui de l'utilisation du bien. Ici le problème du transport se pose d'une façon un peu différente au Grand Duché de Luxembourg parce que le texte dit ceci: "le lieu des prestations de services ayant pour objet la location de biens meubles corporels que le prestataire, en vue de leur utilisation dans le pays de destination, a exportés de l'intérieur du pays vers un autre Etat membre". Le pays extérieur de la Communauté n'est pas pris en considération dans cette dérogation, et le texte poursuit: "ou importé d'un autre Etat membre vers l'intérieur du pays et l'endroit où lesdits biens sont utilisés". Le texte ajoute: "cette dérogation n'est pas applicable à la location des moyens de transport." On constate finalement que l'on a utilisé une seule hypothèse: mais il y a de multiples hypothèses qui économiquement seront identiques et où le principe général sera applicable, c'est-à-dire où la location du bien sera imposable au siège d'activité du prestataire.

En ce qui concerne le lieu du domicile du preneur, l'orateur se réfère à l'énumération de services qui en a été faite précédemment.

Il précise que si une telle activité, parmi celles citées à l'article 9-2, litt.e de la directive est effectuée en relation avec un immeuble, c'est la situation de l'immeuble qui prime.

Quel est le cas du preneur résidant en dehors de la communauté, en ce qui concerne les mêmes services, qui y dispose d'un siège d'activité ou d'un établissement ou simplement d'un domicile?

On distingue, comme dans les exposés précédents, les preneurs assujettis qui sont résidents de la C.E.E. et les preneurs assujettis ou non, résidant en dehors de la C.E.E. Pour les travaux intellectuels visés à l'article 9-2 litt.e de la directive, le lieu de la prestation est réputé se situer au domicile ou au lieu d'activité du preneur.

Débats

Remarque préliminaire: tous les orateurs parlent en leur nom personnel sans aucun préjugé quant à la solution qu'ils pourraient être amenés à prendre, ou leur administration, dans un cas particulier.

Question (M. Richou, France)

L'art. 15, 13 de la 6ème directive exonère: "les prestations de services, y compris les transports et les opérations accessoires, mais à l'exception des prestations de services exonérées conformément à l'art. 13, lorsqu'elles sont directement liées au transit, à l'exportation de biens ou aux importations de biens bénéficiant des dispositions prévues à l'art. 14, par. 1 sous b) etc. et à l'art. 16, par. 1.
En France, cette disposition a été reprise sous l'art. 262, §1 du Code général des impôts, qui exonère de la T.V.A. les exportations de biens meubles corporels ainsi que les prestations de services qui leur sont directement liées.
L'Administration a précisé dans ses instructions que ces exonérations s'appliquaient notamment à la location des moyens de transport, des contenants, et des matériels pour la protection des marchandises exportées; aux prestations de formation dispensées aux membres du personnel d'une entreprise étrangère, dans la mesure où ces prestations sont liées à la vente de matériel exporté.
Les autres états de la communauté interprètent-ils de la même façon les dispositions de l'art. 15, 13 de la 6ème directive?

Réponse

1) Location des moyens de transport
Mr. GUIEU: Tous les Etats membres appliquent le taux zéro. C'est considéré comme une exportation. Il n'y a apparamment pas de difficultés de ce côté là, mais interprétation uniforme de la directive.

2) Formation de personnel d'une entreprise étrangère liée à la vente de matériel exporté
Mr. GUIEU: Il y a une divergence d'approche selon les administrations. L'Administration française place ces prestations de service sous la catégorie 9, §2, e; tandis que l'administration belge la classe pour partie dans le 9, §2, c et les taxe avec la possibilité de demander le remboursement par le biais de la 8ème directive (délais et formalités à accomplir, mais le résultat économique est le même).
En ce qui concerne les autres pays, la question n'a pas pu être prospectée.

M. CAPPELLEMAN: Fait preciser par M. Lebrun que dans l'hypothèse visée la prestation de formation a lieu en France et non au lieu du preneur, mais est exonérée pour cause d'exportation.
Pour la situation belge, la prestation de formation est fournie en Belgique aux membres du personnel d'une entreprise qui a acheté en Belgique du matériel qui doit être exporté; dans ce cas, pour nous, la prestation se situe en Belgique et il est parfaitement concevable que cette prestation soit exonérée pour des raisons d'exportation, mais nous n'appliquons en tout cas pas le critère de l'art. 9, §2,e de la 6ème directive.

M. LEBRUN: En effet l'Administration française a analysé cette opération comme une opération de conseil en formation, partie de cette idée que lorsqu'on apprenait à des gens à se servir d'un matériel déterminé, c'était une formation de ce personnel sur le matériel en cause et les conséquences que l'on en tire sont conformes d'une certaine manière à la directive. La seule chose, c'est qu'à partir du moment où elles sont liées également à une opération d'exportation, il nous a paru que pour des raisons pratiques évidentes il était préférable d'avoir une situation d'exportation "classique", sans avoir le sentiment de tirer sur la ficelle, dans la mesure où le résultat

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est dans les deux cas une opération qui ne doit pas laisser de taxes à la charge des entreprises auxquelles appartiennent les personnels en cause.
Les analyses auxquelles se sont livrées la France et la Belgique ont finalement les mêmes conséquences et atteignent toutes les deux les objectifs fixés par la Commission; qu'il n'y ait ni double imposition, ni double exonération.

Question (M. Richou, France)

Les règles de territorialité relatives aux locations de moyens de transport sont elles les mêmes dans tous les Etats de la Communauté?

Réponse

M. GUIEU: Après étude des législations des Etats membres, en ce qui concerne les locations de moyens de transport, il ne semble pas y avoir de divergences: c'est toujours le lieu du prestataire.
Cependant trois pays, la France, la Belgique et l'Allemagne, ont fait usage de la faculté prévue à l'art. 9, §3, c'est-à-dire que s'il y a utilisation faite hors de la C.E.E., il y a quand même détaxation; ce n'est donc plus le lieu du prestataire de services; par contre, s'il y a un véhicule qui vient de l'extérieur mais qui est utilisé à l'intérieur de leurs pays, il y a taxation, bien que le prestataire soit situé hors communauté.
En résumé donc, tous les Etats membres appliquent la règle du prestataire de services avec utilisation de la faculté, pour la Belgique, la France et l'Allemagne.

M. PRUSSEN: Au Grand Duché, il n'y a pas encore de dispositions dérogatoires, mais il y a une habilitation prévue dans la loi. Par voie de règlement cette faculté peut être appliquée.

Question (M. van Roye, Belgique)

Quel est le lieu de la prestation de services pour la location de wagons citernes? En ce qui concerne la prestation de services ayant pour objet la location d'un moyen de transport, le lieu de la prestation est réputé se situer à l'endroit où le moyen de transport est utilisé lorsqu'il est donné en location par un loueur qui est établi dans le pays et ce dans la mesure où ce moyen de transport est utilisé hors de la Communauté, ou bien par un loueur établi hors de la C.E.E.

Réponse

M. CAPPELLEMAN: La règle principale est le lieu du prestataire, mais avec une double exception selon la législation belge; c'est le lieu d'utilisation lorsque le moyen de transport est donné en location en vue d'être utilisé hors du Marché Commun, c'est alors à concurrence de l'utilisation en dehors du Marché Commun que le lieu du service est situé en dehors du Marché Commun: ou, deuxième exception, quand il s'agit d'un moyen de transport donné en location par un loueur établi hors de la C.E.E.
Ces exceptions sont ainsi limitées car à l'art. 9 de la 6ème directive, on ne parle même pas de moyens de transports et en tant que tels, c'est la règle principale du lieu du prestataire qui s'applique avec la faculté laissée à l'art. 9/3 aux Etats membres de situer le lieu du service dans l'Etat d'utilisation lorsque le lieu du service se situe selon la règle principale en dehors du Marché Commun et qu'on peut établir qu'il y a eu utilisation dans le Marché Commun ou, inversément, lorsque selon la règle principale, le lieu du service se situe dans le Marché Commun et que l'utilisation effective a lieu en dehors. Le Code belge fait usage de l'art. 9/3, mais ne peut aller au-delà.

Même Question concernant la location de palettes (support plat servant à transporter des marchandises)

Réponse

M. CAPPELLEMAN: Ceci rentre dans les locations de biens meubles corporels autres qu'un moyen de transport.
Que les palettes soient ou non des moyens de transport peut déjà donner lieu à discussion. Si elles en sont, voir réponse supra; si elles n'en sont pas, c'est à nouveau le lieu du prestataire qui est le lieu du service, sauf lorsque le prestataire exporte le bien d'un pays du Marché Commun dans un autre pays du Marché Commun où il doit être utilisé, ou sauf lorsque le bien est donné en location par un loueur qui est établi hors C.E.E.: où dans les deux cas le lieu du service est le lieu d'utilisation.
Dans les cas de locations de palettes ou de wagons si la T.V.A. est due en Belgique d'après les règles énoncées, il peut y avoir exonération, pour des raison d'exportation s'il s'agit de matériel utilisé en trafic international.

Question (Mme. Villalong, France)

Une société établie en Suisse a effectué pour le compte d'une société française, bureau d'Etudes Immobilières, des opérations de prospection immobilière. Quel est le sort fiscal de ces opérations de prospection à l'égard de l'art. 259 du C.G.I. selon que ces opérations aboutissent à un marché de travaux immobiliers ou n'aboutissent pas.

Réponse

M. LEBRUN: En principe, c'est une opération concernant les immeubles et donc est taxée en France. Si l'opération n'aboutit, j'aurais tendance à penser que dès lors que c'étaient des opérations dont la réalisation éventuelle devait s'effectuer en France, le bon sens implique que ce soit en France que l'imposition soit établie et supportée.

Intervention d'un participant (M. Leroy)

La réponse de M. Lebrun me semble contradictoire avec celle qu'a donnée M. Cappelleman tout à l'heure. Pour M. Cappelleman, quand on fait de la publicité pour la vente d'immeubles, on applique la règle relative aux opérations de publicité, et on applique le lieu de l'établissement du preneur. En revanche, quand il s'agit d'une opération immobilière, dit M. Lebrun, même si ça n'est pas dénoué, c'est une prestation de service relative à un immeuble, donc on applique le lieu de situation de l'immeuble.
Ce sont donc là, pour l'intervenant, deux règles dérogatoires qui sont appliquées distributivement par les diffé-

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rentes administrations, ce qui n'est guère satisfaisant. De plus, quelle est la dérogation qui prime l'autre? Celle relative aux immeubles ou celle relative à la nature des services?

M. LEBRUN: La question relative à la publicité reçoit sa réponse dans la directive elle-même, peu importe qu' elle soit relative à des immeubles ou non. Pour la question relative aux opérations de prospection, sa réponse a été un peu rapide tout à l'heure: il lui apparaissait qu' elles se situaient à l'intérieur du champ des opérations immobilières.
Il y ajoute que si l'on veut poursuivre l'analyse à partir du moment où l'opération ne s'est pas réalisée, l'on peut considérer qu'il s'est agit en réalité d'opérations de recherche et qu'à ce titre et au titre de l'art. 9, §2,e, le lieu d'imposition est le même.

M. CAPPELLEMAN: Est sur la même longueur d'ondes que M. Lebrun. Pour les prestations de publicité, en Belgique, on applique le critère propre aux prestations de publicité et on ne suit pas le critère relatif aux immeubles.
Quant aux opérations de prospection d'un marché immobilier, si l'affaire aboutit, c'est une prestation se rapportant à un immeuble, et c'est le lieu de l'immeuble qui est pris en considération. Si l'affaire n'aboutit pas, ce dont il n'a pas l'expérience depuis le 1/1/78, on ne considère pas qu'il s'agit d'une affaire qui se rapporte à un immeuble mais on a affaire à une étude de marché, et c'est le lieu du prestataire, mais avec le critère du pays du preneur le cas échéant (art. 9, §2,e).

L'intervenant: Ne critique pas la solution mais estime invraisemblable que l'on retienne le critère de l'aboutissement ou non de l'opération pour savoir comment la taxer. C'est oublier que le bureau d'études techniques doit être payé avant, on doit envoyer des factures, des acomptes, sur lesquelles il doit demander une T.V.A., mais laquelle? Et une fois la T.V.A. demandée, si on ne réalise pas l'opération de bureau d'études, est ce qu'on va lui restituer la T.V.A.? Non, parce qu'il l'a mentionnée sur les factures, et dans cette affaire on paiera deux fois la T.V.A.

M. GUIEU: Ne peut que lire les textes communautaires et confirme les interprétations des délégations belge et française.
Pour lui, il est clair que lorsque dans la directive, il y a une qualification d'une prestation de services qui a été citée, c'est ce lieu qui prévaut. Ainsi pour la publicité, c'est toujours le 9, §2,e, ainsi que pour les assurances et les opérations financières. Si l'on prend un crédit pour son immeuble, c'est le 9, §2,e qui joue. Par contre, pour les autres prestations relatives à l'immeuble, il y a une finalité, il faut que l'opération se concrétise.
Si elle ne se concrétise pas, c'est la nature de l'opération qui réapparaît, et c'est le lieu de l'opération qui réapparaît. Il y a peut-être des régularisations à effectuer, mais on ne peut agir différemment, c'est le législateur qui a voulu cela.

Question (Mme. Villalong, France)

Une société française transmet à sa maison mère, établie hors C.E.E., certaines données comptables de base. La maison mère tire de ces données comptables certains ratios ou certains documents de gestion. Ces documents ne ressortent pas de façon caractéristique de la profession d'expert-comptable (la maison mère n'exerce pas cette profession), il serait à priori excessif de parler de traitements de données. Où la prestation est-elle taxable?
Dans l'hypothèse la maison mère facture à sa filiale le coût de cette "assistance" administrative, de ce travail de pure gestion. Dans quel sens, large ou restreint, entend on le traitement des données?
Dans un groupe dependant d'une société mère située hors de la communauté, la société mère dispose des moyens, informatiques et autres, qui lui permettent de fournir des services de gestion à ses filiales, en exploitant les données économiques et comptables que les filiales lui transmettent, services qui leur sont facturés.

Réponse

M. LEBRUN: Pense que ces opérations doivent se placer sous l'art. 9, §2,e/fournitures d'informations et traitement de données. Donc imposabilité en France en la circonstance, dans le chef du preneur. Au point de vue communautaire, il y aurait pu avoir en plus la garantie du 9, §3 (utilisation du service), mais elle n'est pas utilisée en France.

M. CAPPELLEMAN: Suppose que la société mère et la société filiale ont une personnalité juridique distincte. Car sinon il n'y a pas de T.V.A., mais simple échange entre divisions sans personnalité juridique distincte et donc de prestations de services facturés. Il marque son accord avec M. Lebrun.

Question (M. Gossiaux, Belgique)

Une succursale belge d'une société de droit américain vend à un société française du même groupe des marchandises au même prix que cette société française les revend à ses clients en France; pour couvrir les frais encourus par la société française et pour lui assurer une marge bénéficiaire, la succursale belge accorde à la société française un pourcentage minimum de commission.
Le contrôleur français prétend qu'il y a lieu d'appliquer sur la note de commission la T.V.A. française, et que par la suite la succursale belge pourra au moyen d'un représentant responsable en France récupérer cette T.V.A.
Cette T.V.A. française est-elle due ou non?
La succursale belge lui paie donc une commission qui permet de couvrir les frais de la société française et de lui donner un léger bénéfice.

Réponse

M. LEBRUN: Dans une opération de cette nature, il constate d'abord que il y a une opération par laquelle quelqu'un est devenu propriétaire de marchandises donc il n'y a pas de situation de commission.
Deuxièmement, une analyse sur le plan français interne, en ne franchissant pas de frontières, et en analysant les rapports entre deux sociétés, il considérerait qu'il y a une réduction de prix. Mais en tenant compte du fait qu'il y a un franchissement de frontières, il y a une recette complémentaire en quelque sorte, qui est attribuée à la société française.

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Cette recette est une recette imposable, en quelque sorte à titre de complément de rémunération, et elle est imposable en la circonstance en France. Ici il ne s'agit pas d'une prestation de nature intellectuelle.
Il semble donc qu'il y a, quelle que soit la dénomination qui lui est donnée, une recette "complémentaire" de l'entreprise française. Celle-ci reçoit un prix de son client qui est celui auquel elle vend le bien, elle reçoit de l'entreprise belge une rémunération pour la vente de ce produit.

M. CAPPELLEMAN: Réagit de la même façon que M. Lebrun, mais ajoute une hypothèse: Si la société belge agit comme courtier de la société française, en principe le lieu du service de la société belge en tant que courtier serait la Belgique; mais la T.V.A. ne serait pas due en Belgique si le courtier intervient dans la réalisation d'une opération qui a lieu à l'étranger, par exemple d'Amérique en France. La T.V.A. n'est pas due en Belgique sur le courtage, quand elle se rapporte à une exportation ou à une opération se déroulant à l'étranger.

Question (M. Thielemans, Belgique)

Pourquoi, dans la 6ème directive, n'a-t-on pas retenu comme critère principal le lieu du preneur (critère utilisé en Belgique avant 1978)?

Réponse

M. CAPPELLEMAN: Le lieu du preneur est le bon critère car automatiquement on replace la perception dans le pays du preneur qui a normalement droit à la déduction: il y a récupération de T.V.A. qui est portée en compte par le prestataire établi dans un pays étranger. Mais ce critère ne peut non plus être appliqué de façon générale, notamment en ce qui concerne les services qui sont effectués pour le compte de personnes privées ou pour le compte de personnes qui n'ont pas droit à déduction (ex: les prestations de coiffeurs). Il faut donc, quand on accepte le critère du preneur, prévoir une série d'exceptions. Une autre exception est celle qui concerne les immeubles. On en a parlé.

Question

Quelles sont les prestations de services qui se rapportent à un immeuble?

Réponse

M. CAPPELLEMAN: On a reproché, peut-être avec raison, que le système développé supra était de nature à créer des complications chez les assujettis, étant donné qu'au moment du paiement de l'acompte, il fallait savoir si la T.V.A. était due ou non, ou dans quel pays cette T.V.A. était due.
M. Cappelleman en profite pour insister sur un point: si on dit que la T.V.A. n'est pas due en Belgique parce que le lieu du service n'est pas en Belgique, on ne peut en inférer que la T.V.A. n'est pas due du tout. Or pour les prestations qui sont visées à l'art. 9, §2,e, si la T.V.A. n'est pas due en Belgique, c'est qu'elle est due dans un autre pays du Marché Commun.
Pour revenir à la question, si une étude est faite pour savoir si tel immeuble peut être exploité comme magasin à grande surface ou non, normalement on est tenté de dire que le lieu du service est celui où se trouve l'immeuble, mais d'autres pourraient considérer qu'il s'agit d'une étude de marché aussi longtemps qu'on n'a pas la conclusion. On tourne donc un peu en rond. Et on peut se demander si le critère de la situation de l'immeuble ne doit pas être réservé aux seuls cas où il est tout à fait sur qu'une prestation se rapporte à un immeuble, par exemple les prestations matérielles de construction, de démolition, d'intervention dans la vente de tel immeuble, etc.

La Belgique n'a pas encore du se prononcer et n'a pas encore de solution à cette question pour le moment.

M. LEBRUN: L'analyse de Mr. Cappelleman est tout a fait judicieuse. Il est sur que quand nous sommes dans une opération de cette nature il y a des difficultés d'application pratique.

Si, par exemple, une entreprise anglaise demande à une entreprise Suisse de rechercher en France un terrain sur lequel elle pourrait effectuer une opération de promotion immobilière, d'après les schémas communautaires, cette opération est imposable en France; mais si elle ne se concrétise pas, c'est à priori une opération imposable en Angleterre.

Garantir que derrière l'application de ces principes, il y a une réalité fiscale totale, serait présumer des forces des administrations. C'est un phénomène classique de prestations ternaires.

Les Etats membres ont, en matière de territorialité des prestations de service, presque toujours un possibilité de solution pour les opérations dans lesquelles il y a des relations binaires, c.à d., la Belgique et la France, la France et l'Allemagne, etc.

A partir du moment où intervient un troisième pôle dans l'opération, aucune administration, dans quel que système de taxes indirectes que ce soit, n'est en état de garantir l'application des principes qu'elle peut avoir posé en matière d'imposition.

C'est peut être quand même l'avantage du système de l'imposition dans le pays du lieu de l'immeuble à savoir que s'il y a réalisation, à ce moment là il y aura un intérêt fiscal pour un des opérateurs, à éventuellement dégrever de taxe ce qui aura concourru à la réalisation de l'opération en cours; encore faut-il que cette opération soit soumise à la taxe?

Dans des opérations de cette nature, M. Lebrun est d'un scepticisme absolu et défie la Commission et toute administration de pouvoir proposer une solution qui, si elle n'est pas respectée, puisse être véritablement contrôlée. La faiblesse des hommes et des textes sont incommensurables.

Question (M. Gossiaux)

Une société de droit français fait de la publicité en France, la T.V.A. française lui est facturée. La société refacture cette publicité à une société belge ayant une personnalité juridique distincte de la sienne. Le contrôleur français prétend qu'il y a lieu d'appliquer sur cette deuxième facture une T.V.A. française. Ceci pa-

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raît à l'intervenant en contradiction avec l'art. 21, §3, 7o, c.

Réponse

M. CAPPELLEMAN: Tel est aussi son avis. Si une société française porte des frais de publicité en compte à une société belge, et que tout cela se passe en nom propre de la société française, c'est une prestation de publicité pour laquelle le lieu du service est le lieu du preneur lorsque le preneur est établi dans un Etat membre autre que celui du prestataire.
Pour des services qui sont donnés en cascade, il faut voir chaque relation et non voir la solution finale.
Entre la société française et la société belge, ce n'est pas la T.V.A. française qui est due, mais la T.V.A. belge.

M. LEBRUN: D'accord avec M. Cappelleman.

Question

Comment le prestataire sera-t'il assuré que le preneur établi à l'étranger est assujetti, lorsque l'assujettissement est un facteur déterminant de la localisation de service? Sera-t'il responsable si la déclaration du preneur s'avère fausse?

Réponse

M. GUIEU: Suppose qu'il s'agit des prestations de services visées à l'art. 9, §2,e (taxation au lieu du preneur)? Quelle est la preuve qu'il faut apporter pour montrer qu'on est un assujetti communautaire?
Par tous moyens de preuve, y compris par une attestation de l'administration fiscale nationale du pays du preneur envers le prestataire.
D'après l'art. 21, §1,b; dans ce contexte là, les Etats membres peuvent prévoir que le prestataire est solidairement tenu responsable d'acquitter la taxe s'il y a eu fraude. C'est une question de contrôle, d'intendance administrative plus que de principes.

Un intervenant (Me. de Longueville): On ne peut quand même pas imaginer que chaque fois que quelqu'un va faire un achat dans un autre pays, il se promène avec en poche une attestation à jour de son administration locale. Est-il d'ailleurs prévu? Une carte d'identité d'assujetti pour dans les différents pays? Pas à sa connaissance. Or les contrôles se font quatre ans plus tard. Que se passe t'il s'il y a eu un abus de l'intéressé qui a produit de faux papiers? Déjà sur le plan national le prestataire n'a aucun moyen de contrôle, mais sur le plan international encore moins!
Y a-t'il quelque chose de spécifiquement prévu pour éviter cette situation?

M. GUIEU: C'est exact. Il n'y a pas encore de carte d'identité fiscale et j'espère qu'il n'y en aura pas de sitôt. Mais il y a système d'attestation prévu par la 8ème directive pour le remboursement de la taxe à des assujettis étrangers. Ce moyen pourrait être utilisé déjà. Le prestataire qui va prester quelque chose à un preneur étranger doit quand même savoir à qui il va faire sa prestation car il a une responsabilité non seulement vis-à-vis de lui même pour en recevoir le paiement, mais également vis-à-vis de l'administration puisqu'il peut être solidairement responsable. C'est donc à lui de s'entourer de certaines garanties de preuve. Il pense que ce sont des situations marginales, mais qui peuvent exister. Laisse aux administrations nationales le soin d'indiquer ce qu' elles demandent sur base de ces textes communautaires.

Question (Me. de Longueville)

En Belgique, le problème se pose pour l'instant pour des centaines de millions, avec notamment des assujettis, entrepreneurs de travaux qui sont rayés sans que personne ne la sache. Cela bouleverse toute la technique de perception de l'impôt sous la responsabilité du payeur, lequel est obligé pour avoir un minimum de sécurité, même s'il connait très bien son entrepreneur, de téléphoner à son contrôleur, qui lui répond qu'il n'en sait rien, ou écrire et recevoir une réponse trois mois plus tard. Et quant aux listes, elle ne sont pas à jour, c'est d'ailleurs une impossibilité technique. Mais en attendant vous avez reçu des fournitures et vous payez la T.V.A. irrégulièrement sans le savoir.
Comment pense-t-on résoudre ce problème sur le plan international, car la qualité d'assujetti entraine des conséquences très importantes sur le plan de la taxation, déplace les responsabilités. Comment peut on avoir ses apaisements au moment même où on traite, pour savoir si le preneur est vraiement assujetti dans son pays.

C'est un grave écueil du système mis sur pied par la 6ème directive que de faire dépendre de la qualité d'assujetti un régime fiscale particulier.

Réponse

M. CAPPELLEMAN: Dans le cadre du lieu de prestation des services, l'art. 22 de la directive contient une possibilité de faculté pour les Etats membres de prendre toutes les mesures destinées à éviter la fraude.
L'Administration belge a donc tiré la couverture à soi en disant qu'en matière de prestations de services, dès qu'une des parties en cause est établie en Belgique, selon une présomption légale la T.V.A. est due jusqu'à preuve du contraire.
C'est donc au prestataire de service qui n'a pas imposé sa prestation de service de démontrer qu'il avait une raison pour ne pas imposer. Ainsi, du côté belge nous n'avons pas trop de problèmes.

M. LEBRUN: Apporte une nuance; dans la pratique, la situation en cause doit être appréciée au moment où les faits se sont produits c.à d. qu'il faut tenir compte du caractère de certitude que pouvait avoir la situation invoquée pour le redevable en cause au moment où les faits se sont produits.
D'autre part, ceci peut être corroboré par les contacts qu'on peut avoir entre administrations. Si l'administration étrangère fait savoir que la personne en cause était régulièrement inscrite et n'a été radiée qu'à partir d'une certaine date, la bonne foi peut être admise. Ce sont des situations de fait dans lesquelles jouent par définition toutes les imprécisions et toutes les incertitudes éventuelles d'appréciation d'une bonne foi. Si un avocat tient à ce que cette bonne foi profite à la personne poursuivie, l'administration de son côté doit s'entourer de toutes les garanties et de prendre tous les éléments de contrôle qu'elle peut avoir pour en apprécier le degré.

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C'est la seule réponse possible face à une situation de fait.

Question

Est-ce qu'il ne serait pas possible d'envisager un formulaire unifié qui serait tamponné par le représentant de l'administration néerlandaise, ou belge, qui serait adressée au prestataire français ou allemande et qui apporterait la preuve. C'est tout le problème du document probant.
Ne pourrait-il pas y avoir un formulaire européen qui dit tel preneur est assujetti?

Réponse

M. GUIEU: Nous avons prévu un tel formulaire dans le cadre de la 8ème directive. Ce formulaire est communautaire dans les différentes langues de la communauté, pour un échange facile entre les administrations de langues différentes. Cette attestation pourra être utilisée le cas échéant. Mais il ne faut pas les multiplier pour chaque opération sinon on risque d'encombrer et les administrations de base pour viser celles-ci, et les administrations d'arrivée avec des masses de papier énormes. Il faut donc avoir une tolérance et des mesures à date avec la connaissance des assujettis qu'ont les services locaux. La mise en place va se faire.

Question

Est-ce que l'apport en société d'un brevet est une opération taxable?

Réponse

M. GUIEU: Il faut voir deux opérations dans cette affaire. Un brevet est considére comme une prestation de service quand il y a une contrepartie. Quand c'est un apport en capital, cela rentre dans le patrimoine social de la société à qui on apporte un brevet. Il ne pense pas qu'à ce moment là il y ait taxation.

M. CAPPELLEMAN: Il faut savoir qui fait l'apport. Est-ce quelqu'un qui le fait de manière occasionnelle parce qu'il a inventé quelque chose, ou est-ce quelqu'un qui fait cela dans le cadre de son activité professionnelle?
Si c'est une société qui dans le cadre de son activité normale peut exploiter un brevet et qui fait apport de ce brevet soit en propriété, soit en concession, elle fait une prestation de services qui est taxée comme toute autre prestation de service.

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SUJETS II ET III: Assujettis étrangers et leur droit de récupérer la T.V.A.

Exposé

BELGIQUE:
Régime applicable aux assujettis établis à l'étranger

par J. Autenne*

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I. NOTION D'ASSUJETTI

En vertu de l'article 4 du Code de la TVA, ci-après dénommé "CTVA", est un assujetti toute personne dont l'activité consiste à effectuer d'une manière habituelle et indépendante, à titre principal ou à titre d'appoint, avec ou sans esprit de lucre, des livraisons de biens ou des prestations de services visées par ce code.

Il résulte de cette définition très large que la qualité d'assujetti belge n'est nullement conditionnée par la nationalité ou le domicile d'une personne.

Par ailleurs, il a été précisé dans les travaux préparatoires lors de l'examen du projet de loi créant le Code de la TVA que, pour déterminer si une personne réalise des opérations de manière habituelle, il y avait lieu de prendre en considération non seulement son activité exercée en Belgique, mais également son activité exercée à l'étranger.

Il en résulte qu'une société commerciale établie à l'étranger deviendra assujetti belge pour une seule opération qu'elle réaliserait en Belgique (livraison de biens ou prestation de services) lorsque son activité exercée à l'étranger lui donnerait la qualité d'assujetti belge.

Si cette activité est exercée en Belgique, le régime applicable aux assujettis étrangers est fondamentalement différent selon que ces personnes ont ou non en Belgique un établissement stable.

Nous examinerons donc successivement le régime applicable aux assujettis étrangers selon cette distinction et ce, à la lumière des précisions données par une circulaire de la TVA, de l'enregistrement et des domaines no. 30 de 1975, qui remplace la circulaire no. 105 de 1970.

II. ASSUJETTIS ETRANGERS QUI ONT EN BELGIQUE UN ETABLISSEMENT STABLE

A. Notion d'établissement stable

La circulaire No. 30, du 5 décembre 1975, point 8, précise que pour l'application de la TVA, un assujetti établi à l'étranger est considéré comme ayant en Belgique un établissement stable, lorsque les deux conditions suivantes sont réunies:

1) L'assujetti a dans le pays un siège de direction, une succursale, une fabrique, une usine, un atelier, une agence, un magasin, un bureau, un laboratoire, un comptoir d'achat ou de vente, un dépôt ou toute autre installation fixe;
2) Cet établissement est géré par une personne apte à engager l'assujetti envers les fournisseurs ou les clients.

B. Régime applicable

1. Principe

L'assujetti étranger qui a en Belgique un établissement stable est traité comme un assujetti établi dans le pays.

Il peut exercer les mêmes droits, tels les droits à déduction et au remboursement de la TVA en amont et est soumis aux mêmes obligations, telles notamment celles:

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— de déposer une déclaration de commencement d'activité lors de son installation en Belgique et de déposer une déclaration lors d'un changement ou d'une cessation éventuelle d'activité exercée en Belgique.
(Lorsque l'activité est complètement abandonnée, l'immatriculation de l'assujetti est radiée. Si l'activité se poursuit sans établissement stable, les règles décrites au III ci-après sont applicables);
— de délivrer, sauf exceptions, des factures ou documents en tenant lieu conformément aux dispositions de l'arrêté royal No. 1 et de tenir une comptabilité prévue par cet arrêté, comptabilité qui peut être simplifiée lorsque le chiffre d'affaires de l'établissement ne dépasse pas 15 millions de francs belges;
— de remettre, chaque mois ou chaque trimestre, selon le cas, une déclaration à la TVA (la déclaration peut être trimestrielle lorsque le chiffre d'affaires de l'établissement ne dépasse pas 15 millions de francs belges) et d'acquitter, dans les délais prévus, la TVA ou les acomptes de TVA pour les assujettis soumis à la déclaration trimestrielle dont ils sont redevables;
— de remettre, chaque année, un listing des opérations réalisées avec des clients assujettis, etc.

En ce qui concerne la facturation, il y a lieu de remarquer que celle-ci doit comporter le numéro d'immatriculation à la TVA de l'assujetti étranger et l'adresse de l'établissement stable établi en Belgique.

L'administration admet, toutefois, que les factures soient établies à l'étranger et expédiées de l'étranger, pour autant, bien entendu, que les doubles de ces documents soient conservés en Belgique à l'appui de la comptabilité.

2. Immatriculation de l'assujetti étranger

L'assujetti étranger doit se faire immatriculer à la TVA et dépend du contrôle du ressort duquel est situé l'établissement.

Lorsque l'assujetti possède plusieurs établissements, l'office compétent sera celui de l'établissement principal où d'ailleurs devra être tenue centralisée la comptabilité des divers établissements.

3. Sort des opérations réalisées sans l'intervention de l'établissement stable

En principe, les opérations que l'assujetti étranger réalise sans l'intervention de son établissement stable en Belgique ne doivent pas être reprises dans la comptabilité tenue en Belgique ni dans les déclarations à la TVA.

Toutefois, si, parmi ces opérations, se trouvaient des livraisons de biens ou des prestations de services qui sont réalisées en Belgique, qu'elles soient ou non soumises à la taxe, et à l'égard desquelles, pour un assujetti étranger sans établissement stable, la désignation d'un représentant responsable est requise, ces livraisons de biens ou ces prestations de services doivent être reprises dans la comptabilité de l'établissement stable et sont soumises aux mêmes règles que les opérations réalisées par l'établissement stable en ce qui concerne la débition de la TVA.

III. ASSUJETTIS ETRANGERS QUI N'ONT PAS D'ETABLISSEMENT STABLE EN BELGIQUE

A. Principe

Nous avons vu que lorsque des personnes établies à l'étranger réalisent des opérations en Belgique, même isolées ou exceptionnelles, ces personnes acquièrent la qualité d'assujettis belges si, en raison de leur activité exercée à l'étranger, elles répondent aux conditions de l'article 4 du CTVA.

Lorsque ces entreprises ne réalisent pas ces opérations par le canal d'un établissement stable, elles doivent, avant de réaliser des opérations en Belgique, faire désigner un représentant fiscal responsable.

Nous verrons toutefois que ces personnes sont, dans de nombreux cas, dispensées de cette formalité.

B. Régime normal: désignation d'un représentant responsable

La réalisation des opérations en Belgique doit se faire par le canal d'un représentant fiscal responsable.

1. Nature des opérations réalisées en Belgique qui rendent nécessaire la désignation d'un représentant responsable

En principe, seule la réalisation d'opérations qui répondent à la définition de livraison de biens au sens des articles 9 et suivant du CTVA (vente de marchandises, etc.) ou de prestation de services au sens de l'article 18 du CTVA (exécution de travaux, cession, concession de droits incorporels, location de meubles, transport, etc.) nécessite la désignation d'un représentant fiscal responsable.

Il importe peu d'ailleurs que ces livraisons de biens ou prestations de services soient imposées à la TVA ou exonérées en vertu des articles 39 à 43 du CTVA (exportation, transit, etc.).

Il faut cependant remarquer qu'en cas d'importation, lorsque la personne établie à l'étranger déclare la marchandise en consommation en se portant destinataire, il y a tout lieu de croire qu'elle revendra la marchandise en Belgique et réalisera donc une livraison de biens imposable.

C'est la raison pour laquelle elle est tenue de désigner un représentant responsable avant l'importation.

Par contre, aucun représentant fiscal ne devrait être désigné si le destinataire et un co-contractant ou lorsque la marchandise n'est pas déclarée en consommation mais bien en transit, en entrepôt ou en franchise temporaire.

2. Agréation du représentant responsable

a. Conditions à remplir par le représentant responsable

En vertu de l'article 2 de l'arrêté royal no. 31, le représentant fiscal responsable doit être non seulement domicilié ou établi en Belgique, mais en outre être capable de contracter et présenter une solvabilité suffisante pour assumer les obligations prévues par le code

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ou en exécution de celui-ci et avoir accepter la représentation.

Il y al lieu de noter que l'agréation peut notamment être accordée à une société avec laquelle l'assujetti établit un courant d'affaires et n'est pas limitée aux organismes de crédit, agences en douane, fiduciaires, etc.

b. Procédure d'agréation

L'agréation requiert:

- qu'une demande d'agréation, sur un formulaire préétabli, soit introduite par l'assujetti établi à l'étranger ou par le représentant qu'il compte désigner agissant en son nom et pour son compte, au Bureau Central de la TVA pour assujettis étrangers: rue Van Orley, no. 15 à 1000 Bruxelles (tél. 02/218.44.40). (Le représentant responsable relèvera de ce bureau de TVA);
- que la demande soit accompagnée par une déclaration de commencement d'activité prescrite par l'article 50, paragraphe 1 du CTVA et par l'article 1 de l'arrêté royal no. 10, et pour les personnes morales par une copie de l'acte de constitution de la société ou de l'association avec, le cas échéant, copie des actes modificatifs;
- que le représentant responsables accepte expressément sur un formulaire préétabli la représentation qui lui est confiée.

c. Etendue de l'engagement pris par le représentant responsable

(i) *Principe*

En vertu de l'article 55 du CTVA, le représentant responsable est substitué à l'assujetti étranger non seulement pour tous les droits accordés à celui-ci (droit à déduction ou à remboursement de la TVA), mais également pour toutes les obligations imposées à celui-ci (facturation, dépôt de déclarations, paiement de la TVA).

Il est solidairement tenu, avec son commettant, au paiement de la taxe des intérêts et des acomptes dont les opérations en Belgique entraînent la débition.

Il résulte de ce texte général que la responsabilité du représentant peut être très étendue.

Aussi, est-il intéressant de voir quand et comment cette responsabilité pourrait, le cas échéant, être limitée?

Ce problème fera l'objet des points (ii) et (iii) ci-après.

(ii) *Limitation de l'engagement à des opérations déterminées*

La responsabilité du représentant peut, à sa demande, être limitée à des opérations déterminées ou fixées jusqu'à concurrence d'un montant à déterminer d'un commun accord avec l'Administration.

Cette demande de limitation de l'engagement peut être introduite soit lors de la demande d'agréation, soit plus tard, mais alors uniquement pour l'avenir ultérieur.

Il y a lieu de noter que l'assujetti étranger ne peut faire agréer qu'un seul représentant responsable en Belgique.

Il en résulte que l'assujetti étranger ne pourra réaliser en Belgique d'autres opérations pour lesquelles son représentant n'est pas engagé qu'à la condition qu'il soit dispensé pour ces opérations de désigner pareil représentant.

Dans la négative, il y aurait lieu de demander la levée de la limitation de la responsabilité du représentant ou de lui substituer une autre personne.

En tout état de cause, en cas de limitation de responsabilité du représentant, celui-ci ne sera substitué à l'assujetti étranger que pour les droits et obligations qui concernent les opérations couvertes par son engagement.

D'autre part, le bureau central de TVA pour assujettis étrangers peut, dans des cas exceptionnels, limiter la responsabilité de l'engagement financier du représentant à un certain montant qui ne peut être inférieur à 100.000 FB et qui doit couvrir en moyenne le montant de taxe due ou qui sera due pendant trois mois par l'assujetti étranger.

(iii) *Limitation de l'engagement dans le temps*

En principe, le représentant reste responsable jusqu'à la date de cessation d'activité en Belgique de l'assujetti étranger ou jusqu'à l'agréation d'un nouveau représentant responsable.

Il en résulte que le représentant ne peut, en principe, démissionner que s'il notifie par écrit, à l'Administration, soit la cessation de l'activité de l'assujetti étranger, soit l'introduction par l'assujetti étranger de l'agréation d'un nouveau représentant responsable.

Toutefois, l'Administration, consciente du fait qu'une personne ne pouvait être liée indéfiniment pour les opérations accomplies par une personne établie à l'etranger qui continue à avoir une activité en Belgique sans accepter de pourvoir au remplacement de son représentant qui le demande, accepte de prendre en considération la renonciation de celui-ci à sa mission s'il établit avoir fait tout le nécessaire pour assurer son remplacement.

L'assujetti étranger, même après son remplacement ou la cessation d'activité de son commettant étranger, reste tenu, pendant le délai de recouvrement prévu par l'article 81 du CTVA, de la TVA, des intérêts et des acomptes se rapportant aux opérations effectuées sous sa responsabilité.

L'Administration a toutefois admis que le représentant était délié de toute responsabilité des irrégularités:

- lorsque, dans les six mois de la date de retrait de son agréation, le représentant a demandé qu'un contrôle approfondi des opérations traitées par lui soit effectué;
- lorsque ces irrégularités, qui seraient découvertes ultérieurement, ne résultent pas du fait du représentant ou d'une collution entre lui et son commettant étranger.

3. Obligations et droits du représentant responsable

a. Principe

Le représentant responsable remplit en lieu et place de l'assujetti étranger toutes les formalités imposées par le

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CTVA pour les opérations que ce dernier effectue dans le pays.
On consultera pour la liste des principales obligations, B (1) ci-avant.

b. Dispositions particulières applicables en matière de facturation

(i) *Mode de facturation*

(1) Règle générale:

— L'assujetti étranger, pour les livraisons de biens ou les prestations de services qu'il a réalisées en Belgique, envoie à son représentant responsable la facture à adresser au cocontractant en ayant soin de ne pas indiquer, sur cette facture, le montant de la TVA due.
— Le représentant responsable établit, en double exemplaire, le document où figurent outre la mention de son identité, de son adresse et d'une référence en sa qualité de représentant, la date de délivrance du document, le nom et l'adresse du commettant, le numéro d'immatriculation à la TVA qui a été attribué à ce dernier, le numéro d'inscription du document au facturier de sortie qu'il tient au nom et pour le compte du représenté, le montant de la TVA due et les autres mentions exigées par l'article 2 de l'arrêté royal no. 1.
— Le représentant responsable adresse l'original du document visé à l'alinéa précédent au cocontractant de l'assujetti étranger, après y avoir annexé la facture reçue de l'étranger. Le double de ce document est conservé par lui.
(Article 4, paragraphe 2 de l'arrêté royal no. 31).

(2) Exception:

L'Administration admet que la procédure visée au point 1 ci-avant ne soit pas suivie et soit remplacée par la manière de procéder décrite ci-après:

— L'assujetti étranger adresse à son représentant la facture destinée à son cocontractant sans indiquer le montant de la TVA due ainsi que deux copies de la facture originale ainsi établie.
— Le représentant mentionne sur les deux copies de facture son identité, son adresse et sa qualité de représentant responsable, la date de délivrance, le numéro d'immatriculation à la TVA de l'assujetti étranger, le numéro d'inscription de la facture au facturier de sortie qu'il tient au nom et pour le compte de l'assujetti étranger, le montant de la TVA due ainsi que les mentions prescrites par l'article 2 de l'arrêté royal no. 1 qui ne figuraient pas sur la facture originale.
— Le représentant responsable adresse l'une des copies de facture ainsi complétée au cocontractant de l'assujetti étranger après y avoir annexé la facture originale; il conserve l'autre copie.

(3) Comptabilisation de la facture par le cocontractant de l'assujetti étranger:

Le cocontractant, s'il peut enregister en comptabilité la facture originale, ne peut toutefois exercer son droit à déduction que sur base du document visé au point 1 ci-avant ou d'une copie de la facture visée au point 2 ci-avant.

(ii) *Délai de facturation et de paiement*

En vertu de l'article 1 de l'arrêté royal no. 1, la facture doit être délivrée au cocontractant au plus tard le cinquième jour du mois qui suit celui au cours duquel le bien est livré, le service est achevé ou la taxe est due.

L'Administration a admis que le représentant responsable peut, lorsqu'il n'est pas en mesure de délivrer le document dans le délai prescrit, le délivrer encore valablement jusqu'à la fin du mois au lieu du cinquième jour ouvrable de ce mois.

Il va de soi que, dans ce cas, la TVA due peut être encore valablement reprise dans la déclaration suivant celle de la période au cours de laquelle elle aurait dû être reprise.
En compensation, le cocontractant assujetti se voit reporter d'une mois dans l'exercice de son droit à déduction.

c. Dispositions particulières en matière de déduction

Pour pouvoir opérer la déduction, les assujettis doivent normalement détenir l'original de la facture qui leur a été adressé par le cocontractant ou le document d'importation qui a été levé à la frontière.

Pour tenir compte du fait que très souvent l'original de la facture doit être comptabilisé au lieu d'établissement de l'assujetti étranger, l'Administration admet que la déduction soit opérée au vu de photocopie de facture pour autant que les conditions suivantes soient remplies:

— L'assujetti étranger doit justifier à l'Administration l'obligation légale que lui impose le pays où il est établi, de détenir les factures originales au siège de l'entreprise.
— Les photocopies doivent porter la mention, apposée par la société étrangère et certifiée par elle, qu'elles sont conformes à l'original; cette mention doit être paraphée par le représentant responsable qui en prend la responsabilité.
— L'assujetti étranger doit s'engeger par écrit à mettre temporairement les factures originales à la disposition du représentant responsable, à la demande de l'Administration pour les besoins du contrôle (Code, art. 61).

4. Création d'un établissement stable

Lorsqu'un assujetti étranger avait désigné un représentant responsable en Belgique et créé ensuite un établissement stable, il conserve son numéro d'immatriculation mais change d'office de contrôle pour dépendre de celui dans le ressort duquel est situé l'établissement stable.

Dans ce cas, une déclaration de changement d'activité doit être établie.

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C. Régime général d'exception: dispense de l'agréation d'un représentant responsable

1. Cas dans lequel l'assujetti étranger est dispensé de désigner un représentant responsable

L'assujetti étranger est dispensé de faire agréer un représentant responsable:

- pour les prestations de services de caractère intellectuel qu'il effectue dans le pays (travaux d'étude et de contrôle, études de marché, entreprises de publicité, cession ou concession de droits intellectuels, tels que brevets, marques de fabrique et de commerce, droits d'auteur);
- pour les prestations de services de caractère matériel qu'il effectue occasionnellement en Belgique;
- pour les opérations, de caractère occasionnel, comportant la revente, dans le pays, de biens qu'il y a achetés ou importés;
- pour les livraisons de biens et les prestations de services effectuées dans le pays mais exemptées de la taxe en vertu des articles 39 à 42 du Code (par exemple, les transports internationaux de marchandises).

Le point de savoir si l'assujetti étranger effectue habituellement ou occasionnellement des opérations en Belgique est évidement délicat.

L'Administration a précisé à ce sujet qu'il y avait lieu de considérer que les opérations réalisées en Belgique avaient un caractère répété lorsqu'elles auraient entraîné l'assujettissement de la personne qui les réalise, si celui-ci était établi en Belgique.

Il faut toutefois remarquer que bien qu'une opération puisse juridiquement être considérée comme isolée, elle nécessitait la désignation d'un représentant responsable lorsqu'elle impliquait la réalisation de grands travaux de génie civil (construction de routes, ponts, usines, etc.).

Il faut enfin noter que l'assujetti peut avoir intérêt à désigner un représentant responsable et renoncer à la dispense. Tel sera notamment le cas de l'assujetti qui veut déduire immédiatement la taxe dans sa déclaration, qui désire bénéficier du régime de report de paiement de la TVA à l'importation (Article 4, paragraphe 3 de l'arrêté royal no. 7) ou qui désire réaliser des importations temporaires de matériel destinées à l'exécution de travaux de toute nature (voir à ce sujet circulaire no. 9 de 1978 de l'Administration de la TVA, de l'enregistrement et des domaines).

2. Mode de perception de la taxe

a. L'assujetti étranger accomplit des opérations autres que des prestations de transports internationaux de personnes

(i) *L'assujetti a exercé le droit à remboursement de TVA belge en amont*

En vertu de l'article 5 de l'arrêté royal no. 31, la TVA due sur les opérations réalisées en Belgique est acquittée par l'apposition et l'annulation de timbres fiscaux.

A cette fin, l'assujetti étranger établit une facture, en double exemplaire, portant les mentions prescrites par l'article 2 de l'arrêté royal no. 1. Il appose et annule la partie supérieure des timbres sur la facture qu'il délivre à son cocontractant et la partie inférieure de ces timbres sur le double de la facture qu'il conserve.

L'annulation de chaque partie des timbres est faite en caractères très apparents, soit par une mention manuscrite, au moyen d'une encre indélébile, comprenant la date de l'annulation et la signature de l'assujetti étranger, soit par l'emploi d'une griffe reproduisant à l'encre grasse, outre la date, le nom patronymique, la dénomination ou la raison sociale de l'assujetti étranger. La date doit seule être reproduite entièrement sur la partie du timbre annulée; la signature doit être complète, mais elle peut déborder (v. arrêté royal no. 31, art. 5, al. 3).

L'apposition et l'annulation des timbres fiscaux peuvent être opérées, non seulement par l'assujetti établi à l'étranger, mais également par un correspondant ou un mandataire agissant pour son compte en Belgique, et notamment par son cocontractant établi dans le pays.

(ii) *L'assujetti étranger n'a pas à exercer de droit à remboursement de TVA belge en amont*

Dans cette hypothèse qui se rencontrera surtout lorsque l'assujetti étranger effectue de simples prestations de services de nature intellectuelle (cession ou concession de brevets, travaux d'études, etc.), la TVA belge ne droit pas être acquittée par l'assujetti étranger.

En effet, le cocontractant de l'assujetti étranger payera la TVA en lieu et place de son fournisseur étranger. S'il est assujetti, il le fera par inscription au cadre V. a) ou à la case 31 ou 32 selon qu'il dépose une déclaration mensuelle ou trimestrielle.

Lorsque le cocontractant n'est pas assujetti, il acquitte la taxe en apposant ou annulant des timbres fiscaux entiers sur la facture reçue de l'étranger ou à défaut de facture, sur un document qu'il crée à cette fin.

Cette obligation doit être remplie dans les 10 jours consécutifs au 5me jour ouvrable du mois qui suit celui au cours duquel le bien a été livré, le service a été achevé ou la TVA est devenue exigible.

La facture ou le document en tenant lieu doit contenir les mentions prescrites à l'article 2, 2me à 6me alinéas de l'arrêté royal no. 1, ainsi que la date de sa délivrance ou de son établissement et éventuellement le numéro d'ordre sur lequel il est inscrit au facturier d'entrée.

L'annulation se fait comme cela a été décrit ci-avant (voir point (i)), sous la seule réserve que les deux parties du timbre doivent restées adhérentes et que la mention ou la griffe doit être apposée dans le sens de la plus large dimension du timbre (article 6, 2° de l'arrêté royal no. 31).

b. L'assujetti étranger accomplit des prestations de transports internationaux de personnes

Le transport rémunéré de personnes autre qu'un transport maritime ou un transport aérien international est soumis à la TVA dans la mesure où le transport est effectué dans le pays.

Les transporteurs de personnes, à défaut d'établissement

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en Belgique, doivent normalement avoir un représentant responsable dans le pays. (L'existence de ce représentant est justifiée par la production à la douane d'une lettre d'agréation ou d'un certificat en tenant lieu, délivré par le Bureau Central de TVA pour assujettis étrangers.)

L'Administration admet cependant que les transporteurs étranger qui n'ont pas de représentant responsable, puissent être admis dans le pays pour des transports internationaux de personnes, en acquittant à la douane les sommes forfaitaires suivantes, moyennant dépôt d'une quittance no. 258:

— Transport de personnes par service non régulier:
  - véhicule carrossé pour transporter au maximum 6 personnes, outre le chauffeur: 30 F;
  - véhicule carrossé pour transporter plus de 6 personnes et au maximum 10 personnes, outre le chauffeur: 75 F;
  - autocar carrossé pour transporter plus de 10 personnes et au maximum 20 personnes, outre le chauffeur: 150 F;
  - autocar carrossé pour transporter plus de 20 personnes, outre le chauffeur: 300 F;
  - bateau: 300 F.
— Transport de personnes par service régulier (autobus ou bateau): 600 F.

Pour autant que la quittance no. 258 comporte le numéro de la plaque d'immatriculation du moteur et du châssis et soit présentée à la douane, le véhicle peut pénétrer plusieurs fois par jour en Belgique.

3. Mode d'exercice d'un droit à remboursement de la TVA en amont

a. Conditions mises au remboursement

L'assujetti étranger peut obtenir le remboursement des taxes grevant ses entrées pour autant qu'il fournisse au Bureau Central de TVA pour assujettis étrangers le double, dûment revêtu des timbres, des factures délivrées à son cocontractant conformément à l'article 5 de l'arrêté royal no. 31.

Le remboursement ne peut porter que sur les taxes grevant les biens et les services qu'il justifie avoir utilisés pour l'exécution des opérations ainsi facturées. Une comparaison des factures d'entrée ou des documents d'importation — qui doivent être produits à l'appui de la demande — et des factures de sortie est ainsi nécessaire, ce qui implique une rédaction précise de ces factures, notamment en ce qui concerne la désignation des biens et des services et des quantités achetées et vendues.

Le remboursement des taxes en amont peut également être accordé à l'assujetti établi à l'étranger:

— lorsqu'il prouve que les biens et les services grevés des taxes belges ont été utilisés pour l'exécution d'opérations exemptées de la taxe en vertu des articles 39 à 43 du Code (exportations, transports internationaux de marchandises, ventes à des ambassades, fournitures de biens ou de services à des assujettis titulaires d'une autorisation délivrée en application de l'article 43 du Code, etc.);
— lorsqu'il prouve que les biens ou les services grevés des taxes belges ont été utilisés pour l'exécution d'opérations effectuées par lui à l'étranger et qui auraient été imposées si elles avaient été effectuées en Belgique;
— lorsqu'un transporteur étranger de personnes établit qu'il a acquitté la taxe, à la douane, selon les règles prévues ci-avant.

b. Procédure de remboursement

Les demandes en remboursement doivent être accompagnées d'un relevé récapitulatif des factures d'entrée et des documents d'importation ainsi que des factures de sortie constatant les TVA dues.

Dans l'hypothèse où les factures de sortie sont exonérées de TVA en raison d'une exportation, l'assujetti doit également transmettre les documents qui justifient la cause de l'exemption tels par exemple les documents d'exportation.

Les remboursements sont normalement effectués dans les trois mois de l'introduction de la demande. Lorsque la demande de remboursement est justifiée par des opérations exonérées de la taxe parce que afférentes à l'exportation, non soumises à la taxe parce que réalisées à l'étranger ou soumises à la taxe mais sujettes au régime particulier du paiement examiné ci-avant pour un transport de personnes, celle-ci n'est prise en considération que si elle porte sur un montant de TVA qui atteint 65.000 F. ou 25.000 F. selon que le chiffre d'affaires annuel réalisé en Belgique dépasse ou est inférieur à 15 millions. En tout état de cause, la demande peut être retenue en fin d'année civile, pour autant que le montant de TVA à rembourser atteint 300 F.

Le paiement est effectué par virement au compte courant postal ouvert en Belgique ou à l'étranger au nom du créancier ou de son mandataire, ou par transfert à une banque établie en Belgique, à un organisme visé à l'article 1er, alinéa 2, 1°, de l'arrêté royal No. 185 du 9 juillet 1935, sur le contrôle des banques et le régime des émissions de titres et valeurs, à une entreprise visée à l'article 1er, alinéa 2, 3°, du même arrêté, à une association de crédit agréée par la Caisse Nationale de Crédit Professionnel ou à une caisse de crédit agréée par l'Institut National de Crédit Agricole.

Lorsque le paiement doit être fait en mains d'un mandataire, une procuration doit être jointe à la demande de remboursement. Les signatures doivent être légalisées par l'agent diplomatique ou consulaire belge et par le Ministère des Affaires étrangères de Belgique, si l'acte est dressé à l'étranger, sauf en ce qui concerne les actes publics qui ont été établis sur le territoire d'un Etat contractant de la Convention supprimant l'exigence de la légalisation des actes publics étrangers, faite à La Haye le 5 octobre 1961. Dans ce cas, la seule formalité qui puisse être exigée pour attester la véracité de la signature, la qualité en laquelle le signataire de l'acte a agi et, le cas échéant, l'identité du sceau ou timbre dont cet acte est revêtu, est l'apposition de l'apostille définie à l'article 4 de ladite Convention, délivrée par l'autorité compétente de l'Etat d'où émane le document. Pour les actes sous seing privé établis en Belgique, les signatures doivent être certifiées authentiques par un notaire belge. Les procurations établies dans une langue autre que le

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français, le néerlandais ou l'allemand doivent être accompagnées d'une traduction.

Si le bénéficiaire du remboursement n'est pas titulaire d'un compte courant postal en Belgique ou à l'étranger, ni d'un compte auprès d'un des organismes financiers précités, le paiement a lieu par assignation postale. Les frais d'encaissement de cette assignation sont à la charge du bénéficiaire du remboursement.

Le bureau central renvoie à l'assujetti étranger les documents qui ont justifié sa demande. Ceux-ci doivent être conservés par l'assujetti étranger pendant cinq ans.

D. Régimes particuliers d'exception

Des régimes particuliers sont prévus par la circulaire No. 2 du 11/1/79 pour les ventes par filières avec l'intervention occasionnelle d'assujettis établis à l'étranger et par la circulaire No. 4 du 14 février 1979 sur les importations de biens avec montage.

FRANCE: Documentation

Conséquences de la territorialité des prestations de services: moyens mis à la disposition du prestataire étranger non établi en France, débiteur d'une T.V.A. française, pour lui permettre de s'acquitter de ses obligations

Les règles législatives et administratives se trouvent dans les documents suivants:
Code Général des Impôts, Article 289A;
Document de base 3A 222 et Instr. Adm. du 15 février 1979.

Conséquences de la territorialité des prestations de services: récupération par le bénéficiaire étranger d'une T.V.A. afférente à une prestation de service taxable à la T.V.A. française

Document de base 3A 223 et Instr. Adm. 3A-16-79.

MINISTERE DU BUDGET

Service de la Législation Fiscale
Sous-Direction D *Paris, le 15 janvier 1980*
Bureau D2

Direction Générale des Impôts
Service de l'Administration Générale
Sous-Direction III C
Bureau III C 2

Monsieur le Chef de Service,

Vous avez appelé l'attention sur le régime applicable, en matière de taxe sur la valeur ajoutée, aux prestations de caractère immatériel désignées à l'article 259 B du Code général des Impôts, rendues par des prestataires étrangers à des preneurs assujettis en France.

Faisant observer que les prestataires étrangers ignorent généralement la réglementation en vigueur dans ce domaine et ne facturent pas la taxe sur la valeur ajoutée, vous demandez que soient précisées, dans ce cas, les modalités de déclaration, de paiement et de déduction de la taxe par les bénéficiaires des prestations.

Conformément aux dispositions de l'article 259 B du Code général des Impôts, les prestations figurant à cet article sont imposables en France lorsqu'elles sont effectuées par un prestataire établi hors de France et lorsque le bénéficiaire est établi et assujetti à la taxe sur la valeur ajoutée en France.

Par ailleurs, aux termes de l'article 283-2 du Code, la taxe exigible sur ces prestations doit être acquittée par le bénéficiaire. Toutefois, le prestataire est solidairement tenu avec ce dernier au paiement de la taxe.

En outre, pour les mêmes prestations, les articles 289-I et 289-A-II du Code font obligation au prestataire d'une part, d'établir la facture et d'autre part, de désigner, à défaut du paiement de la taxe par le preneur, un représentant établi en France qui remplit les formalités incombant au redevable et acquitte la taxe.

Lorsque la taxe est acquittée par le bénéficiaire, il est admis que le prestataire étranger ne fasse pas mention de cette taxe sur la facture ou le document en tenant lieu (note de frais, note d'avoir. . .) qu'il adresse à son client français.

Celui-ci annote alors cette facture ou ce document de la mention "Prestation désignée à l'article 259 B du Code général des Impôts — Taxe sur la valeur ajoutée due par le bénéficiaire" et du montant de la taxe dont il est redevable.

La taxe correspondante est ensuite déduite du cadre III de la même déclaration pour son montant réel (ligne 11) ou forfaitairement (ligne 12).

L'imprimé CA12 (ou CA12 E) ne permettant pas d'individualiser les prestations énumérées par l'article 259 B, le bénéficiaire doit indiquer dans le cadre réservé à la correspondance, qui figure au bas de la première page, ou sur une note annexée, la base d'imposition correspondant à ces opérations ainsi que la date d'exigibilité de la taxe sur la valeur ajoutée.

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BELGIQUE:

M. CAPPELLEMAN

Description du régime auquel sont soumis les assujettis étrangers en ce qui concerne d'une part leur obligation d'acquitter une T.V.A. étrangère, d'autre part le droit de récupérer la T.V.A. qui leur est portée en compte conformément aux prescriptions de la 8ème directive récemment publiée au Journal Officiel

Lorsqu'il s'agit d'assujettis étrangers (établis à l'étranger) qui font en Belgique certaines opérations, on peut faire une triple distinction.

1) Les assujettis étrangers qui ont en Belgique un établissement stable ou un siège d'exploitation.
   Ils sont tenus en Belgique pour les opérations qu'ils y font aux mêmes obligations que les assujettis belges, sans aucune distinction.
2) Les assujettis étrangers qui effectuent en Belgique des opérations soumises à la T.V.A., sans y avoir un siège d'exploitation ou un établissement stable.
   Ces assujettis sont en principe tenus d'avoir en Belgique un représentant responsable qui, en fait, remplit au nom et pour le compte de l'assujetti étranger les obligations des assujettis belges en général et qui exerce également les mêmes droits. C'est donc par ce représentant responsable que la T.V.A. due est payé et que la T.V.A. à déduire est récupérée.
3) Mais dans certains cas, l'assujetti étranger est dispensé d'avoir un représentant responsable.
   Tel est le cas lorsque l'assujetti étranger effectue en Belgique des opérations qui tombent dans le champ d'application de la T.V.A., mais qui ne sont pas soumises effectivement à la T.V.A., parce qu'il y a exonération pour raisons d'exportation ou parce qu'il s'agit d'opérations tout à fait isolées, ou encore et surtout parce qu'il effectue en Belgique des prestations de services qui sont taxables dans le pays du preneur (art. 9, §2 de la 6ème directive ou l'art. 21, §3, 7º du Code belge).

Dans cette situation où l'assujetti étranger n'a pas de siège d'exploitation ou d'établissement stable en Belgique , la T.V.A., lorsqu'elle est due, doit être payée directement par le preneur. L'assujetti ne la devra éventuellement que par application des règles de solidarité.

Si l'assujetti étranger a exposé en Belgique des dépenses grevées de T.V.A., en relation avec ces prestations de service qui sont imposées directement à charge du preneur, il pourra récupérer cette T.V.A. qui lui a été portée en compte sur ses dépenses sous forme de restitution.

Il en est de même lorsque l'assujetti étranger effectue en Belgique des opérations qui sont exonérées pour des raisons d'exportation.

Tout cela sous la réserve qu'un assujetti belge aurait pu récupérer la T.V.A. dans les mêmes conditions.

Il y a certaines limitations du droit à déduction en Belgique, notamment pour les véhicules, pour le transport de personnes où la déduction ne peut jamais dépasser 50 pour cent de la T.V.A. qui a été payée. En ce qui concerne les biens d'investissement, nous avons une disposition "temporaire" qui existe depuis 1970 et qui maintient une limitation de 5 pour cent, sauf lorsqu'il s'agit d'investissements complémentaires ou créateurs d'emploi.

Tel que ce régime fonctionne en Belgique depuis 1971, les assujettis étrangers ont toujours pu récupérer les T.V.A. qui ont été payées, dans les circonstances décrites ci-dessus. Ce régime de restitution va même au-delà de ce qui est prévu dans la 8ème directive, étant donné que celle-ci oblige les Etats membres à rembourser aux assujettis étrangers la T.V.A. qu'ils ont supportée sur leurs dépenses, uniquement dans les cas où les assujettis étrangers n'effectuent pas dans un autre Etat membre des opérations soumises à des taxes, par exemple quand un industriel français participe à une foire commerciale en Belgique où il ne vend pas et ne fait qu'exposer sa marchandise; mais une T.V.A. lui est portée en compte pour des frais d'électricité, de publicité, etc. . .

La 8ème directive dit encore que la T.V.A. doit être remboursée aux assujettis étrangers qui effectuent dans un autre Etat membre des opérations exonérées de transport (trafic international de marchandises surtout).

Autre cas: lorsqu'un assujetti étranger effectue dans un autre pays membre des prestations de services, pour lesquelles la T.V.A. doit être payée exclusivement par le preneur du services.

D'après le contenu de la 8ème directive les assujettis étrangers qui font en Belgique des dépenses grevées de T.V.A. peuvent depuis 10 ans déjà récupérer cette T.V.A. à condition de prouver qu'il s'agit de dépenses qui ont été faites dans le cadre d'une activité permettant la déduction. Mais à partir du 1er janvier de l'année prochaine en tout cas, les autres Etats membres devraient accorder aux assujettis belge la restitution de la T.V.A. que ces derniers auront payée dans les autres Etats membres pour effectuer les opérations qui viennent d'être décrites.

La législation belge nécessite-t-elle beaucoup d'adaptation au regard de la 8ème directive? En fait, non. Tout au plus certaines formalités seront-elles à adapter, ou certains délais ou le plafond de restitution, car actuellement on ne restitue que sur la base d'une demande trimestrielle et pour autant que le montant de T.V.A. à restituer atteigne au moins 25.000 Fr.Frs.; or, il faudra l'accorder dès qu'on atteint 200 unités de compte Européens (+ ou — 8000 FB).

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FRANCE:

MONSIEUR LEBRUN

L'orateur partage la conclusion de Monsieur CAPPELLEMAN sur les bienfaits de la 8ème directive, car la mise en oeuvre de cette directive apportera en France une situation qui a été demandée par beaucoup d'assujettis étrangers. Il croit donc qu'elle apportera également dans les relations économiques internationales quelques avantages.

Si l'on s'en tient à la situation antérieure (avant la mise en oeuvre de la 8ème directive) on peut dire qu'en ce qui concerne les modalités dans lesquelles un prestataire redevable de la taxe en France s'acquitte de ses obligations, qu'elles sont essentiellement les suivantes: lorsqu' il s'agit du prestataire, on applique l'article 259a, pour les entreprises établies en France, et l'article 259c, pour les entreprises établies hors de la Communauté. Les modalités sont claires: la nécessité pour ces entreprises de faire accréditer auprès de l'Administration française un représentant qui s'engage à remplir les formalités incombant au redevable et à acquitter la taxe en ses lieu et place.

Ce représentant fiscal doit être une entreprise établie en France et connue à ce titre de l'Administration fiscale. Il doit accomplir exactement toutes les obligations qui incomberaient à une entreprise établie en France et conduisant en France ses activités, c'est-à-dire notamment la tenu de la comptabilité de l'opération.

Un point particulier: c'est la facturation. Normalement, la facturation des opérations est établie par le représentant fiscal qui doit mentionner qu'il agit en qualité de représentant de l'entreprise représentée, indiquer son nom et son adresse, mais on a également admis que l'entreprise représentée puise faire la facturation avec l'obligation inverse, c'est-à-dire qu'elle indique qu'elle est représentée en France par telle et telle personne.

Le représentant fiscal bénéficie de l'ensemble des dispositions applicables à tous les redevables établis en France. Il en bénéficie et en supporte aussi les conséquences, c'est-à-dire qu'il peut avoir à réparer les omissions ou les insuffisances qu'il aurait commises pour le compte de l'entreprise étrangère.

En ce qui concerne les prestations de services imposables du chef du preneur, imposables au titre de l'article 259b, on note qu'en la circonstance il y a accomplissement de ces formalités par le bénéficiaire du service et que l'on a établi une solidarité entre le bénéficiaire et le prestataire. Il est admis que lorsque le prestataire est étranger, il ne fasse pas mention de la taxe sur les factures ou les documents en tenant lieu qu'il adresse à son client français, à condition de noter sur cette facture qu'il s'agit d'une prestation visée à l'art. 259b, du Code général des impôts, taxe sur la valeur ajoutée, due par le bénéficiaire. Cette solution est de nature à imposer un minimum d'obligations aux entreprises étrangères puisque dans cette hypothèse, l'entreprise étrangère est simplement solidaire du prestataire établi en France.

Sur les modalités de récupération de la taxe par une entreprise étrangère non établie en France, taxe qui lui a été facturée par un prestataire français, l'orateur déclare que l'Administration française appliquera dans son entièreté, la 8ème directive à compter du 1er janvier 1981.

LUXEMBOURG:

MAITRE PRUSSEN

Si un assujetti étranger a un siège d'exploitation ou un établissement stable au Grand-Duché, c'est le même système qu'en Belgique avec quelques petites différences, pour autant qu'on veuille appliquer l'art. 21 de la directive qui prévoit le paiement de la taxe par le débiteur en cas de services visés par l'art. 9/2.

En effet, au Grand-Duché, on a simplement prévu une habilitation dans la loi et aucun règlement n'est intervenu à l'heure actuelle, de façon que le prestataire de services reste le débiteur. L'application de cet article 21 de la directive ne se fera pas sans difficultés.

L'on aura des preneurs qui sont assujettis, mais qui feront eux des opérations exonérées et qui devront déposer des déclarations pour des services qui leur ont été facturés.

Tous les médecins, tous les hôpitaux, tous ceux qui ne déposent pas de déclaration devront le faire dans le futur, sous l'empire de l'art. 21.

C'est peut-être là la raison pour laquelle l'Administration n'a pas encore réglementé et peut-être considère-t-on que le système où le prestataire fait lui-même la déclaration est plus simple.

Declaration et garanties

En pratique, le prestataire de services étranger qui fait une opération à Luxembourg, est obligé de la déclarer. Il n'est pas nécessairement obligé d'avoir un représentant fiscal, tel que c'est le cas en Belgique.

Mais s'il est obligé de déclarer, il peut être obligé par l'Administration d'avoir un représentant fiscal. On peut également demander d'autres garanties. En principe la déclaration se fait assez simplement; un seul bureau à Luxembourg est compétent, c'est le bureau no. 10. Le préposé du bureau en question se met en rapport avec le prestataire pour fixer une entrevue et voir quel régime on pourrait appliquer. En effet, le régime varie selon la multiplicité des services et le nombre des clients.

La manière est donc assez souple. On demande aux prestataires de faire une déclaration par voie de lettre. Un dossier fiscal sera ouvert mais sans numéro d'immatriculation.

S'il s'agit d'opérations multiples auprès d'un client unique, on peut convenir que ce sera le preneur, tenu solidairement en vertu de la législation interne, qui fera la déclaration à décharge et paiera également la décharge. Sinon on demandera au prestataire de faire les déclarations mensuelles ou trimestrielles, ou annuelles; cela dépendra du nombre de service prestés.

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Mais l'Administration demandera le cas échéant des garanties. Ces garanties peuvent consister en la nomination d'un représentant fiscal ou un cautionnement à la Caisse de consignation ou une garantie bancaire.

En principe, le préposé du service fixera le montant du cautionnement en raison de la créance estimée du Trésor, mais toujours est-il que le prestataire peut demander et peut toujours fournir un représentant fiscal qui assumera alors l'obligation de garantie solidaire et qui assumera certaines obligations, lesquelles toutefois ne vont pas aussi loin qu'en Belgique.

Il faudra détenir le double des factures et toutes les pièces nécessaires pour la déclaration et le contrôle. C'est le prestataire qui établira les factures et non le représentant fiscal. Les taux étant relativement simples et facilement identifiables, il ne se posera pas tellement de problèmes aux prestataires en question.

Le prestataire aura immédiatement eu des rapports très personnels et très directs avec l'Administration, il discutera lui-même avec le préposé responsable de la manière la plus appropriée, compte tenu des services prestés, pour faire la déclaration en question.

Sous la législation actuelle donc, c'est toujours le prestataire qui est obligé en principe de faire la déclaration et ce n'est pas le preneur de la prestation, même dans le cas de différents services, l'art. 21 de la directive le prévoyant.

Déduction et remboursement

Alors quid de la procédure de la déduction et du remboursement?

L'assujetti pourra récupérer la taxe par le biais de la déduction de la taxe en amont, s'il fait des opérations imposables dans le pays qui prélève la taxe. Mais c'est lui qui aura dû faire la déclaration de ses propres prestations et demander au preneur de faire la déclaration à décharge.

Le texte de la 8ème directive est très clair en ce qui concerne les remboursements. Il prévoit comment il faut faire la demande de remboursement.

En principe, aucune difficulté n'est à prévoir à condition que la demande soit accompagnée des factures originales et de l'attestation de l'Administration.

Je dois préciser que la 8ème directive ne s'applique pas aux cas où le preneur fait lui-même des opérations imposables dans le pays puisque dans ce cas il pourra lui-même obtenir le remboursement par restitution ou par déduction de la taxe en amont ou par restitution de l'excédent de taxe. Mais il faut dire qu'à l'heure actuelle, la pratique administrative est telle qu'on demande au prestataire de faire lui-même les déclarations parce qu'on estime que s'il ne le fait pas lui-même ou qu'il n'exécute pas lui-même les obligations qui sont à sa charge et qu'il laisse par exemple le preneur déclarer à décharge, il ne remplit pas ses obligations, auquel cas l'excédent de taxe ne lui est pas remboursé.

Cette pratique administrative n'a pas encore été soumise jusqu'à présent au Tribunal. Elle sera adaptée au moment où le Gouvernement décidera effectivement de prendre le règlement qui concernera les services plus spécialement énumérés à l'art. 9/2,e.

Sauf exception, il ne devrait pas se poser de discussion à Luxembourg pour le preneur de services pour obtenir le remboursement d'une façon ou d'une autre.

Débats

Question

La question est relative au cautionnement et au représentant responsable au Luxembourg.
M. Prussen avait dit dans son exposé que l'Administration, d'après un texte récent, peut, avant la réalisation d'une opération imposable par un assujetti qui n'a pas d'établissement stable au Luxembourg, faire agréer un représentant responsable. Il a ajouté que l'Administration pourrait exiger en lieu et place dudit représentant responsable la fourniture d'un cautionnement approprié par un institut financier établi au Grand-Duché de Luxembourg.
L'Administration ferait valoir que le régime en question est instauré pour des raisons pratiques et de facilité, mais elle empêcherait dans certains cas, en raison de l'importance du cautionnement bancaire, certaines entreprises belges à obtenir des crédits pour les besoins de leur trésorie.

Voici la question: Est-ce que les membres du groupe connaissent dans leur secteur des difficultés similaires? Dans l'affirmative, la charge financière du système de cautionnement a-t-elle été réellement excessive? N'estime-t-on pas que l'obligation de cautionnement est en contradiction avec le texte même de l'article du règlement qui dispose que le cautionnement est applicable sans préjudice des dispositions des art. 66 et 67, si ce sont des articles qui ont trait au représentant permanent.

Réponse

M. PRUSSEN: L'interprétation qui est donnée par l'Administration à ce texte est que, pour des raisons pratiques, il est possible, pour un entrepreneur étranger qui n'a pas de base fixe à Luxembourg, de donner un cautionnement soit en versant une some à la Caisse des consignations, soit — ce qu'il fait généralement — en présentant une caution bancaire en lieu et place d'un représentant parce qu'on estime que, peut-être à tort, il est parfois plus difficile de trouver une personne qui accepte d'assumer toutes les obligations.

C'est une solution de rechange. Le texte doit être interprété de cette façon que l'on peut donc exiger ce cautionnement et que le prestataire peut toujours proposer et faire agréer un représentant responsable en lieu et place du cautionnement. Si ce cautionnement ne peut pas être fourni ou si l'Administration, pour d'autres raisons, l'estime nécessaire, elle peut exiger de tout façon un représentant responsable. Si l'entreprise en question estime que les charges financières sont trop élevées, elle a toujours la possibilité de s'adresser par exemple à son

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preneur pour demander à celui-ci d'être le représentant responsable.

Question

Les Administrations compétentes savent-elles qu'une rémunération est demandée normalement par le représentant responsable professionnel?

Réponse

M. CAPPELLEMAN: Je dirais personnellement: non. Mais je suppose qu'il y en a une.

Question

Les Administrations compétentes savent-elles si les formalités imposées en fait aux redevables étrangers sont, en frais financiers et en perte de temps, incompatibles avec le fonctionnement normal du commerce international et une transparence aussi grande que possible des frontières spécialement pour les petites et moyennes entreprises et pour les professions libérales?

Réponse

M. CAPPELLEMAN: Je voudrais bien insister sur le fait que si notamment en Belgique on exige qu'un assujetti étranger qui effectue des opérations soumises à la taxe ait un représentant responsable, ce n'est pas pour le seul plaisir d'avoir un représentant responsable, c'est surtout en vue d'assurer l'exacte perception de l'impôt, d'avoir des garanties quant à l'application normale de la T.V.A. et d'avoir également des garanties de recouvrement. Nous comprenons fort bien que l'on insiste sur la grande transparence des frontières, mais nous devons assurer un contrôle aussi exact que possible et aussi fermé que possible. Il existe encore un phénomène que l'on appelle fraude en matière de T.V.A. Le système T.V.A. n'est pas hermétique, malheureusement. Et l'on constate tous les jours que le système T.V.A. permet certaines fraudes. C'est pourquoi l'on ne peut pas enlever aux Administrations nationales les moyens de lutter contre la fraude.

Nous n'ignorons pas qu'un représentant responsable, cela demande du temps et des formalités, mais nous estimons que c'est une nécessité. Je voudrais ajouter que le représentant responsable ne doit pas être nécessairement une personne tout-à-fait étrangère à l'opération conclue. Il est admis en Belgique que si une société étrangère fait une opération isolée avec une entreprise belge, c'est ce client qui se porte le représentant responsable, auquel cas des frais supplémentaires sont évités. Le représentant responsable entraîne une charge, sans doute, surtout pour les entreprises qui font régulièrement des opérations en Belgique avec des clients différents.

M. GUIEU: Nous sommes très conscients évidemment qu'il y a de la fraude en matière de T.V.A. et qu'il faut essayer, par tous les moyens, de l'éviter ou du moins de la prévenir.

Mais il faut essayer de trouver aussi des mécanismes qui évitent l'utilisation du représentant fiscal. Et justement, en matière de prestations de services, notamment celles visées à l'art. 9,2°,e, si on avait suivi l'opinion de la Commission, à savoir "taxation auprès du prestataire avec la notion d'exportation du service" on aurait peut-être évité tout un champ d'application du représentant fiscal. Il est regrettable que nos propositions n'ont pas abouti; nous avons eu des contacts avec les professionnels et ils nous indiquent tous qu'un représentant fiscal ou une caution coûtent fort cher aussi bien pour la société que pour l'économie générale de l'entreprise. Il faut donc essayer par tous les moyens de limiter autant que faire se peut, cette utilisation du représentant fiscal.

On est donc obligé de l'utiliser, mais on a déjà essayé dans le cas de la 8ème directive, de supprimer le représentant fiscal et l'on a pu atteindre ce but de tout façon pour tous les assujettis étrangers qui peuvent obtenir un remboursement dans le pays étranger sans l'intervention d'un représentant fiscal. C'est une amélioration sensible par rapport à la situation ancienne. Les efforts ne doivent pas se ralentir, il faut essayer de trouver des mécanismes évitant de telles interventions, tout en évitant bien entendu les fraudes.

M. LEBRUN: Les réponses de mes deux prédécesseurs indiquent qu'il y a une préoccupation de l'Administration et, de l'autre côté une préoccupation plus économique. Cette dualité a été en fait au coeur de nos débats. Je ne pense pas trahir un secret en disant que lorsque nous avons discuté une proposition de la Commission sur la 8ème directive, celle-ci conduisait en France à l'abandon de la notion de représentation fiscale. Mais elle a été accompagnée en réalité de l'adoption de deux directives relatives à l'assistance fiscale des états pour le recouvrement en matière de droit des douanes et en matière de taxe sur la valeur ajoutée. On a donc été conscient qu'il existait des problèmes de d'administration.

D'autre part, la notion de représentant fiscal ne doit pas être totalement condamnée, ne serait-ce que parce que dans un certain nombre de cas elle permet d'assurer une égalité entre les différents pays concernés; j'ajoute aussi qu'il n'est pas en soi condamnable que quelqu'un effectuant des opérations imposables en France, par exemple, soit astreint dans certaines conditions d'avoir une représentation fiscale. Mais la notion de représentation fiscale, on doit s'efforcer de la circonscrire afin de libérer davantage les échanges. Je partage également et entièrement les préoccupations de mon collègue M. Cappelleman au sujet des phénomènes qu'il a mis en avant.

Question (M. Autenne)

Lorsque le preneur, tel un établissement hospitalier, qui aurait la qualité d'assujetti au sens de la 6ème directive, reçoit un service pour lequel le critère d'imposition est le lieu d'établissement du preneur, comment la T.V.A. du pays est-elle perçue? Quelles sont les garanties de perception pour le Trésor dans l'hypothèse où ce preneur, n'étant soumis à aucune obligation, ne fait pas l'objet d'un contrôle? Comment la taxe doit-elle être perçue dans ce cas-là?

Réponse

M. CAPPELLEMAN: Tout d'abord effectivement, un établissement hospitalier est un assujetti au sens de la 6ème directive, mais un assujetti exonéré parce que les activités sont de caractère social. En Belgique on con-

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sidère que tous les établissements hospitaliers sont de nature sociale.
Depuis l'Arrêté royal no. 31 de 1971, dans une situation pareille, la T.V.A. doit être perçue par le preneur du service, par l'apposition de timbres fiscaux entiers, sur la facture reçue et la taxe doit être acquittée dans les dix jours qui suivent la réception de la facture ou l'expiration du délai de la facturation.
Je pense donc que le mode de paiement de la T.V.A. est parfaitement réglé par les textes. Quant à dire qu'il en est de même de ce qui concerne le contrôle du paiement, j'estime que le contrôle est possible.

M. LEBRUN: C'est d'abord un problème d'Administration. Mais je crois, tout-au-moins au travers de la législation française, qu'à partir du moment où nous avons créé une solidarité entre les prestataires et le preneur, le prestataire lui-même a intérêt à ce que son preneur ne se soit pas placé dans une situation fiscale irrégulière. Nous ne pouvons pas écarter l'opinion suivant laquelle les intérêts "solidaires" du prestataire et du preneur consisteraient à tenter d'éviter l'impôt, surtout si, dans l'hypothèse qui a été envisagée, il s'agit d'un établissement qui n'est pas soumis à la taxe et qui n'a donc pas la possibilité de déduire les taxes sur ses achats. Dans l'exemple de la clinique, ou bien celle-ci est soumise à la T.V.A. étant donné les conditions dans lesquelles elle exerce en France son activité, et dans ce cas-là il n'y a pas de problème. Ou bien elle n'est pas soumise à la T.V.A. (hôpital public, centre hospitalier, centre universitaire) ces établissements sont de toute façon tenus d'avoir une comptabilité, ils sont même dans un certain nombre de cas, des établissements publics et, à ce titre, soumis à un contrôle d'un représentant de l'Etat.

M. PRUSSEN: Le problème ne se pose pas seulement pour les hôpitaux, mais pour tous les assujettis qui font les opérations exonérées et qui ne sont pas tous les assujettis qui font partie des pouvoirs publics. Chez ceux-là, il y aura effectivement un problème de contrôle. C'est la raison pour laquelle au Grand-Duché de Luxembourg, on n'a pas encore fait application de cette disposition, on a simplement prévu une habilitation.
Donc le prestataire devra lui-même déclarer par voie de lettre à l'Administration et payer lui-même la taxe.

Question

Une société belge possède un établissement stable en France. Elle prend en location des wagons citernes auprès de bailleurs français. Ces wagons citernes sont utilisés en Belgique. Depuis le 1er janvier 1979, en suite de l'adaptation de la législation française à la 6ème directive communautaire, la T.V.A. française est due. Comment récupérer cette T.V.A.?
Il ne serait pas, selon certains avis, possible pour l'établissement français d'imputer la T.V.A. sur celle due en raison de son activité, étant donné que cet établissement français est considéré comme formant un secteur d'activité distinct de celui exercé en Belgique.

Réponse

M. LEBRUN: Je crois qu'il y a une réponse à terme et une réponse immédiate. La réponse à terme, c'est la 8ème directive à l'évidence. La réponse immédiate: il est exact que la société en cause ne peut pas déduire la taxe dont elle est redevable en France puisque ce n'est pas au titre de son activité imposable en France que la taxe est demandée en déduction, mais l'Administration a fait prendre une décision ministérielle en la circonstance autorisant le remboursement, et avant même l'intervention de la 8ème directive (décision ministérielle du 29.09.1979 qui a été diffusée d'une part dans le Bulletin officiel, et d'autre part dans un certain nombre de publications).

Question

Une société belge agit comme courtier pour le compte d'un client au Canada, sollicitant des ventes pour le compte de la société canadienne auprés de clients en Europe. L'opération est en principe exemptée de T.V.A. en vertu de l'art. 21. Mais la solution est-elle la même, que les ventes de la société canadienne se fassent à l'étranger ou en Belgique?
L'auteur de la question précise également que la société belge touche une commission de la société canadienne, que les marchandises sont vendues et expédiées au client final, mais non prélevées dans un dépôt se trouvant en Belgique par exemple.

Réponse

M. CAPPELLEMAN: Dans ce cas, la T.V.A. n'est jamais due en Belgique puisque le courtier intervient toujours dans des opérations qui se situent à l'étranger pour la livraison de biens, livraison qui a lieu au départ des marchandises. Il en est de même quand le client final est en Belgique.
Le raisonnement est toujours le même pour les prestations de courtage où la règle principale, c'est le lieu du prestataire. Mais il y a exonération lorsque le prestataire intervient dans une opération qui est exonérée pour des raisons d'exportation, ce qui n'est pas le cas ici, où lorsqu'il intervient dans des opérations qui s'effectuent à l'étranger, ce qui est bien le cas, puisque la marchandise est toujours expédiée du Canada à destination de tous pays dans le monde, en sorte que la T.V.A. n'est pas due: le lieu du service, c'est en Belgique, mais il y a exonération en vertu de l'art. 41, §2 du Code belge.

Question (Me. de Longueville)

Quel recours a le contribuable quand il y a divergence d'interprétation entre deux administrations nationales? Existe-t-il au sein du Marché Commun une commission chargée de régler ces problèmes et le contribuable peut-il introduire auprès de cette Commission le recours que cela comporte?
Cette Commission peut-elle être consultée avant que le problème ne se pose concrètement c'est-à-dire qu'il y ait conflit ouvert entre le contribuable et deux ou plusieurs administrations nationales?

Réponse

M. GUIEU: La question peut comporter plusieurs réponses.
D'abord il faut savoir où se situe le problème. Y a-t-il ambiguité de texte qui aboutit à des législations ou à des interprétations différentes de pays à pays, auquel cas le

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contribuable ou le représentant ou le syndicat professionnel peut toujours demander à l'Administration de son propre pays de poser ce problème dans le cadre du Comité de T.V.A., pour savoir comment est appliquée dans les autres pays, la disposition ambigüe. Ici nous avons une mécanisme de concertation où l'on examine les orientations que l'on peut dégager pour arriver à une interprétation communautaire, si possible, ou, au moins majoritaire ou grande majoritaire, parce qu'il y a des nuances dans nos orientations.

Mais il peut aussi y avoir un litige au cours duquel le contribuable pense que la disposition nationale ne correspond pas du tout aux directives communautaires. Alors deux possibilités: ou l'intéressé saisit la Commission par une plainte et la Commission doit examiner la situation et répondre à la plainte, le cas échéant ouvrir une procédure d'infraction sur base de l'article 169 du Traité de Rome.

Avant d'arriver à cette application de l'article 169, un dialogue est engagé avec l'Administration concernée, des explications sont demandées, des visites sur place sont parfois effectuées, on cherche des précisions et ce n'est qu'en connaissance de cause définitive que l'on envoie l'affaire devant la Cour de Justice de Luxembourg.

Une autre procédure est possible: le contribuable saisit la juridiction nationale en demandant à la juridiction nationale de poser une question préjudicielle à la Cour de Luxembourg pour connaître l'interprétation de cette Instance sur le texte litigieux et sur la 6ème directive.

Il y a donc beaucoup de possibilités d'approche en fonction du degré de divergences entre la législation nationale et ce que croit l'assujetti par rapport à la législation communautaire, pour arriver à savoir exactement où se situe la difficulté.

Mais avant d'arriver à ces cas de procédure, il y a toute une procédure amiable de contact avec l'Administration nationale. Il nous arrive à nous-mêmes de recevoir des demandes des syndicats professionnels, etc., et je vous dirai que nous sommes d'une prudence assez grande dans ce domaine et que nous renvoyons très souvent aux Administrations nationales pour provoquer une concertation multi-nationale.

Enfin, je voudrais compléter ma réponse en disant qu'à partir du 1er janvier 1981, on appliquera la directive sur l'assistance mutuelle. Ce sera une occasion inespérée d'avoir des échanges entre administrations pour essayer de régler cela d'abord sur le plan bilatéral et ensuite tous les problèmes qui peuvent se poser au sein du Comité de T.V.A.

Mais je ne vois pas de saisine directe des assujettis devant les instances communautaires sauf la plainte auprès de la Commission.

Question

Quelle est la solution apportée dans les trois pays sur le problème d'assujettis étrangers n'ayant pas d'établissement stable à l'étranger ni dans le pays, ni d'activité connue à l'étranger, mais bien dans le pays?
Quel est le cas du commerçant ambulant, par exemple, qui pourrait avoir un domicile de complaisance non réel.

Réponse

M. CAPPELLEMAN: Cette personne doit au moins avoir quelque part un établissement, un domicile en matière de prestations de services. Il est dit expressément que le prestataire de services a un lieu où il établit son activité etc., ou, à défaut d'un tel siège ou d'un tel établissement stable, le lieu de son domicile ou de sa résidence habituelle.

En Belgique, il n'y a pas mal de familles de tziganes (dont il a été question il n'y a pas encore si longtemps); quand on essaye de chercher quelqu'un dans la famille, on ne le trouve jamais, mais toujours quelqu'un d'autre. Cela pose effectivement des problèmes et c'est d'ailleurs pour cela qu'on parle de prendre certaines mesures, notamment en matière de véhicules d'occasion.
En fait, si un étranger passe la frontière avec une roulotte chargée de marchandises, il est obligé d'avoir un représentant responsable. C'est vraiment un des cas dans lequel le représentant responsable est nécessaire, parce que même s'il ne peut pas passer la frontière sans payer la T.V.A., il faut encore assurer la perception de la T.V.A. pour les ventes qu'il fera dans le pays. C'est précisément un des cas où on ne voit réellement que le représentant responsable comme sauvegarde pour l'observation et le respect des formalités normales en tant qu'assujetti.
En matière de prestations de services, c'est encore beaucoup plus délicat. Je crois que je ne peux pas m'expliquer beaucoup sur le cas de commerçants ambulants en matière de prestations de services. Cela pourrait être un cirque, mais dans ce cas-là précisément la 6ème directive dit expressément que le lieu du service est le lieu où le cirque exerce son activité. Ce sera donc une imposition coup par coup.
Mais si c'est une autre petit commerce ambulant, je crois que dans la plupart des pays on dira qu'en tant que petite entreprise il sera exonéré; en Belgique, ce commerçant sera taxé.

M. LEBRUN: Je me suis interrogé pour savoir comment j'arriverais à répondre à cette question. Je me suis dit si on me lit les lignes de la main, c'est une prestation de services.

Je me suis fait deux réponses. La première c'est que c'est le prestataire qui est taxable et qu'à partir du moment où ce prestataire a, dans l'hypothèse envisagée un domicile fictif et que nous ayons la possibilité de démontrer le caractère fictif de ce domicile, j'aurais tendance à dire que le prestataire a son domicile à l'endroit où il a lu les lignes de la main en question.
La deuxième réponse, Monsieur de Président, parce que dans les choses sérieuses, il faut à certains moments ajouter une boutade, il n'est vraiement pas besoin de lui faire franchir une frontière et je défie toute administration de faire réellement payer la taxe sur la valeur ajoutée aux cartomanciennes ou aux lectrices de la main que l'on peut trouver sur les foires et marchés. Mais ceci est une autre histoire.
En d'autres termes, je crois que la territorialité en la circonstance n'intervient pas. Mais comme il s'agit a priori de petites entreprises, en tout état de cause, elle bénéficieraient des différents régimes applicables aux petites entreprises dans les différents pays communautaires.

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VAT SEMINAR organized by the French-Belgian-Luxembourg Branch of IFA –

March 7, 1980

INTRODUCTION

by Prof. Dr. Paul Sibille

Several national branches of the International Fiscal Association (I.F.A.) have for several years maintained the excellent custom of bilateral meetings at which reports are presented and discussions take place on topics and questions of particular interest to the participant countries.

In this way, as a continuation of the workshop held in Paris in May 1978, the French and Belgian-Luxembourg branches organized a workshop in Brussels on March 7, 1980.

The topic for the workshop was the difficulties in applying Article 9 of the Sixth Directive of the European Communities of May 17, 1977, concerning the place where services are considered to be supplied, thereby creating liability to VAT, and the solutions which must be brought to bear (taking into account the Eighth Directive, which has just been adopted by the Council of Ministers of the European Community, concerning arrangements for the refund of value added tax to taxable persons not established in the territory of the country).

Experience since January 1, 1978 — the date on which the Sixth Directive of the European Communities came into force, at least in certain of the member states — would seem to indicate that Article 9 of the Directive poses some problems to which the solution under the current legislation and relevant administrative instructions of the countries concerned, to the extent they exist, is far from obvious as it varies from one country to another.

The particular problems considered at this workshop were the following:

a) *to define concretely the services, enumerated in Article 9 of the Directive, which are placed under the jurisdiction of the tax administration in the country where the supplier of services is domiciled;*
b) *what would the supplier of services, who owes VAT in a country where he has no business or establishment, do to meet his obligations* **without excessive difficulty** *on an administrative or financial plane?*
c) *how can the consumer of services who has borne the charges for these services recover them* **without excessive difficulty** *when, fulfilling the necessary conditions to obtain this refund, he has not established a business in the country where VAT has been paid by the supplier of services?*

The workshop was presided over by Mr. Henry LEVY MORELLE, President of the Belgian-Luxembourg branch of I.F.A., assistant professor at the Free University of Brussels. Co-chairman was Mr. Georges EGRET, Secretary-general of the French branch of I.F.A., replacing the President, Mr. Max LAXAN.

That this workshop was productive is due, on the scientific side, to Messrs. Jean de LONGUEVILLE and Guy van FRAYENHOVEN, respectively President and member of the Scientific Committee of the Belgian-Luxembourg branch, and, on the organizational side, to M. Jacques AUTENNE, lecturer at the Catholic University of Louvain, Secretary of the Belgian-Luxembourg branch.

The Belgian-Luxembourg branch is pleased to be able to publish the results of this workshop, comprising the reports, the essential parts of the lectures and resumés of the debates, with the International Bureau of Fiscal Documentation in Amsterdam.

The gathering of this material has been realized thanks to the notes taken and transcribed by Madame Marie-Cécile van GRIEKEN, assistant at the Higher School of Fiscal Sciences, under the direction of Professor P. SIBILLE, Director of the School.

This publication will doubtless constitute a valuable guide for lawyers and tax experts and for enterprises which are continually confronted with one of the most complex international problems concerning VAT.

INCORPORATION OF THE SIXTH VAT DIRECTIVE INTO DOMESTIC LEGISLATION

All member countries of the European Communities have now adjusted their VAT legislation in accordance with the Sixth Directive. The changes have become effective at the following dates:

Belgium	– 1st January, 1978
Denmark	– 1st October, 1978
France	– 1st January, 1979
German Federal Republic	– 1st January, 1980
Ireland	– 1st March, 1979
Italy	– 1st April, 1979
Luxembourg	– 1st January 1980
Netherlands	– 1st January, 1979
United Kingdom	– 1st January, 1978

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SUMMARY *

of *"Localisation of taxable operations"* by Jacques Malherbe, Lecturer at the University of Louvain and advocate at the Brussels Bar

Delivery of goods. Both the Sixth Draft Directive (Article 8.1.b.) and the Belgian VAT Code provide that the delivery of a good occurs at the place where the good in question is physically present at the moment of delivery. The Directive further provides that where a good is transported the delivery is deemed to take place at the point of departure (Article 8.1.a.). The Belgian Code obtains the same results by providing that the delivery is deemed to have taken place at the moment that transportation starts. Where goods are assembled, the delivery is deemed to take place upon completion of the assembly (Article 15, Para. 1, (2)(1°)).

Rendering of services. The Sixth VAT Directive situates the place where a service is rendered at the main place where the economic activities of the entrepreneur are performed or at the location of his permanent establishment if the service is rendered by this establishment. In the absence of these criteria the service is deemed to have been rendered at the place where the entrepreneur has his domicile or residence. Thus the Sixth Directive abandons the criterion of place where the service is utilized, which was introduced by the Second Directive and which is also to be found in the former Belgian VAT legislation.

Article 21 (new) of the Belgian VAT Code brings Belgian VAT law in line with the provisions of the Sixth Directive. This also applies to the numerous exceptions to the main rule which the Sixth Directive introduced. These exeptions include:

1. Services connected with real property are deemed to have been rendered where the property is situated (Directive, Article 9.2.a. and Code, Article 21, Para. 3 (1°)). These services include, in addition to construction activities, services rendered by real estate agents acting as intermediaries and experts, services rendered by architects, by surveyors, and by engineers, the renting of parking lots, of furnished lodgings, of warehouses, of camping sites and of other real property as well as of strong boxes and also the management of real property.
2. Transportation is deemed to be carried out where transportation takes place varying with the distance covered (Directive, Article 9.2.b. and Code, Article 21, Para. 3 (3°)).
3. Services which are deemed to have been rendered in the place where the service is actually performed include: cultural activities, activities connected with transportation, activities connected with tangible movable property. The Belgian Code localizes the latter activities in the place where the good is physically present.
4. The renting of movable tangible goods (other than means of transportation) is deemed to take place where they are being used. If the lessor is established in the EEC the good in question must be exported to the Member State where it is being used.
5. The main place where the economic activities of the entrepreneur are performed or his permanent establishment is situated (or, in the absence of these criteria, his domicile or residence) is considered as the place where the following services are performed:
   - sale or licensing of rights, including sales monopolies and the right to exercise a professional activity,
   - advertising,
   - banking and financial operations (excluding the renting of strong boxes and insurance transactions which are exempted),
   - the hiring out of personnel,
   - services of intermediary persons with the exception of those carried out by certain commission agents (Directive, Article 9.2.e.; Code, Article 21, Para. 3 (7°)).

SUMMARY*

of *"The regime of the value-added tax applicable on the rendering of services after the amendments of the law resulting from the implementation of the Sixth Directive"* by Messrs. R. Gerbes (chartered accountant) and Y. Prussen (attorney at law).

In Luxembourg the Sixth Directive on VAT was implemented by the Law of February 12, 1979 which became effective on January 1, 1980. With respect to services the most important change introduced by this law was a new definition of the place where a service is deemed to be rendered which changed the liability for Luxembourg VAT purposes.

Currently the main rule is that a service is deemed to be rendered in the place where the supplier has his business or permanent establishment from which the service is rendered.

However, there exist numerous exceptions to this rule.

Services connected with real property are deemed to be rendered where the property is situated. This is, for instance, the case with services rendered by architects, the maintenance of a building, services rendered by real estate agents, notaries and other experts in connection with real property, the renting of real property, including hotel rooms, storage rooms, safes and parking space. However, the service must be rendered with respect to a *specific* real property otherwise the main rule applies.

Transportation services are deemed to be rendered where the transport takes place. However, international transport is generally exempt.

In a number of cases a service is deemed to be rendered where it is physically carried out. This is, for instance, the case with cultural, scientific and similar activities, ancillary transport activities and work with respect to movable goods.

The place of utilization determines the place where the service is rendered in case of hiring out of movable tangible property which is exported by the lessor from one Member State with a view to its being used in another Member State. However, in all other cases the main rule applies. Another group of services is generally deemed to be rendered in the place where the *customer* has established his business or has a fixed establishment to which the service is rendered. This group includes the sale and licensing of patent rights and other industrial rights as well as banking services and publicity. The rule applies when the services are performed for customers established outside the Common Market or for *taxable persons* established in the Common Market.

Non-resident entrepreneurs carrying on taxable transactions in Luxembourg must — as under the previous legislation — register the transaction with the VAT office. Generally a return must be filed before the fifteenth day of the second month following the month in which the transaction was effected. If the Luxembourg customer is subject to Luxembourg VAT the non-resident entrepreneur must send him an invoice indicating the amount of VAT before the 25th day of the month in which the transaction was effected. If the non-resident entrepreneur regularly operates in Luxembourg he will be registered by the VAT office and the authorities may demand that he appoint a responsible representative or put up a guarantee.

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SUMMARY OF PAPERS ON THE FIRST SUBJECT *

Mr. Guieu (Common Market)

The speaker pointed out that the present provision in the Sixth Directive regarding the place where a service is deemed to be rendered is a compromise which the EEC Members were able to approve, but he admitted that it could possibly cause difficulties at the national level.

When in April 1967 the Second Directive was adopted it was believed that the ideal solution had been found: services would be subject to VAT in the place where they were utilized.

However, the scope of this provision was very limited since it applied only to services indicated in Annex B of the Second Directive which was, in addition, not compulsory for the Member States. These States were further permitted to deviate from the above rule, provided that no double taxation would occur.

Another problem which emerged was that the Member States defined the place of utilization in different ways. Criteria used were: (i) the place where the supplier of the service was located, (ii) the place where the receiver of the services was located and (iii) the place of actual utilization. Double, or even triple, taxation or non-taxation would have resulted if the Member States had not introduced a great number of exceptions. However, this resulted in a multitude of complicated rules which deviated from country to country.

In order to remedy this situation the Commission proposed to abandon the criterion of utilization of a service and to concentrate the criterion for determining the place where a service is rendered around the person rendering the service. However, one correction was necessary: where a service would be "exported" from one Member State to another, VAT should be levied by the "importing" State as is the case with export of merchandise. Unfortunately, two more exceptions had to be introduced, i.e. for services relating to real property which are deemed to have been rendered in the place where the property is situated, and for transportation which is deemed to be rendered where the transportation is carried out taking into account the distance covered on the territory of the countries concerned.

In the present text of Article 9 of the Sixth Directive one finds the general rule that a service is deemed to be rendered in the place where the supplier has established his business. This permits the legislature to cover all cases where services are rendered to persons not subject to VAT, using one uniform rule which permits neither non-taxation nor double taxation.

However, the Member states did not stop at the introduction of deviating rules for real property and transportation. Other exceptions to the main rule comprise cultural activities, activities connected with transportation and services rendered with respect to tangible movable goods.

Another exception to the main rule is to be found in Article 9.2.e. of the Sixth Directive where, in case of "export" of certain, sometimes indicated as "intellectual", services to either a taxable person in a Member State or to any person (taxable or not) in a non-Member State, it is the place of business establishment of the receiver of the service which is the criterion for determining the place where the service is rendered. This means that to such services two different criteria apply according to the circumstances, i.e. where the receiver is established and whether he has the status of taxable person or not. Although this exception can be defended on economic grounds, the Common Market experts regret this dualistic approach.

The situation is even more complicated since the Member States are authorized to use the old criterion (of place of utilization where services are rendered to persons established in non-Member States) in those cases where there would otherwise be non-taxation, double taxation or distortion of competition.

What kind of difficulties may arise can be illustrated by the following example. Assume an entrepreneur purchases a tangible movable good (not a means of transportation) in another Member State, which it leases to a customer in that other State. Some countries consider this transaction to be effected in the place where the supplier of the service is established, whereas other countries find that the place where the customer is established is decisive.

In order to clarify this situation the Commission has proposed a Tenth Directive which provides that the service is in such a case rendered in the country where the customer is established by deeming that the supplier of the service has his business in that country.

Another problem which arises after the determination of the place where a service is rendered is: who is responsible for the payment of VAT? In many cases the taxable person and the payer of the tax are the same person, but in other cases where a non-resident supplier of services is involved the Government of the "importing" country may demand the nomination of a fiscal representative who will be responsible for the payment of VAT or it may introduce legislation under which it can collect the VAT from the receiver. However, with respect to the services which we have described as being mainly of an intellectual nature (Sixth Directive, Article 9.2.e.), it is the receiver who is the sole person from whom VAT can be collected.

With respect to the manner in which VAT can be recouped or refunded the Sixth Directive contains provisions to the effect that the taxpayer can receive full reimbursement for any VAT paid. According to the speaker the refund procedure as laid down in the Eighth Directive will have little significance for persons rendering services.

Mr. Lebrun (France)

The speaker indicated that because of the difficulties which arose from the use of the *place of utilization* when determining the place where a service is rendered, it was the original idea of the Commission to turn either to the concept of *supplier* or *receiver of a service* as a decisive factor. However attractive these juridical concepts may be, there remains the economic reality that VAT is a consumption tax which is destined to be shifted on to the consumer. For this reason a realistic approach is needed, which, as Mr. Guieu indicated, has resulted in a compromise.

How have the tax administrations reacted vis-à-vis the problems connected with the definition of place where a service is rendered?

An important problem relates to the definition of certain services enumerated in Article 9 of the Sixth Directive which are not subject to VAT in the country where the supplier is established. These services include the renting of real property and services connected with such property, services connected with transportation and a number of intellectual services and operations connected with the sale or licensing of copyrights.

With respect to the renting of means of transportation no fundamental difficulties have yet been encountered. A problem might arise, however, with respect to the definition of domicile of the taxpayer or the definition of his permanent establishment. The approach followed by the Sixth Directive with respect to services connected with real property seems to be realistic. It is sensible to subject these services to VAT in the country where the

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property is situated and make no exceptions. Otherwise an absurd situation might exist under which some of these services would be taxable in one country and others in another country. It is for the same reason that all services connected with transportation — loading, unloading, the handling of merchandise etc. — follow the same rules as those which apply to transportation services.

The most important difficulty in the field of cultural, educational and similar services is, according to the speaker, to be found when training foreign personnel, since in many cases such training is a corollary to export operations. It would be in the spirit of the Commission to treat such training in the same manner as an "exportation".

Cultural services are in most cases rendered in the country where the performer is established. However, difficulties of an administrative nature may arise where a foreign performer is only present in a country for a short time. Collection of tax may in such cases prove to be difficult. It is for this reason that the national delegates have sometimes posed the question whether it was worth returning to the "place of utilization" as a criterion in some of these cases.

A second field of problems related to the rendering of intellectual services. The speaker indicates that there have been some difficulties with the delimination of publicity transactions. Also, the concept of counselling (in case of patents, in the information field, management, etc.) is difficult. Furnishing of information includes, for instance, the use of a computer for tourist information and also for the use by airlines or travel agencies for their terminals and cultural information broadcast by television or radio.

Other problem fields indicated by the speaker include such concepts as the main place of activities of a permanent establishment, the concept of beneficiary in the sense of Article 9.2.c of the Sixth Directive and the definition of taxpayer.

Mr. Cappelleman (Belgium)

The speaker's intention was to describe certain problems which the Belgian legislature encountered when introducing the provisions of Article 9 of the Sixth Directive in Article 21 of the Belgian VAT Code.

Para. 2 of Article 21 of the Belgian Code provides, in conformity with the Sixth Directive, that a service is generally deemed to have been rendered in the place where the supplier has established his business or where he has his permanent establishment.

There are, however, a number of exceptions to this rule, in the first place with respect to real property: all services connected with real property (and which have been listed in Royal Decree No. 5) are deemed to have been rendered in the place where the property is situated. This also applies to services rendered by intermediaries for the creation or the establishment of a right in rem or right to enjoy real property and services rendered by real estate agents which were formerly subject to different rules. Services in the form of administering real property also follow the above rule.

A second exception to the main rule is that work performed in connection with tangible movable property is deemed to have been carried on in the place where the good is physically present. In some cases where goods are imported with a view of being processed in Belgium and subsequent re-exportation, an exemption is available provided that certain conditions have been met.

Valuation of movable tangible property located in Belgium is considered to be effected in that country. The question may be asked whether the term "work" means actual physical work or also work of an intellectual nature.

The third exception concerns transportation which is deemed to have been supplied where the transport takes place having regard to the distances covered.

The fourth exception deals with cutural, artistic, scientific, educational and similar services which are deemed to have been rendered in the place where they have been physically carried out. Normally, training of personnel would fall under this rule, although where such training is connected with the exportation of equipment it is defensible that such services would follow the rules for export of merchandise and thus be exempt from Belgian VAT. However, it is doubtful whether the Belgian tax administration will adopt this theory considering that exempt services connected with exportation have been exhaustively listed in the Code and such training schemes are not included. However, the supplier of the training may invoice the non-resident customer for the training of his personnel, using an invoice which will show Belgian VAT for which the customer may claim a refund.

Services rendered by cafes and restaurants are deemed to have been supplied where these establishments are located. If similar services are rendered ancillary to transportation services it is also the place where the services are physically carried out which is decisive for Belgian VAT purposes.

Other services ancillary to transportation which follow the rules applicable to transportation services include loading, unloading and handling of merchandise as well as: weighing, measuring, receipt of merchandise, including quantity and quality checks, the taking of samples, etc. However, where these services are connected with importation and exportation they will in many cases be exempt.

A rather controversial criterion is the one which applies to the renting of movable tangible goods (except means of transportation). This type of service is deemed to be rendered where the supplier has his business, unless he is established in a Common Market country and exports the good to another Common Market country where it will be utilized. In that case the place of utilization is decisive. A second exception to the general rule is that the place of utilization is also decisive if the lessor is established outside the Common Market. These rules have caused a number of problems in Belgium, which may be illustrated by the following case.

A Dutch company purchases equipment in the Netherlands which is rented to a Belgian company for which purpose the equipment is exported to Belgium. In this case VAT is due in Belgium. However, if the Dutch company purchases identical equipment in Belgium for renting to its Belgian customer there is no question of exportation so that the main rule applies, i.e. the service is in principle subject to VAT in the Netherlands. This rather bizarre situation will be remedied when the Tenth Directive on VAT has been adopted.

Another exception applies to means of transportation rented to third persons. According to the Sixth Directive the place where such a service is rendered is the place of business of the lessor. However, the Sixth Directive permits Member States to deviate from this rule for the renting of movable tangible goods in two cases: (i) if the place of service (according to the provisions of the Sixth Directive) is located in the Common Market but the good is used outside the Common Market, and (ii) if the place of service is located outside the Common Market but the good is used inside the Common Market. In those cases, Member States may use the criterion of place of utilization and Belgium has indeed made use of this facility. To give a concrete example: if a person rents a car for travel abroad he will be subject to Belgian VAT for that part of his journey in Belgium and the other Common Market countries, but will be exempt for the distance covered outside the Common Market. On the other hand, if a person rents a car outside the Common Market and visits Belgium he is in principle subject to VAT with respect to the use of the car in Belgium, although collection of the VAT will not be a simple matter.

The last exception to the main rule discussed by the speaker concerns the "export" of certain services (which are sometimes indi-

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cated as "intellectual" services) in the sense of Article 9.2.e. of the Sixth Directive. In those cases the service is deemed to have been rendered in the place where the customer has established his business. These services include advertising services which include any advertisement, whether for the sale of real property or for the hiring of personnel. The concept of intellectual services proper (services performed by legal counsel, accountants, engineers, research centers, etc.) is taken very broadly by the Belgian tax administration since these services, if exported, are normally used by entrepreneurs. Thus, in case of export of those services they will in most cases be exempt under the provisions based on Article 9.2.e. which is preferred over the cumbersome refund procedure of Article 17 (4°) to which entrepreneurs are entitled. Finally, the place where the customer has his business establishment is also used as the criterion for banking and financial services in the cases described in Article 9.2.e. of the Sixth Directive, as well as for the supply of personnel and for services of agents when they procure for their principal the services enumerated in the above article.

Mr. Prussen (Luxembourg)

The text of the Luxembourg VAT law after its adjustment to the provisions of the Sixth Directive only entered into force on January 1, 1980 so that the experience with the new provisions is rather limited.

As prescribed by the Sixth Directive the place where a service is deemed to be rendered is where the supplier has his business establishment or his permanent establishment or, in the absence of this criterion, the place where he has his domicile. The term "permanent establishment" is defined as for the direct (e.g. income) tax.

The situation with respect to the first exception, i.e. for real property, is not as simple as it seems, Assume, for instance, that an engineering bureau established in Paris gives advice with respect to the purchase of real property located in Germany for a Japanese firm established in the United Kingdom. VAT with respect to this service will be due in Germany even where the purchase of the property is eventually not effected.

In some cases (covered by Article 9.2.e. of the Sixth Directive) Luxembourg VAT law deems the place where a service is rendered the place where an *essential* part of the service has physically been carried out. Difficulties may arise with the definition of "essential part". For instance, an expert established in a country is invited to value a movable object located in another country. Where is the essential part of the transaction effected? In the country where the contract has been concluded? Or the country where the good in question is located? Or where the expert discussed the case with his principal? Or perhaps the country where the actual intellectual work, the writing of a report, was performed?

The third exception to the general rule is where the place of utilization determines the places where a services is rendered in the sense of Article 9.2.d. of the Sixth Sirective. The speaker points out that this exception only covers one special case and there exist numerous transactions which lead to the same economic result to which the general rule (place where the supplier of the service has his business establishment) applies.

The fourth exception is where the place where a service is rendered is determined by the place where the customer has his business establishment in the sense of Article 9.2.e. of the Sixth Directive. The speaker remarked that services regarding real property, even if they could be brought under this article, will follow the rules set for services connected with real property in the sense of Article 9.2.a. of the Sixth Directive.

SUMMARY OF DEBATES ON THE FIRST SUBJECT *

1. Article 15.13 of the Sixth Directive exempts from VAT the supply of services including transport and ancillary transactions but excluding the supply of services exempted under Article 13, when these are directly linked to the transit or the export of goods, or to the imports of goods benefiting from the provisions of Articles 14.1.b. and c. and 16.1.

This provision has been included in Article 262, Para. 1 of the French General Tax Code which exempts the export of movable goods as well as the rendering of services which are directly connected with such exports. This exemption in particular applies to the lease of means of transportation, of containers, of material used for the protection of the exported merchandise and training of personnel of the foreign customer in connection with the exported goods.

All EEC Member States exempt the lease of means of transportation (or apply a zero rate) but, apart from France, there are doubts with respect to the treatment of training of foreign personnel. It seems that Belgium subjects such services to VAT but with the possibility of refund to the foreign entrepreneur, although another speaker believes that there may be a possibility in Belgian law to exempt these services as an export transaction.

2. With respect to the lease of means of transportation, all EEC Member States in principle apply the general rule, i.e. such services are deemed to be rendered in the place where the supplier has his business establishment. Belgium, France and Germany, however, have made use of the exception laid down in Article 9.3 of the Sixth Directive, i.e. where these goods are used outside the Common Market no VAT will be due and VAT will be imposed where these goods are used in the country but the supplier of the service is established outside the Common Market.

3. With respect to the lease of tank cars (wagons citernes), the general rule applies, i.e. the place of the business establishment of the supplier of the service determines the place where the services are rendered. Belgium, however, applies the two exceptions to the main rule indicated above.

4. With respect to the lease of pallets the rules for the lease of movable tangible goods apply, although it may perhaps be debatable whether they should not fall under means of transportation.

5. Where a French real estate agency requests a similar Swiss organization to investigate real property in Switzerland with a view to purchasing this property, the services rendered by the Swiss supplier will be subject to VAT in France if the purchase is not effected (rules of Article 9.2.e. of the Sixth Directive) and exempt from French VAT where the property is purchased (rule of Article 9.2.a.). Anyway, this seems to be the opinion of the Belgian, French and EEC experts at the meeting, although it was admitted that this solution is not always convenient for the parties concerned.

6. Where a parent company established outside the Common Market renders administrative assistance to its subsidiaries established in the Common Market (including France) based on data furnished by its subsidiaries, the services rendered by the parent will follow the rules of Article 9.2.e. of the Sixth Directive. Thus it would be subject to French VAT with respect to the administrative assistance rendered to its French subsidiary.

7. A Belgian permanent establishment of an American company sells merchandise to a French subsidiary of the American compa-

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ny at the same price for which the French company sells the merchandise to its customers. In order to compensate the French company for its activities the Belgian permanent establishment grants the French company a commission. The French tax administration subjects the commission fee to VAT. In fact, the term "commission fee" is incorrect since the goods become the property of the French company and it should therefore be considered to be increase of the purchase price of the goods which is indeed subject to VAT in France.

8. The question was asked why the EEC in its Sixth Directive has adopted as the main rule for the place where services are rendered the place where the supplier of the service has a business establishment and not the criterion of the place where the customer is established. It was conceded that the latter criterion is also a good one since the VAT is then levied in the country where the customer has the right to credit the tax. However, it would not have been possible to avoid the introduction of a rather large number of exceptions to the main rule.

9. Where a French company utilizes advertisement services in France and charges part of the VAT invoiced to it to a Belgian company, the latter transaction is subject to Belgian and not to French VAT. In practice, the French VAT administration seems to have erroneously imposed French VAT in such a case.

10. The question was raised in what manner a supplier of services may ascertain whether he deals with a person subject to VAT, since this will in a number of cases affect his VAT liability. It seems that all manner of proof will be acceptable, including a statement from the VAT administration of the country concerned. At the moment no VAT identification card exists. In Belgium difficulties may be met in the area of construction since entrepreneurs may have been removed from the list of taxpayers without anybody knowing it. In order to prevent tax fraud the Belgian VAT authorities consider all transactions with a party established in Belgium to be subject to Belgian VAT and leave it to the supplier of the service to show that in his case no VAT is due.

11. It was suggested that a uniform form to be stamped by the VAT authorities be introduced to prove that a person has been subject to VAT. A like form exists under the provisions of the Eighth Directive but there is a real danger that the VAT administration will thus be snowed under with paper work.

12. Upon the contribution of a patent right to a company against shares, no VAT will be due. However, where the transaction is effected against other consideration it will be a taxable service.

SUMMARY*

of *"Regime applicable to non-resident taxpayers"* by J. Autenne, tax adviser of the Federation of Chemical Industries of Belgium and lecturer at the Catholic University of Louvain.

Non-resident entrepreneurs carrying on business transactions in Belgium are generally subject to VAT in that country. An important issue is whether the taxpayers carry out such operations through a permanent establishment in Belgium or not.

1. Taxpayers who possess a permanent establishment in Belgium

A non-resident taxpayer who possesses a permanent establishment in Belgium is treated for VAT purposes as a resident taxpayer.

A permanent establishment is deemed to exist if the taxpayer has in Belgium a branch office or agency or any other fixed place of business, provided that the establishment is managed by a person who is authorized to conclude contracts on behalf of the taxpayer.

The consequences are, inter alia, the following:

(i) The taxpayer must register with the Belgian VAT authorities as soon as he commences business in Belgium and he must report any subsequent changes in his status, including the termination of his activities when deciding to cease his business operations in Belgium.
(ii) He must send his customers invoices in the prescribed form and keep financial records in conformity with Belgian law (a simplified recording system may be used if his turnover does not exceed 15 million Bfrs.).
(iii) He must regularly submit tax returns (normally on a monthly basis, but three-monthly if the turnover does not exceed 15 million Bfrs.) and pay VAT to the Belgian Treasury on the dates fixed by law.

The general rule is that the taxpayer is not required to record any transactions which are not effected through his Belgian permanent establishment. However, if he delivers goods or renders services in Belgium which would, in the absence of a permanent establishment, oblige him to appoint a responsible representative (see below), such transactions must be included in the financial records of his Belgian permanent establishment.

2. Taxpayers not possessing a permanent establishment in Belgium

Non-resident entrepreneurs who carry out business transactions in Belgium must generally appoint a responsible representative if they do not possess a permanent establishment in that country. This will, for instance, be the case if the non-resident taxpayer carries on construction or assembly operations in Belgium or if he rents goods in Belgium to other persons. Note also, that where a non-resident taxpayer imports goods into Belgium and indicates himself as the recipient of those goods when paying the taxes at importation (e.g. customs duties and VAT), he is also obliged to appoint a VAT representative, since he will be deemed to re-sell the merchandise involved.

The VAT representative, who may be the non-resident taxpayer's customer or a bank or other financial institution or any other person approved by the Belgian VAT authorities, is severally liable for the VAT liability of his principal. However, he may request the VAT office to limit his responsibilities. However, the non-resident taxpayer may only appoint *one* VAT representative so that such limitation may have consequences for the volume of transactions he carries on in Belgium.

Where a non-resident taxpayer renders services in Belgium the obligation to appoint a VAT representative is often waived. This will, for instance, be the case for:

(i) services of an intellectual nature such as the drafting of reports, checking and supervising, market research, advertising and the sale and licensing of certain incorporeal rights, such as patents, trademarks and copyrights;
(ii) if the taxpayer occasionally renders services other than those designated under (i).

The fact that a non-resident taxpayer is exempted from the obligation to appoint a VAT representative does not necessarily mean that he is also exempt from Belgian VAT. In those cases he must generally pay the tax through the affixing of stamps on the invoices he submits to his customers. This system of payment will in particular be used where the non-resident taxpayer has requested a refund of Belgian VAT charged to him by his suppliers.

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However, in those cases where the non-resident taxpayer does not request such a refund (for instance, because he did not use either goods or services subject to Belgian VAT), the VAT will not be collected from the taxpayer but instead from his Belgian customer. Generally, this situation would occur in the case of rendering services of an intellectual nature.

Special rules apply to international passenger transportation. With the exception of sea or air transportation (which is exempt), passenger transportation effected on Belgian territory is subject to VAT. If the transporters do not have a permanent establishment in Belgium they should normally appoint a VAT representative. However, lacking such a VAT representative the Belgian tax administration usually imposes a lump sum tax ranging from 30 to 600 Bfrs. at the frontier.

SUMMARY OF PAPERS ON THE SECOND AND THIRD SUBJECTS *

Mr. Cappelleman (Belgium)

Non-resident taxpayers carrying on taxable transactions in Belgium may be divided into three categories:

1) Those having in Belgium a permanent establishment or a business are subject to the same legal obligations as resident taxpayers.
2) Those who do not have in Belgium a permanent establishment nor a business must in principle appoint a fiscal representative in Belgium who takes care of all administrative and legal obligations. Any VAT due is paid through this representative and any VAT to be refunded is collected through him.
3) Non-residents who have no permanent establishment in Belgium nor a business in that country are exempt from the obligation to appoint a fiscal representative in case of exempt export transactions, isolated transactions and the rendering of services which are subject to VAT in the country where the customer is established.

Where services are subject to VAT in the country where the customer is established, the tax is directly collected from the latter, although the non-resident supplier of the service may be severally liable. If the non-resident supplier has incurred VAT invoiced to him by a Belgian supplier he is entitled to a refund, provided that a Belgian taxpayer would also be eligible for such a refund under the same circumstances. However, there exist some limitations with respect to the refund, inter alia, where vehicles for the transportation of persons and investment goods are concerned. In fact, Belgian VAT legislation, with respect to refund of VAT, is more generous than the Eighth Directive which prescribes such refund only in those cases where the non-resident does not carry on taxable operations in the country which has to make the refund. The Eighth Directive prescribes, further, that VAT must be refunded to non-resident taxpayers who perform exempt transportation services in another Member State, which is a situation also covered by current Belgian VAT legislation. Therefore, Belgian VAT law does not need to be much amended in order to adjust it to the provisions of the Eighth Directive.

Mr. Lebrun (France)

Non-resident entrepreneurs rendering services in France are in principle obliged to appoint a fiscal representative in France who must be accepted by the French tax administration. This representative is subject to all obligations to which any other taxpayer is subject, like the preparing of invoices and the keeping of records of the transactions performed. However, the tax administration permits the non-resident entrepreneur to prepare the invoices providing that the name of the fiscal representative is indicated. Where services rendered by a non-resident are subject to VAT in France and are collected from the customer, the formalities with which the supplier of the services must comply are reduced to a minimum. He will in such a case only be severally liable for the payment of the VAT due.
The speaker stated that starting from January 1, 1981 France will fully apply the Eighth Directive on the refund of VAT.

Mr. Prussen (Luxembourg)

Where a non-resident entrepreneur has a business or permanent establishment in Luxembourg, approximately similar rules apply as in Belgium. However, there are some slight differences, in particular with respect to those services whereby VAT should be collected from the customer under the provisions of Article 21 of the Sixth Directive. The Luxembourg VAT only authorizes the Government to introduce such rules but no further regulations have been issued. Thus, under current law it is always the non-resident supplier of the services who must submit the VAT returns and make the payments.

However, non-resident suppliers of services performed in Luxembourg are not necessarily obliged to appoint a fiscal representative in that country. In many cases the customer may take over the obligation to pay VAT or the supplier may put up collateral. With respect to refund of VAT the speaker stated that currently the Luxembourg tax authorities demand that the supplier of the services file the VAT returns himself. No refund is available if the formalities are being taken care of by the customer.

SUMMARY OF DEBATES ON THE SECOND AND THIRD SUBJECTS *

1. The question was raised whether Belgian enterprises have met with financial difficulties because the collateral demanded by the Luxembourg VAT authorities and which must be placed with a Luxembourg financial institution is very substantial. *Mr. Prussen* replies that it is not obligatory to put up collateral and that the non-resident supplier can always propose to appoint a fiscal representative instead. In many cases the customer will be prepared to act as such a fiscal representative.

2. It was further asked whether fiscal representatives do normally demand compensation for their services. *Mr. Cappelleman* has no personal knowledge of such situations but he believed that a remuneration will be asked.

3. It was agreed that the formalities imposed on non-resident entrepreneurs are financially burdensome and time consuming. However, no VAT system is in itself watertight and the VAT authorities need these formalities to combat tax fraud. *Mr. Guieu* pointed out that the EEC Commission did its utmost to draft the Sixth Directive in such manner that no fiscal representative would be needed but unfortunately not all its proposals were accepted. However, the Eighth Directive will further reduce the number of cases wherein a fiscal representative must be appointed.

4. Taxpayers who are exempt from VAT (e.g. hospitals) may cause a problem where they receive services from a non-resident supplier and become liable to the payment of VAT on such services. In Belgium, payment is effected through the affixing of stamps and it was thought that administrative checks were possible. In France such taxpayers, when exempted, are often subject to investigation by public authorities representing the State. Luxembourg does not yet have rules under which the customer is subject to VAT.

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5. The following question was asked: a Belgian company possesses a permanent establishment in France. It rents a tank car to be used in Belgium from a lessor in France. In this case French VAT is due. Is this VAT refundable? The reply was: yes under the provisions of the Ministerial Decree of September 29, 1979. When the Eighth Directive is in force, a refund will be available under the provisions of that Directive.

6. The next question was: a Belgian company acts as an agent for the account of a Canadian customer, soliciting sales for this customer. Sales are effected in Belgium and abroad. The merchandise is sent to the final customer but not from a warehouse situated in Belgium. The reply was: in such a case no Belgian VAT is due.

7. What possibilities exist for a taxpayer in case the VAT authorities of two EEC Member Countries have different interpretations of VAT law? The following solutions may be available:

(i) If the text of the VAT Directive is ambiguous, resulting in differing legal provisions or differing interpretations in two or more countries, the taxpayer may request his VAT administration to submit the problem to the VAT Committee of the EEC Commission. In this manner a certain uniform interpretation may be reached.

(ii) If there is litigation the taxpayer may file a complaint with the EEC Commission which then examines the situation and may open the procedure of Article 169 of the Rome Treaty for violation of the Treaty. The taxpayer may also request the national court to let the Court of Luxembourg render a preliminary decision.

As of January 1, 1981 the Directive on mutual assistance will come into effect and from then on the tax administrations of the countries concerned may attempt to solve the problem bilaterally.

8. The last question concerned services rendered by itinerant traders (e.g. cobblers) and having no fixed domicile or permanent establishment. Admittedly, these persons, when performing taxable services, will be difficult to assess to VAT and in many cases they may benefit from relief accorded to small entrepreneurs.

ERRATUM

The article by Howard M. Liebman, "Allocations of foreign blocked income under United States tax law", in the June 1980 issue of the Bulletin contains a serious printing error which distorts the meaning of the article. Please read on page 253, left column, 18th line from bottom: "The Sixth Circuit refused to accept this argument, however, and reversed the decision of the court below. The Circuit Court cites a number of decisions, including *First Security Bank of Utah*, for the principle that a taxpayer need not arrange its affairs so as to maximize its tax liability. [25]" The underlined part was omitted in the article.

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Einkommensteuer, Körperschaftsteuer, Gewerbesteuer, Umsatzsteuer. Munich, Verlag C.H. Beck, 1980. 2700 pp., 124 DM.
Annual guide for filing 1979 returns for individual income tax, corporate income tax, business tax and turnover tax.
(B. 102.674)

STEUERBERATER — JAHRBUCH 1979/80

Edited by Franz Hörstmann, Ursula Niemann en Gerd Rose. Cologne, Verlag Dr. Otto Schmidt, 1980. 582 pp., 89 DM.
Proceedings and lectures of the 31st congress of German tax advisers held in 1979. Congress topics dealt, inter alia, with tax policy from the point of view of the "Länder", the new 1980 Turnover Tax Law, possibilities to set up private old age pensions, tax problems with respect to the finishing of business activities, the available net worth and corporate income tax, etc. (B. 102.570)

DIE VERANLAGUNG ZUR EINKOMMENSTEUER FÜR 1979

Einkommensteuergesetz, Durchführungsverordnung, Richtlinien, Anlagen, Rechtsprechung, Nebengesetze, Tabelle, Stichwortverzeichnis. Düsseldorf, IdW-Verlag, 1980. 1259 pp., 36 DM.
Annual guide for purposes of filing individual income tax return for 1979 assessment year. Relevant text of statutes is appended.
(B. 102.591)

DIE VERANLAGUNG ZUR GEWERBESTEUER FOR 1979

Gewerbesteuerg

DIE VERANLAGUNG ZUR GEWERBESTEUER FÜR 1979

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Annual guide containing the text of the business tax law, the regulatory ordinance to the business tax law, case law and other relevant material for the 1979 tax assessment year. (B. 102.593)

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Annual guide containing the text of the corporate income tax law, the regulatory ordinance to the corporate income tax law, case law and other relevant material for the 1979 tax assessment year. (B. 102.592)

DIE VERANLAGUNG ZUR UMSATZSTEUER FÜR 1979

Umsatzsteuergesetz, Durchführungsverordnung, Anlagen, Rechtsprechung, Nebengesetze, Stichwortverzeichnis. Düsseldorf, IdW-Verlag, 1980. 1378 pp., 44 DM.
Annual guide for purposes of filing turnover tax return for 1979 assessment year. Relevant text of statutes is appended.
(B. 102.594)

GUATEMALA

TAXATION IN GUATEMALA

International Tax and Business Service. New York, Deloitte Haskins & Sells, 1979. 46 pp.
Comprehensive outline of taxation in Guatemala. After an introduction to the tax system, income taxes and other taxes are covered. (B. 15.973)

HONG KONG

HONG KONG: A TAX HAVEN FOR EVERYONE

By S. Nomine. Hong Kong, Excelsior Publications, Ltd., 1980. 182 pp., HK$14.95.
A pseudonymous author provides a guide for anyone interested in finding ways to reduce taxation, dedicated to all long-suffering taxpayers. Topics include invoicing, reinvoicing and similar operations. Some interesting cases are also presented. (B. 51.567)

INDIA

CASES ON VALUATION UNDER DIRECT TAX LAWS

Vol. I, 1977 and Vol. II, 1978. By H.G. Agarwal and Rani Kharbanda. Allahabad, Law Publishing House, 1977/78. 786 pp.; 600 pp.
Two bound volumes containing text of case law on valuation under direct tax laws of India, covering annual letting value, assets, estate, gold, goodwill, house property, land, shares, etc.
(B. 51.525/526)

COMMENTARIES ON THE LAW OF INCOME TAX IN INDIA

11th Edition. Volume II (Sections 35-137), 1979-80. By V.S. Sundaram. Allahabad, Law Publishers, 1979. 2272 pp.
Volume II of a four-volume series containing comment on Sections 35 to 137 of the Indian income tax law. (B. 51.563)

DISPARITY TAX IN A COMPOSITE ECONOMY

By Gautam Mathur. Dehli, Macmillan Company of India, Ltd., 1975. 264 pp.
Study explaining the implications of the introduction of an expenditure tax in lieu of an income tax in a planned, guided developing economy where public and private sectors exist.
(B. 51.561)

INCOME-TAX READY RECKONER; ASSESSMENT YEAR 1979-80

With rates tables and examples for: (1) wealth-tax; (2) estate duty; (3) gift-tax; (4) companies surtax; (5) compulsory deposit (taxpayers) scheme. Assessment year 1980-81 for deduction of tax from "salaries" and computation of "advance tax" during the financial year 1979-80. By V.G. Mehta and N.V. Mehta. Bombay, Shri Kuber Publishing House, 1979. 320 pp.
39th Consecutive edition of quick reference guide for the assessment year 1979-80 with respect to major taxes levied in India.
(B. 51.544)

REGISTRATION AND ASSESSMENT OF FIRMS AND THEIR PARTNERS UNDER THE INCOME TAX ACT, 1961

Amended and brought up-to-date including the Taxation Laws Amendment Act, 1975. By Ved Prakash Verma. Allahabad, Central Law Agency, 1976. 458 pp.
Second edition of monograph explaining registration of firms under the Income Tax Act of India. (B. 51.562)

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Peraturan perundang-undangan Republik Indonesia. Jakarta, Pusat Dokumentasi Hukum, 1979. 400 pp.
Sourcebook entitled "Information" containing all statutes of the Republic of Indonesia promulgated in 1978, compiled by the Pusat Dokumentasi Hukum (Documentation Law Centre), Faculty of Law of the University of Indonesia, Jakarta. (B. 51.566)

LIST OF PRIORITY SCALES FOR FIELDS OF FOREIGN INVESTMENT FOR THE YEAR 1980

Daftar skala prioritas bidang usaha penanaman modal dalam negeri tahun 1980. Jakarta, Badan Koordinasi Penanaman Modal (Investment Coordinating Board), 1980. 60 pp. (B. 51.533)

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INTERNATIONAL

THE DIALOGUE BETWEEN THE TAX ADMINISTRATION AND THE TAXPAYER UP TO THE FILING OF THE TAX RETURN

XXXIVe Congrès International de droit financier et fiscal, Paris, 1980. Deventer, Kluwer, 1980. Cahiers de droit fiscal international, Volume LXVa. 444 pp.
Analysis by Huy Delorme, the general reporter, on the national reports contributed by the various authors on the title subject. A summary of each report in English, French, German and Spanish is appended. National reports include the following countries: German Federal Republic, Argentina, Australia, Austria, Belgium, Canada, Colombia, Denmark, U.S.A., France, Greece, Hong Kong, Israel, Norway, the Netherlands, Portugal, United Kingdom, Sweden, Switzerland, Uruguay. (B. 102.699)

EAST-WEST INDUSTRIAL CO-OPERATION

New York, United Nations, 1979. 122 pp. (B. 102.705)

ESTUDIOS DE DOBLE IMPOSICION INTERNACIONAL

Edited by José Maria de la Villa. Madrid, Instituto de Estudios Fiscales, 1979. 395 pp.
Studies by various authors on aspects of international double taxation. Problems in the OECD Model Convention are considered. (B. 102.697)

INTERNATIONAL MONETARY FUND

Summary proceedings of the thirty-fourth annual meeting of the Board of Governors, October 2-5, 1979. Washington, International Monetary Fund, 1979. 376 pp. (B. 102.623)

KENNIS VAN ZAKEN

Aspecten van know-how-recht in de Europese Gemeenschap en de Verenigde Staten. Know-how-law in the European Community and the United States. By Petrus Johannes Idenburg. Deventer, Kluwer, 1979. 247 pp.
Dutch-language thesis with a summary in English. (B. 102.626)

PENSION PLANNING

By Mark Daniel. London, Gee & Co. (Publishers) Limited, 1980. 128 pp.
Guide primarily intended for accountants, discussing pension planning schemes with reference to tax advantages. (B. 102.688)

LES REGIMES FISCAUX VISANT A ENCOURAGER LES INVESTISSEMENTS DIRECTS ET DE PORTEFEUILLE DANS LES PAYS EN VOIE DE DEVELOPPEMENT

L'interaction du système fiscal zaïrois et des régimes préférentiels des pays de l'O.C.D.E. By Lofumbwa Bokila. Louvain, Université Catholique de Louvain, 1980. 309 pp.
Thesis on tax regimes designed to encourage direct and portfolio investments in developing countries. The interaction of the tax systems between capital importing and exporting countries is taken into account with emphasis on the tax system in Zaire and possible developments in the industrialized OECD countries.
(B. 102.700)

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XXXIVe Congrès International de droit financier et fiscal, Paris, 1980. Deventer, Kluwer, 1980. Cahiers de droit fiscal international, Volume LXVb. 690 pp.
Congress report for the International Fiscal Association containing general report and national reports on the title subject. A summary of each report in English, French, German and Spanish is appended. The report by the general reporter, Robert J. Patrick Jr., is printed in full in the four languages. National reports include the following countries: South Africa, German Federal Republic, Argentina, Australia, Austria, Belgium, Canada, Colombia, Spain, U.S.A., Finland, France, Greece, Hong Kong, Israel, Italy, Japan, Luxembourg, Mexico, New Zealand, the Netherlands, Portugal, United Kingdom, Switzerland. (B. 102.699)

ITALY

I.V.A.

Milan, Banco Commerciale Italiana, 1980. 1161 pp.
Compilation of statutes concerning VAT. (B. 102.638)

JAPAN

GUIDE TO JAPANESE TAXES 1979-80

By Gomi Yuji. Tokyo, Zaikei Shobo Sha, 1979. 278 pp.
Annual updated information on Japanese taxes levied as of April 1, 1979. (B. 51.353)

OECD ECONOMIC SURVEYS: JAPAN

Paris, Organisation for Economic Co-operation and Development, 1980. 87 pp. (B. 102.383)

KENYA

FUNDAMENTALS OF INCOME TAXATION IN KENYA

By Ngotho Wa Kariuki. Nairobi, Midi-Teki Publishers, 1978. 282 pp.
Textbook on income tax in Kenya, with exercises at the end of each chapter. (B. 13.055)

FOREIGN INVESTMENT IN A DEVELOPING ECONOMY

Prepared and published by Business International, Geneva, 1980. 166 pp.
Monograph on Kenya describing foreign investment opportunities, including labour law and taxes. Appended are the texts of relevant laws (such as the Foreign Investment Protection Act) and addresses of relevant institutions. (B. 13.060)

MALAYSIA

MONEY AND BANKING IN MALAYSIA

By the Economic Research and Statistics Department. Kuala Lumpur, Bank Negara Malaysia, 1979. 437 pp.
Study of the development and present state of money and banking in Malaysia. (B. 51.575)

MEXICO

BUSINESS STUDY: MEXICO

London, Touche Ross International, 1979. 155 pp.
Introductory information to doing business in Mexico dealing, inter alia, with taxation. (B. 15.977)

THE NETHERLANDS

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Elfde druk 1980. Deventer, Kluwer, 1980. 526 pp.
Eleventh edition of consolidated text of tax laws of the Netherlands (for the tax year 1980) with a short introduction by C.P.A. Geppaart. (B. 102.683)

BEDRIJF EN BELASTINGEN

By H.B. Benist, P.W. Moerland and W.H. Somermeyer. Deventer, Kluwer; Alphen a.d. Rijn, Samsom, 1980. Serie "Burger en belastingen; bevindingen uit een enquête", No. 4. 68 pp., 30 Dfl.
"Enterprise and Taxation" is a study based on the results of a 1973 questionnaire answered by private persons (sole proprietors, employees) with respect to their reactions to taxation.
(B. 102.588)

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Documentatie van juridische literatuur. Deventer, Kluwer, 1980. Monthly loose-leaf publication providing annotated documentation of legal publications (books, articles) appearing in the Dutch language. (B. 102.537)

DIRECT TAXES IN THE NETHERLANDS

A summary. The Hague, Ministry of Finance, 1979. 28 pp.
Description of the corporate income tax, individual income tax and net wealth tax in the Netherlands and related taxes such as wages tax, dividend tax. (B. 102.644)

ELSEVIERS VENNOOTSCHAPSBELASTING

Uitgave 1980 bestemd voor de aangifte over 1979. 10de jaarlijkse editie. By A.C. de Groot and W.H. van der Meer. Amsterdam, Annoventura, 1980. 216 pp., 34.50 Dfl.
Tenth annual edition of guide providing information for filing corporate income tax returns for 1979 (B. 102.620)

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Deventer, Kluwer, 1980. 80 pp.
Revised edition providing up to date financial and economic figures and other information. (B. 102.643)

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Tweede Lustrumcongress Tilburgse Fiscalistenvereniging "De Smeetskring". Deventer, Kluwer, 1980. 58 pp.
Proceedings and reports of a conference of tax experts dealing with real estate tax levied by municipalities in the Netherlands. (B. 102.587)

DAS HANDELS- UND GESELLSCHAFTSRECHT DER NIEDERLANDE

Deutsche Übersetzung der gesetzlichen Bestimmungen. 4. Auflage. Düsseldorf, Deutsch-Niederländische Verlags GmbH., 1980. 337 pp.
German translation by P. Gotzen of the current provisions concerning business and company law in the Netherlands contained in the Commercial Code and Civil Code. (B. 102.586)

INKOMENS- EN VERMOGENS-VERDELING VAN BURGERS VOOR BELASTING

By W.H. Somermeyer, P.C. van Batenburg and A.J. Jaeger. Deventer, Kluwer; Alphen a.d. Rijn, Samsom, 1980. Serie "Burger en belastingen, bevindingen uit een enquête", No. 5. 96 pp.
Study analyzing the concepts of income and net wealth and their distribution among the population, as affected by taxation. (B. 102.622)

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En andere verhalen waarin het belastingrecht een bescheiden plaats inneemt. By Laurent J.M. Nouwen. Utrecht, Coöperatieve Centrale Raiffeisen-Boerenleenbank, 1979. 52 pp.
Collection of short stories in which taxation plays a discreet role. (B. 102.548)

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14e Druk, 1 januari 1980. By H.J. Doedens. Deventer, Kluwer, 1980. 20 pp.
Revised and updated 14th edition of comparative survey of Netherlands tax laws, effective as of January 1, 1980. (B. 102.602)

WONEN EN WERKEN AAN WEERSZIJDEN VAN DE NEDERLANDSE GRENS; FISCALE ASPECTEN

By G.J. van Leijenhorst. Deventer, Kluwer; The Hague, Fenedex, 1980. Serie "Fiscale en juridische documentatie voor internationaal zakendoen", No. 7. 130 pp.
"Living and working on both sides of the Netherlands border" contains explanation of double taxation of residents of the Netherlands, particularly in connection with taxes levied by Belgium and the German Federal Republic. (B. 102.567)

NEW ZEALAND

NEW ZEALAND MASTER TAX GUIDE 1980

Auckland, Commerce Clearing House (New Zealand), 1980. 604 pp.
Annual guide providing information for filing income tax returns for the income year ending March 31, 1980. (B. 51.535)

NIGERIA

1979-80 BUDGET NOTES FOR GUIDANCE ON COMPANIES INCOME TAX

Lagos, Federal Inland Revenue Department, 1979. 13 pp. (B. 13.061)

STRUCTURE OF THE NIGERIAN ECONOMY

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Compilation of essays dealing with various aspects of the Nigerian economy, including "Fiscal system and policy" by F.A. Olaloku. (B. 13.058)

PACIFIC ISLANDS

31ST ANNUAL REPORT OF THE TRUST TERRITORY OF THE PACIFIC ISLANDS, OCTOBER 1, 1977 TO SEPTEMBER 30, 1978

Saipan, Department of State Publication, 1979. 320 pp.
Annual report of the 1978 fiscal year prepared by the Department of the Interior. (B. 51.510)

COUNTRY STUDY ON MICRONESIA

For presentation to the Second Seminar on Foreign Investment and Tax Administration of the U.N. Economic Social Commission for Asia and the Pacific, September 27 to October 7, 1976, Tokyo, Japan. By Elizabeth S. Udui and Eulogio S. Inos. Saipan, Trust Territory of the Pacific Islands, 1976. 78 pp.
The study on foreign investment was prepared by Mrs. Udui, that on tax administration by E.S. Inos. (B. 51.509)

PAKISTAN

COMMENTS ON THE INCOME TAX ORDINANCE, 1979, THE FINANCE ORDINANCE, 1979 AND AMENDMENTS IN MERCANTILE LAWS

By Akbar G. Merchant. Karachi, Flecbon Corporation, 1979. 420 pp.
Comments on the new Income Tax Ordinance of 1979 (which replaced the Income Tax Ordinance of 1922), the Finance Ordinance of 1979 and amendments in business laws affecting commerce, trade and industry. (B. 51.545)

PAPUA NEW GUINEA

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THE PNG NATIONAL PUBLIC EXPENDITURE PLAN

By Charles Lepani. Published by the Institute of National Affairs, P.O. Box 3530, Port Moresby, Papua New Guinea, 1979. I.N.A. Speech Series, No. 7. 17 pp. (B. 51.520)

PRICE SURVEILLANCE: A POLICY APPRAISAL

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TAX POLICY IN PAPUA NEW GUINEA

By Robert Neild. Published by the Institute of National Affairs. P.O. Box 3530, Port Moresby, Papua New Guinea, 1979. I.N.A. Discussion Paper, No. 4. 82 pp. (B. 51.517)

PHILIPPINES

THE EFFECTS OF INFLATION ON THE PHILIPPINE INDIVIDUAL INCOME TAX STRUCTURE

Overview of Metropolitan Manila Public Finance. Manila, National Tax Research Center, 1978. NTRC Staff Papers, December 1978. 94 pp. (B. 51.559)

TAX REFORMS INTRODUCED BY THE INTERIM BATASANG PAMBANSA

(June 12, 1978 — December 31, 1979). By Angel Q. Yoingco. Manila, National Tax Research Center, 1980. 18 pp.
Highlights and brief comments on enactments during the period June 12, 1978 to December 31, 1979. (B. 51.549)

SAUDI ARABIA

LEGAL ASPECTS OF BUSINESS IN SAUDI ARABIA

By Ernest May. London, Graham & Trotman Limited, 1979. 162 pp.
Monograph explaining the current state of commercial law and business practice in the Kingdom of Saudi Arabia as well as the early laws of Islam. Tax and related laws are dealt with. English translations of relevant statutes are appended. (B. 51.564)

SINGAPORE

ANNUAL REPORT 1978

Inland Revenue Department, Republic of Singapore. Singapore, Inland Revenue Department, 1978. 69 pp. (B. 51.536)

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A GUIDE TO THE EMPLOYMENT TAX

Singapore, Ministry of Labour, 1980. 26 pp.
Employment Act of Singapore explained in question and answer format. (B. 51.537)

SECURITIES REGULATIONS IN SINGAPORE AND MALAYSIA

A primer on the laws of the stock market with cases and materials. By Tan Pheng Theng. Singapore, Stock Exchange of Singapore, Ltd., 1978. 751 pp.
Each topic is introduced with selected cases and materials dealing with securities regulation law of Singapore and Malaysia. Topics include: public floatation, unit trusts and investment companies, sharebroker and client relationship, insider trading takeovers. (B. 51.528)

SOUTH AND CENTRAL AMERICA

TAX AND TRADE PROFILES

South and Central America. London, Touche Ross International, 1979. 159 pp.
Informative guide for doing business in South and Central America, also dealing with taxation. The countries covered are: Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador, Guatemala, Mexico, Panama, Peru, Uruguay, Venezuela. (B. 15.976)

SPAIN

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By César Albinana Garcia-Quintana. Madrid, Ministerio de Hacienda, Escuela de Inspección Financiera y Tributaria, 1979. 757 pp.
Handbook on public finance and tax law. (B. 102.696)

INVESTITIONEN IN SPANIEN

By Wolfgang Stenger. Herne/Berlin, Verlag Neue Wirtschafts-Briefe, 1980. 104 pp., 25 DM.
Investment opportunities in Spain. Economic, political and social aspects relevant to investment assessment are discussed, followed by company law, taxation and investment law and procedures, with emphasis on financial opportunities for German investors. (B. 102.538)

MEMORIA DE LA ASOCIACION ESPANOLA DE DERECHO FINANCIERO 1978

Madrid, Asociación Española de Derecho Financiero, 1980. 702 pp.
Annual report of the Spanish branch of the International Fiscal Association with respect to 1978 activities (both national and international). (B. 102.694)

EL REGIMEN TRANSITORIO DE LA IMPOSICION INDIRECTA

By Alejandro Pedros Abello, Agustin Bas Serra and Joaquin Vila Calsina. Barcelona, Marcombo, 1980. 92 pp.
The consolidated texts of the turnover tax law and the luxury tax law, which have a transitional function, are printed. A short introduction is included. (B. 102.695)

DAS SPANISCHE ZIVILGESETZBUCH

By Witold Peuster. Cologne, Bundesstelle für Aussenhandelsinformation, 1979. Schriftenreihe "Ausländisches Wirtschafts- und Steuerrecht", Band 55. 530 pp.
German translation of the text of the Spanish civil code of 1889, in the amended version of 1978. (B. 102.693)

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Grundsätze sowie Besteuerung im Verhältnis Schweiz-U.S.A. By Ruedi Baumann. Zürich, Ruedi Baumann, 1979. 456 pp.
Study on the principles and taxation of income from international associated companies, in particular with respect to Switzerland-U.S.A. companies. (B. 102.692)

STEUERBELASTUNG IN DER SCHWEIZ

Charge fiscale en Suisse 1979. Bearbeitet von der Eidgenössischen Steuerverwaltung/Elaboré par l'Administration fédérale des contributions. Bern, Bundesamt für Statistik, 1980. Statistische Quellenwerke der Schweiz, Heft 645. 105 pp.
Statistical survey of the tax burden in Switzerland for individuals and corporations. (B. 102.684)

STEUERENTLASTUNGEN AUF GRUND VON DOPPEL-BESTEUERUNGSABKOMMEN

Für Dividenden, Zinsen, Lizenzgebühren und Private Pensionen und Renten. Übersichten — Wegleitungen — Formulare. Bern, Eidgenössische Steuerverwaltung, 1979.
Loose-leaf publication on tax relief granted by comprehensive double taxation treaties concluded by Switzerland with other countries concerning dividends, interest, royalties, private pensions and other income. Schedules, explanation and forms for each concluded double taxation treaty are appended. The same is available in the French language. (B. 102.599/600)

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Second edition. Second cumulative supplement. By John Tiley. London, Butterworths, 1979. 68 pp., £3.95. (B. 102.689)

U.S.A.

FEDERAL ESTATE AND GIFT TAXES: CODE AND REGULATIONS AS OF MAY 9, 1980

Including federal income taxes of estates and trusts (sub-chapter J). Chicago, Commerce Clearing House, Inc., 1980. 830 pp. $8.50.
Complete texts of the estate and gift tax and the tax on certain generation-skipping transfers, as well as corresponding official regulations. (B. 102. 690)

FEDERAL INCOME TAXES OF DECEDENTS AND ESTATES

Chicago, Commerce Clearing House, Inc., 1980. 174 pp., $5.
(B. 102.691)

INDIVIDUAL RETIREMENT PLANS

Individual retirement accounts; individual retirement annuities; government retirement bonds, simplified pension plans. Chicago, Commerce Clearing House, Inc., 1980. 32 pp., $1.50.
Discussion of several retirement related tax problems.
(B. 102.647)

INTERNAL REVENUE CODE

As of May 1, 1980. Alcohol, tobacco, and excise tax provisions, including windfall profit tax. Chicago, Commerce Clearing House, Inc., 1980. 250 pp., $3.50. (B. 102.669)

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Proceedings of the fifty-third annual meeting, held in Philadephia, Pennsylvania, October 14-17, 1979. Washington, Federation of Tax Administrators, 1979. 134 pp. (B. 102.666)

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Law and Explanation. Enacted April 1, 1980. Chicago, Commerce Clearing House, Inc., 1980. 184 pp., $6.
This act became law in 1980 and clarifies the provisions enacted by the Revenue Act of 1978, the Energy Tax Act of 1978, the Foreign Earned Income Act of 1978. Excerpts from the Senate Finance Committee report are appended. (B. 102.598)

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Chicago, Commerce Clearing House, Inc., 1980. 231 pp., $6.
Annual quick reference guide to U.S. excise taxes. (B. 102.668)

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DROIT DES AFFAIRES DANS LES PAYS DU MARCHE COMMUN

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— Kommentaar op het EEG, Euratom en EGKS verdrag; verdragsteksten en aanverwante stukken
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Confédération Fiscale Européenne (C.F.E.): Second Congress of European Tax Consultants (subject: "La pratique de la Fiscalité en Europe"), Rome (Italy), November 6 and 7 (English, French, German).

Management Centre Europe: International Tax Management Seminar (Discussion of tax problems in today's multinational environment), Munich (German Federal Republic), November 10-11 (English).

Seminar Services International: Two International Tax Conferences. (1) Direct Investment between Major European Countries (including: General Introduction to the Taxation Aspects of Cross Frontier Corporate Investment, Harminization of Corporate Tax Systems in the EEC); (2) Direct Investment into the United States (including: U.S. Taxation of Foreign Investors). London (United Kingdom), November 10-11 (English).

International Tax Planning Association: Bahamas (Caribbean Seminar) (including: How Canada Views the Bahamas and other Tax Havens; How the U.S.A. Views the Bahamas and other Tax Havens), Nassau (Bahamas), November 10-13 (English).

Management Centre Europe: Managing and developing foreign subsidiaries (including: Tax in international operations), Munich (German Federal Republic), November 12-14 (English).

The American Tax Institute: New Developments in Euro-American Taxation (including: Tax Havens and Treaty Shopping in Light of Current Treasury Department Activities in the Treaty Area), Cannes (France), November 24-26 (English).

Management Centre Europe: Leasing Seminar (including: Tax aspects of leasing), Brussels (Belgium), November 26-28 (English).

DECEMBER 1980

Management Centre Europe: International cash management (including: International tax aspects in cash management), London (United Kingdom), December 8-10 (English).

FEBRUARY 1981

Management Centre Europe: International Tax Management (including: Inter-company pricing: licensing, service fees) (Seminar), Brussels (Belgium), February 12-13 (English).

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APRIL 1981

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SEPTEMBER 1981

35th Annual Congress of I.F.A.: I. Mutual agreement procedure and practice, II. Unilateral measures to prevent double taxation, Berlin (German Federal Republic), September 21-25 (English, French, German, Spanish).

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NIGERIA: Capital Transfer Tax

A Critical Review

by A.C. Ezejelue *

I. INTRODUCTION

The Capital Transfer Tax Decree [1] introduced the capital transfer tax (CTT) throughout the country with effect from April 1, 1979. The Decree makes provision for the imposition of capital transfer tax on transfer of property inter vivos or on death. It also provides, inter alia, for certain exemptions from the tax and generally for its due administration.

The tax is at a graduated rate on chargeable transfers and the rates [2] vary from 10 to 60 percent on the value of transfers exceeding ₦100,000. The tax is administered by the relevant State Tax Authorities.

One of the main objectives of CTT is to control the colossal acquisition of personal wealth and fortune by the affluent minority in the last few years. [3]

II. CTT ON TRANSFERS INTER VIVOS

CTT shall be payable under the Decree on the value of any property [4] transferred by any person during his lifetime. [5] However, the tax will not be levied if the transfer is a genuine outright sale of the property and is not intended to confer gratuitous benefit on the transferee. [6] Specifically, the transfer must either be made or be such as might be made in a transaction at arm's length between persons not connected with each other.

In the case of a settlement, where property comprised in a gift inter vivos is property settled by that gift, it is treated as an ordinary gift inter vivos for purposes of CTT. The person to whom the gratuitous transfer is made is accountable for CTT. [7] The transferor is in no way liable.

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(a) Cumulative transfers

Section 2(1) of the Decree exempts a transferee from CTT where on the date of the transfer the value of the property does not exceed ₦100,000. However, if there are subsequent transfers to the transferee, the value of all the transfers is aggregated, and only the first exemption of ₦100,000 is applied to the cumulative transfers made to the same person. [8] Thus, where gifts of property worth ₦40,000, ₦50,000, and ₦20,000 are made to X on different dates, the value of the property that will attract CTT is ₦10,000 = ₦(40,000 + 50,000 + 20,000 — 100,000). This provision is subject to the exclusion of any property tranferred before the coming into effect of this Decree. [9]

As a corollary, the emphasis is not on the total value of gratuitous gifts by any person to a number of donees during his lifetime, but on the cumulative and total

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1. No. 12 of 1979.
2. Sec. 18. See footnote 22, below.
3. General Olusegun Obasanjo, "1979/80 Federal Budget", *New Nigerian*, April 2, 1979, pp. I-IV.
4. According to Sec. 28, "property" includes money and all interests capable of being held in land, and personal property and the proceeds of sale thereof, respectively, and any money or investment for the time being representing the proceeds of sale.
5. Sec. 1(1).
6. Sec. 1(2).
7. Sec. 1(3).
8. Sec. 2(2).
9. Sec. 2(3).

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transfers to each donee. Thus, assume that the sum of the value of all transfers made by Obinna after April 1, 1979 is as follows:

To Chizoba ₦45,000 + ₦30,000 + ₦50,000
To Ifeyinwa ₦60,000 + ₦25,000
To Chinasa ₦90,000

The value of the property subject to CTT is only ₦25,000 = ₦(45,000 + 30,000 + 50,000 — 100,000) to Chizoba. The first ₦100,000 value of gifts to Chizoba is specially exempt and the gifts to Ifeyinwa and Chinasa are also exempt as each is cumulatively less than ₦100,000.

(b) Title to property and valid registration

In order to ensure that CTT is paid by the person accountable for the tax. Section 3 provides that the title to property transferred inter vivos and which is liable to CTT shall not pass to the transferee until the tax has been paid. It further provides that where an instrument effecting the transfer is registrable under any law in Nigeria, such instrument shall not be registered unless the Relevent Tax Authority has issued a certificate of clearance evidencing payment of such tax. Any registration made without the discharge certificate having been issued shall be void ab initio and of no effect whatsoever.

III. CTT IN RESPECT OF TRANSFERS ON DEATH

Section 4 provides that CTT shall be imposed on the value of all property passing on the death of a person. In order to determine the rate of CTT payable on any property passing on death, all such property situated within a State is aggregated to form one estate for the purposes of the tax. [10]

(a) Property deemed to pass on death

Section 5 includes the following property as passing on the death of the deceased:

(i) Property in which the deceased was at the time of his death competent to dispose.
(ii) Property in which the deceased or any other person had an interest ceasing on the death of the deceased, to the extent to which a benefit accrues or arises by the cesser of such interest.
(iii) Any property taken as donatio mortis causa (i.e. gift in contemplation of death) made of taken under a disposition made by the deceased, purporting to operate as an immediate gift inter vivos whether by way of transfer, delivery, declaration of trust or otherwise but exclusive of any such property in respect of which CTT had been paid during the lifetime of the deceased.

For a donatio mortis causa to be valid the following conditions should be expected to be satisfied:

— It must be made in contemplation of the death of the donor. If a gift is made in contemplation of suicide it is void for being repugnant to public policy. [11]
— The condition that the gift must be by way of delivery, transfer, declaration of trust or otherwise is met if there is an antecedent delivery of the chattel alio intuitu to the donee before the date of the gift. [12] In *Re Lillingstone* [13] it was held that if the property was bulky and could not be transferred, the provision of the means of making use of it or taking delivery thereof was sufficient.
— The circumstances are likely to be such as to establish that the gift is intended to take full effect only after the death of the donor such that the thing is to revert to the donor (unless the donor indicates otherwise) in case he should recover. [14]

(iv) Any property which the deceased was entitled to and which he has caused or may cause to be transferred to or vested in himself and any other person jointly whether by disposition or otherwise, so that the beneficial interest therein or in some part thereof passes or accrues by survivorship on his death to such other person.
This is reminiscent of an estate held in joint tenancy with one of its peculiar characteristics of jus accrescendi. There might be a problem of survivorship in a case where the joint tenants perish in a common disaster. In this situation it is likely that the common law rule would apply allowing their heirs to hold as joint tenants so that there is no survivorship. [15]

(v) Any property passing under any past or future settlement made by the deceased by deed or any other instrument not taking effect as a will, whereby an interest in such property for life or any other period determinable by reference to death is reserved either expressly or by implication to the settlor, or whereby the settlor may have reserved to himself the right, by the exercise of any power, to restore to himself, or to reclaim the absolute interest in such property.
This creates a reversionary interest whereby the residue of the estate reverts to the grantor upon the determination of the prior estate as opposed to a remainder which stands over for the remainder-man at the end of the particular estate.

(vi) Any annuity or other interest purchased or provided by the deceased either by himself alone or in concert or by arrangement with any other person, to the extent of the beneficial interest accruing or arising by survivorship or otherwise on the death of the deceased.

(b) Exemptions from CTT

No CTT shall be payable in respect of any family house. [16] Also, no CTT shall be payable in respect of such paintings, manuscripts, works of art or scientific collections as may be donated or bequeathed to any body or institution in Nigeria such as museums, universities or other public institutions as may be specified by the Federal Executive Council. [17]

(c) Persons accountable for CTT

The executor of the deceased is accountable for the CTT on all personal property wheresoever situate in the

10. Sec. 7.
11. Re Dudman (1925), Ch.D. 553. See also Agnew v. Belfast Banking Co. (1896), 2 IR 204.
12. Cain v. Moon (1986), 2 QBD 283.
13. (1952), 2 All ER 184.
14. Delgoffe v. Fader (1939), 3 All ER 682.
15. Bradshaw v. Toulmin (1784), Dick, 633.
16. Sec. 17(1). Family house is defined by Sec. 17(2) as any house or part thereof used wholly by a particular family as the principal place of residence for that family and in respect of which no income accrues to such family or any member thereof.
17. Sec. 17(3) and (4).

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State concerned of which the deceased was competent to dispose at his death, but shall not be liable for any tax in excess of the assets which he has received as executor, or might but for his own neglect or default have received. [18]

Where by operation of any law property passes on the death of the deceased, and there is no executor, or the executor is not accountable for the CTT in respect of such property, sub-section 2 of Section 11 deems the following responsible for the CTT on the property:

(i) every person to whom any property so passes for any beneficial interest in possession,
(ii) every trustee, guardian, committee or other person in whom any interest in the property so passing or the management thereof is at any time vested, and
(iii) every person in whom the same is vested in possession by alienation or other derivative title.

These are subject to the proviso that a person who acts merely as agent or bailiff for another person in the management of property shall not be held accountable for the tax. Also a bona fide purchaser for value without notice of tax attaching to the property takes the property free from CTT liability.

IV. ADMINISTRATION AND GENERAL

The Decree is administered by the State in which the property subject to CTT is situated. CTT is under the care and management of the Relevant State Tax Authority charged with responsibility for the assessment and collection of tax on the income of persons resident in that State. [19] In order that the Relevant Tax Authority of the State where the property is situated should exercise jurisdiction over the assessment and collection of the CTT, it is not necessary that the deceased or transferor should be resident for income tax purposes in that State.

Section 9 provides that every person who is accountable for CTT, in the case of transfers on death, shall not later than 12 months after the death of the deceased or six months after the transfer in the case of transfer inter vivos prepare and deliver to the Relevant Tax Authority the CTT Form. While in the case of the former the Form shall contain a true and perfect inventory and account of the estate of the deceased and a statement of the value of the estate, in the case of a transfer inter vivos the Form shall contain a description of the property and a statement of its value.

(a) Determination of value of property

The value of any property is the estimated price which, in the opinion of the Relevant Tax Authority, the property would fetch if sold in the open market at the time of the death of the deceased or of the transfer of the property. [20] For this purpose, the value can be ascertained by the Relevant Tax Authority in such manner as it thinks fit, such as by appointing valuers.

In determining the value of a deceased's estate for CTT, allowance shall be made, subject to a few exceptions, for reasonable funeral expenses and for debts and incumbrances incurred bona fide for full consideration wholly for the deceased's own benefit.

Where an estate includes an interest in expectancy and CTT on such interest is paid together with the rest of the estate, the value of the interest is that at the date of the death of the deceased. Where, on the other hand, CTT is not paid until the interest falls into possession, the value of the interest is calculated according to its value when it falls into possession. [21]

(b) Rates of CTT and quick succession relief

The scale of rates of CTT on chargeable transfers is at a graduated rate ranging between 10 and 60 percent. [22] However, Section 19 provides for a reduction of tax in the case of quick succession such as where within ten years of a first death a second death occurs subjecting the same property or any part thereof to CTT for a second time. A tax reduction is given on the death of the donee or legatee based on a percentage, which depends upon how long the donee or legatee survived the gift or legacy, of the rate of tax originally paid on the property by the transferee. The percentages, which decrease with the increase in the length of time the transferee survived the property, range from 80 percent where the second death occurs within twelve months of the first to 10 percent where the second death occurs within ten years of the first death. The quick succession relief avails where CTT becomes payable on any property consisting of land or a business (not being a business carried on by a company), or any interest in land or such a business. Where, however, the value of the property on which the tax is payable on the second death exceeds the value on which tax was payable on the first death, the former value would be used to determine the amount of tax on which the quick succession relief is to be computed.

(c) Disposition to relatives

Any disposition made by the deceased in favour of his relative [23] shall be treated as a gift unless:

18. Sec. 11(1).
19. Sec. 8(1).
20. Sec. 10(1).
21. Sec. 13(3) (a) and (b). Interest in expectancy may include future interests such as remainders or reversions whether vested or contingent.
22. Sec. 18. The rates are graduated as follows:

Net value of the estate or property transferred	*Rate of CTT*
₦	%
First 100,000	Nil
Next 150,000	10
Next 150,000	20
Next 250,000	30
Next 500,000	40
Next 1,000,000	50
Thereafter	60

23. See paragraph 1 of Part I of the Schedule to Sec. 6. Deceased's relative means: (i) the wife or husband of the deceased; (ii) the father, mother, children, uncles and aunts of the deceased; and (iii) any issue of any person falling within (i) or (ii) and the

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(i) the disposition was made for full consideration in money or money's worth paid to the deceased for his own use or benefit, or
(ii) the disposition was to discharge a fiduciary obligation imposed on him.

Where, however, the consideration for the disposition was only partial, the value of the consideration shall be allowed as a deduction from the value of the property for the purpose of CTT.

(d) Payment options and recovery actions

Under Section 22, the Relevant Tax Authority may, on the application of any person accountable for CTT, accept any property (including interest in land) in satisfaction of the whole or any part of such tax. However, in order to alleviate the undue strain and excessive sacrifice of lump sum payment of CTT it is provided that the tax authority may, on such terms as it thinks fit, allow payment to be postponed for such interest not exceeding 3 percent. [24] But under certain conditions [25] specified in the Decree, such as the difficulty in ascertaining the exact amount of CTT payable, the Revenue has the power, on the application of any person accountable, to accept by way of composition for all the CTT payable, payment of the sum so assessed in full discharge of all claims for the taxes in respect of such property or interest, and shall give a certificate of discharge accordingly. The certificate shall not, however, discharge any person from any tax in case of fraud or failure to disclose material facts. But under Section 20(3) a discharge certificate in respect of any property included in the certificate shall exonerate a bona fide purchaser notwithstanding any such fraud and failure.

For the purposes of enforcing payment of CTT on any person accountable where that person fails, neglects, or refuses to pay the tax, the tax authority may for the non-payment of such tax distrain:

(i) upon the land, premises or place in respect of which the tax was charged;
(ii) the person charged by his goods or other chattels including money, bills of exchange, bonds or other securities. [26]

The amount of tax unpaid may be recovered by the sale of anything so distrained.

If after the tax has been paid, it appears for any reason that too little tax was paid, an additional tax shall, unless a discharge certificate has been issued, by payable, and be treated as tax in arrears. [27]

As a counterpoise to the provisions on raising additional tax in case of underpayment, the Decree provides that where the tax authority is satisfied that too much tax has been paid, a repayment of the excess shall be made. [28] Where the overpayment was due to overvaluation of the property by the tax authority, the repayment will attract an interest of 3 percent per annum.

(e) Offences, penalties, and appeals

A person accountable for CTT who violates the provisions of Section 11 such as by his wilful failure to supply required information or to complete correctly the CTT Form shall be guilty of an offence and will be liable on conviction to a fine of a sum equal to double the amount of the CTT, if any, remaining unpaid for which he is accountable. [29] Also if any person makes any statement in a CTT Form which is false in any material particular he shall be guilty of an offence and liable on conviction to a fine of ₦10,000 or to imprisonment for two years. [30]

If any person is aggrieved by the decision of the Relevant Tax Authority with respect to the amount of CTT payable on any property whether on the ground of the value of the property, or the rate charged, or otherwise, he may on payment of 50 percent of the tax assessed, or of such portion of it as is therein payable by him, appeal to the High Court of the State concerned for the determination of the amount of the tax. [31] Any excess payment of tax will be repaid, and the High Court may, where it appears to it just, order the repayment of such excess with interest at 3 percent per annum for such period as appears to the court just. Appeals shall lie from decisions of the High Court in the same manner and to the same extent as appeals from the decisions of the Court in civil proceedings given by that Court sitting at first instance. [32]

V. REVIEW OF THE OBJECTIVE OF THE DECREE

While introducing the Decree in the 1979-80 Federal Budget the then Head of State, General Olusegun Obasanjo, specifically mentioned the following factors [33] as contributing to the promulgation of the Decree:

(i) the tendency among the youths to regard the material successes of their parents as reasons for not wanting to make any effort to improve themselves and earn their own living;
(ii) the belief that every individual should work for his or her livelihood because that is what self-respect dictates;
(iii) the fact that in the process of working for a living, the individual inevitably makes some contribution to the growth and development of the society;
(iv) the noticeable trend among children and youths in our educational institutions and elsewhere of believing that they should have no ambition and relying on their parents' wealth to see them through life;
(v) the imposition of some measure of control in the acquisition of personal wealth and fortune by the affluent minority in order to avoid future disaffection and social explosion;
(vi) the additional effect of providing, in due course, one more source for financing the economic and social programme of the nation.

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other party to a marriage with any such person or issue. Children and issue include those born out of wedlock and those adopted.
24. Sec. 12(9).
25. See Sec. 16.
26. Sec. 24(1).
27. Sec. 12(7).
28. Sec. 12(10).
29. Sec. 11(4).
30. Sec. 11(5).
31. Sec. 21(1).
32. Sec. 21(2).
33. *New Nigerian*, April 2, 1979, p. IV. columns 3 and 4.

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Some of the objectives for introducing this tax, which is a combination of gift tax and death duty, in Nigeria appear to be similar to some of the objectives for introducing it in the United Kingdom in 1974. This is because it has been claimed that "the object of CTT is to reduce large individual holdings of wealth in the United Kingdom" [34]; it is also for "the redistribution of wealth as a means to greater justice and equality in our society". [35] The similarity is not suprising since "as usual the Decree is patterned after the United Kingdom law". [36]

It is believed that the social and economic considerations which motivated the promulgation of the Decree are laudable and that the Decree may have a far-reaching effect towards achieving the declared objective. This is particularly so if the provisions of the Decree are faithfully and efficiently implemented both by the taxpayers themselves and by the already over-worked staff of our various Revenue Departments.

However commendable the objectives may appear to be when examined in isolation, some of them are self-defeating when looked at in collectivity. For instance, while in one breath the Decree tends to encourage youths to remain self-sufficient through the process of working hard for a living and having some ambition, in another breath it tends to impose some control in the acquisition of personal wealth and fortune. How far does labouring towards self-sufficiency go before the imposition of the control sets in? It amounts to blowing hot and cold to require a person to work hard for his economic independence and at the same time requiring him to stop at some point in that pursuit.

One of the reasons for this control is to avoid future disaffection and social explosion since according to the Head of State, "self-interest is undeniably part of human nature but so is envy". [37] If everyone becomes self-sufficient by working hard, then the issue of envy and disaffection will not arise. The reference to envy and disaffection imports some degree of economic equality through some elements of socialism. But his has no validity in a capitalist set up. It has been emphasized that "we cannot impose socialist norms and dogma . . . on an essentially capitalist institution without ensuring that the ethos and core values are redefined and the institution redesigned to serve the new values". [38]

Furthermore, the issue of control of acquisition of personal wealth is in conflict with the objective of using the tax as a source of revenue for the government. The idea of restraining such acquisition has an inherent disincentive effect. The government will not therefore try to discourage one of its possible sources for financing its economic and social programmes.

One of the criticisms of taxing marginal incomes heavily is its disincentive effect to work. Therefore if CTT bites seriously into a personal wealth such that hard work and enterprise is discouraged, it countervails some of the well-conceived intentions of the Decree. In particular, it will be a counter-offensive to the belief that every individual should work for his or her livelihood and that in doing so the individual inevitably contributes to the growth and development of the society. Although excessive wealth ought to be taxed, CTT should not be used as a vehicle for restricting the acquisition of personal wealth and fortune.

CTT must not be considered in isolation. It must be emphasized that there are other taxes such as income tax, capital gains tax and corporation tax, which together with CTT may affect the same persons who are supposedly well-to-do. Apart from the fact that the taxpayers may be suspicious of the multiplicity of the taxes, the government should not create a situation where a taxpayer's financial security will be endangered by his desire to minimise tax liabilities. Therefore CTT should be regarded more as a means of wealth redistribution rather than as a means of raising revenue. This appears to be the conception in Britain because, according to Ind, "the tax is not presented by Parliament as a revenue-raising measure but as a social measure with the objective of redistributing wealth. . . although a man should be allowed to accumulate wealth created by his own energies during his lifetime, that same wealth should not be too readily transferable to his children". [39] The principal "raison d'être" of CTT should be viewed from this perspective.

It is doubtful whether CTT per se can in fact, in all cases, curb the tendency among youths to regard the material successes of their parents as reasons for not wanting to make any effort to improve themselves and earn their own living. If a substantial amount of wealth is bequeathed to a son by his father, CTT can make only such a little dent on the whole bequest that the son who so desires can conveniently rely on it without further improving himself. The desire to improve oneself and have one's own ambition is more a factor of the social and political set up and self-discipline rather than of CTT.

VI. SHORTCOMINGS OF THE DECREE

Since one of the objectives of the Decree is for the tax to serve as a revenue-yielding source, the fact that all property within the federation is not aggregated en bloc reduces the yield from the tax. The yield from this source could have been more substantial for financing our economic and social programmes if the aggregation were on national level rather than on piecemeal State levels. However, the problem of aggregation on a nation-wide level is to determine which of the States will be responsible for the overall aggregation and how the tax yield will be distributed among the States having regard to such exemptions as the first ₦100,000 and the family house and also the debts to be paid out of the various properties.

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34. Ronald C. Ind. *Capital Transfer Tax* (Great Britain: Macdonald and Evans, 1977), p. 21.
35. R.J. Clements, "Capital Transfer Tax: Planning for the individual", *Journal of the Institute of Bankers*, Vol. 97, Part I, February, 1976, pp. 25-27.
36. C. Njokanma, *Capital Transfer Tax Handbook* (Enugu, 1980) p. 1 (unpublished).
37. *New Nigerian*, Op cit., p. IV.
38. Pius N. Okigbo, "The Capital Market and the Nigerian Economy", *Management in Nigeria*, Vol. 16, No. 3, March, 1980, pp. 8-13.
39. Ronald C. Ind, Op. cit., p. 278.

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Also for the purposes of aggregation it is not clear from the Decree how property located outside Nigeria as well as shares and other such investments should be treated. For example, is the location of shares to be based on where the share certificate is deposited or where the register of shareholders is maintained?

The Decree provides that the value of any proprty for CTT shall be estimated to be the price such property would fetch if sold in the open market at that time. This may be fraught with difficulties. For instance, a market may not exist for that property, or where it exists it may not be perfectly competitive. Besides, a quoted price for a property is strictly comparable with another only if the grade, quality, location, delivery terms, credit terms, and auxiliary services are exactly the same. Some isolated prices represent nothing but distress prices for quick disposition of property in a financial emergency. Again there is the possibility that the property cannot be sold, or can only be sold to restricted persons, or can only be sold at a fixed price. Also, the Decree does not provide for the costs of the realisation of the property. It is for the High Court to determine the issue of the open market valuation when a case goes on appeal. The following observations of Swinfen Eady, L.J. on the same issue in the English case of *Commissioners of Inland Revenue v. Clay* [40] may be persuasive:

"A value, ascertained by reference to the amount obtainable in an open market, shows an intention to include every possible purchaser. The market is to be the open market, as distinguished from an offer to a limited class only, such as the members of the family. The market is not necessarily an auction sale. The section means such amount as the land might be expected to realize if offered under conditions enabling every person desirous of purchasing to come in and make an offer, and if proper steps were taken to advertise the property and let all likely purchasers know that the land is in the market for sale.... Not only is the probable buyer a competitor in the market, but other persons, such as property brokers, compete in the market for what they know another person wants, with a view to a resale to him at an enhanced price, so as to realize a profit."

As reasonably persuasive as these explanations are, they are difficult conditions to fulfill.

In determining the value of the state of a deceased person an allowance shall be made, inter alia, for reasonable funeral expenses which include reasonable expenditure in embalming and transporting the deceased to the burying place. However the Decee went beyond the requirement of reasonableness to put the ceiling of such admissible expenses at ₦1,000 in respect of a tombstone and ₦3,000 in respect of all other expenses. The restrictions completely ignored two important things which have remained with us, namely: the inflation and the differences in the status and place of the deceased. The Decree could have stopped short at the requirement of reasonableness which ought to vary with time and status of the deceased. Also the Decree does not provide for the apportionment of funeral expenses where the assets are located in more than one State.

Although the CTT is a combination of gift tax and death duty, some form of the latter is not new in Nigeria. There are the Administrator-General's Laws [41] which apply to an estate of a deceased person in respect of which probate or letters of administration may be granted by the High Court. Under these Laws, the Administrator-General may be appointed the sole executor of a will, and in some circumstances a person who establishes his claim may be granted probate of the will or letters of administration. One of the duties of the Administrator-General under this Law is to dispose of the property of the estate in the prescribed manner [42] which includes payment to the credit of the Consolidated Revenue Fund such percentage [43] as may be prescribed of the gross amount of money arising from the realization of the estate. This represents the duty on the estate of the deceased person. Since this duty could be readily avoidable by the simple device of transferring property inter vivos so as to reduce the taxable estate at death, the CTT has a more far-reaching effect.

One could have thought that like our predecessor, the United Kingdom, the CTT Decree which operates throughout Nigeria could have specifically repealed all the previous estate duty legislations. "The introduction of a far-reaching CTT [i.e. U.K. Finance Act 1979] removed the need to retain the long-standing estate duty liability and no liability for this duty will arise in respect of deaths occurring on or after March 13, 1975". [44] On the contrary, the Decree does not repeal or amend the Administrator-General's Laws and Ordinance, and one is left with the problem of determining their relationship with the Decree.

However, Section 20(4) provides that, where after filling the CTT Form by the person prima facie responsible for accounting for the tax, the Revenue shall, if satisfied with the information disclosed therein that CTT is payable in respect of any estate, issue a certificate of provisional assessment to him for the purposes [45] only of exempting him, if he applies to any court for probate or letters of administration in respect of the will or estate of, or of any matter connected with the distribution of the estate of, a deceased person, from payment of such fees as may be prescribed by any law including rules of court. It is further provided that such certificate shall not relieve any such person from payment of court fees chargeable for oaths or, subject to the Decree, of any probate fees where it is subsequently revealed that the estate is not chargeable to CTT.

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40. (1914), 3KB 466, 475.
41. See, for example, Administrator-General's Law (Eastern Nigeria) 1963 — Cap 4; Adminsitrator-General's Law (Western Region of Nigeria) 1959 — Cap 2; and Administrator-General's Ordinance (Federation of Nigeria and Lagos) 1958 — Cap. 4.
42. See Sec. 37 of Eastern Nigeria Law; Sec 35 of Western Region Law and Sec. 39 of Federal Ordinance.
43. The schedule of fees operating as per Eastern Nigeria Law representing percentage of value of assets collected under Sec. 16 or gross amount realized under Sec. 37(2) (b) is as follows:

Not exceeding £100	4 percent
exceeding £100 but not exceeding £300	5 percent
exceeding £300 but not exceeding £800	6 percent
exceeding £800	7 percent

(The schedule is subject to Sec. 55 of the Law)
44. K.R. Tingley, *Key to Capital Transfer Tax* (Second edition) (U.K.: Taxation Publishing Co.), p. 314.
45. See Sec. 25.

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The implication of this, it would appear, is that both the CTT Decree and the Administrator-General's Law will operate pari passu. Where the value of the estate transferred on death exceeds ₦100,000 CTT will be imposed, but where it does not exceed ₦100,000 estate duty under the Administrator-General's Law will be payable. In the case of transfer inter vivos, however, any property whose value is not greater than ₦100,000 stands exempt from both taxes since transfer inter vivos does not come under the Adminstrator-General's Law. Being federal legislation, it is expected that in the case of any conflict the Decree would take precedence over the estate duty laws.

However, it would have been better if, as in the U.K., the estate duty legislation gave way to the CTT Decree for the sake of tidiness and unification and for the elimination of any doubts and possible confusion. The Decree could, where necessary, incorporate any portions of the Administrator-General's Law and similar laws which should be saved. Moreover, some aspects of the Administrator-General's Law, for example the rates of estate duty, are, in the light of current changes, out of alignment with some provisions of the Decree.

VII. SUMMARY

Although efforts have been made to highlight the principal issues involved in our Capital Transfer Tax Decree, there are a few obscure points which were deliberately left out. As a new piece of legislation some time is needed to put it in practice before a meaningful stock is taken. Until it is fully understood and practised, its merits, pitfalls as well as ways of mitigating the tax cannot be fully appreciated. However, the introduction of CTT is another landmark in the development of taxation in Nigeria.

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by Drd. Ioan Condor *

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6. Conclusion.

1. The necessity of amending the financial mechanism and the legal framework therefor.

At the present time in the multilevel development of the entire national economy, based on the Program of the Romanian Communist Party,[1] as changes in society rapidly occur, the constant perfection of economic and financial management and planning and improved efficiency in all fields of activity become imperative. From the point of view of the Romanian Communist Party, the forms and methods of management, far from being immutable, must constantly be subject to improvement and adapted to the pace of development of economic and social life and at the same time to the objective requirements for the material and spiritual development of society.

In accordance with these facts and with exacting demands as to the quality of the management process as well as great openness to new elements, the Romanian Communist Party acted, and is still acting, to eliminate everything which had become superannuated and which no longer corresponds to the targets necessitated by rapid progress in constructing the socialist society to improve permanently the management and planning of the entire socio-economic sphere. Decisive moments in this framework for drawing up the socio-economic development strategy for the country were the measures taken by the Romanian Communist Party at the 9th Congress and the National Conference of 1967, the 10th and 11th Congresses and the National Conferences of 1972 and 1977 on perfecting socio-economic management and planning.

In conformity with the requirements of the present stage of development of the national economy, the Plenum of the Central Committee of the Romanian Communist Party,[2] which met on 22 and 23 March 1978, made decisions of exceptional importance on economic and financial management and planning, the raising of workers' self-management to a higher level, and increasing role and responsibility of each separate work collectivity (party) in the administration, with the goals of the most efficient utilization by the party of the national experts involved in the sphere of management, and of reinforcing economic-financial self-management. The entire process of elaborating the Party's documents and the laws of the country, intended to lead to the perfection of the economic-financial mechanism, has been directly led by President Nicolae Ceausescu, Secretary-General of the Romanian Communist Party.

The measures taken by the Plenum of the Central Committee of the Romanian Communist Party of 22-23 March 1978 are intended to increase the role of the financial-banking system which, while ensuring the financial means necessary to the progress of economic activity under the proper conditions, must pay more attention to the adequate use of these funds to encourage increasing economic efficiency. At the same time, the financial-banking system has to ensure permanent systematic financial control in all sectors of the economy in order to intervene promptly in settling the various matters which arise in the multilevel progress of our economy.[3]

With a view to implementing the measures decided upon by the Party on the further perfecting of financial and banking activity and the reinforcing of the role of finance to create better conditions for achieving the financial, monetary and foreign currency policies, the proper adjustment of the existing legal framework appeared to be necessary.

The Finance Law (No. 9 of 1972) which entered into force on 1 January 1973 was responsive to the goals set up by the 10th Congress of the Party and the National Conference of the Party of July 1972:

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* Head of Legal Department, Ministry of Finance.

1. Program of the Romanian Communist Party for creating a multilevel developed socialist society and Romania's advancing to communism. Politic Publishing House, Bucharest, 1975, pages 110-111.
2. Decision of the Central Committee of the Romanian Communist Party on the improvement of self-management and economic-financial planning, published in Official Bulletin No. 28 of April 8, 1978(I).
3. Speech at the Plenum of the Central Committee of the Romanian Communist Party, March 23, 1978 (Politic Publishing House, Bucharest, 1978), page 10.

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— to raise to a higher level the planning, management and organization of the economy; and
— to ensure, within this framework, the improvement of economic-financial activity.

Coherently dealing with socialist financial matters at both a macro- and micro-economic level, the Finance Law was unique, not only nationally but also on the international scene. [4]

The decisions of the 11th Congress of the Romanian Communist Party, the National Conference of 1977 and the Plenum of the Central Committee of the Romanian Communist Party 22-23 March 1978, taken together with the requirements of the present stage of development of the national economy, call for the further improvement of the juridical framework of financial relations in order to reflect the measures adopted to perfect economic and financial management and planning.

To this end, the Great National Assembly has adopted the Law Amending and Completing the Finance Law (No. 9 of 1972). [5]

The measures adopted to perfect economic and financial management and planning are reflected also in the fiscal law field. Thus, as of January 1, 1979, provisions relating to the contribution to society of a part of the net production value (the so-called "prelevarea pentru societate a unei părți din valoarea producției nete") became effective (Decree No. 429/1978). [6]

2. The system of monetary funds within the national economy

To best determine the proportions and pace of economic growth, one must consider the role played by proper distribution of the national income between development and the consumption fund. [7] With this in view, the Law has enacted many and various improvements which significantly fill out the provisions referring to the functioning of monetary funds in the national economy, thus creating a highly perfected legal system for the formation and distribution of these monetary funds.

The national income serves as a basic source of monetary funds in the economy and is distributed between a fund for consumption and a national fund for the socio-economic development of the country. The latter, however, is also funded through the depreciation fund as well as other sources.

The national fund for socio-economic development functions as an overarching fund system, comprised of a central fund for socio-economic development, a local fund for socio-economic development, the own funds for socio-economic development belonging to the State economic units, the own funds for socio-economic development set up by co-operatives as well as by other public organizations, [8] and the funds used by the people for building houses, production and raising of livestock, and other similar purposes.

From a material point of view, the national fund for socio-economic development is intended to finance new investments and the growth of material stocks out of it.

The means contained in the *fund for consumption* are remitted — in monetary form — to the working people through several channels, i.e. as a remuneration (according to the quantity, quality and social importance of the work performed), as profit sharing and as social retributions from the state budget or from the funds of the socialist units.

The Law reserves an important place and ensures a complete control to *the own funds* [9] of state economic units, cooperatives and other public organizations. Within the framework of measures adopted by the Romanian Communist Party, the concept of economic management has been enriched, amplified and given new qualities, as the enterprises must now cover their expenses from their own income, reimburse the amounts provided by society, ensure the self-financing of their own growth, provide material incentives for the working people and, at the same time, participate efficiently in the formation of the centralized resources of the state which are earmarked for certain objects and activities.

The material forms in which the enterprises hold part of the financial resources for self-financing of development and for creating incentives for the working people, as well as the conditions on which depend the amount of the resources held, both constitute component parts of the economic-financial mechanism and reflect, as regards the content and manner of functioning of the system of the monetary funds belonging to the economic units, the principal framework which was approved by the Plenum of the Central Committee of the Romanian Communist Party of 22-23 March 1978.

The amendments and completions to the Law of Finance effected by Law No. 2 of 1979 elaborate the measures by which these funds are legislatively instituted. The resources for the own funds of which state enterprises

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4. Iulian Vacărel, Law of Finance, a favourable framework for the increase of economic efficiency, enforcement of order and discipline in all fields of activity (Finance and Credit Revue No. 1/1973, page 4).
5. Law No. 2 of July 6, 1979, published in the Official Bulletin No. 59 of July 13, 1979.
6. This tax is a new form of profits tax which, in the case of realization according to plan, taxes away a portion of the net production value which is not needed by the entreprise. In the case of plan overfulfillment, a part of the incremental production value is to be returned to society in the form of a higher tax, due to the increased tax base, similarly in the case of plan underfulfillment, the tax will be reduced.
7. Constantin Iuga, Perfecting of the financial relations in the conditions of the new economic mechanism (Socialist Era No. 14 of July 20, 1979, pages 18-21).
8. The concept of "*socialist units*" comprises: the State economic units (enterprises and industrial centrals-enterprises association), state institutions (establishments), ministries and the other central and local bodies, agricultural, handicraft and consumption co-operatives and other public organizations. These socialist units are, in general, *economic units*, except the State institutions, ministries and the other central and local bodies and, sometimes, other public organizations.
9. M. Meheninţu, Enterprise funds, economic-financial self-management and its characteristic features (Economic Review No. 6 of February 9, 1979, pages 24-25); T. Stolojan, Monetary funds system belonging to the economic units (Accounting Review No. 1, 1979, pages 9-16).

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can dispose are constituted from profits, [10] the depreciation of capital goods [11] and other sources established by law.

In order to enable the self-financing of their own development (i.e. financing from their own resources), the state enterprises can use the fund for economic development and the working means fund. The industrial "trusts" (associations of enterprises) may call upon the fund for the financing of investments in new enterprises and for the financing of important developments as well as the reserve fund for working means.

What is of paramount importance in the new regulations on self-financing is the basic principle that, from their funds, the enterprises must ensure the coverage of planned investments, the payment of installments due on the bank credits granted for investments, the planned annual growth of working means and the installments to be paid back to the state budget from the amounts received by new enterprises to cover their needs of working means in their first year of activity. Thus, only the financing of investments in new enterprises and important developments in existing enterprises, as provided for by the national one-time plan [12] (Appendix No. 1 of the Law), is ensured from the fund which has been set up for such a goal by a "Central".

In order to increase the role of the enterprises in satisfying social needs and to provide incentives for the working people to increase profits, provision is made for the establishment of a fund for housing construction and other investments with a social character, a fund for profit sharing of the working people and a fund for social activities. In addition to these funds, the enterprises may set up — based on production expenses — as own funds: a fund for scientific research, technological development and introduction of technical progress, a fund for labor protection and other funds provided for by law.

Provision is also made for the obligation of the enterprise to repay the funds received from society for financing their investment as well as the funds received for covering the necessary working means to the new enterprises during the first year of operation. For such new enterprises, the obligation to repay the amount received for financing the investment begins in the year following that in which the project begins operations.

There are also new and specific regulations with regard to the funds of the agricultural, handicraft and consumption co-operatives and also funds of other public organizations.

In this way a uniform, clear and precise legal framework is ensured for the own funds of the socialist units, which facilitates a better knowledge, application and control of their means of formation, distribution and utilization.

3. Income and expenses budget

The main instrument implementing the measures which aim at perfecting the economic-financial mechanism — in the financial field — is represented by the income and expenses budget. In this context Finance Law No. 9 of 1972 (amended by Law No. 2 of 1979) provides for financial activities on all organizational levels of the economy to be set up and developed on the basis of an income and expenses budget as well as other financial plans, all comprising a uniform system. This system of financial plans which has been brought to fruition by the new law comprises: the income and expenses budget; the state budget; the cash plan; the credit plans; the balance of income and expenses of the population, the foreign payments balance; the centralized financial plan; the territorial financial plans of the counties and the municipality of Bucharest.

In comparison to the previous regulation, new elements of the Finance Law regarding the system of financial plans include the income and expenses budget, the foreign payments balance and the territorial financial plans of the counties and the municipality of Bucharest. In this way, a complete schedule of financial plans, each of which is separately defined in the Finance Law, has been accomplished, thus ensuring a legal delimitation of the contents of each of the plans.

The *income and expenses budget* [13] has a central place and a special importance in the economic-financial activity of the state enterprises. The introduction thereof in all state enterprises and "industrial centrals"

10. Law No. 29/1978 on the forming, planning, destination and payment of profits, published in the Official Bulletin, I, No. 114 of December 27, 1978. The law is also intended to apply the measures established to perfect management and economic and financial planning. In accordance with the law, which entered into force on January 1, 1979, "profit" refers to that portion of the newly earned profits generated by an enterprise's business activities which remains after deduction of the tax discussed in note 6, wages paid to the employees and other similar payments, research costs, including the costs for the introduction of new techniques, the tax on total remuneration fund, contribution to social insurance and any other cost connected with the labor force. The anticipated profits for enterprises are planned in advance on the basis of efficiency indicators and standards prescribed by law, and are then set forth in the enterprise's income and costs budget. The planned profits of the State economic unit are applied to returning the funds received from society, to form own funds in order to replenish or expand its own supply of funds and in payment of any outside obligations as provided by law. The sums remaining subsequent to such distributions represent payments to the State budget. In the event that an economic unit generates profits in excess of the planned profit level, the law requires that at least 35 percent of the excess amount must be paid to the State budget. The exact amount which must be paid is determined taking into account the relevant legal provisions concerning the allocation of over-planned profits either to an enterprise's own funds or in satisfaction of outside obligations. If the State economic unit is not successful in achieving its planned profit level, then it is only required to pay into the State budget the amount of profits it actually achieved.

11. Law No. 62/1968 on the capital goods redemption, republished in the Official Bulletin No. 6-7 of January 19, 1977.

12. The national unic (single) plan for economic and social development can be — in the Romanian legal system — an annual (yearly) or five year plan.

13. Gh. Boulescu, Income and expenses budgets, instruments of management of the economic-financial activity (Accounting Reveiw No. 10/1978, pages 1-5); Gh. Vîlcu, Income and expenses budget for the state establishments (Accounting Review No. 4/1979, pages 1-9); A. Bran, Income and expenses budget of the economic units (Economic Review No. 23/June 8, 1979, pages 10-11); A. Sesan, Economic-financial self-management (Scînteia No. 10222 of Sept. 20, 1978).

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occurred during the second half of 1978, under the terms of the previous legislation.

This budget has been conceived as a basic instrument of the managing bodies in enterprises, "industrial centrals", establishments, ministries and the other central and local bodies for the planning of economic-financial activity, with the aim of ensuring the achievement of the targets of the economic and financial plans and guaranteeing the financial balance.

In fact, the income and expenses budget is a basic instrument of the collective management of the State enterprises in reinforcing economic-financial self-management and self-financing, because it constitutes a synthesis, in monetary form, of the economic and social activity in every enterprise: it is a reflection of the conditions under which material and financial funds are managed and ultimately of the results obtained and the efficiency with which these results are obtained. Using these budgets, the general assemblies of the working people and the collective managing bodies of the enterprises are able to consider and set up measures to strengthen economic-financial self-management, the growth of economic efficiency and the degree of self-financing for their respective enterprises only.

At the same time, the income and expenses budgets are a useful tool in planning financial activity, used at the draft stage when proposals must be submitted for approval. The budget is drawn up by the collective managing body of the State enterprise on the basis of the proposals and is adopted by the general assembly of the workers.

Finally, these budgets are an instrument to analyze the implementation of financial activity and also the financial balance, for they can be used to take appropriate measures in fields where deficiencies or shortfalls in economic and financial proposals or infringements of planning and financial discipline appear.

The income and expenses budgets, at all levels, are conceived as part of an integrated system, in correlation with the national one-time plan, the state budget, the credit plans and the centralized state financial plan.

Measures to implement the perfected economic-financial mechanism are also relevant for the activity of the territorial administrative bodies and the state establishments. In this way emphasis has been placed on the fact that self-management and self-financing require that each territorial administrative body, each town, each commune, would have its own income and expenses budget. It is intended that, within a few years, all localities in the country will be able to finance themselves without expecting allowances from the state budget. [14] Thus, the income and expenses budget of the administrative territorial bodies becomes the main instrument through which the people's councils try to achieve more rapid development of the urban and rural communities.

The increased resources for the rise in the degree of self-financing are ensured by the increase in the income of the local budgets, because a close relationship exists between the socio-economic development of each administrative territorial body and the strengthening of its self-financing. Therefore, in addition to the introduction and application of a strict savings scheme so that the targets could be implemented with as reduced an amount as possible of material and financial aid, it seemed necessary to aim at further enlarging the income basis of each locality through the development of industrial activities relating to local needs for services, and handicrafts and other income-producing activities utilizing to the utmost local raw materials. [15]

4. Amended forms of financing and crediting the national economy

The measures taken to perfect the economic-financial system have also imposed new regulations in the fields of financing and granting credits for production, turnover and investments. An improvement can be seen in the system which established the level of the funds for the working means and the methods for covering them financially.

The working means fund is partially constituted from profits expressed as a rate of the yearly increase of the total working means and approved through the state budget. The other part of the increased need for working means is covered by bank credits. In the first year of activity, the financing of the needed working means of a new state enterprise is guaranteed from the state budget. In succeeding years the financing of the working means is secured from the working means funds and other resources which are temporarily available, according to law.

Financing and crediting of investment projects which have been approved through the national one-time plan for economic and social development are provided for as follows:

- investments in new enterprises and important expansions (detailed in Annex 1 to the Law) are financed from the fund established by the "industrial centrals" and, where this fund is insufficient, redistribution can be made within the same ministry; should the planned needs not be met, the difference is to be covered by allowances from the central fund for socio-economic development which is included in the state budget;
- investments in existing enterprises, except important expansions (mentioned in Annex 1 to the Law), are financed from the enterprise's own fund for economic development, supplemented by bank credits;
- house building and other investments with a social character are financed from an own fund which has been especially set up for this purpose by the enterprise, supplemented by bank credits;
- investments of the state establishments are financed from the state budget.

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14. Nicolae Ceausescu, Speech at the Conference of presidents of the people's councils, 29-31 March 1978 (Politic Publishing House, Bucharest 1978, page 20).
15. I. Condor, L. Varlam, Forms of material incentives applied in the field of local budgets (Economic Review, supplement No. 28 of July 13, 1979, pages 10-11); I. Pătrascu, Self-financing, incentive in development of localities (România Libera of January 9, 1979).

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Through the means of financing and granting credits in the field of investment, emphasis is placed on the stimulation of state enterprises to provide themselves with sufficient resources and to finance the investments first out of their own funds.

Funds which the enterprises have received for financing investments and covering the need for working means in the first year of activity are to be repaid out of the redemption of capital investments as well as out of profits.

The Law provides an important explanation for the jurisdictional character of the credit. It provides for credit relations between banks and economic units to be established on a contract basis containing: the amount of credits to be granted, the terms for the granting and reimbursing of the credits, the interest rate and the obligations and responsibilities of the contracting parties.

Of particular importance are the provisions regarding the measures for economic-financial recovery which are established by law in order to strengthen discipline in the management of material and financial means for those economic units which are not fulfilling their plan targets, are immobilizing the working means and are unable to reimburse within the time limit the credits received. These measures are essentially the following:

- setting up of bank control on payments which have been due for more then 60 days, the financing-bank having the right to refuse to effect those payments which breach the legal rules related to reasonable management of material and financial means, planning and financial discipline and to introduce an instrument of payment based on the prior liquidity of the enterprise. At the same time, the banks are obligated, together with the next-highest ranking body of the concerned unit, to examine the economic-financial condition of the enterprise and to propose or even establish measures intended to lead to the recovery of the activity;
- examination of the economic-financial situation of those units whose working means are frequently immobilized and which are unable to reimburse on time the credits received. The examination is to be made by the bank, together with the managing bodies of the respective enterprises, "industrial centrals", ministries and other central or local bodies, with the assistance of the State Committee of Planning, Ministry of Finance, Ministry of Technical Material Supply and Capital Goods Management Control, Ministry of Foreign Trade and International Economic Co-operation. On the basis of the examination and subsequent debate in the general assembly of the working people from the respective enterprises, effective measures are set up in order to restore a sound economic-financial situation. The means for achieving the established measures are controlled by the Ministry of Finance together with the Central Board of Workers Control of Economic and Social Activity and the Superior Court of Financial Control;
- establishment of a special regime of economic-financial supervision, set up for those economic units which continue to be unable to make payments despite the measures taken, or which incur losses or seriously breach the rules of fund management. The setting up of this regime is intended to take measures aiming at the profitability and recovery of the enterprise's economic-financial activity, and to establish the reasons for such unprofitable activity and the responsibilities of the persons in charge of the management of the enterprise. The special regime is set up by the Council of Ministers, on the proposal of the Central Board of Workers Control of Economic and Social Activity, the Superior Court of Financial Control and the Ministry of Finance. During the period established by the Council of Ministers for this special regime, an economic-financial supervisory board is constituted which must analyse the reasons for the unprofitability of the enterprise and establish compulsory measures to restore economic-financial soundness, which proposals are subsequently debated in the general assembly of working people. The responsibility for the recovery of economic-financial soundness lies by law with the working people's board together with the economic-financial supervisory board. Should it appear that the condition of the economic unit is a result of the actions of the manager or another person of the unit leadership, the supervisory board can propose the dismissal of such individuals and forbid them assuming further managerial positions for a limited period.

5. Provisions referring to financial-foreign exchange relations

A new Chapter (V) was introduced by Law No. 2 of 1979 which, for the first time in the framework of the Finance Law, governs financial-foreign exchange relations.

The Law establishes *the uniform system of plans*, which forms the basis for the functioning of financial-foreign exchange activity and which is comprised of: the balance of foreign payments, the plan of payments and receivables in foreign currency of enterprises, "industrial centrals", ministries and other central and local bodies and the balance of foreign rights and liabilities.

The *balance of foreign exchange* [16] is drawn up by the Ministry of Finance, the State Committee of Planning, the Ministry of Foreign Trade and International Economic Co-operation and the banks together with the ministries and other governmental bodies, keeping in mind the indicators of the national plan and the state budget and the need for an even balance in foreign exchange. It is submitted to the Council of Ministers and approved simultaneously with the national one-time plan for socio-economic development, annual or five-year.

Law No. 2 of 1979 introduces, for the first time, such a plan for *foreign exchange receipts and payments of enterprises, "industrial centrals" and ministries.* This

16. C.C. Kiritescu, International currency-financial relations (Scientific encyclopedia Publishing House, Bucharest 1978, page 170); I. Bituleanu, The trade balance and its role in economy (România Libera No. 10742 of May 11, 1979).

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plan encompasses the total of foreign exchange receipts and payments, drawn up in conjunction with the economic and financial plan and the balance of foreign payments situation.

The economic units and central bodies are authorized to engage in importation and to make payments within the limits of the provisions of the plan, dependent upon the availability of foreign exchange resources from exports. In cases where export receipts do not meet the quota established in the quarterly plan approved for the ministries and such a condition affects the planned foreign exchange balance, the ministries involved cannot contract new imports within the limits of the unfulfilled receipt amounts. At the same time, the central bodies are obligated to report to the Council of Ministers on the measures taken in order to meet the receipts and ensure the planned foreign exchange balance.

The balance of foreign receipts and liabilities [17] is drawn up by the Ministry of Finance, the State Committee of Planning, the Ministry of Foreign Trade and International Economic Cooperation and the banks. It is submitted to the Council of Ministers at the same time with the yearly and five-year plans.

The socialist entities, from the enterprises up to the ministries and banks, keep records in both foreign and domestic currency of the receipts and liabilities resulting from foreign trade and other foreign activities and are responsible for collecting receivables in foreign currency and for payments of debts engaged abroad, and for periodically reporting their position to the Ministry of Finance.

The basic legal regulation of foreign credits and payments is also established by the Finance Law. In this way, provision is made for setting up foreign credit relations on the basis of foreign contracts, agreements, conventions and other understandings. Foreign credits are granted and received through banks, foreign trade enterprises and other authorized bodies. There are also regulations for those financial resources from which foreign credits are granted and for obligations of economic units which engage in foreign trade and of banks with regard to the performance of credit transactions abroad, as well as their obligation to keep records thereof and to make proper provisions in the foreign contracts in order to ensure receipt of the rights to which they are entitled and to fulfil due procedure to collect all rights and obtain the due amount. At the same time, the Finance Law established the duties of the central bodies and those of the economic and financial central synthesis bodies charged with collecting by the due date the rights resulting from the granted credits and also the repayments due on credits received.

Law No. 2 of 1979 has added to the Finance Law (No. 9/1972) rules with regard to the financing and crediting of foreign trade and regulations as to the crediting of Romanian economic units which participate in joint ventures.

We can therefore see that this new chapter of the Finance Law, which is justified by the unprecedented upward trend of foreign trade and international economic cooperation of Romania, is made up of the major regulations which form the general legal framework of financial-foreign exchange relations. This is necessary because Romania's growing participation in world-wide economic trade imposes the necessity of perfecting the national monetary system and financial-foreign exchange and credit relations, in the light of the close inter-influence among international economic co-operation, foreign exchange relations and finances.

6. Conclusion

In implementing the measures taken to perfect the economic-financial mechanism, encompassed in the amendments made to the Finance Law, the enlarged role, duties and responsibilities of all state units in strengthening the workers' self-management, economic-financial self-management and discipline in handling financial funds is ensured.

These same ameliorated provisions of the Finance Law also ensure the enlarged role, duties and responsibilities of the Ministry of Finance and the banks in working out and implementing the national one-time plan, the state budget, the centralized Financial plan, the foreign payments balance, the plans of receipts and payments in foreign currency, the balance of receipts and liabilities abroad, and other plans, and also ensure obtaining peak efficiency in the conditions necessary to maintain a general economic and financial balance, and prompt and firm action in solving economic-financial problems. In the same way, the duties and responsibilities of financial accounting departments have increased as have those of the staff charged with the task of exercising financial control from the outset which must both observe planning, contractual and financial discipline.

17. The balance comprises the rights and obligations towards foreign countries, at a certain moment, from export, import and international economic co-operation activities, construction, services, tourism and other activities, as well as the external credits received and allowed, related interest and fees, participants in joint ventures and international financial-banking bodies, liquidity in foreign currency abroad and liquidity of foreign partners with Romanian banks and other rights and liabilities in foreign currency in foreign relations.

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Economic Development, Foreign Investment and Taxation in the Trust Territory of the Pacific Islands

by Elizabeth S. Udui*

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I. INTRODUCTION

The Trust Territory of the Pacific Islands includes virtually all (2,203) Micronesian islands in the North Western Pacific except the U.S. Territory of Guam, the Republic of Nauru, Tuvalu and Kiribati. Spread over a three million square mile expanse of water, these islands together amount to less than 720 square miles of land area.

The Trust Territory is administered by the United States under a Trusteeship Agreement with the United Nations. This agreement was never intended to be a permanent arrangement. In 1976, the Northern Marianas group became a Commonwealth of the United States. The other three entities, the Federated States of Micronesia (comprised of Kosrae, Yap, Truk and Ponape States), the Marshall Islands and Palau will have separate constitutional governments and will sign future agreements with the United States, scheduled for 1981.

Major commodity exports include coconut oil, copra cake, frozen tuna fish, copra, and handicraft. The entities also receive "invisible exports" from tourism and the sale of fishing rights within their 200-mile economic zones to foreign fishing companies.

The Northern Marianas, as a Commonwealth of the United States, will follow the United States tax system and will be excluded from this discussion. For the moment the three remaining entities of Micronesia have a relatively simple tax system based on gross receipts and gross wages with no deductions. The tax burden is low. In 1978, for example, only about 4 percent of the more then $138 million in grants and revenues to the Trust Territory Government was made up of local tax revenues. So far, Palau has been the only area in which export incentive tax measures have been passed.

II. ECONOMY

The Micronesian economy is based primarily on Government employment and services arising therefrom. In the private sector, it depends on agriculture, fishing and tourism. Similar to other developing areas its rural population derives its primary income from subsistence activities.

Estimates based on the 1973 Census of Population indicate that the population of Micronesia in 1980 is about 121,000, of which about 70 percent live on or near the six administrative centers.

There are 16,500 people employed for wages; average wage is US$3,412. The average government wage is about 1.5 times the average private sector wage. Average per capita income is $820.

Micronesia has an overall deficit in its balance of trade, which varies from entity to entity. Palau, with more

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than 60 percent of all exports, has a favorable trade balance. Government imports are not taken into account in these calculations.

There are about $18 million worth of aggregate assets of foreign investment in Micronesia. Of this, more than half is in Palau in a coconut oil plant, tuna freezing plant, POL distribution center and hotel.

U.S. currency is used; U.S. postal services and branches of U.S. banks are in all administrative centers.

III. INVESTMENT OPPORTUNIES AND PROCEDURES

Because of the overall dependency of the Territory on U.S. grants, the development of the private sector has been relatively limited. Nevertheless, there are investment opportunities in tourism, marine resources, agriculture and related industries.

A. Tourism

Tourism offers the most immediate opportunities for expansion. Although tourist numbers are small (25,700 visitors during 1979), growth has averaged over 11 percent for the past five years. Major constraints to the development of tourism include hotels (there are only 367 rooms throughout the Territory) and airline seats. About 50 percent of visitors are from the United States and 25 percent from Japan. Over one third of all tourists visit Palau. Development of tourism is monitored carefully to protect the fragile island environments.

B. Marine Resources

Micronesia's millions of miles of ocean and hundreds of square miles of fringing reef and lagoons present many opportunities for development. The offshore resources are presently being harvested by Japanese, Taiwanese and American fishing vessels under various agreements with local maritime authorities. The only local harvesting of the offshore tuna resources is done in Palau where between three and five thousand tons of skipjack are harvested annually and exported to canneries abroad.

C. Agriculture

Agriculture is the largest productive sector of the economy, constituting the major activity of more than 50 percent of all households.

Commercial agriculture development will require intensive use of land, involving substantial capital investment and technology. Copra oil mills in Palau and the Marshalls are the major investments in agriculture-related business. Other areas with potential for development for production and processing include coconut products, staple crops, vegetable and fruit crops, black pepper, livestock and poultry (eggs).

D. Procedures

1. *Foreign investment permits.* Permits to conduct business are issued in accordance with the Foreign Investors Business Permit Act. Under this law, applications from foreign investors are reveiwed by foreign investment boards in the various states prior to approval or disapproval by Chief Executives. Further information on this procedure may be obtained from foreign investment boards in Palau and the Marshalls and from the Director of the Department of Resources and Development of the Federated States of Micronesia.

2. *Work permits.* Import of alien labor is regulated by the Protection of Resident Workers Act. Under this law, alien workers may be granted one year work permits after it has been determined that no local person is available with requisite skills.

3. *Corporations and partnerships.* Corporations and partnerships may be chartered or registered with Registrars of Corporations in the Marshalls, Palau and Federated States of Micronesia.

4. *Licenses.* Other licensing requirements are in force in various localities and vary from state to state.

IV. TAXES

Because of the present emergence of three separate entities (Marshalls, Palau and Federated States of Micronesia) in the Trust Territory, it is extremely difficult to discuss the tax administration of each separate entity and of states within entities. In general, tax laws derive from general taxing and licensing laws which were in force prior to the transfer of these functions to the new constitutional governments of Micronesia.

The following economic controls are generally held by the Marshalls, Palau and Federated States of Micronesia central governments.

A. Economic controls and taxation authority

1. Central governments

The Central Governments fulfill the following tasks:

(a) Control of banking, organization of business corporations, business associations, credit unions and cooperatives, insurance, sale of securities, and public utilities, including the exclusive licensing of such activities. Persons and companies engaged in these activities are subject to local general taxation, but not subject to any local licensing requirements or payment of license fees for these activities other than to the central government.

(b) Control of the establishment and operation of and investment in business and corporations by non-citizens.

(c) Establishment and control of the terms and conditions under which importing and exporting licences shall be issued.

(d) Exclusive control of import, export, and income taxes including any excise taxes which are actually collected on the basis of imports.

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2. State governments

State governments are charged with:
(a) Liquor control, including the right to collect wholesale liquor license fees and to impose taxes on alcoholic beverages; however, neither of these shall be on imports or volume or value of imports.
(b) Exclusive issuance of licenses for wholesale business, other than banking, insurance, sale of securities, and public utilities, including the exclusive right to collect fees for such licenses, provided these are not based on imports or volume or value of imports.
(c) The imposition and collection of sales taxes, and the authorizing of municipalities to impose and collect excise taxes on any items other than foodstuffs.

B. Taxes, levies, charges, duties, etc.

1. Import taxes

All entities levy taxes on certain goods imported into and exported from their jurisdictions and on the use, distribution, and sale of gasoline and diesel fuel within their jurisdictions.
(a) Cigarettes — seven cents per every 20 cigarettes;
(b) Tobacco, other than cigarettes — 50 percent ad valorem;
(c) Perfumery, cosmetics and toiletries, including cologne and other toilet waters, articles of perfumery, whether in sachets or otherwise, and all preparations used as applications to the hair or skin, lipsticks, pomades, powders and other toilet preparations not having medicinal properties — 25 percent ad valorem;
(d) Soft drinks and non-alcoholic beverages — at the rate of two cents on each 12 fluid ounces or fractional part thereof;
(e) Beer and malt beverages — at the rate of four cents per can or bottle of 12 fluid ounces or fractional part thereof;
(f) Distilled alcoholic beverages — at the rate of seven dollars per wine gallon, except that any person permitted by applicable law to possess, consume and use distilled alcoholic beverages may bring into such district/state of the Trust Territory tax free, an amount of liquor not to exceed two fifths of a wine gallon per trip, if such liquor is for his personal use and consumption and not for resale;
(g) Wine — at the rate of two dollars per wine gallon, except that this tax shall not apply to any religious organization which is importing or receiving into the Trust Territory sacramental wine for use in the religious rites of such organization;
(h) Foodstuffs for human consumption — one percent ad valorem;
(i) All other imported products, except those specified above and gasoline and diesel fuel — three percent ad valorem.

2. Export taxes

The following export taxes have been levied on all scrap metal exported from the various jurisdictions:
(a) Nonferrous — 25 percent ad valorem;
(b) Ferrous — five percent ad valorem;
(c) Lead and lead covered cable—ten percent ad valorem.

3. Gasoline and diesel fuel tax

An excise tax is levied upon the use, distribution or sale within the Trust Territory of all gasoline and diesel fuel at the rate of five cents per gallon so used, distributed or sold. The tax is paid by the importing company directly to the three entities.

4. Income tax

All entities impose a tax of five to ten percent upon the gross wages and salaries received by every employee, except that those employees whose gross annual wages and salaries are $5,000 or more are allowed a deduction of $1,000 per year from all wages and salaries subject to tax. Employee is generally defined as any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee.

5. Business tax

A forty dollar tax per year is levied upon that portion of the amount of gross revenues earned by every business which does not exceed $10,000 per year and an additional tax of 2.5 percent to 3 percent per year is levied upon that portion of the amount of gross revenues earned by every business which is in excess of $10,000 per year. Businesses which earn gross revenues of not more than $2,000 per year are exempted from taxation.

6. Meaning of income

Although taxable income in the ordinary sense excludes certain types of expenses, for Trust Territory entities' income tax purposes, income is divided into two major categories: gross wages and salaries of employees and gross revenue of businesses. The following is the statutory definition of income:

(a) *Wages* or *salaries* mean and include commissions, fees, compensation, emoluments, bonuses, and every and all other kinds of compensation paid for, credited or attributable to personal services performed by an individual, which services have been performed by such person as an employee. Wages and salaries shall not include the following:
— Wages and salaries received from the United States by members of the Military or Naval Forces of the United States or the Armed Forces of the United States.
— Reasonable per diem and travel allowances to the extent that they do not exceed any comparable Trust Territory Government rates.
— Rental value of a home furnished to any employee or a reasonable rental allowance paid to any employee (to the extent such allowance is used by the employee to rent or provide a home).
— Any payment on account of sickness or accident disability, any payment of medical or hospitalization expenses, made by an employer to or on behalf of an employee. Normal wages or salaries paid to an employee for a period of time during which he is excused from work because of sickness are not excluded from wages and salaries.
— Remuneration paid for casual or intermittent labor not performed in the ordinary course of the em-

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ployer's trade or business and for not more than one week in each calendar month.
- Any payment in the form of a scholarship, fellowship, or stipend made to any employee while he is a full-time, bona fide student at an educational institution within the Trust Territory.
- Wages and salaries received by a minister of the gospel, or clergyman from a religious group or organization.
- Wages and salaries received by an employee for services performed or rendered in the capacity of a domestic or household employee for a private individual or family.
- Wages and salaries received by a non-Trust Territory citizen employee for services performed or rendered within the Trust Territory for a total of not more than 90 days or less during any one calendar year.

(b) *Gross revenue* means the gross receipts, cash or accrued, of the taxpayer received as compensation for personal services not in the form of salaries or wages and the gross receipts of the taxpayer derived from trade, business, commerce or sales and the value proceeding or accruing from the sale of tangible personal property, or service, or both, and all receipts, actual or accrued by reason of the capital of the business engaged in, including interest, discount, rentals, royalties, fees, or other emoluments however designated, and without any deductions on account of the cost of property sold, the cost of materials used, labor cost, taxes, royalties, interest or discount paid or any other expenses whatsoever.

Gross revenue does not include the following:
- refunds, rebates and returns;
- monies held in a fiduciary capacity;
- income in the form of wages and salaries which is taxed separately.

Income has also been administratively interpreted to include casual sales as follows:
- Sales made in performance of any profession, trade, manufacture or any other undertaking that requires different skills, materials and tools than those normally used in the conduct of the taxpayer's activity. Casual sales are limited to 12 individual transactions per calendar year and $2,000 in annual gross revenue.
- Casual sales include annual gross revenue of $200 or more from the sale of farm produce, fish or native handicraft.

7. Rules governing apportionment of income

(a) If an employee is credited or paid salaries or wages derived from, or attributable to, personal services performed or rendered both within and without the jurisdiction during any given month, then the whole of the salaries or wages is presumed to have been earned within the jurisdiction. The employer paying the tax or the employee whose compensation is taxed may file for an apportionment of the tax.

(b) If any business earns or derives its gross revenue from business activities or undertakings both within and without the jurisdiction during the taxable year, then the whole of its gross revenue is presumed to have been derived from sources within the jurisdiction. The business may file for an apportionment of the tax.

8. Ascertainment of income

The tax imposed is collected by the employer by withholding the appropriate tax from the employee's wages and salaries. The employer is liable for payment of the tax withheld on a quarterly basis. All taxes withheld by the employer are held in trust by such employer for the government. Employees whose taxes have been withheld by their employers do not file a return. Annual wage and tax statements and reconciliation of income tax withheld coupled with field audits serve as a basis for compliance. Any individual who is paid or credited wages or salaries from an employer who does not have a place of business in the Trust Territory and does not have an agent within the Trust Territory responsible for withholding the appropriate tax is required to file an individual return.

As a practical matter, all taxes may be passed on to consumers. However, specific notation on an invoice showing taxes as additional charges to consumers is misleading and such a practice has been administratively interpreted to be unlawful.

9. Ascertainment of income from businesses

Business means any profession, trade, manufacture or other undertaking carried on for pecuniary profit and includes all activities, whether personal, professional or incorporated, carried on within the Trust Territory of the Pacific Islands for economic benefit either direct or indirect, and excludes casual sales. One who qualifies as an employee is not considered as a business.

A business is exempted from tax if its gross revenue is $2,000 or less during any one tax year. Since the tax is on gross revenues or gross receipts the following receipts are not considered gross revenue:
- Refunds, rebates and returns.
- Monies held in a fiduciary capacity.
- Income in the form of wages and salaries which has been taxed under other provisions of the law.

Businesses are also exempted from taxation on revenues which are accrued but which subsequently are found to be uncollectible (bad debts). The amount of such bad debts will be allowed as a deduction only in the year in which it is determined to be uncollectible. The law does not allow deduction and exemption from taxation of business expenses such as directors' remuneration, management fees, rents, interest expense, travelling, accounting and consultancy expense, entertainment expense, and research.

The only item of pure income exempted specifically by law is income from copra production by unincorporated copra producers either collectively or severally. This was intended to encourage production and export of copra, a major income earner of a large proportion of those engaged in subsistence activities.

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10. Tax treatment of special sources of income

Dividends, interest, technical service fees, management remuneration, film leasing, rents, etc. are taxed on their gross amount if they are attributable to the engagement of business capital or if they are connected with the carrying on of a business.

Again, the tax on businesses is on gross revenues as gross receipts. Rules governing ascertainment of profits, conditions of expenses and other deductions from gross revenue do not apply.

11. Treatment of losses

The tax on gross revenues does not allow deduction for losses sustained by a business except for bad debts which have been determined to be uncollectible; provided, however, that accrual of revenue was made for which the tax had been paid. Allowable losses incurred by a business arising out of change of ownership may be taken in the same manner as an additional tax liability.

Setting off refunds and additional tax liability may be made provided that the refunds and the additional tax liabilities have been determined using the appropriate tax rate in the year incurred or otherwise accrued. Carry forward or carry backward of losses is not provided for by law.

12. Tax treatment of corporate entities

Corporations are taxed at the same rate and in the same manner as any other business. For purposes of reporting, businesses are classified in three major categories:

(a) *Unincorporated "Unitary Business"*. A "unitary business" is one carrying on one kind of business of which the component parts are too closely connected and necessary to each other to justify division or separate consideration.
(b) *Unincorporated "non-unitary businesses"*. A "non-unitary" business is one which shows units of substantial separateness and completeness, each of which might be maintained as an independent business and be capable of producing profit in and of itself. Each unit is taxed as a separate business.
(c) *Incorporated businesses*. A corporation consisting of two or more separate and distinct businesses would pay the tax on the combined gross revenues of all the business as one entity.

13. Tax treatment of the family: head, wife, children and dependents

The tax on personal income is a tax on gross wages and salaries of an individual who qualifies as an employee. As the tax is on gross wages and salaries, the liability is determined on the basis of each individual employee and no regard is given as to dependents, head of household, spouse or any other kind of support which an individual taxpayer may provide for his family.

As the only income tax applicable within the Trust Territory is on wages and salaries, a tax liability exists only if an individual qualifies as an employee. There is no liability for wealth tax, gift tax or any other tax (with the exception of social security) as there is neither law nor statute imposing such taxes. Considerations relative to property ownership, property held by members of a family do not apply therefore.

14. Liability of non-citizens, non-residents (individuals and companies)

Individuals. Non-resident means any individual who received income from sources within the Trust Territory but does not reside or perform services within the Trust Territory for a period of 90 days or more during any one calendar year (tax year). Non-residents do not pay the tax but are required to file a return for ascertainment of status. Non-citizen means any individual who is not a citizen of the Trust Territory of the Pacific Islands and who performs services within the Trust Territory. Non-citizens are required to pay the Trust Territory income tax in the same manner as that required for citizens, except that the tax rates for non-citizens are limited to three percent if they are employees of the United States Government, agencies, instrumentalities thereof, and contractors if their purpose is not in the interest of the Government.

Companies. Non-resident company means a business activity which operates both within and without the Trust Territory and whose principal place of business is located outside the Trust Territory. Non-resident companies are taxed in the same manner as resident companies except that that tax rate is limited to one percent if they are contractors of the United States, United States agencies and instrumentalities; provided, however, that their activities are not in the interest of the Government.

15. Liability of partnerships and joint ventures to tax

The gross revenue tax applies to all businesses as defined, without regard to the business formation such as sole proprietorship, partnership, corporation, or joint venture. A partnership must file a return and pay the tax in the same manner as any other business.

16. Liability of foreign states, foreign state trading enterprise

Although it was not the intent to tax enterprise activities of other government units, agencies or instrumentalities, the tax would apply to a specific government enterprise only is such activity was determined to be carried on for pecuniary profit and is considered a non-essential government service.

17. Trusts

There are generally no trust companies established within the Trust Territory.

V. DOUBLE TAXATION, EVASION, AVOIDANCE

A. Double taxation

Foreign enterprises (non-resident companies) and permanent establishments (resident companies) are subject to tax only on that portion of income which is earned in or derived from sources or transactions or parts of transactions within the Trust Territory. This

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scheme eliminates double taxation on that portion of the revenue earned outside the Trust Territory. It is presumed that the same principle applies to other countries.

Although there is no statute in the Trust Territory governing the exchange of information with other countries, data and information of a general nature may be made available to other countries. Specific details pertaining to a particular taxpayer cannot be exchanged, however, except for the purpose of carrying into effect the tax law or any other enactment imposing taxes or duties payable to the governments. For the purpose of ascertaining the correctness of any return and determining the liability of any person for any income tax the particular government is authorized to:

- Examine any books, papers, records, or other data which may be relevant or material to such inquiry. The required records shall be made available no later than ten days beginning with the date that the request is received.
- Summon the person liable for tax or required to perform the act, or any person having possession, custody, or care of books of account containing entries relating to the business of the person liable for tax or required to perform the act, or any other person the Director or his designee may deem proper, to appear before the Director or his delegate at the time and place named in the summons and to produce such books, papers, records, or other data, and to give such testimony, under oath, as may be relevant or material to such inquiry.
- Take such testimony of the person concerned, under oath, as may be relevant or material to such inquiry.

B. Avoidance, evasion

The Trust Territory income tax law has the following provisions as anti-avoidance statute.

1. Assessment.

Upon the failure of any person, business, or employer to make and file a return required by law within the time and in the manner and form prescribed, or upon failure to pay any amount due, the Director may notify such person, business or employer of such failure and demand that a return be made and filed and the tax paid as required.

If such person, business or employer upon notice and demand by the Director fails or refuses within 30 days after receipt of said notice and demand to make and file a return and pay the tax required, the Director may make a return for such person, business or employer from any information and records obtainable, and may levy and assess the appropriate amount of tax. Such assessment shall be presumed to be correct unless and until it is proved incorrect by the person, business or employer disputing the amount of the assessment.

2. Records and audit.

All persons, employees, and businesses required to make and file returns shall keep and maintain accurate records, which may be inspected and audited at any reasonable time by the Director.

3. Criminal penalties.

Any person or business convicted for tax evasion shall be fined not more than $1,000, or (if a natural person) imprisoned for not more than one year, or both.

4. Separate civil penalties.

The criminal penalties imposed for violation of provisions of the law are separate from, and in addition to, all other penalties or interest. The following civil penalties are levied and may be assessed and collected.

(a) *Failure to file return on time.* If any taxpayer fails to make and file a required return on or before the date set, unless prior to that date such taxpayer applied for and received an extension for reasonable cause, one percent of the tax shall be added for each 30 days or fraction thereof elapsing between the due date of the return and the date on which it is actually filed. The minimum penalty is five dollars.

(b) *Failure by employer to file statement.* Any employer required to furnish a written statement who willfully failed to file such statement on the date prescribed, except with regard to any extension of time for filing, is subject to a five dollar penalty for each statement not so filed.

(c) *Failure to file return and pay tax after demand.* In any case where the Director makes a return and assesses a tax after a taxpayer's failure or refusal to make and file a return and pay the required tax, 25 percent of the tax assessed, in addition to penalties, is added.

(d) *False and fraudulent returns.* If any part of any deficiency is due to fraud with intent to evade the tax, or any portion thereof, 50 percent of the total amount of such deficiency, in addition to penalties, is assessed and added to the deficiency assessment.

(e) *Interest.* If any tax or penalty imposed is not paid on or before the date prescribed for such payment, interest is collected, in addition to such tax and penalties, on the unpaid balance of the tax principal at the rate of six percent per annum from its due date until the date it is paid.

(f) *Lien on property.* All taxes imposed or authorized under the law are a lien upon any property of the person or business obligated to pay these taxes and may be collected by levy upon the property.

The Trust Territory income tax laws have provided that all tax information is considered privileged and that secrecy is required.

VI. FISCAL AND OTHER INCENTIVES FOR TRADE AND INVESTMENT

Except for a few isolated cases, the Trust Territory does not specifically allow deductions or any other form of tax holiday to promote trade and investment within the Trust Territory. Copra production from unincorporated copra producers whether severally or collectively is exempted from tax. This promotes copra production and exportation of the major cash crop.

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No import taxes are levied on raw materials imported into the Trust Territory for manufacturing.

No customs charges are levied on equipment and machinery required to establish and maintain a business in Micronesia. Customs charges are levied when the equipment or machinery is sold locally.

Tax rebates or refunds are allowed on goods imported into the Territory and then exported to a buyer outside of the Territory.

Tax rebates or refunds are allowed on goods damaged or not received by importers.

Export incentives tax (Palau)

In January 1980, the Palau District Legislature enacted the first tax incentives law in the history of the Trust Territory. This law basically relieves exporters of commodities manufactured, processed, assembled, and packaged in Palau of the tax on gross revenues on these exports. Instead, in lieu of the gross revenue tax, it levies a special export tax of one percent per year upon the net profit derived from the exempted export activities.

APPENDIX

Sources of information

Code of the Trust Territory of the Pacific Islands, with supplements. Available from the Publications Division, Trust Territory of the Pacific Islands, Saipan, CM 96950.

Compilation of Tax and Revenue Laws in Micronesia, 1978. Available from the Director of Finance, Trust Territory of the Pacific Islands, Saipan, CM 96950.

Invest in Micronesia, 1979. Available from the Director, Bureau of Resources, Trust Territory of the Pacific Islands, Saipan, CM 96950.

Other sources of information

Director, Bureau of Resources, Trust Territory of the Pacific Islands, Saipan, CM 96950.

Director, Bureau of Finance, Trust Territory of the Pacific Islands, Saipan, CM 96950.

President, Marshall Islands Government, Majuro, Marshall Islands 96960.

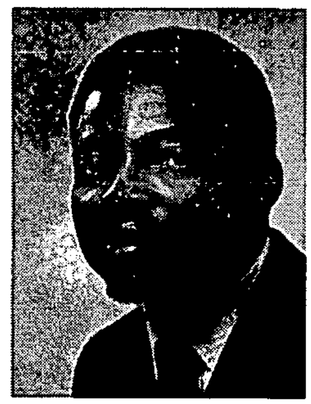
President, Federated States of Micronesia, Kolonia, Ponape 96941.

District Administrator, Palau District, Koror, Palau 96940.

IFA NEWS

MITCHELL B. CARROLL PRIZE FOR BOKILA LOFUMBWA

On September 19, 1980, at the final meeting of the General Assembly of IFA during the Paris Congress, the Mitchell B. Carroll prize was presented to Mr. Bokila Lofumbwa for his work entitled: *Les régimes fiscaux visant à encourager les investissements directs et de portefeuille dans les pays en voie de développement, l'interaction du système fiscal zaïrois et des régimes préférentiels des Pays de l'OCDE.* The medal which goes with the prize was awarded in the presence of its founder, Dr. Mitchell B. Carroll, whose advanced age does not prevent him from taking an active part in the proceedings of IFA.



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SUDAN: New Investment Law

by Elizabeth De Brauw-Hay*

The Sudan's new investment law has been in force since April 26 of this year. The law, entitled the Encouragement of Investment Act, repeals and replaces the three laws which previously regulated investment in the Sudan, namely the Encouragement of Investment in Economic Services Act, 1973, the Development and Encouragement of Industrial Investment Act, 1974 and the Development and Encouragement of Agricultural Investment Act, 1976.

The new Act relates both to foreign and domestic investment and a clause in the Act expressly forbids discrimination on account of the nationality of the project. Investment is encouraged in the Act in the agricultural, animal, mining, industrial, transport, tourism, storage and housing fields and any other economic field subsequently prescribed by the Ministerial Committee for Investment.

Within these sectors investment will be encouraged generally in projects which:

"(a) contribute effectively to the increase of national income and widening of the base of national economy and the strengthening of its activity, or

(b) contribute to the removal of any bottlenecks obstructing development, or

(c) make available necessary services which contribute in the consolidation of economic and social development, or

(d) the production of which depends on local material or the establishment of which is encouraged for production of such materials, or

(e) assist in the realization of self sufficiency and creation of surpluses for export, or

(f) assist effectively in the consolidation of balance of payments, or

(g) make available directly or indirectly chances of employment for citizens, or

(h) have defense or strategic importance, or

(i) contribute in the realization of the objects of economic cooperation or integration with Arab and African countries".[1]

Incentives under the Act

A number of incentives, fiscal and otherwise, are available. These include the following:

(a) Total or partial exemption for a period of up to five years from the business profits tax from the date of commencement of production. This exemption may be extended for a further period of up to five years in the case of so-called "integrated projects". These are projects requiring large investments or which, in addition to production, provide for the building of roads and provision of other essential services. This latter provision is of major importance in the Sudan where development in many sectors of the economy is severly hampered by the lack of infrastructure.

Losses incurred during the exemption period will be deemed to have been incurred during the last year of that period.

(b) Total or partial exemption may also be granted from the following duties:

(i) customs duties on machines, equipment, apparatus and imported spare parts necessary for the project, and imported raw, manufactured and intermediary materials necessary for the project which cannot be found locally in the required quality and quantity;

(ii) import duties on manufactured or semi-manufactured goods arising from the project;

(iii) any other duties and taxes imposed on the project. This would presumably include the development tax imposed on virtually all imports and exports and import surcharges;

(iv) exemption — total or partial — from excise duties on locally produced materials and commodities required for the project.

(c) Projects will also be given exemption from local taxes unless the locality involved obtains the consent of the Minister of finance to impose such taxes.

Other incentives of a non-fiscal nature include reductions in electricity and freight rates, allotment of land necessary for the establishment of the project at reduced prices, protection of the production of a new project for a limited (but unspecified) period by means of raising customs duties on or restricting imports of competing products and preferential facilities for projects established in less developed regions.

Guarantees under the Act

Remittance is guaranteed of profits from foreign capital invested in a project and interest on foreign loans after taxes, duties, dues and other obligations due to the Sudanese government have been paid or fulfilled in the currency in which the capital or loan was imported or in any other agreed currency. Also guaranteed is the remittance of profits arising on liquidation, sale or transfer of the investment project in the currency in which the capital was imported or in any other agreed currency. Foreign capital is defined in the law [2] as:

"(a) the foreign hard currency transferred to the Sudan at the exchange price current at the time of transfer through a bank working in the Sudan for the utilization thereof in execution of a project.

(b) imported machinery, equipment and means of transport financed from abroad and necessary for the execution of the project and compatible with the technical development suitable for the Sudan, answering such specification as prescribed by the Minister.

(c) the foreign hard currency utilized on preliminary studies, feasibility studies and foundations undertaken by the investor within the limits approved by the Minister.

(d) the profits realized by the project if capitalized with the consent of the Minister or if invested with his consent in another project in accordance with the provisions of this Act.

(e) intangible assets, i.e., patents, trademarks, technical experience, etc, registered by the foreign investor for utilization in the project".

A provision does, however, exist in the new law prohibiting liquidation of a project within five years from the commencement of production.

The Act also contains a guarantee against nationalisation except where the public good is involved. Where nationalisation does, nevertheless, occur then "just" compensation at the price current at the time of nationalisation must be paid. Such compensation must be evaluated within six months from the date of nationalisation and paid within a period of five years therefrom in the currency in which the investment was originally made or in any other agreed currency.

Miscellaneous

Other provisions of the Act deal with the procedure to be followed for obtaining the required license and the various available incentives. The conditions of cancellation thereof are also covered as is the arbitration procedure for settlement of investment disputes.

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* Senior staff member of the International Bureau of Fiscal Documentation.

1. The Encouragement of Investment Act, 1980, Article 6.
2. Ibid. Article 3.

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BIAC's* Response to the OECD's Report on Transfer Pricing and Multinational Enterprises

This paper has been prepared to supplement the comments contained in the OECD report, which it is hoped, will add to the value of the OECD report in the hands of readers.

I. INTRODUCTION

The OECD report on "Transfer Pricing and Multinational Enterprises" is welcomed by BIAC. It is a useful contribution to efforts being made to achieve some degree of uniformity in this overly complex field, which, as the report rightly notes, is in the interest of both governments and multinational enterprises (MNE's). As noted in the report, the fact that international business and industry can be a victim of conflicting national requirements occurs all too frequently in practice. It is hoped that the report will contribute towards reducing the number of cases in which this does occur.

BIAC considers that the OECD report clearly reflects the complicated nature of the problem of intercompany transfer pricing, with all the many and varied aspects inherent in it. BIAC also warmly endorses the comment in the report that it is not possible to "lay down rules that are appropriate to every aspect of every case." This comment constitutes recognition of the fact that to draw up a manual establishing a procedure for determining whether the transfer prices within a group conform to the arm's length principle is simply not possible or feasible.

BIAC regards as significant the fact that the report provides a set of parameters which can be applied by tax authorities in forming a judgement on transfer prices and pricing structures within a group. The implicit recognition that there is no such thing as "the right price", but that, in fact, the arm's length principle contemplates a range of prices, prompts BIAC again to express the view that managerial flexibility in regard to transfer pricing policy within a group must not be preempted by revenue authorities. Once it has been established by appropriate means that prices and pricing within a group are maintained within this range, tax authorities should refrain from attempting to apply adjustments. In such a situation the transfer pricing policy of an MNE group should simply not be susceptible to change under pressure from a Revenue examiner; in other words, it should be respected and accepted.

BIAC concurs enthusiastically with the view of the OECD report that the "so-called global methods" of allocating profits within a group of companies are entirely inappropriate to a proper determination of an arm's length price. Such an approach is not only incompatible with the arm's length principle, but it opens the door to taxation on an arbitrary basis and thus potential double taxation. Accordingly, BIAC commends OECD for including this comment in the report, with the anticipation that it will deter the use of the global method by OECD member states as well as non-member states whose MNEs engage in transactions with MNEs in member states.

While in the more detailed analysis of the OECD report to follow, some criticism is expressed on certain points, OECD should understand that this has not been done with any intent to detract from the overall impact of the report. As already mentioned, BIAC considers that the OECD study provides a clear picture of the myriad of problems in the area of transfer pricing.

On the other hand, as expected, the report has been prepared from the vantage point of the tax authorities, who are confronted with a formidable task of having to pass judgement on a countless variety of intragroup pricing practices. This inevitably leads to an approach to the problem from a perspective which differs in a number of respects from the perspective of business and industry. These points are dealt with in more detail below.

BIAC emphasizes that fiscal authorities should not permit themselves the luxury of hindsight when making adjustment to transfer prices. This point is partially met in the report where it is stated that tax authorities should not substitute hypothetical transactions or their own commercial judgement in relation to the transactions at the time they were concluded. BIAC would have liked to see a more positive statement that when examining the actual transactions and the commercial judgement of the enterprises, it is not permissible to use facts which were not available to the enterprise at the time.

II. GENERAL

1. The language in several places in the text conveys the view that an MNE can use transfer pricing as a device for artificially shifting profits so as to minimize its world-wide tax burden. The report seems to emphasize the battle by revenue authorities against tax evasion. This approach, however, fails to recognize the fact that the possibility of tax evasion, as well as the means of combating it, are only one, perhaps minor, aspect of the problem. In fact, it should be noted that actual cases of abuse in the transfer pricing area in recent years are probably minimal since pricing policies are generally established from a business point of view. The more significant aspect of the problem stems from the fact

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that transnational movements of goods and services within an MNE involve the fiscal sovereignty of different countries, and that an MNE is faced with the sometimes conflicting views of these countries regarding their respective right to levy taxes on the income generated by cross border transactions. Where, for example, there are transactions within an MNE involving two countries having the same approximate rate of taxation, then it will generally not matter to the MNE where the profit is allocated, since the total tax liability of the group will not be substantially affected. The two tax authorities involved, however, view the matter differently, since each of these has a fiscal interest in the income allocation process and, therefore, in the observance of the arm's length principle.

The fact that this aspect of the application of the arm's length principle has been overlooked in the report surfaces with particular impact in the discussion (or lack of discussion) in the area of *corresponding adjustments* and the discussion of *central costs.*

With regard to *corresponding adjustments*, the OECD takes the view that this subject need not be dealt with since it is "a related problem, but outside the scope of this report." BIAC emphatically disagrees with this approach. Understanding that OECD will in the near future commence a study of this subject, BIAC urges this study to be undertaken and concluded expeditiously because of the uncertainties created during the period from issuance of the OECD report until some clear internationally accepted rules are accepted. No topic is more directly concerned with the entire area of transfer pricing than is the topic of corresponding adjustments, because it is inextricably wound up in establishing the demarcation of the power of the different countries involved to levy their tax. An argument is often heard that the absence of a definitive rule requiring corresponding adjustments is in the interest of tax authorities, on the grounds that the possibility of double taxation will provide an additional obstacle to prevent MNEs from attempting to reduce their tax liabilities through artificial pricing schemes. Not only does this proposition lack validity in today's economic climate, but it imposes a heavy burden upon taxpayers by making them vulnerable to arbitrary and capricious pricing adjustments proposed by examining revenue agents. The application of the arm's length principle is equally a concern of the two countries involved in the cross border transaction. Therefore, BIAC considers that the OECD report should have set forth and endorsed a mandatory system of corresponding adjustments binding on all members of the OECD.

BIAC considers this essential for the following reasons:

- The report indicates that each situation should be examined in light of its own particular facts and circumstances. Since the tax authorities in different countries will very probably attach different weight to the various elements in a transfer pricing practice of an MNE, the wish expressed by the OECD that "a common approach . . . should help to reduce the need for any such corresponding adjustments" will be of little value of taxpayers in reducing double taxation.

- The same rationale may apply as to the methods mentioned in the report for determining whether prices conform to the arm's length principle, in that, if one country adopts the "cost plus" method and another adopts the "resale minus" method for the same transfer price, the result may well lead to double taxation, to the detriment of the taxpayer.

Although the report will obviously have a direct impact on relations between OECD countries, it seems to BIAC that it may well influence relations between member and non-member states, as well as among non-member states. Since it seems that such non-member countries base their taxation policies on a mixture of OECD concepts and principles other than those adopted in the OECD countries, the failure to deal adequately with corresponding adjustments may raise the specter of increasing cases of double taxation in non-member states opting to follow the principles laid out in *this* report.

In summary, BIAC concludes that it is essential to the effectiveness of what OECD is attempting to accomplish in the transfer pricing report that the subject of corresponding adjustment be definitely dealt with. The fact that this was not done is regrettable, BIAC hopes that consideration of this subject be undertaken and concluded as rapidly as possible.

With regard to the treatment of *costs of central services and activities*, the OECD report devotes a great deal of attention to the means by which tax authorities can determine whether or not is is appropriate for subsidiary companies to bear all or some portion of such costs. It is not stated in the report, however, that such costs should, in any event, be deductible in some jurisdiction. The report should have acknowledged this fact, to provide assurance that MNEs will not suffer double taxation arising out of disputes with the tax authorities of the MNE's home and host countries.

2. Although BIAC realizes that subdividing the subject into its separate components, dealing with each in a separate chapter of the report, was necessary for analytical purposes, this approach could conceivably give rise to misunderstandings between taxpayers and the tax authorities. This fact should have been recognized and pointed out in the preface of the report to avoid such a potential misapplication of the report. It is indicated that it is not always possible to draw a clear distinction between, for example, the transfer of know-how and services related thereto. BIAC believes that the various concerned tax authorities are extremely likely to use the specific methods set forth in the OECD report in their review of each individual type of intercompany transaction within an MNE. The danger arises that, without specific guidance in the report, an overall consideration of the totality of relationships between the entities of the group will be ignored. In effect, tax officials will not see the forest for the trees. In such cases, although it may seem that the arm's length principle has not been observed with regard to certain of the individual intercompany transactions between two associated enterprises, conformity to the arm's length principle will nevertheless have been achieved when the picture is reviewed as a whole, as for example, by means of package deals or set-offs. In this regard, incidentally, BIAC notes

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that, contrary to the implication in the OECD report, such arrangements are not uncommon in third-party relationships.

For this reason BIAC wishes to emphasize that, in any scrutiny of transfer pricing with an MNE, initial emphasis should be placed on a judgment of the totality of overall relations within the enterprise, over a reasonable period of time, and this should be borne in mind while reviewing the separate categories of transactions within the area of transfer pricing.

III. PARTICULAR POINTS

1. Burden of proof

As noted above, the OECD report appears to espouse the concept that generally MNEs adopt transfer pricing schemes as a device to reduce artificially their tax liabilities (a view with which BIAC does not concur). This could lead to the assumption that the burden of proof (of the appropiateness of transfer prices) is to be placed upon the MNEs. In BIAC's view, the initial burden of proof (that a particular transfer price does not comply with the arm's length principle) should rest with the relevant tax authorities.

2. Benefit test

In the chapters covering transfer of technology and intragroup services, the report suggests that a group member must demonstrate that it has derived a benefit (or was expected to derive a benefit) in consideration for payments made to another affiliate (often the parent) for services or certain intangible property rights. This concept is acceptable insofar as it relates to specific services rendered and specific property transferred. In addition, however, a parent company of a group often incurs substantial costs for central activities carried on to benefit the group as a whole, rather than to benefit any one or more specific affiliates. For example, know-how of all kinds is available centrally for all members of the group to avail themselves of, if desirable or necessary; and a continuous stream of information of all sorts (e.g., marketing, advertising, technical, etc.) flows to the subsidiary companies. It seems to BIAC that the members of a group should make an appropriate contribution toward defraying these costs, whether or not specific benefit (actual or intended) can be demonstrated.

The performance of central services and central activities is inherent in the very nature of a multinational group, and, accordingly, it is logical to conclude that the enterprise as a whole is benefited by the costs incurred for activities carried on by the headquarters unit. In many cases, however, it will not be possible to substantiate that an immediate benefit has been conferred upon the group members, even though they are called upon to bear an allocable portion of such central costs. BIAC believes that it is reasonable that every group member of an MNE should pay its share of those central costs from which it can expect to benefit collectively, each respective share being determined by an appropriate apportionment formula.

3. Information

In dealing with the subject of information flows, both the provision of information by the enterprises itself and the exchange of information between the tax authorities of the relevant States should be considered.

A. Information provided by the enterprise

BIAC recognizes the obligation of MNEs to co-operate with the tax authorities in a pricing examination as regards the providing of information, as long as the information requested by the authorities is relevant to the examination in process and is necessary to allow the authorities a basis upon which to form a proper judgement of the pricing structure under study. It must be emphasized, however, that the tax authorities involved in a pricing examination should *not* request from any member of the group detailed information on transfer pricing in transactions in which the particular tax authority has no direct interest.

Moreover, where there is no actual evidence that the arm's length principle has *not* been observed, the tax authorities should not be permitted to go on a "fishing expedition". If the obligation to provide information were, in fact, to encompass the type of data mentioned in the preceding two sentences, it would impose a heavy and unjustifiable burden on an MNE, particularly since the MNE could be confronted with such requests from tax authorities in many countries of the world.

B. Exchange of information between States

BIAC strongly recommends that information to be exchanged between states on transfer pricing should relate only to such matters as are relevant to an actual pricing examination; furthermore, such information as is exchanged, should only be used for the specific purpose of the particular examination. Further, it is important that any exchange of information does not involve the disclosure of business secrets. BIAC also believes that, before any such exchange of data takes place between tax authorities, the enterprise concerned should be informed and given an opportunity to register any objection it might have to such exchange.

4. Marginal pricing

BIAC believes that proper attention should be devoted to the subject of marginal pricing, which is missing from the report. The failure to discuss this concept conveys an impression that marginal pricing occurs only by way of exception. BIAC wishes to emphasize that marginal costing and pricing are normal practices. As a result of the non-treatment of the subject, BIAC fears that tax authorities in a pricing examination of one or more affiliates of an MNE may reach erroneous conclusions in cases in which intercompany pricing has been based on a marginal costing method. Accordingly, BIAC strongly urges that the OECD consider this subject for inclusion in a subsequent report and, in fact, is undertaking a

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study of this topic for the use of OECD in its deliberations.

5. Accounting methods

The tax authorities of two countries, when reviewing the transaction between two affiliates of an MNE in each of their countries, should be required to accept uniform methods of calculating transfer prices with respect to the transactions under study. To do otherwise would open up a potential for distortion and ultimately result in double taxation (i.e., taxation of an amount of profit in both countries in the aggregate exceeding the actual profit). BIAC therefore makes a plea that the MNE's own method of calculating prices should be accepted if in conformity with generally accepted accounting practices consistently applied.

6. Shareholders costs

BIAC concurs with the report insofar as it treats shareholder (stewardship) costs as costs of the parent company only, not allocable to other members of the group. BIAC does not agree, however, with the overly broad interpretation of what constitutes shareholders costs.

Shareholders costs should be limited to only those costs incurred by a parent company *solely* in its capacity as a shareholder (investor) in the other group affiliates. It should not include any costs attributable to coordinating the various business activities of the group. The costs of internal auditors, for example, should not be included as a shareholder cost. Since examinations carried out by internal auditors are primarily intended to provide information to the parent and the group members which is, *inter alia*, used for management purposes, the tion that the result of an internal audit merely serves to protect the investment of the parent company is not correct, and is a misconception of the role of the internal audit function.

BIAC cautions against interpreting the concept of shareholders costs too broadly, inasmuch as the result could be to create a sitution where a significant portion of the central costs of a group would effectively not be deductible anywhere.

7. Retroactivity

In view of the fact that the transfer price in every cross border transaction involves at least two jurisdictions and that an MNE must, for business considerations, be afforded the opportunity to arrange a suitable transfer pricing structure, any pricing structure, once acceptable to the tax authorities in question, should not subsequently be challenged by such tax authorities, unless circumstances have substantially changed since original acceptance. Even in such a situation, tax authorities should proceed very cautiously in proposing any retroactive price adjustments, as this may create particularly difficult problems, including the threat of double taxation, for the MNE concerned.

8. Advance rulings

BIAC considers it desirable to offer an MNE the opportunity to satisfy itself in advance whether or not a particular approach, structure or system contemplated for use in intercompany transfer pricing is fiscally acceptable. This can be accomplished through the mechanism of advance rulings whereby an MNE could consult with the tax administration(s) in advance of implementing a pricing structure and request the views of the administration(s) involved. This could be done formally or informally, depending upon the customs of the particular country. Once approved, however, the pricing system should not be subject to challenge; in other words, the ruling should be binding on the tax administration. BIAC believes that further study of this matter is warranted.

IV. CONCLUSION

BIAC wishes once again to express its appreciation to the OECD for the Report on Transfer Pricing and Multinational Enterprises. It is a signal achievement. It is evident, however, that the transfer price problem has many and varied aspects, and that it is not possible to treat the subject in its entirety in a report of this scope. Moreover, several of the issues discussed, including those commented upon above, have been treated primarily from the perspective of the government (i.e., the revenue authorities), without giving full weight to the taxpayer's viewpoint.

As we are informed that OECD will continue its work on areas not covered in the report, BIAC is pleased to offer its assistance and co-operation in such endeavor.

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IFA NEWS

SOME HIGHLIGHTS

FROM THE SECRETARY GENERAL'S 1979-80 REPORT PRESENTED AT THE PARIS CONGRESS 1980.

IN GENERAL

The Secretary General, Prof. Dr. Jan H. Christiaanse, paid special attention to the administrative aspects of IFA. The appointment of Prof. Dr. J.C.L. Huiskamp (Director of the Fiscal Economic Institute of the Erasmus University in Rotterdam) as Assistant Secretary General will enable IFA to fulfill better certain tasks which have in the past received too little attention. Prof. Huiskamp will in particular be involved with the preparatory work for Seminars held at Congresses. This year he edited the papers for the Seminar entitled: "Recourse to Tax Havens — Use and Abuse" for the Paris Congress. Prof. Huiskamp is further responsible for the contact with IFA liaison officers to various international organizations and he takes part in the sessions of the Permanent Scientific Committee which is the scientific arm of IFA. He will also coordinate the work and the promotion of the Mitchell B. Carroll Prize.

The Permanent Scientific Committee's decision to prepare for Congresses two years in advance has added to the work load of the General Secretariat, which has been busy with preparations for the Paris, Berlin and Montreal Congresses in 1979-80.

Recent changes in the Dutch legislation governing associations made it necessary to amend the statutes of IFA. This proved to be a time-consuming task which took much of the General Secretariat's time.

The General Secretariat, desirous to be kept informed of the activities of the national branches, has requested the supply of information on a regular basis. This information will be published under the heading "IFA News" in the *Bulletin for international fiscal documentation*. It is, of course, vital that the national branches keep the General Secretariat informed of their work.

COPENHAGEN CONGRESS

The 33rd Congress held in Copenhagen organized by the Danish Branch under the supervision of Mr. Aa. Spang-Hansen was very successful. General reporters were Prof. Th. Nielsen (Denmark) and Mr. Gerhard Laule (Germany) and discussion leaders Mr. J.F. Avery-Jones (U.K.) and Prof. I. Claeys Boúúaert (Belgium). Two highly interesting seminars were held, one chaired by Prof. Stanley Surrey (U.S.A.) and the other by Prof. Dr. Gustaf Lindencrona (Sweden) and booklets containing information as a basis for these discussions were distributed by IFA.

MITCHELL B. CARROLL PRIZE

At the Copenhagen Congress Prof. Dr. Klaus Vogel (Germany), chairman of the jury, handed the medal to Mr. Edwardes-Ker for his work: "International Tax Treaties Service". For the 1980 prize there are four competitors:

H.M. Liebman (Belgium):
— A Formula for Tax-Sparing Credits in U.S. Tax Treaties with Developing Countries.

Jean-Pierre Panis (France):
— Tax Harmonisation and Industrial Policy within the EEC; Company Taxation: Corporate Income Tax.

Dr. A. Storck (Germany):
— Ausländische Betriebstätten im Ertrags- und Vermögenssteuerrecht.

Lofumbwa Bokila (Belgium):
— Les régimes fiscaux visant à encourager les investissements directs et de portefeuille dans les pays en voie de développement, l'interaction du système fiscal zaïrois et des régimes préférentiels des Pays de l'OCDE.*

PARIS CONGRESS 1980

The two subjects of the Paris Congress are in the capable hands of the two General Reporters:
— Mr. Guy Delorme (France) for Subject I, "The dialogue between the tax administration and taxpayer up to the filing of the tax return"; and
— Mr. Robert J. Patrick (U.S.A.) for Subject II, "Rules for determining income and expenses as domestic or foreign".

Prof. J. van Houtte (Belgium), honorary president of IFA, is prepared to act as discussion leader for Subject I and Mr. P. Kerlan (France) for Subject II. Prof. Vedel (France) will be the chairman of the working session on Subject I and Prof. Dr. Th. Nielsen (Denmark) of the working session on Subject II.

FUTURE CONGRESSES

1. Berlin Congress 1981

During the Spring meeting of the Permanent Scientific Committee (PSC) the directives for the Berlin Congress were discussed. The topics are:

Subject I — Mutual agreement — procedure and practice
General reporter: Dr. K. Koch (German Federal Republic)

Subject II — Unilateral measures to prevent double taxation
General reporter: Dr. D. Juch (Netherlands)

The PSC decided to hold Seminar I on the subject "Taxation of income arising from the international seabed" (this title may be subject to rephrasing) instead of on "The OECD Model Convention on Estate Taxes" since the pertinent OECD Report scheduled to be published in Spring 1981 may be delayed.

The Berlin Congress will be held from September 21-25, 1981.

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* See page 507.

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2. Montreal Congress 1982

At the same PSC meeting the topics for the Montreal Congress were established:

Subject I — The tax treatment of interest in international economic transactions
General reporter: Prof. E. Höhn (Switzerland)

Subject II — Taxation of transportation of passengers and goods in international traffic
General reporter: Mr. G. Coulombe (Canada)

3. Other Congresses

Further congresses are scheduled in Venice (Italy) in 1983, in Buenos Aires (Argentina) in 1984 and in London (United Kingdom) in 1985.

IFA OFFICERS COME AND GO

Mr. C.J. Berg (Australia) and Mr. R. Baconnier (France) joined the Permanent Scientific Committee whereas Mr. P. Kerlan (France) left after a long and active participation.

Mr. K. Beusch (Germany), Mr. A. Elvinger (Luxembourg) and Dr. A. Toffoli Tavolaro (Brazil), elected at the Copenhagen Congress, took their posts in the Executive Committtee.

Prof. P. Sibille was welcomed as President of the Editorial Committee. Mr. M. Laxan will be proposed for nomination as President-Elect of IFA during the Paris Congress. [1] Mr. R.M. Hammer (U.S.A.), Mr. J.L. Perez (Spain) and Mr. K. Beusch (Germany) were elected as 1st, 2nd and 3rd Vice Presidents respectively.

Mr. P.F. Vineberg (Canada) will be due for statutory retirement at the meeting of the Executive Committee at the Paris Congress.

Mr. D.E. Richards acted for the last time as President of the Nominations Committee.

NATIONAL BRANCHES

During the Copenhagen Congress two new national branches were recognized: Hong Kong and Colombia. Applications for such recognition were received from Indonesia and Malaysia which will be recognized during the Paris Congress. [2]

NUMBER OF MEMBERS

IFA had 5,659 members in January 1980 (the last count in March 1979 was 5,427).

MEMBERSHIP FEES

The membership fees will be increased for 1980/81:
US$ 38 for individual members of national IFA branches;
US$ 40 for direct individual members of IFA;
US$ 90 for corporate members, both direct and of national branches.

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1. His nomination was approved by the General Assembly of IFA during its session on September 19, 1980.
2. Their recognition was approved by the General Assembly in the above meeting (note 1).
3. The increase was approved by the General Assembly in the above meeting (note 1).

AUSTRIA

The Austrian Branch of IFA reports the following on its activities during the first half of 1980.

1. Meetings

On May 9 and 10, 1980 the Austrian and German Branches organised a workshop in Salzburg. The following subjects were discussed:

(i) The German VAT reform which became effective on January 1, 1980 and which was partly based on the Eighth EEC Directive on VAT. Special attention was paid to the place of rendering of services, the refund procedure and the limitation of the tax jurisdiction.

(ii) The current tax situation in Austria and the Federal Republic of Germany. During World War II German tax law was applicable in Austria and the papers read showed to what extent the developments in Austrian and German tax law have diverged, but in some cases tend to similar solutions.

(iii) Dr. Bechinie, the President of the Austrian Branch, read a paper dealing with the work of the Austrian Tax Reform Committee which concluded its work in the beginning of 1980. He reported in detail on the Committee's proposals but pointed out that their implementation will necessarily depend on budgetary circumstances, since it is not intended to reduce or increase taxes.
He also mentioned some subjects which are currently in the center of interest, like the reform of tax rates and the introduction of a withholding tax on interest from savings accounts and bonds. Although the Tax Reform Committee has completed its task, some sub-committees continue to study the structure of the Austrian income tax law and the reform of the present investment incentives.

(iv) A German speaker discussed some fundamental problems with respect to taxation of families, the envisaged tax rate reform and amendments of the unilateral relief for double taxation.

(v) Officials of Austrian and German local tax administrations (from the city of Salzburg and from Bavaria, respectively) discussed the functioning of the mutual agreement procedure under the Austrian-German double taxation treaty. The results are very favorable and the fact that also lower tax administrations have been involved leads to a substantially less time-consuming procedure.

On June 17, 1980 the General Assembly of the Austrian Branch convened. Considering the success of the meeting in Salzburg the members expressed their wish to continue the cooperation with the German Branch in 1981.

2. Members honored

Dr. Robert Halpern, vice-president of the Austrian Branch, mem-



Dr. Alexander Hörtlehner.



Prof. Dr. Robert Halpern

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ber of the General Council of Central IFA and Chairman of its Finance Committee, received from the President of the Austrian Federal Republic the title of "Professor".

Dr. Alexander Hörtlehner, the Secretary of the Austrian Branch, received the Gold Medal for Merit of the Austrian Republic during a ceremony at the Ministry for Trade.

BRAZIL

The Brazilian Branch announces that from November 16-21, 1980 a joint congress will be held entitled:

I Congresso Internacional de Estudios Tributários
IV Congresso Interamericano de Tributação

The subject of these congresses is: Municipal tax policy facing urban concentration — a search for a new system.

Speakers will include:

Ives Gandra da Silva Martins, Geraldo Ataliba, Ruy Barbosa Nogueira, Bernardo Ribeiro de Moraes, Aires Fernandino Barreto, Gilberto de Ulhôa Canto, Souto Maior Borges	Brazil
Manuel de Juano	Argentina
Carlos A. Mersan	Paraguay
Ramón Valdés Costa	Uruguay
Euzébio Gonzales Garcia	Spain
Victo Uckmar	Italy
Sergio Francisco de la Garza	Mexico
Klaus Vogel	Germany

Further information from the Secretariat:
Rua Juataba no. 20
CEP 05441 SAO PAULO
Brasil

SPAIN

The Spanish Branch of IFA reports that their membership is gradually increasing: from 70 to 79 during 1979 and it is hoped that this trend will continue in 1980. With respect to its activities it indicates that it is involved in the preparation of the national reports for the Paris Congress of IFA and that it took part in the Congress of the I.I.F.P. Its members will also contribute to the IX "Jornadas Luso-Hispano-Americanas de Derecho Financeiro" which will take place during 29 September — 2 October 1980 in Oporto (Portugal). Subjects to be discussed at this meeting include: (i) the influence of taxation on the financing of enterprises, and (ii) the family as a taxable unit.

The foundation of a tax journal in the Portuguese and Spanish languages is envisaged, which will act as the official organ of the Portuguese and Spanish-speaking Branches of IFA and which will be entitled "Fiscus". Contact for this purpose has been established with the Argentine and Portuguese Branches.

The Spanish Branch of IFA is also involved in the creation of a national association of taxpayers. At this moment the charter and by-laws have been drafted and officially approved.

Finally, the Spanish branch participates with the Chamber of Commerce and Industry in a center for the study of taxation and economics which was created in 1960. The main goal of this center is the training of tax experts, accountants and business consultants. The center is managed by Latin American experts.

SWEDEN

The annual general meeting of the Swedish Branch, chaired by Mr. C.O. Sandström, was held on May 28, 1980. After the meeting Mr. Hans Pehrson of the National Tax Board spoke on "The development in Sweden of international tax control".

UNITED KINGDOM

The Annual General Meeting of the British Branch of IFA was held on May 29, 1980.

Mr. R.T. Esam was reelected Chairman, and Mr. D.A. Clarke, Mr. C.J. Crowe and Mr. D.F.A. Davidson were reelected Vice Chairmen. For 1980-81 the Branch's Committee comprises the following persons:

Mr. J.F. Avery Jones	Mr. E.J. Henbrey
Mr. I.D. Barnett	Mr. A. Lord
Mr. J.B. Bracewell-Milnes	Mr. J.D.B. Oliver
Mr. J.F. Chown	Mr. J.S. Phillips
Mr. H.L. Duncan	Mr. H.R. Roe
Miss M.E. Erskine	Mr. B. Sabine
Mr. W.K. Evans	Mr. F.H. Seale
Mr. D.E. Evennett	Mr. C.H. Thomas
Mr. M.J. Gammie	Mr. D.N.C. Gray

The U.K. Branch met on September 30, 1980 to discuss the draft national report on the first subject for the 1981 Congress in Berlin: "Mutual agreement — procedure and practice". The national reporter on the first subject is Mr. Ivor Barnett, Tax Adviser, Beecham Group Ltd. On October 21, 1980 the meeting discussed the draft national report on the second subject: "Unilateral measures to prevent double taxation". Reporter is Mr. Harvey McGregor, Q.C.

On November 4, 1980 there will be a talk on "Recent developments in U.S. tax" by Mr. W. Donald Knight, Jr.

IFA Manchester Sub-branch

The following programme was established:

October 9, 1980: Mr. John Avery Jones on "VAT pitfalls".

November 4, 1980: Mr. Walter Richards (GKN Ltd) will lead a tax workship dealing with interest paid to non-residents. It is hoped to examine (and provoke discussion on) grey areas surrounding foreign loans, foreign borrowing vehicles, Eurobonds, Sections 248 and 249, interaction of interest payments and double taxation relief, the effect of double taxation agreements etc.

December 3, 1980: Mr. John Stevenson (Inland Revenue, Somerset House) on "Practical problems relating to Section 485".

February 17, 1981: Sir Norman Price (former Chairman of the Board of Inland Revenue) on "EEC finance, including Revenue aspects such as the U.K. contribution".

March 4, 1981: Mr. Peter Holdstock (Price Waterhouse & Co, London) will lead a tax workship on "Outward direct investments".

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People's Republic of China

Promulgation of the Regulations on Special Economic Zones in Guangdong Province

On August 26, 1980, the 15th Session of the Standing Committee of the Fifth National People's Congress of the People's Republic of China passed the Regulations on Special Economic Zones in Guangdong Province as submitted by the State Council.

Plans for the establishment of such Special Economic Zones in China have been in existence for some time now, and, indeed, some work has been done towards the establishment thereof particularly in Guangdong and Fujian Provinces. [1]

The present regulations concern the Special Economic Zones in an area in the South of Guangdong Province, namely in Shenzhen (Shekou), Zhuhai and Shantou.

The Shenzhen (Shekou) Zone was established earlier this year; the BULLETIN FOR INTERNATIONAL FISCAL DOCUMENTATION reported on this Zone. [2] One of the most significant differences between the rules then established for Shenzhen (Shekou) and the present Regulations concerns the tax rate. This was originally set at 10 percent of taxable profit whereas the Regulations for the entire Guangdong Province have now promulgated a rate of 15 percent. We have been informed by the competent authority that the 10 percent rate will apply for all the agreements in Shenzhen (Shekou) which were signed before August 27, 1980; agreements signed after that date will, however, be governed by the Regulations below.

The following translation has been released by XINHUA. The headings preceding the Articles were, however, added by the International Bureau of Fiscal Documentation.

REGULATIONS OF THE PEOPLE'S REPUBLIC OF CHINA ON SPECIAL ECONOMIC ZONES IN GUANGDONG PROVINCE

Chapter I — General principles

Article 1 — Location and type of activities
Certain areas are delineated from the three cities of Shenzhen, Zhuhai and Shantou in Guangdong Province to form special economic zones (hereinafter referred to as special zones) in order to develop external economic cooperation and technical exchanges and promote the socialist modernization program. In the special zones, foreign citizens, overseas Chinese, compatriots in Hong Kong and Macau and their companies and enterprises (hereinafter referred to as investors) are encouraged to open factories or set up enterprises and other establishments with their own investment or undertake joint ventures with Chinese investment, and their assets, due profits and other legitimate rights and interests are legally protected.

Article 2 — Legal framework
Enterprises and individuals in the special zones must abide by the laws, decrees and related regulations of the People's Republic of China. Where there are specific provisions eontained in the present regulations, they have to be observed as stipulated herewith.

Article 3 — Administrative authority
A Guangdong Provincial Administration of Special Economic Zones is set up to exercise unified management of the special zones on behalf of the Guangdong Provincial People's Government.

Article 4 — Scope of operation
In the special zones investors are offered a wide scope of operation, favourable conditions for such operation are created, and stable business sites are guaranteed. All items of industry, agriculture, livestock breeding, fish breeding and poultry farming, tourism, housing and construction, research and manufacture involving high technologies and techniques that have positive significance in international economic cooperation and technical exchanges, as well as other trades of common interest to investors and the Chinese side, can be established with foreign investment or in joint venture with Chinese investment.

Article 5 — Development of the infrastructure
Land-levelling projects and various public utilities in the special zones such as water supply, drainage, power supply, roads, wharves, communications and warehouses, are undertaken by the Guangdong Provincial Administration of Special Economic Zones. When necessary, foreign capital participation in their development can be considered.

Article 6 — Advisory board
Specialists at home and abroad and personages who are enthusiastic about China's modernization program will be invited by each of the special zones to form an advisory board as a consultative body for that special zone.

Chapter II — Registration and operation

Article 7 — Registration application
Investors wishing to open factories or take up various economic undertakings with investment should apply to the Guangdong Provincial Administration of the Special Economic Zones, and will be issued licenses of registry and use of land after examination and approval.

Article 8 — Banking and insurance
Investors can open accounts and deal with matters related to foreign exchange in the Bank of China in the special zones or other banks set up in the special zones with China's approval.
Investors can apply for insurance policies at the People's Insurance Company of China in the special zones and other insurance companies set up in the special zones with China's approval.

Article 9 — Sale of products
Products of the enterprises in the special zones are to be sold on the international market. If an enterprise wants to sell its products in the domestic market in China, it must have the approval of the Guangdong Provincial Administration of Special Economic Zones and pay customs duties.

Article 10 — Operation; Employment of foreign personnel
Investors can operate their enterprises independently in the special zones and

1. A detailed survey of Special Economic Zones in the People's Republic of China will be included in a forthcoming supplement of our loose-leaf publication: TAXES AND INVESTMENT IN ASIA AND THE PACIFIC, Chapter on the People's Republic of China.
2. BULLETIN FOR INTERNATIONAL FISCAL DOCUMENTATION, April 1980, at 171 ff.

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employ foreign personnel for technical and administrative work.

Article 11 — Termination of activities
If investors want to terminate their business in the special zones, they should submit the reasons for their termination to the Guangdong Provincial Administration of Special Economic Zones, go through related procedures and clear the debts. The assets of the closed enterprises can be transferred and the funds can be remitted out of China.

Chapter III — Preferential treatment

Article 12 — Provision of land
The land in the special zones remains the property of the People's Republic of China. Land to be used by investors will be provided according to the actual needs, and the length of tenure, rent and method of payment will be given favourable consideration according to the different trades and uses. Concrete methods will be specified separately.

Article 13 — Importation of equipment
Machinery, spare parts, raw materials, vehicles and other means of production for the enterprises in the special zones are exempted from import duties. The necessary consumer goods shall be subjected to full or lower import duties or exempted, depending on the merits of each case. Imports of the above-mentioned goods and exports of products of the special zones must go through existing customs procedures.

Article 14 — Income tax on enterprises
The rate of income tax levied on the enterprises in the special zones is to be 15 percent. Special preferential treatment will be given to enterprises established within two years of the promulgation of these regulations, enterprises with an investment of US$5 million or more, and enterprises involving higher technologies or having a longer cycle of capital turnover.

Article 15 — Remittance abroad
Legitimate after-tax profits of the investors, salaries and other proper earnings after paying personal income tax of the foreign, overseas Chinese and Hong Kong and Macao workers and staff members of the enterprises in the special zones can be remitted out of China through the Bankc of China or other banks in the special zones in line with the zone's foreign exchange control measures.

Article 16 — Reinvestment
Investors who reinvest their profits in the special zones for five years and longer may apply for exemption of income tax on profits from such reinvestment.

Article 17 — Use of domestic items
Enterprises in the special zones are encouraged to use China-made machinery, raw materials and other goods. Preferential prices will be offered on the basis of the export prices of China's similar commodities and settled in foreign exchange. These products and materials can be shipped direct to the special zones with the vouchers of the selling units.

Article 18 — Entry and exit procedures
Entry and exit procedures will be simplified and convenience offered to the foreign, overseas Chinese and compatriots in Hong Kong and Macau going in and out of the special zones.

Chapter IV — Labour management

Article 19 — Provision of labour
Labour service companies are to be set up in each of the special zones. Chinese staff members and workers to be employed by enterprises in the special zones are to be recommended by the local labour service companies or recruited by the investors with the consent of the Guangdong Provincial Administration of Special Economic Zones. Enterprises can test them before employment and sign labour contracts with them.

Article 20 — Performance and dismissal
The employees of the enterprises in the special zones are to be managed by the enterprises according to their business requirements, and, if necessary, can be dismissed in line with the provisions of the labour contracts.
Employees of the enterprises in the special zones can submit resignation to their enterprises according to the provisions of the labour contracts.

Article 21 — Remuneration
Scales and forms of the wages, award methods, labour insurance and various state subsidies of the Chinese staff members and workers in the enterprises are to be included in the contracts signed between the enterprises and the employees in accordance with the stipulations of the Guangdong Provincial Administration of Special Economic Zones in Guangdong province.

Article 22 — Labour protection
Enterprises in the special zones should have the necessary measures for labour protection to ensure that the staff members and workers work in safe and hygienic conditions.

Chapter V — Administration

Article 23 — Supervisory body
The Guangdong Provincial Administration of Special Economic Zones exercises the following functions:
1. Draw up development plans for the special zones and organize for their implementation.
2. Examine and approve investment projects of investors in the special zones.
3. Deal with the registration of industrial and commercial enterprises in the special zones and with land allotment.
4. Coordinate the working relations among the banking, insurance, taxation, customs, frontier inspection, postal and telecommunications and other organizations in the special zones.
5. Provide staff members and workers needed by the enterprises in the special zones and protect the legitimate rights and interests of these staff members and workers.
6. Run education, cultural, health and other public welfare facilities in the special zones.
7. Maintain law and order in the special zones and protect according to law the persons and properties in the special zones from encroachment.

Article 24 — Administrative agencies
The Shenzhen Special Zone is under the direct jurisdiction of the Guangdong Provincial Administration of Special Economic Zones. Necessary agencies are to be set up in the Zhuhai and Shantou Special Zones.

Article 25 — Business promotion company
A Guangdong Provincial Special Economic Zones Development Company is to be set up to cope with the economic activities in the special zones. Its scope of business includes fund-raising and trust investment, operating enterprises or joint ventures with investors in the special zones, acting as agents for the investors in the special zones in matters related to sales and purchases with other parts of China outside the special zones, and providing services for business talks.

Chapter VI — Appendix

Article 26 — Entry into force
These regulations shall be enforced after their adoption by the Guangdong Provincial People's Congress and after they have been submitted to and approved by the Standing Committee of the National People's Congress of the People's Republic of China.

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TAX GLOSSARY

by H.W.T. PEPPER *

TAX SPARING — Where one country grants a tax holiday in respect of profits, e.g., from a "pioneer" enterprise, and/or to the dividends declared out of those profits, and the income belongs to a resident of another country with which a double tax treaty has been made, the other country may grant "tax-sparing" relief. The "sparing" amounts to a "recognition", by the county of residence, of the tax given up by the other country in its tax holidays and giving relief as if the tax had actually been charged and paid in the country where the enterprise is operating. The tax thus recognized is sometimes known as PHANTOM TAX (q.v.).

TAX THRESHOLD — The level (of income, capital, sales, etc.) at which tax commences to be levied. A taxpayer with income below the threshold level would be exempt from income tax, an estate below a certain value would be exempt from death duties, and a trader whose sales are below a certain threshold is excluded from Value Added Tax (though in that case the goods he buys will contain a tax element which will not ordinarily be available for refund).

TAXABLE BASE — The "taxable base" or "tax base" is a term used in connection with a tax or duty to indicate what is covered by the levy. For example, an income tax might apply to all income received within a country and foreign income remitted to the taxing country by resident taxpayers. In the case of death duties, the duty might apply to all assets situated within the country where the deceased person was domiciled, and also to all the foreign assets of such a deceased person. (See also SCOPE OF TAX, TAX-INCLUSIVE BASE.)

TAXABLE CAPACITY — A somewhat abstract concept as far as individuals are concerned (as regards taxes on goods where the maximum "capacity" for tax may be regarded as a point beyond which additions to the tax charge would result in DIMINISHING RETURNS (q.v.) of revenue). The capacity of individuals to pay tax is proportionate to per capita income, to the political stability of the country, the efficiency of the tax administration, and probably to the proportion of the total revenue which comes from indirect, rather than direct taxes. (See also UNMERKLICHKEIT.)

TAXABLE EVENT — This term is used mainly in connection with sales taxation which may be chargeable, e.g., upon a sale taking place, on delivery of goods to a customer, or on the movement of goods from the trader's premises, including in each case those goods for the internal or personal or domestic use of the business or the proprietors thereof. (See also TAX POINT.)

TAXABLE INCOME — Some income tax systems use the term "taxable income" to refer to all income which is by definition taxable, and under other tax codes the term may relate to the income which is actually subjected to tax rates, representing the gross or assessable income less deductions for items such as depreciation, losses, and personal reliefs.

TAXABLE PERIOD — Many taxes are related to a particular period of time, such as a fiscal year in the case of income taxes (which are applied to the income of the whole year). In the case of sales taxes, the tax is usually payable by reference to the sales of, transactions in, or movements of goods, or the rendering of services, within a particular period of time, and the taxpayer is usually required to pay tax on the basis of each period within a fairly short time of the end of it. Typically, the taxable period for sales taxation is either a month or a quarter of a year, but there are some instances where tax has been collected at shorter intervals, and others where, exceptionally, it has been related to a period of six months or a year.

TAXABLE PRICE — In the case of sales taxes, and ad valorem customs duties, where the duty or tax is a percentage of the price or value of the goods, it is usual to define the price in the tax law. For example, a manufacturer's sales tax would make a levy on certain classes of goods on the price at which the manufacturer would ordinarily sell (at arm's length) to a wholesaler, and a wholesale tax would normally define the taxable price as that at which a wholesaler would ordinarily sell the goods (in the open market) to a retailer (note, for example, the British purchase tax which adopts this definition of wholesale value. (See also TAXABLE VALUE.)

TAXABLE VALUE — The value upon which various duties and taxes are to be levied. In the case of imports, the taxable value for ad valorem customs duties is generally taken to be the price, either C.I.F. (q.v.) or "F.O.B." (domestic price in country of origin) at which goods are sold, and the rules enunciated in the Brussels Tariff Nomenclature (B.T.N.) (q.v.) represent those which are most widely followed, even among countries which do not yet use the B.T.N. The concept of "value" rather than actual price has to be adopted in certain cases with regard to sales tax, e.g., where goods are transferred from one part of a business to another for internal use or to the proprietor for personal consumption, so that the arm's length, or open market, price is not necessarily charged, and in other instances where the buyer controls, or is controlled by, the seller, or both are controlled by a third person. In practice the tax charge is often related to "value" which is then defined in the tax law as being the open market price, where this price is available, and, where it is not, rules are laid down for determining a value equivalent to open market price. Other instances of the value concept being used as the basis for charging duty or tax include death duties, which are based on the value of assets as at the date of death, wealth taxes upon the aggregate wealth of an individual at specified dates, e.g. each 31 December, and transfer taxes which extend to transfers of assets other than for full cash consideration. (See also TAXABLE PRICE, ANNUAL VALUE.)

TAXATION AT SOURCE — A system of tax collection pioneered in the U.K. where the payer of certain types of

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income to others was required by law to deduct tax (and account for it to the Revenue) at the STANDARD RATE (q.v.) from the payments, in effect as a prepayment by the recipient of the income who would be credited with the tax deducted.
Deductions were required from interest on loans and mortgages, alimony, ground rents on land, dividends paid by companies and interest on Government securities. The system was extended to tax on salaries and wages by tax deduction schemes culminating in the P.A.Y.E. system; deduction at source, or withholding, is now widely adopted in other countries. See, for example, PRECOMPTE.

TAXATION YEAR — Income taxes are normally "annualised", i.e., levied for successive 12-month periods, whereas sales taxes may be levied on a monthly, quarterly or annual basis. Reliefs are given from income tax on the basis of the circumstances of the year when the tax is payable (or of the basis year where this is different). The tax year usually, though not necessarily, coincides with the Government's fiscal year. See also TAXABLE BASE.

TAXE D' APPRENTISSAGE — (Belgium, France, Luxembourg) Apprentice tax.

TAXE LOCALE — The retail sales tax in France, which was abolished when V.A.T. was extended to the retail level.

TAXE OCCULTE — Tax charged upon the incredients or components of an article which is not easy to quantify, and hence difficult to relieve where the goods are exported, represents a "hidden tax" or "taxe occulte". Attempts have been made to relieve such tax when embodied in goods for export, e.g., by EXPORT REBATES (q.v.) and by border adjustments as a means of tax equalisation on imports. The difficulties regarding exports involved have also been tackled in another way, i.e., by adoption of V.A.T. (q.v.). (Note, also, the SANDWICH EFFECT IN V.A.T.)

TAXE SUR LES ACTIVITES FINANCIERES — (Belgium, France, Luxembourg) Turnover tax on certain financial transactions.

TAXE UNIQUE — In the context of a cascade tax, certain articles of commerce may be specially treated by being charged with a composite tax levied at a single stage and exempted at all other stages of distribution. Such a composite tax is sometimes known as a "taxe unique", but the terms "Forfaitaire" and "Phasenpauschalierung" have also been applied.

TAXE SUR LA VALEUR AJOUTEE (T.V.A.) — (Belgium, France, Luxembourg) Value-added tax (V.A.T.).

TAXFLATION — Term used in U.S.A. for FISCAL DRAG (q.v.).

TEILWERT — This term refers to the system in Federal Germany whereby in calculating income tax depreciation on assets the sale proceeds of an asset may be taken to be a proportion of the sale price of the business where it is sold as a going concern if this figure is less than the WRITTEN-DOWN VALUE (q.v.) for tax purposes.

TELEVISION ADVERTISEMENT DUTY — A duty levied in Britain on advertisements inserted in television programmes provided by private sector contractors.

TELEVISION LICENCE FEES — Annual fees collected in some countries from users of television sets as a contribution towards the cost of broadcasting programmes by the television broadcasting authority appointed by the government. In the U.K., prepayments by purchase of stamps has recently been revived in respect of television licence fees. Being payable once yearly these fees are a substantial liability for those in lower-income groups who may spread payment by buying special television stamps to fix to the licence renewal application form in due course.

TEMPORARY ENTRY (IMPORTATION) — Many countries allow the temporary importation (without levying customs duty and sales taxes) of items which are to be within their borders for only a short time. Examples include motor cars brought in by visitors, including those temporarily employed in the country. Work done in the country by foreign contractors may involve the temporary importation of specialised equipment not available in the country. While some countries allow temporary duty-free import another treatment some times adopted is to charge a proportion of duties and tax based on the ratio of the period the items are employed in the country to the period of the normal working life of the equipment. See also PERFECTION OF ENTRY.

TENTHS — A 14th century tax on real property in England charged at the rate of 1/10 of value. (See also FIFTEENTHS.)

TERMINAL ADJUSTMENTS — See BALANCING ALLOWANCES AND CHARGES: CESSATION ADJUSTMENTS.

TERMINAL LOSSES — Losses in the final year of a business cannot obviously be carried forward because the business has ceased, but some tax codes provide for a carry-back against earlier profits and an offset against other income of the same taxpayer for the same year. In the U.K. and the U.S.A. the carry-back period is 3 years.

TERMINAL PAYMENTS — See GOLDEN HANDSHAKE, LOSS OF OFFICE, REDUNDANCY PAYMENTS, SEVERANCE PAYMENTS.

TERRITORIALITE — See TERRITORIALITY.

TERRITORIALITY — The scope and incidence of a tax is usually related to a particular geographical area, in that residents of that area may be subjected to tax. In addition, assets, income, or transactions located within that territory may be taxed, even though respectively belonging to, or carried out by or on behalf of, non-residents. The territorial concept has relevance, e.g., to income tax, where residents may be taxed on their world-wide income and non-residents on their income that arises within the territory. In the case of death duties the world assets of those domiciled in the territory may be taxed, and the assets in the territory of those domiciled outside it may also be taxed. For sales taxation, tax may apply to transactions taking place within the territory other than exports to customers resident outside the territorial limits. See also SALES AND USE TAXES.

THERMAL INSULATION — As in the case of expenditure on fire prevention, safety measures, anti-pollution, etc., the tax treatment of the cost of fuel economy, including thermal insulation, is usually favourable. In the U.K., for example, expenditure on heat insulation in industrial buildings by the person carrying on trade is regarded as equivalent to expenditure on plant and machinery, thus qualifying for CAPITAL ALLOWANCES. See also RESIDENTIAL ENERGY CREDIT.

[to be continued]

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Loose-leaf publication explaining the concept of partnership under Dutch law and its effect on business operations, as well as the taxation aspects thereof. (B. 102.743)

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BUSINESS OPERATIONS IN THE NETHERLANDS ANTILLES

By Robert D. Kramer, Leendert Roeloffs and Karl F. Walboom. Washington, Tax Management, Inc., 1972. 106 pp.
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NEW ZEALAND

U.S. BUSINESS OPERATIONS IN NEW ZEALAND

By John K. Connor and C.J. Fernyhough. Washington, Tax Management, Inc., 1978. 242 pp.
Guide containing basic information designed to enable American businessmen to choose the best method of conducting operations in New Zealand from both the tax and the general legal points of view. (B. 102.728)

O.E.C.D.

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No. 27, July 1980. Paris, Organisation for Economic Co-operation and Development, 1980. 157 pp. (B. 102.745)

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By Silvio Bianchi. Washington, Tax Management, Inc., 1976. 146 pp.
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U.S. VIRGIN ISLANDS

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By Gustav A. Danielson. Washington, Tax Management, Inc., 1978. 166 pp.
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Conference Diary

DECEMBER 1980

Institute for International Research: Asian Property in the 80's (including: Hong Kong tax and related accounting implications of property transactions; Taxation of property profits in Singapore and Malaysia), Hong Kong (Hong Kong), December 1-3 (English).

Management Centre Europe: International cash management (including: International tax aspects in cash management), London (United Kingdom), December 8-10 (English).

JANUARY 1981

The Economist: Joint ventures in China (including: Some practical tax case studies), London: January 29; Zürich (Switzerland): February 2 (English).

FEBRUARY 1981

Management Centre Europe: International Tax Management (including: Inter-company pricing: licensing, service fees) (Seminar), Brussels (Belgium), February 12-13 (English).

MARCH 1981

Management Centre Europe: Managing and Developing Foreign Subsidiaries (including: Tax in international operations), Brussels (Belgium), March 4-6 (English).

APRIL 1981

Management Centre Europe: Fourth MCE International Tax Conference. Chairman: Prof. J. van Hoorn Jr., Co-Chairman: A.G. Davies C.B.E. Main subjects: Transfer pricing; Government and business views on tax avoidance; Taxation of international leasing; small meeting groups directed by members of the faculty, Munich (German Federal Republic), April 8-10 (English).

SEPTEMBER 1981

35th Annual Congress of I.F.A.: I. Mutual agreement procedure and practice; II. Unilateral measures to prevent double taxation, Berlin (German Federal Republic), September 21-25 (English, French, German, Spanish).

FOR FURTHER INFORMATION PLEASE WRITE TO:

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Institute for International Research, The Conference Manager, P.O. Box 38, Hong Kong.

Management Centre Europe, Avenue des Arts 4, B-1040 Brussels (Belgium).

The Economist (Conference Unit): Mrs. Marion Bieber, 25 St. James Street, London SW 1 1HG (United Kingdom).

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The author discusses the development of U.S. estate and gift tax treaties and the impact which the O.E.C.D. Draft Treaty of 1966 and the U.S. Model Treaty of 1977/1979 have had on these treaties. A number of important current issues are also dealt with.

NOUVELLES CONVENTIONS AMERICAINES TENDANT A EVITER LES DOUBLES IMPOSITIONS EN MATIERE DE SUCCESSIONS ET DE DONATIONS

L'auteur étudie l'évolution des conventions américains en la matière et l'impacte que le Projet de Convention de l'O.C.D.E. de 1966 et la Convention Modèle Américaine de 1977/1979 ont eu sur ces conventions. Un certain nombre de publications courantes importantes sont également présentées ici.

DIE NEUESTEN NACHLASS- UND SCHENKUNGSTEUER-ABKOMMEN DER U.S.A.

Der Verfasser untersucht die Entwicklungen bezüglich den neuesten Nachlass- und Schenkungsteuerabkommen der U.S.A. und den Einfluss, den das O.E.C.D. Musterabkommen von 1966 und der U.S.—Mustervertrag von 1977/1979 auf diese Abkommen ausüben konnte.

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REFUGES FISCAUX

L'auteur étudie les différentes façons permettant d'arrêter l'évasion fiscale par l'intermédiaire des facilités offertes par les refuges fiscaux. Il insiste particulièrement sur l'obtention de données suffisantes par le Service du Fisc Américain.

STEUEROASEN

Der Verfasser stellt verschiedene Möglichkeiten vor, womit die Einschaltung von Steueroasen unterbunden werden kann. Besonderen Wert legt er auf die Bereitstellung notwendiger Daten durch die amerikanischen Steuerbehörden.

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The author raises a number of questions regarding tax treaty interpretation, such as whether it makes a difference who is interpreting, what kind of law does a treaty create and what materials are relevant.

INTERPRETATION DES CONVENTIONS TENDANT A EVITER LES DOUBLES IMPOSITIONS

L'auteur soulève un certain nombre de problèmes quant à l'interprétation des conventions tendant à éviter les doubles impositions, ainsi existe-t-il une différence en fonction de la personne qui interprète, quelle sorte de loi crée une convention et quels sont les matériaux importants.

DIE AUSLEGUNG VON DOPPELBESTEUERUNGS-ABKOMMEN

Der Verfasser beschäftigt sich mit einer Reihe von Fragen bezüglich der Auslegung von Doppelbesteuerungsabkommen, wie z.B. der Frage, ob es eine Rolle spielt, wer diese auslegt, welches Recht ein Abkommen schafft und welche Referenzen relevant sind.

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PRINCIPLES TO BE APPLIED IN INTERPRETING TAX TREATIES. 545

The author presents a survey for tax practitioners of some well developed principles of public international law shich may be brought to bear on problems of tax treaty interpretation.

PRINCIPES A APPLIQUER DANS L'INTERPRETATION DES CONVENTIONS TENDANT A EVITER LES DOUBLES IMPOSITIONS

L'auteur fait un exposé pour les praticiens fiscaux de quelques principes bien établis de droit international public qui pourraient s'appliquer aux problèmes d'interprétation des conventions fiscales.

ANZUWENDENDE PRINZIPIEN BEI DER AUSLEGUNG VON DOPPELBESTEUERUNGSABKOMMEN

Der Verfasser präsentiert eine insbesondere für Praktiker zusammengestellte Übersicht allgemein anerkannter Prinzipien, die im Rahmen des Völkerrechts entwickelt wurden und die dazu benutzt werden können, im Zusammenhang mit der Interpretation von Doppelbesteuerungsabkommen auftretende Probleme einer Lösung näher zu bringen.

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DEROGATION AUX TRAITES FISCAUX PAR LA LEGISLATION ORDINAIRE
L'auteur étudie l'introduction d'une nouvelle législation aux Etats-Unis qui entrera inévitablement en conflit avec les dispositions des traités fiscaux existants. Il considère que le Congrès a en effet le droit de promulguer une loi dérogant aux dispositions contradictoires d'une traité s'il en exprime clairement l'intention.

VORRANG NATIONALER GESETZGEBUNG GEGENÜBER DOPPELBESTEUERUNGSABKOMMEN
Der Verfasser untersucht die Einführung neuer Gesetze in den U.S.A., die unzweifelhaft mit bestehenden Bestimmungen in Doppelbesteuerungsabkommen in Konflikt stehen. Er stellt dabei fest, dass der Kongress in der Tat das Recht habe, Gesetze zu verabschieden, die gegenüber Doppelbesteuerungsabkommen Vorrang geniessen, und zwar dann, wenn dies mit dem ausdrücklichen Zweck geschieht, Widersprüche in den Abkommensbestimmungen zu bereinigen.

David Brockway:

OVERRIDE OF TAX TREATIES BY ORDINARY LEGISLATION. 553

The author comes to a similar conclusion as Mr. Langer with some difference in emphasis. He points out the difficulties with which Congress is faced when amending U.S. tax law in case such an amendment conflicts with a provision existing in a multitude of tax treaties.

DEROGATION AUX TRAITES FISCAUX PAR LA LEGISLATION ORDINAIRE
L'auteur arrive à une conclusion similaire à celle de M. Langer en mettant l'accent sur des points différents. Il souligne les difficultés auxquelles le Congrès doit faire face lorsqu'il modifie une loi américaine et que l'amendement est en conflit ave une disposition prévue dans un grand nombre de traités fiscaux.

VORRANG NATIONALER GESETZGEBUNG GEGENÜBER DOPPELBESTEUERUNGSABKOMMEN
Der Verfasser komt zu ähnlichen Schlussfolgerungen wie Hr. Langer, wobei er allerdings die Schwerpunkte etwas anders setzt. Er weist dabei auf die Schwierigkeiten hin, mit denen der Kongress konfrontiert ist, wenn es darum geht, eine Änderung des amerikanischen Steuerrechts herbeizuführen und diese mit einer Vielzahl von Doppelbesteuerungsabkommen in Konflikt gerät.

John F. Avery Jones:

MUTUAL AGREEMENT PROCEDURE 556

The author discusses, inter alia, the question whether mutual agreements bind courts or the competent authority which has concluded the agreement.

PROCEDURE AMIABLE
L'auteur étudie, entre autres, la question de savoir si les procédures amiables lient la Cour ou l'autorité compétente qui a conclu le traité.

VERSTÄNDIGUNGSVERFAHREN
Der Verfasser untersucht u. a. die Frage, ob ein Verständigungsverfahren die Gerichte oder die zuständige Behörde, die dieses Verständigungsverfahren vereinbarte, zu binden vermag.

Paul McDaniel:

SOURCE RULES IN U.S. TAX TREATIES 559

The author discusses the question which principles guide the United States when it agrees to modify its source rules by treaty.

LES REGLES DE LA SOURCE DANS LES CONVENTIONS TENDANT A EVITER LES DOUBLES IMPOSITIONS CONCLUES PAR LES ETATS UNIS
L'auteur étudie le question de savoir quels sont les principes qui guident les Etat-Unis lorsqu'ils acceptent de modifier leurs règles de la source par une convention.

DIE BESTIMMUNG DER QUELLE IN DEN DOPPELBESTEUERUNGSABKOMMEN DER U.S.A.
Der Verfasser untersucht die Frage nach dem Rahmen, in welchem die U.S.A. ihre Regeln zur Bestimmung der Quelle bei Doppelbesteuerungsabkommen anzupassen bereit sind.

Robert J. Patrick Jr.:

INCOME TAX TREATY SOURCE RULES; A U.S. PERSPECTIVE 560

Preliminary discussion of the subject to be dealt with at the Paris Congress of IFA. The author focuses on individual country rules for determining the origin of income and expenses.

LES REGLES DE LA SOURCE DANS LES CONVENTIONS TENDANT A EVITER LA DOUBLE IMPOSITION SUR LE REVENU; UNE PERSPECTIVE AMERICAINE
Discussion préliminaire du sujet devant être traité au Congrès de l'IFA à Paris. L'auteur met l'accent sur les règles des différents pays pour la détermination de l'origine du revenu et des dépenses.

DIE REGELN FÜR DIE BESTIMMUNG DER QUELLE IM RECHT DER DOPPELBESTEUERUNGSABKOMMEN – EINE AUFFASSUNG AUS DEN U.S.A.
Vorläufiges Positionspapier zu dem Thema, das bein IFA-Kongress in Paris zu behandeln war. Der Verfasser beschäftigt sich insbesondere mit den Regeln bestimmter Länder bezüglich der Bestimmung der Quelle bei Einkünften und Aufwendungen.

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National Meeting of the
U.S.A. Branch of IFA,
January 17 & 18, 1980.

New Developments in Tax Treaties

On January 17 and 18, 1980 the U.S.A. Branch of the International Fiscal Association held its fourth annual meeting in Philadelphia, Pennsylvania. The technical discussions focused on new developments in tax treaties and were co-chaired by Mr. Chester C. Hilinski, executive vice-president of IFA, and Mr. Robert J. Patrick, vice-president of IFA.

As in the past, [1] *the U.S.A. Branch of IFA requested the Editors of the* Bulletin *to publish a number of papers read at the annual meeting. The Editors, considering these papers of particular import for an international readership, are pleased to comply with this request and they wish to congratulate the U.S.A. Branch of IFA on finding so many highly qualified speakers, not only from the United States but also from Canada and the United Kingdom, to discuss a number of subjects which are currently of interest.*

The first subject, estate and gift tax treaties *discussed by Mr. Sanford H. Goldberg, is not only a rare subject for IFA, as the speaker remarked, but also a topic on which not much recent literature exists. Mr. Goldberg analyzed the existing U.S. treaty network as well as the OECD and U.S. Model Conventions. He also mentioned pending legislation which will subject to U.S. tax foreign taxpayers holding U.S. real estate through a corporation, a subject which was touched upon by a number of other speakers.*

The subject of tax havens *featured two speakers, Mr. M. Carr Ferguson, assistant attorney general, and Mr. Richard A. Gordon, a representative of the Internal Revenue Service, who described possible measures to combat tax evasion through the use of tax havens.*

Professor Stanley S. Surrey's talk on the United Nations Group of Experts and the LDC Model Treaty has not *been included in the set of papers published in this issue of the* Bulletin *as Professor Surrey's extended discussion will shortly appear in the series "Selected Monographs on Taxation", which is a joint venture of the Harvard Law School and the International Bureau of Fiscal Documentation.*

The subject of tax treaty interpretation *was represented by three papers: one by Mr. David Rosenbloom of the United States and two by Canadian tax experts, Mr. David A. Ward and Mr. Nathan Boidman. Mr. Rosenbloom, who is a U.S. treaty negotiator and also an international tax counsel to the U.S. Treasury, formulated a number of questions and tentative answers thereto, focusing on issues such as who does the interpreting, what type of law is a tax treaty and which materials will be relevant in a given case. Mr. Ward expressed his views on the Canadian tradition in the field of tax treaty interpretation, giving a survey of some well developed principles of public international law which may have a bearing on tax treaty interpretation. The reader will not find Mr. Boidman's views on this subject in the present issue, as we published his paper in the combined August-September 1980 issue of the* Bulletin *which was distributed at the Paris IFA Congress in September 1980.* [2]

Mr. Marshall J. Langer and Mr. David Brockway treated the subject of overriding of tax treaties by ordinary legislation, *a subject which may be of particular interest and perhaps also surprise to non-U.S. readers who live in countries where it has been firmly established that tax treaties always take precedence over ordinary legislation.*

Mr. J.F. Avery Jones, a solicitor from the United Kingdom, discussed mutual agreement provisions, *a subject that introduces one of the main themes at the 1981 Congress in West Berlin. The focus of his narrative was on the binding force of mutual agreements for the tax authorities as well as for courts.*

Finally, Mr. Robert J. Patrick and Mr. Paul T. McDaniel analyzed source rules, *a subject that was discussed at the 1980 Paris Congress of IFA. A summary of these IFA proceedings can be found on page 564 of this issue.*

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1. See *Exploration of Income Tax Treaty Policy Issues in the United States* (National Meeting of the U.S.A. Branch of IFA March 15 and 16, 1979) in 34 BULLETIN FOR INTERNATIONAL FISCAL DOCUMENTATION 52 (February-March 1980).
2. *Interpretation of Tax Treaties* by Nathan Boidman in 34 BULLETIN FOR INTERNATIONAL FISCAL DOCUMENTATION 388 (August-September 1980).

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Modern U.S. Estate and Gift Tax Treaties

by Sanford H. Goldberg*

The topic I am going to discuss is estate, gift and generation skipping taxes. It is a rare topic for IFA. At the last IFA meeting in Copenhagen, the problems of the closely held corporation and wealth transfers were discussed. The only time that IFA has discussed the subject in all of its ramifications was back in 1968. Since 1968 the world has changed drastically. Inflation has resulted in estate and gift tax problems for all taxpayers. More importantly, the shift in investment into the United States has produced a major problem for many foreign investors who have decided that the United States is the last bastion of capitalism.

Foreign investment in the United States has increased to such a degree that we are now considering tax laws that would tend to discourage investment in certain areas, whereas in 1966 we were passing laws to encourage investment in the United States. One of the proposals by Representative Fisher would subject to U.S. estate tax shares of foreign corporations that own U.S. real estate. Foreign investors often use foreign corporations as investment vehicles to avoid estate tax.

The estate and gift tax area I will discuss is the treaties. I will not focus on the U.S. tax imposed by the Internal Revenue Code. For those of you who are interested in our statutory provisions, I refer you to an article which I wrote about two years ago, which originally appeared in the *NYU International Tax Institute* and which was reprinted last year in the *Canadian Tax Journal*. [1]

The estate tax treaty network of the United States is relatively modest. Not many people seem anxious to discuss and strengthen estate taxation. Compared to the 28 existing income tax treaties and the number that were discussed today as being in the process of negotiation, there are only about 13 estate tax treaties. I say "about", because I have included in this total our estate tax treaty with Canada. We do appear to have an estate tax treaty with Canada, even though Canada terminated its estate tax in 1972 (without, at the same time, abrogating the treaty). For those of you who are interested in whether the Canadian estate tax treaty is still in effect, I suggest you speak to the Internal Revenue Service and the Treasury. Their answer has been "we don't know", which is an interesting comment since, if they don't know, who should know?

Gift tax treaties are almost non-existent. Other than the treaties that I will be discussing shortly, there are only two gift tax treaties, those with Japan and Australia. Thus, there are no treaties (other than the ones that we will be discussing) which concern our generation skipping taxes. The recent treaties with France and the United Kingdom cover estate, gift and generation skipping taxes and are patterned after the U.S. Model Treaty.

Prior to 1966 estate tax treaties were situs-oriented

In order to understand our estate tax treaties, one needs a general sense of the historical background. Prior to 1966, the United States negotiated estate tax treaties that emphasized situs. Under these treaties, each signatory country would decide the situs of the asset in question, which would, in the absence of the treaty, be subject to taxation by both countries with no relief. The situs-oriented treaty would frequently permit the imposition of a tax by each country but would provide relief in the form of tax credits for the taxpayer. This approach frequently resulted in a number of problems. One important problem in a changing world resulted from double domicile, i.e. both countries claiming primary jurisdiction to tax without credit for the other's taxes. This was not covered in the old estate tax treaties, which assumed the existence of a single domicile providing a credit to offset the tax imposed in the other jurisdiction. Another problem was the usage of credits, when credits were made available in more than one jurisdiction.

OECD Draft of 1966

The publication of the OECD Draft of 1966 changed this. It provided an approach whereby taxation could only be imposed on the basis of domicile; and, only in a few situations, would the country of situs be empowered to levy tax. The United States took exception to the most important of the compromises reached in the OECD Draft: the taxation of stock and debt of U.S. corporations exclusively at the place of the taxpayer's domicile. In 1977, the United States published a model estate and gift tax treaty, which was republished and modified in 1979. [2] The above is the background against which the pattern of U.S. negotiations should be considered.

U.S. Model treaty

The Model treaty of 1977 made a radical departure from the earlier U.S. treaties. It embraced the OECD Draft concepts. Its most salient provisions appear in somewhat different form from the OECD Draft of 1966, as well as from the 1971 Netherlands treaty. Developments subsequent to the Model treaties of 1977 and 1979 with France and the United Kingdom have not indicated any major departures, so that the major provisions of these Model treaties are to be found in the U.K. treaty and the French treaty.

The most recent treaties (I am now talking about the Model (U.S.) treaty, the Dutch treaty, the U.K. treaty and the French treaty) are designed to alleviate double taxation on gifts and estates of United States citizens, domiciliaries and foreign domiciliaries by either limiting the right to tax to the country of domicile or by requiring one of the countries to grant a credit for the tax of the other. In most of these treaties, the country of domicile possesses primary tax jurisdiction, that is, the right to tax estates, gifts and transfers on a world-wide basis. However, under the Model treaty the country of situs is given priority of taxation concerning real property, business assets located in that country, tangible property, ships, aircraft, and partnership interests as well.

The Model treaty also affords a country taxing on the basis of citizenship the right to tax the estate or inter vivos transfers, with a credit allowed for taxes paid to the other state. Generally,

* Roberts & Holland, New York, New York; Washington, D.C.; and Miami, Florida.

1. An updated version will appear in an American Bar Association survey on International Estate Planning to be published shortly.

2. *Editor's note:* see for a reproduction of the text of the U.S. Model Treaty, 33 *Bulletin* 473 (1979).

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this is a one-way street, since only the United States still taxes on the basis of citizenship.

Domicile: a troublesome issue

The most recent treaties also attempt to resolve the troublesome issue of domicile. As was mentioned before, this problem is quite common. It is typically presented by the businessman who leaves his homeland to go abroad to manage an operation in a foreign country and then stays for a number of years. The problem presented is whether the businessman will be taxed in both countries — i.e. in his native country and in the land in which the foreign operation is situated. The problems of double domicile are familiar to most of us here in the United States because of our Federal system, which sometimes results in several states claiming to be the domicile of a given taxpayer. The classical problem involved the estate of one of the principal owners of the Campbell Soup Company. Estate taxes were paid to the states of Pennsylvania and New Jersey because neither state would agree that the other state was the sole domicile and each imposed its own tax. The Supreme Court subsequently agreed with the imposition of tax by both states. We also had the famous Hetty Green situation, involving a dispute between Florida and Texas, where it was not possible to determine which of the two states was the domicile. The Model treaty and the Dutch, French and U.K. treaties differ from our domestic decisional law in that they attempt to solve the problem by finding a single domicile. In my discussion of the way in which treaties deal with the question of domicile, I will approach the problem by focusing on the Model treaty provisions and the departures therefrom which appear in the Dutch, French and U.K. treaties.

Fictitious domicile

The Netherlands and the United Kingdom have a peculiar concept — a fictitious domicile which continues for a fixed period after a citizen leaves. The period of fictitious domicile is ten years after a Netherlands citizen leaves the Netherlands, while the U.K. treaty and the U.K. capital wealth tax use three years, so that, for three years after an Englishman leaves England, he is deemed to be a domiciliary of the United Kingdom. Our treaties with the Netherlands and the United Kingdom take this concept into account.

Interestingly, the Model treaty preserves the right of the United States to treat as a U.S. citizen for a period of ten years following the loss of citizenship a former citizen of the United States whose loss of citizenship had as one of its principal purposes the avoidance of tax (including the income tax). None of the treaties in force has adopted this provision of the Model treaty. Of course, if the Internal Revenue Service's position in Revenue Ruling 79-152 is valid, then this provision of the Model treaty is superfluous, since the Service will enforce the rule set forth in this provision of the Model treaty even if it is not incorporated in any treaty, or agreed to by any other jurisdiction. As you may recall, Revenue Ruling 79-152 rules that a former citizen is still a citizen and is therefore not entitled to the benefits of any tax treaty. The true question posed by Revenue Ruling 79-152 is whether someone who is not formally a citizen, but is accorded citizenship status within the meaning of the expatriate rules, is a citizen for purposes of those treaties. Like my partner Sidney Roberts, who wrote an article in the October 1979 *Journal of Taxation*, I think that the position expressed by the Internal Revenue Service in this Revenue Ruling is far from accurate, and it creates some continuing problems.

The Model treaty and the treaties with France and the United Kingdom cover the U.S. estate tax, gift tax and the generation skipping tax.

Gift taxes, potential problems

The Dutch treaty, which was adopted prior to our enactment of the generation skipping tax, only applies to estate taxes. There are very few gift tax treaties, only the two that I mentioned (with Japan and Australia). There has never been much interest in gift tax treaties. A very interesting article about the problem of double and triple or even quadruple gift tax problems, written by one of our panelists, John Avery Jones, appeared in *The British Tax Review* in 1977 with the intriguing title of "Timeo Danaos".

There are at least two principal types of potential tax problems in the gift tax area not effectively dealt with by our present treaty. The first and the easier type to recognize is the imposition of several gift taxes on the same transfer. Gift taxes may be imposed either because a person concerned, such as the donor or the donee, is within the jurisdiction of the taxing state as the result of domicile, residence, or nationality, or because the situs of the property which is the subject of the gift is within the jurisdiction of the taxing state. This problem is intensified when different interpretations are applied by the interested jurisdictions to any of the key terms, domicile, residence, nationality or situs. A simple illustration will call to mind the problems of multiple tax I have noted. Suppose a gift of property that is located in the United Kingdom, which taxes on the base of situs, by a donor who is a citizen of the United States, which taxes on the basis of citizenship. Suppose further that the donor resides in the Netherlands, which taxes on the basis of residence, and that the donee is an individual residing in Germany, which taxes on the basis of the donee's residence. Four gift taxes, the taxes of the United Kingdom, United States, Netherlands and Germany, may be imposed on our hypothetical gift. A bilateral treaty would not resolve all of the problems presented by our illustration. However, meaningful treaty negotiations must try to consider the problem presented by our illustration because it does arise with people having property located all over the world.

The second principal problem of multiple taxation of gifts, which I believe is not covered by our treaty, is the ability to obtain a credit for a gift tax in one country against an estate tax in another country. The Model treaty would require a credit for a prior gift tax in those situations where the United States would grant such a credit under its domestic law. To illustrate the problem, suppose a U.S. donor places his U.K. real estate in a trust in a manner that would be a completed gift for U.S. purposes, but not for U.K. purposes. Later, when the taxpayer dies, the situs of the property is in the United Kingdom. The United Kingdom would impose a death tax based on situs. The question presented is whether in computing the U.K. tax a credit will be provided for the prior gift tax paid in the United States? This is certainly an area that merits attention, and it will probably gain importance in the future.

Death and gift taxes levied by state or local governments

Another problem not dealt with by our treaties is that presented by the death and gift taxes imposed by state or local govern-

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ments. This type of problem is dealt with within our domestic regime of taxation. In computing the Federal estate tax, one derives the benefit of a credit for local estate taxes paid which reduces the amount of the Federal estate tax. Unlike the Model treaty, no similar adjustment is made for the local gift and estate taxes of foreign jurisdictions in our treaties with the Netherlands, the United Kingdom and France. Thus, only if there is no local tax imposed in the foreign jurisdiction will the non-resident alien under the treaty receive a full credit in his home country for foreign tax as required by the treaty. This omission is quite serious. The Federal tax rates on foreign estates are much lower than the rates imposed on the estates of U.S. residents or citizens (ranging from six to 30 percent), but the credit for local estate taxes in the United States is based upon statutory rates which were based upon estate tax rates for estates of U.S. citizens or residents, which may be as high as 70 percent. Therefore, the marginal Federal estate tax credit for local taxes may be as great as 16 percent, so that the effect of the estate tax rates would be to reduce the marginal rate of a foreign estate from 30 to 14 percent. Yet, the 16 percent credit is not a windfall, since it will not be available absent the imposition of local taxes of at least that amount. It thus seems inappropriate that foreign jurisdictions are not required to provide a credit for our local taxes — at least to the extent they offset the Federal tax for which a credit is available. It would appear that this is a serious deficiency of the present system. Foreign jurisdictions may have not realized the nature of this problem, or, perhaps, in our negotiations we were at fault in not seeking to assist foreigners investing in the United States by assuring they would not overpay death taxes.

Multiple domicile

As I have indicated, the most significant feature of the Model treaty, the Dutch, French and U.K. treaties is the adoption of the rule designed to benefit businessmen living abroad under which a citizen of one country who is domiciled in that country can live in the foreign country of his employment without becoming subject to the estate or inheritance tax of the country of employment. The treaties seek to avoid the problem of multiple domicile by applying the rule that one need be domiciled in a foreign country for a certain period ot time before becoming subject to its jurisdiction.

The problems of multiple domicile are caused by a difference in historical approach. The U.S. estate tax is based on domicile, which means physical presence coupled with an intent to permanently reside. In determining the existence of domicile, most European countries do not take intent into account. This poses a problem, since one who was originally a U.S. domiciliary can be physically present abroad for a long period of time, yet make it clear that he always intended to return to the United States. This intent will preserve his U.S. domicile, but it will not prevent the foreign jurisdiction from finding that it had become the place of domicile, as well. The United States' focus on intent in the determination of domicile will not only maintain the existence of U.S. domicile for one absent from these shores, but can also result in acquiring a U.S. domicile with surprising rapidity. For example, an Iranian refugee coming to the United States who says, "I never intend to go back to the Ayatollah. I have moved to the United States and intend to stay here indefinitely", will become a domiciliary of the United States immediately. The Model treaty provides that the taxpayer must be domiciled in the foreign country, if the taxpayer is a citizen of the United States, for at least seven out of the last ten years before the foreign country will obtain primary jurisdiction based upon domicile. If a U.S. citizen lives in a foreign country for less than seven of the last ten years, then he will be deemed domiciled in the United States for treaty purposes.

Dutch treaty: seven out of ten year rule

The French and Dutch treaties raise an interesting double domicile problem. The Dutch treaty provides that the seven out of ten year rule will apply unless a clear intention to the contrary has been shown (i.e. a person who is a citizen of only one of the contracting states, but would under the applicable criteria be deemed domiciled in both, shall, absent the demonstration of a contrary intention, be deemed domiciled in the country of citizenship alone, if at the time of death he was domiciled in the other contracting state for less than seven years of the ten year period ending with death). The problem presented is that of determining what constitutes the requisite clear intention to the contrary. For example, if a Dutch citizen moves his family to the United States, retains a permanent home in Holland and, at the same time, buys a permanent home in the United States and dies ten years later, he would probably, for treaty purposes, be considered to retain his domicile in Holland for at least seven years of the ten year period. But suppose our hypothetical Dutch citizen also applies for and receives a green card, and, when applying for the green card, says: "I want a green card so I can move easily and travel to and from the United States." Has that green card now resulted in our hypothetical Dutch citizen being deemed, for treaty purposes, to possess a clear intention to remain in the United States, with the result that he will not be deemed to be domiciled solely in the United States for purposes of the treaty?

French treaty: five out of seven year rule

The French treaty presents the same problem, although the details are somewhat different in that the French treaty uses as a general rule the five out of seven year rule instead of the seven out of ten year rule of the Dutch treaty (i.e. if a person is a citizen of only one of the two contracting states and would, under the applicable criteria, be deemed domiciled in both countries, he shall be deemed domiciled in the country of citizenship alone provided that he was domciled in the other country for less than five of the seven years before his death or the making of a gift and clearly intended to retain the country of citizenship as his country of domicile). It should be noted that this rule is, unlike the rule in the Dutch treaty, applicable to gifts, as well as to testamentary transfers, and, unlike the Dutch treaty, does not presume the existence of an intent to retain domicile in the country of citizenship. The French treaty also provides alternative situations in which the country of citizenship will be deemed the domicile, even absent the requisite intent needed for the application of the basic five out of seven year rule. One of these alternatives is a five out of seven year rule and the other a seven out of ten year rule. Both alternatives to the general rule depend upon the taxpayer having lived in the country which is not the country of citizenship because of the nature of the employment of the taxpayer or the taxpayer's spouse.

U.K. treaty: seven out of ten year rule

Our treaty with the United Kingdom, like the Dutch treaty, adopts a basic seven out of ten year rule, but uses as the text of residence for this purpose, not residence in the general sense meaning domicile, but, rather, in the manner used for income tax purposes. Residence for income tax purposes differs from the

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definition of residence for estate tax purposes. In the latter case it is equivalent to domicile.

Hierarchy adopted by Model treaty

If the above rules do not determine domicile, the Model treaty, following the OECD Draft, adopts the following hierarchy. The individual would be considered domiciled first in the country in which he maintains a permanent home; second, in the country in which his personal and economic relationships are closest to the center of vital interest; third, in the country in which he has a habitual abode; and fourth, in the country of citizenship. (A similar hierarchy is also set forth in the French, U.K. and Dutch treaties.)

If none of the rules afforded by the treaties will determine domicile in a given situation, then both contracting parties must resolve the question through a mutual agreement procedure. It is not clear what happens if they do not agree. Unlike the provisions that deal with mutual agreement where the parties shall consult, this provision of the Dutch, U.K., French and Model treaties simply provides that they *shall* agree on one domicile.

Habitual abode

The problem with the terms used as the bases for determining domicile, and that John Avery Jones will be discussing in his presentation, is that it is hard to define them with precision, e.g. "habitual abode". Does that differ from a permanent home? Both terms appear in the OECD and the Model treaty and appear to have different meanings. I, for one, am not sure that I understand the difference. Does either term mean a principal residence? Can one, as is the case under the United States' general domestic rules, have more than one habitual abode? The Treasury's technical explanation of the Netherlands treaty states that all of these concepts are highly uncertain in their application and require factual determinations in any particular case, and that these determinations may be extremely difficult to make. More than that, the terms are not terms of art as yet in the United States. Thus, to determine the manner in which these terms will be applied in specific situations may be more in the province of your European counterpart than that of your U.S. consultant.

Permanent home preceding death

As noted, the French, English and Dutch treaties basically follow the hierarchy noted above, although there are variations. The Dutch treaty follows the Model but requires a permanent home for a period of five years immediately preceding death and does not contain the test of habitual abode. An interesting question of interpretation is posed by the way in which this five year rule is expressed. As noted, this five year rule, which is the first test for determining domicile, requires a permanent home for five years or more immediately preceding death. If the individual in question has moved shortly before his death after residing in one country for five years or more, he would appear not to have satisfied this test with respect to either country, since he has not maintained a permanent home in either country for five years or more immediately preceding his death. Yet, the next text to be applied if the five year rule fails to resolve the issue of domicile, based on a determination of the State with which his personal relations were closest, is based on the individual not having a permanent home for five years or more in either country without specifying when this five year or more period need occur. Although it would appear logical that it need occur immediately prior to death, one cannot be certain, so that if the decedent had a permanent home in the Netherlands for five years, moved to the United States for one year, and then died, it is unclear whether the personal relations test would govern with respect to determining domicile or whether you then have to go to the next test for determining domicile, which is the state of citizenship.

Since the United States is the only country that taxes on the basis of citizenship, the citizen of one of the treaty countries who is not domiciled in his country of citizenship is not specifically covered by the treaties except for residual tax in the United States.

Once the determination of domicile has been made, the jurisdiction of domicile is accorded primary tax rights by the treaties. That jurisdiction can levy tax on all manner of assets. However, the tax to be levied by the jurisdiction of domicile is then modified by situs rules, pursuant to which the country of situs is accorded primary jurisdiction over assets with a situs in that country. Although the country of domicile, as noted, may levy a tax on all assets including those with a foreign situs, it is then required to accord a credit for the tax imposed by the jurisdiction of situs. The situs rules govern the following types of property: real property, business property of a permanent establishment, assets pertaining to a fixed base used for the performance of independent personal services, ships, aircraft and interests in partnerships, owning property to which the situs rules apply.

Real property

Under the Model treaty, "real property" is taxable by the contracting state in which it is situated. The treaties generally refer to "immovable property" which is defined as real property. In defining real property, the Model and most of our treaties consider mortgages as debt obligations rather than real property. The Model also excludes ships, boats, and aircraft from the definition of immovable property. The answer is less clear for a lease. Under the earlier French treaty, a lease for less than 18 years was excluded from the definition of immovable property implying that leases longer than 18 years are immovable property. The present treaties make no specific provision for leasehold interests, but provide that the determination of whether a given asset is immovable property is to be determined by the laws of the State in which that property is situated.

Real property owned by one who lost his U.S. citizenship shortly before his death poses an interesting problem. Let us suppose that a U.S. expatriate moves to France and retains the ownership of real estate in the United States. Under the French treaty and other recent treaties (though, as noted, the Model treaty has a different rule), it would appear that the United States has lost its taxing jurisdiction even if expatriation is deemed to have been tax motivated, except that the property is deemed situated in the United States and subject to the situs rules. Thus, under the treaty, the United States is accorded the right to impose a tax, with France to grant a credit. That is clear. But the treaty makes no provision relating to the rate of tax the United States may impose. If it was clear that our hypothetical individual was neither a citizen nor an expatriate of the United States, the real estate would be subject to a tax rate ranging from six to 30 percent. However, under Section 2107 of the Code, the United States will tax the real property of a recent expatriate (whose expatriation was motivated by considerations of tax avoidance) at the much higher estate tax rate for U.S. citizens or residents that ranges up

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to 70 percent. Now, pursuant to the treaty provision, is France required to go along with this? Are they to grant a credit for such an absurdly large tax? I don't know.

Business assets

The second type of property over which the situs country has primary tax jurisdiction is business assets of an individual's permanent establishment which are located in the situs country and assets relating to a fixed base of an individual, who are used for performance of professional services or other similar independent activities. All of the treaties, i.e. Dutch, French, and U.K., have adopted generally the OECD Draft with respect to a permanent establishment.

There are, however, slight variations: e.g. none of the treaties follows the OECD Draft for a "place of management" within the category of business property of a permanent establishment, although the French treaty does refer to "a seat of management", which may be the same. I am not sure whether this concept can be applied meaningfully for individuals or partnerships. Also, the Model treaty requires the presence of a building site or construction or installation project for more than 24 months if the same is to be considered business property of a permanent establishment. None of our treaty partners has agreed to that. They all have reduced that period to 12 months, which is similar to the period used in the income tax area. In addition, the Model treaty, unlike any of the treaties, treats a drilling rig or ship being used for the exploration of natural resources in the same way as a building site and thus as business property of a permanent establishment. None of the Model or the U.K., French, or Dutch treaties specifically excludes from the definition of a permanent establishment the maintenance of a fixed base used for investment purposes (although, perhaps, investment activities would not be deemed a business and so are, in fact, excluded). It would be inappropriate to apply the permanent establishment concept to a base used for investment for estate tax purposes. Under the permanent establishment, or fixed base, provision, business property may be taxed by the contracting state which is not the place of domicile, if it forms a part of the business property of the permanent establishment situated for treaty purposes in that state. This provision not only applies to property situated in the state where the permanent establishment is located, but also appears to apply to property located outside of that contracting state, and in fact, located within the other contracting partner, except with respect to real estate with respect to which the country of situs has the right to retain its jurisdiction (and ships and aircraft, which are to be taxed exclusively by the country of domicile pursuant to the Model, Dutch and French treaties, though not the U.K. treaty).

The permanent establishment concept poses interesting problems, e.g. if the decedent had a permanent establishment in France, which was the non-domiciliary State, and there was connected to that establishment tangible property in the United States, that property would be attributable to the permanent establishment in France, and, therefore, fully subject to tax by the French government (with a credit against the U.S. tax in the amount of the French tax). The problem is that it is conceivable that an individual or partnership may have more than one permanent establishment just as an individual, as we have seen, may have more than one domicile. If so, how does one decide to which permanent establishment the related property is to be attributed? For example, suppose there are two permanent establishments in different countries and one permanent establishment transfers property to the other and the individual dies when the property in question is neither in France nor the United States. To which permanent establishment will that property be attributed? In other contexts, we use a destination rule to determine the situs of property, but when dealing with a transfer within the same entity, the logic of the destination rule may not be applicable, and it is not clear which rule should govern.

Tangible personal property

The Model treaty does not specifically cover tangible movable (personal) property, though the French treaty includes that class (excluding currency, personal use property, planes and ships from that category) and renders it subject to taxation by the contracting state in which the property is sited, if the property in question is not taxable by the other contracting state because it is connected to a permanent establishment within that other state. It is not clear what this provision adds to the French treaty, since the United States taxes the property of a U.S. citizen or resident on a world-wide basis so it would always tax the tangible property of a U.S. citizen or resident regardless of where that property was located. The provision, thus, must have been directed toward permitting the United States to tax the tangible property of a French domiciliary situated in the United States. It is odd the French agreed with this provision, assuming my analysis of its effect, but that is about the only analysis I can find that accords with the words in the treaty.

As I noted above, the treaty excepts from the usual movable property rule personal use property. It is by no means clear what personal use property means. For example, we recently had a case involving a foreigner residing in France who kept more than a million dollars worth of jewelry in a vault in the United States. The jewelry was kept here to avoid the risk of moving the jewelry back and forth. On her infrequent visits to the United States, the foreigner took some of the jewelry from the vault and wore it. When she returned to France, the property was returned to the vault. In France she had other jewelry of comparable value to the jewelry kept in the United States (obviously, this was a wealthy individual). Is the jewelry our foreigner retained in the United States subject to U.S. tax because it is tangible, movable property, or is it that type of property that is exempt from U.S. tax as property used for normal personal use of our foreigner. Under our domestic law, jewelry accompanying a person vacationing abroad or in transit is deemed personal property, with a situs where the individual owner has his domicile. Under our domestic rules, tangible property in the situation just presented, which does not accompany the individual and is stored permanently away from the place of domicile, would be treated like real property and accorded a situs at the place where it is permanently stored, so that, if our domestic rule were applicable, it would be subject to U.S. tax.

Interest in a partnership

The fourth group of property that is accorded a situs under the Model treaty is an interest in a partnership. Under our Internal Revenue Code and the regulations, the situs of an interest in a partnership is not covered. The taxation by the United States of a foreigner's interest in a U.S. partnership would appear to depend on whether the partnership is treated as a juridical entity, and, if it is, whether the entity survives death. If the entity is not respected as a juridical entity following death, then under the Code it would seem to me that one should separately analyse each component of the partnership as one would the property of a sole proprietorship, locating each component where it is sited. This is the rule adopted by the Model treaty. It treats a partnership as an aggregate rather than as an entity. I am not sure whether this would be the rule under the Code. Under the Uniform Partnership Act and the Limited Partnership Act, however,

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a partnership is an entity so that any interest in it is deemed to be intangible personal property with a situs where the individual owner of that interest is domiciled.

The question is presented as to whether, apart from the Model treaty, the United States could impose a transfer tax on an interest in a partnership in the United States held by a foreigner. If it cannot, then certainly the Model treaty provision should not be able to be more onerous than our local law. Unfortunately, there is no conclusive answer as to how the United States views a partnership interest for purposes of transfer taxation. It is clear that a general partnership terminates upon the death of a general partner, suggesting the absence of an entity, for estate tax purposes. However, even this is of little aid, since most foreigners who invest in the United States do so as limited partners, and when they die, the partnership does not terminate. In conclusion, no conclusive answer can be furnished as to how, given the absence of treaty provisions dealing with the problem, under U.S. estate tax law, the interest of a foreigner in a U.S. partnership will be treated. No decided cases or other authority appear to exist other than the government's asserted position.

Other property

If the property involved is not real property, business property of a permanent establishment, ships or aircraft (and under the French treaty tangible, movable property not for personal use), then the property may be taxed only by the state in which the decedent donor or deemed transferor was domiciled at his death or at the time of the transfer. This provision covers such things as shares of stock, debts, as well as all of those intangible personal property rights whose status is unclear under the Internal Revenue Code. It does not appear clear to me as to where a patent is located for purposes of the Internal Revenue Code, or, similarly, where the location of a trademark or a copyright is, assuming that these are not attributable to a business or a profession. (An interest in a trust may raise the same type of problem, as well.) As I indicated earlier, I wrote an article about two years ago in which I tried to deal with those problems, and I was unable to arrive at any definitive conclusions.

Shares of stock

The United States and the United Kingdom have traditionally insisted on taxing shares of stock on the basis of situs, that is, on the basis of the place of incorporation of the corporation, the shares of which are involved. In the OECD Draft, both had reservations concerning Article 8 which would subject shares of stock to taxation by the country of domicile alone. In the Model treaty the United States has retreated from that position and is now willing to treat shares of stock as being taxable solely by the country of domicile.

Deductions

After it is determined what is subject to tax, the next question to consider is what deductions are permitted. Under the Code, the gross estate of a non-resident alien is limited to the property situated in the United States and only certain deductions are permitted in computing the U.S. tax. Those deductions which are permitted must be allocated. Deductions attributable solely to property not situated in the United States are disallowed. Also disallowed is the portion of deductions not specifically applicable to any U.S. property. The portion of deductions not specifically applicable, corresponding to the ratio of the value of the assets included in the U.S. gross estate to the value of total world assets, will be deductible. These proportional deductions under the Code include funeral and administration expenses as well as general obligations. Certain other types of deductions — the marital deduction and the charitable deduction — are completely denied to the estate of a non-resident alien under the Code, but are granted under the Model treaty.

The deductions permitted by the Code are funeral expenses, other administration expenses, indebtedness, certain death taxes and losses. None of the treaties nor the Model discusses any of those provisions. Many jurisdictions do not allow administrative expenses in determining estate tax. For example, I believe the Netherlands will not. [3] So, unless local law or a non-discrimination provision allows one to secure a deduction for a funeral or administration expense or a loss during administration, one will not be permitted to obtain a deduction in the foreign jurisdiction based upon the treaty. With respect to debts, the Model permits a deduction for a proportionate part of debts corresponding to the proportion of world-wide assets subject to a contracting state's jurisdiction, as well as by debts assumed by the transferee or deemed transferee, and the French treaty allows a deduction for debts allowable in France corresponding to the proportion of world-wide assets taxable by French as well as for debts if specifically applicable to a permanent establishment or fixed base or to ships and aircraft, but only against the value of these specific assets.

The Code rule for claiming deductions may be applicable when the relevant treaty is silent. It should be noted that no deductions are allowed under the Code unless the executor includes all world-wide assets in the Federal estate tax return. Most clients do not wish to include their world-wide assets on form 706NR. They, therefore, generally forego all the deductions including debts. I assume they will continue to forego their deductions under the treaties because they will not wish to disclose world-wide assets.

Under the Code, a charitable deduction is available for all transfers to the United States or any state or political subdivision thereof for public purposes, or to any domestic corporation organized and operated exclusively for religious, scientific or educational purposes (as well as transfers to certain charitable trusts or fraternal orders). It should be noted that, to be deductible, the corporations and associations to which the property is transferred need be organized in the United States and transfers to trusts will only be deductible if used in the United States. It should be noted that if property is located here and the non-resident alien tries to give it to a foreign charity, the amount of the transfer is either fully deductible or totally non-deductible depending upon whether the organization, if a corporation or association, is domestic or, if a trust is involved, whether the property is used in the United States. The deduction is not prorated as with expenses and liabilities.

The other limitations upon deductions applicable under the Code to estates such as filing of a return are also required under the treaties.

The Model treaty will permit a charitable deduction in one jurisdiction for transfers to charities of the other jurisdiction if such transfer would be exempt from tax if made to a similar institution situated in the state levying the tax, and if the foreign jurisdiction in which the institution is situated normally permits a charitable deduction for a transfer to such institution. Neither the Dutch nor the U.K. treaty contains a provision for charitable deductions. The French treaty has a charitable provision, but restricts the charitable deduction to transfers to institutions

3. *Editor's note:* In the Netherlands only funeral expenses are deductible.

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which receive a substantial part of their support from contributions from the public or governmental funds. Thus a transfer to a private foundation situated in either jurisdiction would not qualify under the French treaty with the United States.

The marital deduction is not covered in the Code provisions for non-resident alien estates. Under the Regulations, this deduction is specifically denied. The significance of the loss of marital deduction in the United States depends upon whether the property subject to U.S. tax is located in a community property jurisdiction. If it is, the loss of the marital deduction is not particularly important to the taxpayer. If the property is not in a community property jurisdiction, and most states are not, then the loss of the marital deduction could prove significant. In the first Model treaty, the United States granted the marital deduction notwithstanding that in 1966 it reduced its tax rates for non-resident aliens because of the absence of a marital deduction. Thus, even though the reason for not according the marital deduction was the lower tax rates applicable to non-resident alien estates, we were willing to provide a marital deduction for a non-resident alien estate in return for obtaining from the foreign jurisdiction under the Model treaty a 50 percent reduction, up to 50 percent of the value of the property situated in that country, for property passing to the surviving spouse of a United States person. The Netherlands treaty, which became effective in 1971, after the OECD Draft but prior to the first Model treaty, made no provision for a marital deduction to be used in computing the U.S. tax for a non-resident alien; although it did require that the Netherlands provide a marital deduction when dealing with the property of a U.S. person. Both the U.K. and French treaties which were negotiated after the Netherlands treaty provide for a marital deduction in computing the U.S. estate tax on the estate of a non-resident alien. The provisions of the U.K. and French treaties differ with respect to the manner in which the marital deduction will be used in computing the U.S. estate tax on the estate of a non-resident alien. The U.K. treaty requires that the United States accord the marital deduction when dealing with a non-resident alien, while applying the lower rates applicable to the estates of non-resident aliens. The French treaty affords an option. One may in computing the U.S. estate tax for a non-resident alien decedent with a surviving spouse either use the regular rates for a U.S. domiciliary and a marital deduction, or use the rates for a non-resident alien with no marital deduction. The marital deduction provision under the treaties corresponds to the provision of the Code. If one is not entitled to a marital deduction under the Code, if a domiciliary of the United States, one will not secure the deduction under a treaty.

Exemptions, credits and rates

Under the new unified tax regime, the United States imposes a unified Federal estate and gift tax which is reduced by a single unified credit. However, unlike the taxes for a U.S. citizen or resident, the estate and gift taxes are not uniform for a non-resident alien. Non-resident alien estates are subject to lower rates than apply to the estates of U.S. citizens or residents, as I have already noted. With respect to estate taxes, the rates for non-resident alien estates run from six percent on the first $ 100,000 to 30 percent on anything in excess of $ 2,000,000. However, the gift tax for non-resident aliens is imposed at the same rate as for a U.S. citizen ranging up to 70 percent. The generation skipping tax also ranges up to 70 percent, and, as with the gift tax, non-resident aliens deemed transferors are subject to the same rates as apply to U.S. deemed transferors, so that non-resident aliens are not subject to a lower tax rate (as is the case with the estate tax). None of the treaties appears to provide for the reduction by the United States of its rates with respect to gift and generation skipping taxes for non-resident alien donors or deemed transferors. The unified credit under the Code for a non-resident alien is $ 3,600 for the estate tax. No credit is granted by the Code for the gift tax. The Model treaty does not address itself to a credit for gift taxes, but does grant the estate tax credit of $ 3,600, or an equivalent exemption in computing the tax otherwise due. Since we no longer have an exemption, it is unclear to me what purpose that provision in the Model treaty serves. What is the effect of the change in our rules unifying the estate and gift taxes replacing the prior estate and gift tax exemptions with a unified credit on treaties antedating this change? Is the estate tax credit applicable against the gift tax as well on the theory that the two taxes are unified? Similarly, whether a similar credit is available under the old treaties against the generation skipping tax is also unclear. The legislative history would indicate that none of the older treaties, when permitting a credit, contemplated that it could be offset against a generation skipping tax (at least one arising under those generation skipping provisions which are analogous to the imposition of an estate tax upon the deemed transferor).

Relief from double taxation

The Model treaty and our other treaties provide for two credit rules to alleviate double taxation. The first rule is that the United States must grant a credit when it is the country of domicile, and the property taxed is sited under the treaty in the foreign jurisdiction equal to the tax imposed by the country of situs. Situs property consisting of real property, business property, tangible property, ships and aircraft and so forth is property for which the United States must grant a credit. The second rule requires that the United States, when taxing on the basis of citizenship when domicile is elsewhere, grant a credit for the foreign tax. The Model treaty and the treaties with some of our treaty partners provide that the United States when taxing the property of a U.S. citizen not domiciled in the United States must accord a credit for the foreign tax. The normal provision under the Model treaty is that one apportions the credit against U.S. tax for foreign tax based upon the assets located in the foreign jurisdiction to worldwide assets. This would apply both to the situation when the United States taxes on the basis of domicile and when it does so on the basis of citizenship alone. The normal rule also is that the credit accorded by the United States, either when taxing on the basis of domicile or on the basis of citizenship, is to be limited to the pro rata portion of the foreign tax relating to the assets in question. The French treaty contains an exception to the usual rule, which restricts the credit, so that it may not exceed either the amount of foreign tax allocable to the assets subject to double taxation or the amount of U.S. tax allocable to such assets. The French treaty provides, when the United States imposes tax upon property of a transferor or decedent who is a French domiciliary and a U.S. citizen, for a credit in the full amount of the French tax imposed with respect to the decedent or donor in question. If this credit exceeds the U.S. tax allocable to the property in question, the excess is to reduce the U.S. tax applicable to other property in the estate of the decedent or transferred by the donor.

All of the treaties provide for a period of limitations for the purpose of claiming a credit. The Model treaty permits a credit within two years of a final determination and payment, provided that it occurs within ten years of the date of death, gift or deemed transfer. The Dutch, French and U.K. treaties have different provisions. The mutual agreement provisions, of course, may override the normal period of limitation. None of the treaties provides relief from reporting even when no tax is due. The taxpayer cannot make a unilateral determination that his situation comes under the treaty. He must file a tax return. Information exchange is the normal rule, but there are some

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variations. The one that intrigues me is in the Dutch treaty. The protocol to the Dutch treaty provides that the Dutch will not give us information that is held in a bank or in an insurance company, which means that their bank and insurance company security provisions will govern.

The only treaty that provides assistance in collection is the French treaty. An assistance provision is not found in the Model treaty, but the French have decided that they may need United States' assistance, so they requested the incorporation of that provision in the treaty. It is contrary to the usual U.S. posture.

Tax Havens

by M. Carr Ferguson *

Haven has always been a very pleasant word to me. It suggests solace, respite, shelter, and tranquillity. I know that a favorite definition of a tax haven has been any piece of land not owned by the United States which is above sea level, at least at low tide, and which has no domestic taxes. Unfortunately, I think that the definition, while intended somewhat sarcastically, has come to have some real meaning to many of us. As you know, a Subcommittee on Oversight of the House Ways and Means Committee last April held two days of hearings on the subject of "Offshore Tax Havens". [1] The hearings in some ways anticipated a broader inquiry into what is called the subterranean economy or the invisible economy — that portion of our gross national product or wealth which does not show up on any of the traditional barometers or indices: a barter, cash, faceless, and ownerless economy.

Sandy said in his remarks this morning that we all know that people who own Swiss bank accounts never seem to die (at least that is the case looking at 706's which are filed), and that also is part of the subterranean or at least vaulted economy which is causing increasing concern in Washington. The hearings which were held by the Oversight Committee are instructive, and are worth securing and reading if you have not done so already. They reveal a surprising harmony of views between the private practitioners who presented their views, and the positions expressed by representatives of the Government. Your members Marshall I. Langer, Harvey P. Dale and Joseph H. Guttentag presented testimony; and the Government was represented by officials from the Departments of Justice and Treasury, the Internal Revenue Service and the Securities and Exchange Commission.

The concerns expressed by these witnesses were not substantially different from those articulated in 1962 when the Kennedy Administration initiated the first major efforts to control or regulate offshore tax havens used to shelter overseas income from U.S. taxation. These efforts reflected the continuing tension between our principle that U.S. citizens and residents are taxable on their world-wide income, and the territorial limitations on our ability to investigate and collect taxes. For example, we are all familiar with the provisions dealing with foreign base company income, foreign personal holding companies, and foreign trusts. The success of these provisions in controlling the problem is still open to question, certainly in my mind, and perhaps in the minds of many of you who are more experienced and more sophisticated in the techniques of working around Subpart F or working with Subpart F (maybe that is a more euphemistic way of putting it) than I puport to be.

The growing overlay of treaties and the use of third-country treaties as a way of reducing the tax burden on domestic taxpayers, both corporate and individual, is also a matter of increasing concern. To what extent do the provisions in the Internal Revenue Code and the provisions in our system of treaties produce results which were never intended or contemplated? Here, as in any other area of the law, to the extent that imaginative or aggressive tax planners can develop new ways of utilizing the law and conforming a newly developed kind of transaction to the changing patterns of law, new problems develop.

Another concern is the extra dimension to tax avoidance present in the case of offshore tax havens and other overseas entities. The extra dimension which we do not have in, for example, domestic tax planning without offshore ramifications is that not only can we plan to create a favorable reporting position for a client, we can plan to prepare a position for no reporting at all. More and more wealth seems to be slipping abroad invisibly in transactions which have no significance or purpose in international trade. Perhaps our reporting requirement have not kept pace with the legitimate ingenuity of the private bar and the accounting profession, but I think that this slippage has grown largely due to the creation of questionable devices, techniques, and stratagems for not reporting a transaction.

This lack of reporting has caused a gap between information and belief. This credibility gap is not held by consumers of Government with respect to their Government, but the other way around — a credibility gap held by Government officials with respect to the size of the underground economy or the invisible part of our offshore transactions. This has been reflected in a series of attempts to deal with offshore transactions through the Internal Revenue Code, most recently, I suppose, in 1976 with the draconian changes in the taxation of foreign trusts created by United States persons. But just as that legislation was put into place, we found that it did not adequately solve the problem. Practitioners who previously had been urging establishment of foreign trusts by American citizens are now finding ways to have trusts established by non-resident aliens and then utilized by Americans. [2] Some practitioners are now avoiding the trust format, and are calling entities set up abroad in tax haven jurisdictions foreign foundations or some other entity which seems immune from Section 679. At this point many tax officials have come to the belief that continued amendment of the Internal Revenue laws to try to anticipate and correct a transaction which might give rise to no reporting is almost as fruitless as sifting sand. There must be other attitudes or approaches to the problem.

I think that there is a responsibility not just on the part of governmental officials, but on the part of everyone concerned about the shape of our taxation of international transactions, to suggest and recommend changes in the law which will accomplish what seems to me would be the two principal goals here. First, the policing of investments and transactions which are made by Americans abroad but which have no significant purpose outside the boundaries of this country. Second, the establishment of a series of tax laws which will not impose unnecessary or unrealistic impediments upon the continued growth of a vigorous participation by American investors in international business.

With respect to the second goal, it is certainly worth noting the growing concern which some participants in international transactions have that the laws already on the books are beginning to cause problems or place Americans at unfair competitive disadvantages in dealing with investors or businesses in other countries. For example, in the law enforcement area, the problem of

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1. Hearings before the Subcommittee on Oversight of the House Ways and Means Committee on Offshore Tax Havens, April 24 - 25, 1979.

2. This type of transaction was the subject of Rev. Rul. 80-74, I.R.B. 1980-11, 13, where the Service ruled that the double trust was a sham and taxed it as a grantor trust.

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bank secrecy has brought the goals of the investigator and commerce into conflict. In other countries, as you know, there is a growing pressure to increase bank secrecy. This is frequently referred to as a need to reassure investors, who may otherwise feel their capital should be moved to another country, that they will be protected if they keep their bank deposits or other passive investments in a country which has traditionally provided secrecy. American banks both here and in their branches abroad are concerned that if they cannot offer similar confidentiality they will tend to lose their ability to pool capital.

Partly to ameliorate this concern of American banks, Congress in 1978 enacted the Right to Financial Privacy Act.[3] The statute has not totally alleviated the banks' interest in having additional protection as to the identity and size of deposits. On the other hand, law enforcement officials repeatedly suggested during the April 1979 hearings[4] that the Treasury step up its activity with respect to currency transaction reports required of banks in this country. So I think this will be a point of conflict with respect to bank transactions; certainly, until we are all using nothing but universal credit cards, cash will continue to be amoral and at times untraceable and the problem will remain with us.

These are some of our problems and concerns. What should be the avenue of our attack on these problems? Certainly as the traditionally high level of taxpayer compliance and taxpayer morale (which is sometimes described as the best in the world) is threatened by what is perceived as a growing tendency to use tax havens and to engage in transactions lacking any significant purpose other than the reduction of taxes, there will be pressure to make use of both existing weapons and to create new weapons. This country probably takes tax evasion and tax crimes as seriously as any country in the world. That is no less true of tax havens. It is not surprising that when a part of our system seems to be particularly under siege, the instinct on the part of Government officials is to roll out heavier and heavier weapons to confront the problem. The problem here is the fact that non-resident alien entities are not subject to our tax or reporting requirements, and one of the heavier weapons which has been suggested from time to time has been the criminal law dealing with tax evasion.

It seems to me rather obvious that over-reaction by the Government to a problem is not necessarily useful. This is a good example. In a sense, using the criminal statutes with respect to tax evasion and the filing of false documents as a way of controlling what is perceived as the abuse of the laws of tax haven jurisdictions or the utilization of tax haven entities to abuse our own domestic income tax is a little like using cannons to control a mosquito problem. It is ineffective and out of proportion. One cannot end tax manipulation or efforts to reduce taxation, to below an acceptable minimum, by trying to terrorize the lawyers or other tax planners who counsel such transactions. What is needed is across the board increase in the level of intelligence — I don't mean I.Q. — but rather information developed by the Internal Revenue Service.

However, having said that, I think that the criminal laws have played and will continue to play an important role in buttressing taxpayer compliance. Offshore trusts and similar entities used to evade federal taxes are frequently undertaken after seeking rather probing and sophisticated advice from a tax professional. The reliance on the advice of tax counsel is a pretty good defense in any tax evasion suit. Almost unavoidably the focus of attention is then drawn to the tax advisor: is the advice given within the bounds of what is acceptable, or at least within the bounds of what is not criminal; or has the advice strayed beyond that boundary so that it should be characterized under the criminal laws as participating and assisting in the filing of a false document, namely the tax return?

The application of the criminal laws to tax counselors has been tested in recent years in two celebrated cases against tax lawyers who counselled series of transactions involving offshore havens. The results of those cases have not been conclusive one way or the other. All three cases were tried before juries. In one of the cases a jury acquitted the lawyer; in another case the jury convicted the tax lawyer; and in the third case involving two tax lawyers, the jury acquitted one and convicted the other. Juries being as inscrutable as their reasons, it is rather hard to know to what extent the juries weighed carefully or analyzed the boundaries between aggressive tax planning and outright fraud. But certainly there were badges of fraud alleged by the Government in all three cases: for example, the backdating of documents, the creation of documents to describe transactions which never occurred, and the intentional suppression of information required by the returns at the time they were filed. A mere substance versus form kind of argument, nothing more, hardly seems the basis for a criminal prosecution. Indeed, cases have not been brought as far as I know either against lawyers, other counselors, or their clients, where some fairly obvious and I think generally disapproved badge of fraud was not present.

One problem is that the lack of complete reporting, the lack of mechanism for filing a return with respect to the offshore entity in a tax haven, makes it difficult at times for those counselling a client to utilize the usual defense of attaching a rider to the return explaining what happened. I suggest, however, that at least with respect to the domestic part of such a transaction it is usually possible to find a return — say a return claiming a deduction with respect to a transaction which is known to be with a related offshore entity — and to attach the rider at that point even though the offshore entity itself need not file.

I also think that the disclosure problem, to the extent it exists, can be solved by better attention to the reporting forms required with respect to the establishment of an offshore entity in which an American taxpayer has a beneficial interest of a sufficient percentage. The impression which I have, and which I think many of you may share, is that those forms are not filed regularly; to the extent they are filed, as far as many people can tell they are not inspected very carefully by the Internal Revenue Service.

As I say, I think that the use of tax haven jurisdictions for transactions which really have no economic significance either in the tax haven or in a third country does not merely constitute a law enforcement or definitional problem on the civil side; it constitutes a problem for everyone whether in the Government or in private practice. As long as such problems continue or increase, the likelihood is that we will continue to see Congress periodically tightening up the tax law in ways which will penalize not those who engage in the transactions which should be the subject of corrections, but penalize others who are very conscientious in terms of their reporting requirements and in disclosure.

The targets of our investigation and prosecution have not stopped with American taxpayers and their advisers. In fact, a former Bahamian banker and a former Caymanian banker are presently fugitives from justice on criminal charges which were returned against them for participating in schemes with respect to which the United States participants have already been tried and convicted. I think that there is therefore a sense that our problem is one that involves evidentiary problems which are sometimes beyond the power of the federal courts to resolve, or beyond the power of the Revenue Service to fully grasp. And certainly, we have seen cases referred from the Revenue Service for prosecution which no doubt were solid and correct in theory but which were incapable of prosecution because of the inaccessibility of key overseas witnesses. We continue to have a group of specialists within the Criminal Section of the Tax Division working on offshore tax crimes, or tax crimes which have offshore aspects. Some of the conclusions which were drawn about the future success of those cases are rather fully set out in the hearing of last April to which I have directed your attention. I might just say, however,

3. P.L. 95-630, 92 Stat. 3541.
4. See note 1, supra.

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that there are a couple of rather common aspects of those cases. First, in most of them at least 90 percent of the necessary evidence is available within the United States. Second, the fact that a tax crime has been committed is so much more difficult to uncover where a missing party to the transaction is not seen in returns filed in this country, that in many of the cases ultimately referred to us for prosecution civil audits have already been completed without any uncovering of the crime. That means that very frequently the triggering event which prompts consideration of criminal prosecution is the development of information outside the usual civil audit technique — informers, competitors, or an investigation starting outside the tax area.

We shall continue to develop leads and techniques of this type, not just because of the Congressional prompting at the hearing last April, but because of a growing concern generally about the invisible part of our economy. Both the Department of Justice and the Internal Revenue Service will be devoting redoubled efforts to uncovering and prosecuting criminal abuses of present tax laws dealing with international transactions. Perhaps one of the clearest pieces of evidence of this new concern has been the establishment of a Special Commission headed by Dick Gordon to ferret out all the kinds of abuses, to make some estimate for us of the extent of the problem, and to recommend to the Government methods of dealing with the problem. Jerry Kurtz and I are very happy to have had Dick agree to head up this Special Commission, particularly since he comes from outside of the Government. We hope that he can investigate information available in the Departments of Treasury and Justice and in the Internal Revenue Service, and then give us a fresh evaluation of our old methods of dealing with these problems. I believe your organization shares a common interest with us in pursuing this study, so as to ensure the appropriate use of tax haven jurisdictions. I hope you can work with us and with the Congress to develop more effective ways than we have today of policing these problems.

It has been a pleasure to describe to you our concerns and problems, and to lay out broad avenues of attack. I hope that the next time someone from the Department of Justice is invited to speak, he will be able to tell you the effective results of Dick's study and to assure you that we are on the way not simply to realizing what the problems are, but also to solving them.

Impact of Tax Havens on the U.S. Tax System

by Richard A. Gordon *

At the direction of Commissioner Kurtz and Assistant Attorney General Ferguson, we have put together a study group to examine the impact of tax havens on the U.S. tax system. Congress likes us to study things and so we called it a study group. It is made up of employees of the Internal Revenue Service. Also, certain employees of the Tax Division are working with us, and we are getting significant cooperation from David Rosenbloom's office. The best thing I can do this afternoon is to spend five or ten minutes telling you what it is that we will be doing.

Conclusions are premature. I concur in Carr's wish that the next time somebody from the government comes here to speak, they will tell you about all of our conclusions and how successful we have been in acting on them.

When I took this job, I was somewhat skeptical as to the extent of the problem. A lot of strange schemes had been described to me, and there were rumors about large amounts of money flowing to tax havens. My skepticism evaporated when I started receiving brochures from practitioners in the field. Initially these came from California. Very strange things always go on in California anyway, so I disregarded them; but then they started moving east. I thought maybe one example would be very useful.

This is one example of many of these kinds of things we have seen which rely on the foreign trust which we thought we had dealt with in 1976. The promotion guarantees that your life can be 100 percent free of capital gains tax, 85 percent free of tax on ordinary income (and before you think that the 15 percent tax is grounds for malpractice, they say that this tax can usually be sheltered), 100 percent free of probate tax and red tape, 100 percent free of gift tax, and 100 percent free of inheritance tax. You can also avoid state sales tax on big ticket items, and avoid cross-liability which is where assets are protected from personal legal liability. The trusts are ready to use, they are legal, they are guaranteed by the U.S. Constitution, at least so the publicity brochures say. The fee for this, well, $ 15,000 was quoted in one or two brochures I have seen, and the brochures claim it is deductible. You might wonder how you get your money out so that you can continue to live. They allow appointments of privileged recipients who may request tax-free favors; it just goes on and on.

Purpose of the study group

I would like to tell you what we are going to try to do. As Carr pointed out, the government is having a lot of problems and in some areas some think that we are totally incapable of dealing with this epidemic. I am not sure that that is exactly true, but I think we are having trouble, there is no secret to that and a study of this area is long overdue. I think that we have recognized that the project is a very difficult one. Even defining the term "tax haven" is very difficult. At the Gibbons hearings the focus was generally on the Bahamas, and the Netherland Antilles and the Cayman Islands, but now we find that Austria adopted bank secrecy just a year ago. This is a serious development because we have an income tax treaty with Austria and I think it is important to find out whether Austria and other countries are still complying with what we feel are their responsibilities under the exchange of information provisions.

Also, any look at havens can be a very broad project because it obviously gets into the whole area of taxation of international transactions. We are going to try to narrow the focus somewhat so that we can get a report out within a reasonable time. We hope to have something by the end of the year. I think that we have people at the top in the tax administration who are very committed to this and that the time is ripe to attempt to do something and we would like to get it done while those people are still concerned about this issue. In the course of his testimony before the Gibbons Committee, David Rosenbloom described what it is that we are going to do. He said that the first step we would have to take, before we decide what to do about tax havens, is to bring ourselves up to the point where we all understand what is happening. That is our first goal. We plan to find out how offshore havens are being used and the ways in which persons who are subject to U.S. tax are using havens to avoid paying tax. We are interested in both the evasion and in the avoidance of U.S. tax.

I think this understanding of what is happening also involves

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understanding what is happening within the Government, and we intend to find out what is happening by undertaking a thorough evaluation of how the tax administrator has reacted to haven problems. We are going to analyze the efforts of the IRS to deal with havens and we are going to examine everything from IRS published positions to the allocation of IRS resources to the investigative techniques that are used in tax haven related transactions by our agents. We are going to analyze the effectiveness of IRS personnel in dealing with tax haven issues. We are also going to look at IRS coordination with other agencies and particularly of course with the Tax Division of the Department of Justice. Obviously Treasury and Justice are two departments that should be able to work very closely together but they have had problems doing so in the past, at least in some cases, and I think that is a serious concern.

We are also going to try to take a look at the substantive responsibilities of U.S. taxpayers and attempt to determine whether and to what extent U.S. taxpayers are complying with those responsibilities and whether or not there are changes in the law which are necessary to enforce those responsibilities.

In this regard we also intend, as Carr indicated, to analyze the reporting responsibilities of U.S. taxpayers and try to determine whether the reporting can be improved. First, to see whether we can get additional information which can be useful to us. Second, to make it clear to taxpayers what there responsibilities are. I think that all of us have had substantial experience in this area and we feel that at least we in general know when a form should be filed. You have people in small towns who rely on accountants and lawyers who have no experience in this area, who frankly do not know what they are supposed to be filing and there are a lot of forms out there and one hope is that possibly we can combine some of these forms and cut down on the number of forms that people need to file.

Evaluation of tax treaties

When looking at this area we have to look at the treaties and determine what their impact is on the ability of U.S. taxpayers to take advantage of havens. I think that if we find the treaties are a major contribution to avoidance, it may be necessary to reevaluate the program, reevaluate the model treaty. Such a reevaluation is beyond the scope of the present study but certainly an inquiry into the impact of treaties on this problem is not. In looking at treaties we are going to focus on the mutual assistance provision. We will try to find out whether they are working; there is, frankly, some feeling that they do not work well in all cases. You speak to some people in the Internal Revenue Service who have had experience with gathering information and they find out that the quality of information and the ability to get information does not differ from between treaty partners and non-treaty partners, which means that either some of our non-treaty countries are very cooperative or else we are not getting what we should from the treaty partners.

As Carr mentioned, we hope that a good part of this project can be undertaken through discussions with people here, people who are familiar with this area. I have already begun some of these discussions and so far the response has been excellent and I hope that the spirit of cooperation will continue. We would like the problems that are brought forward to be real problems and I think that people with experience who work in the area every day, who have the breadth that the people in this room do, can help us in that regard. We are also going to be talking to foreign tax administrators and try to find out what their problems are and what they have done in the area and try to determine whether there are multilateral approaches that can be taken. In the course of some of those preliminary discussions, we found that other countries are very concerned and a few of them have been even more aggressive on the administrative side than we have.

Finally, we plan to analyze many of the recommendations which have been made, a lot hat were made during the Gibbons Committee hearings, and others which have been made to us. We will also come up with some of our own. I would hope to be able to once again call on many of you for your reactions to some of these recommendations and I hope that these are changes which would enable the Internal Revenue Service and the Department of Justice to better deal with this area.

Non-legislative recommendations preferred

I would hope that most of the recommendations would be non-legislative. Having had some experience in working with income tax legislation I realize that any time you go up to the hill and make proposals you lose control and things sometimes end up a lot more complex that you intended. Complexity, I think, is part of what leads to the kind of scheme I mentioned to you earlier. It is at times difficult to penalize users of such schemes because all too often the courts have not been willing to find the necessary willfulness to evade tax because things are so complex.

We are also going to undertake a project which I think is the most difficult, which is to attempt to determine the extent of haven use. I think that in part our recommendations have to depend on how large the problem is.

Finally, I also think that we have to focus on the responsibility of the practitioner in this area. In the short time I have been on the job, it has become readily apparent that these kinds of things are very often the product of the overactive minds and the promotional skills of tax advisors. Too often, tax avoidance schemes are backed up by the opinion of counsel. These writers of opinions rely on the very complex nature of the law, and on the fact that the bureaucracy is cumbersome, and even if you catch a few of their clients it takes an awful long time to do it. My hope is that the profession can do something to start policing itself.

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Tax Treaty Interpretation

by David Rosenbloom *

I always appreciate the opportunity to talk to IFA and I particularly appreciate the opportunity to speak on the subject of interpretation of tax treaties, a subject which I have interpreted from my own somewhat parochial viewpoint.

Let me begin by observing that Mr. Ward's very interesting paper and presentation focused upon the question of treaty interpretation in the courts, either implicitly suggesting that the interpretation of a treaty should be precisely the same whether it is undertaken in the context of a litigated case or as presented to the competent authority.

The issues

One question that I want to raise at the beginning of my statement is, whether there is a difference in interpretation depending upon who is doing the interpreting. This is the other side of a point which Sidney Roberts made in passing, which forms a central question for me; namely, has any power been delegated by the Congress of the United States to the U.S. competent authority to interpret a treaty in a creative way. Another overall issue that I just want to raise, which I think both Mr. Ward and Mr. Boidman really are suggesting, is what type of law does a treaty create — should a treaty be interpreted as statuted, as a constitution, or in some sui generis way. I would like to come back to that question, and just share with you a few thoughts from my own experience as a treaty negotiator in terms of what makes sense. I would put in a footnote at this point; any country which operates with a rule of statutory construction that legislators, in amending the Internal Revenue Code, were aware of everything that was in the Internal Revenue Code at the time of their amendment and took that fully into account is dealing with a legal fiction. Perhaps my experience as a negotiator might lead to a common sense conclusion as to what type of law a treaty creates, but it would not necessarily lead to a legally binding conclusion as to what type of law a treaty creates, because one could indulge the same type of legal fiction on that issue.

A third question besides who is doing the interpreting and what type of law are we talking about is what materials are relevant. I should say at this point that all of these issues are extremely live in my office these days because there is an ongoing, simmering issue which I have reason to believe will surface in one form or another in 1980 in regard to the role of the U.S. competent authority. This is an issue in which my office is intensely interested, much more interested than in the question of how treaties are interpreted when they reach the courts, that being the province of the U.S. Justice Department, hence my reference to my own parochial views.

Finally, a fourth issue that seems to me perhaps not as sweeping as the others, but also relevant, is what is the appropriate procedure for reaching and enunciating a given interpretation of a treaty. That question is not too terribly relevant, in a litigated case, although I can see ways that it might be made relevant. But if you are thinking about interpretation at the competent authority level, I suppose a very important question is the degree to which reciprocity should enter into the substance of decision making.

Illustration of problems

Now, I realize all of this is highly abstract; so to illustrate the problems concretely, I would like to read to you a very brief provision, paragraph 2 of Article 5 of the income tax convention between the United States and Canada, a convention which could not be more relevant given my Canadian colleagues on the panel today. This provision deals with the taxation of motor carriers. It says, "an enterprise of one of the contracting States engaged in the operation of motor vehicles, as a common carrier or a contract carrier, shall be exempt from tax by the other contracting State in respect of income (if taxed by the former State in respect of such income) arising from the transportation of property for hire between points in one State and points in the other State." An enterprise of one contracting State engaged in the operation of motor vehicles as a common carrier or contract carrier is exempt from tax at source in respect of income arising from the transportation of *property* between points in one State and points in the other State.

The obvious issue is what happens with respect to the income of buses. Now, let us assume, first of all, that the notes reflect absolutely nothing on the reason why the negotiators could conceivably have been prepared to address public transportation only of property and not of persons. Let us further assume that if the question were presented today to any negotiator on either side of the border, that person would not hesitate to reply that the issues should be exactly the same. In other words, do not quarrel with those hypotheses, because I am sure people could invent reasons for distinguishing the two cases. Property is property, persons are persons. If the clause were drafted today, it would include persons and property; and there neither was nor is any policy reason for distinguishing the two cases.

I present that case in the context of what we are talking about now because it is a real case. It is the kind of case that we are encountering regularly, so regularly, that we think we have a serious problem. It is the kind of case that has led us directly into the question of what is the competent authority all about. I suggest, however, that it also has relevance if this type of issue is being considered in the context of a litigation.

Type of law created by treaty

Now I want to return to my questions. First of all, what type of law does a tax treaty create? It seems clear that from my perspective on the U.S. side of things, a treaty does not create a type of law that is exactly the same as the Internal Revenue Code. It is inconceivable that the treaty negotiators could attempt to resolve every particular case with terminology that would track the language of the Internal Revenue Code; much less that they could spend the time on the variables that arise with respect to each treaty article to achieve the degree of detail that appears in the Internal Revenue Code.

A treaty quite clearly is an attempt to set out principles, and, in that sense, the OECD Model and the UN Model have made

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tremendous contributions to the area, because they have limited the amount of things left open to discuss. The process of negotiation is long enough as it is. Now that we have models that are relatively workable, we have to come to some kind of general understanding of what we have achieved. And what we have, in my view, is a set of principles that are intended to provide guidelines for the resolution of disputes. I would not go so far as to say that an adequate tax treaty is a complete delegation to the administrator, the implementor of the tax treaty, that is, competent authority — simply to resolve cases of double taxation. Obviously, on both sides of any treaty the legislatures and the governments are going to be concerned that there be guidelines. But that is essentially what a tax treaty is; it is a set of guidelines.

A tax treaty is essentially a set of guidelines

Now, I am always amused when I see courts or anyone else who reads a treaty too literally. But again I call attention to the legal fiction about how Congress acts. I suppose I should be equally amused when the court says the Ways and Means Committee had the full scope of the Internal Revenue Code in front of it when it enacted a new tax provision.

The treaty negotiators, as a practical matter, if they are going to achieve their objective, have to narrow the range of things they are going to talk about. In many cases (and I would say, not completely flippantly, even in regard to Canada), there are language differences among the treaty negotiators. It is hard, given the limits of language, to be sure that we have a true meaning of minds, on the meanings of the operative terms. Even a term that seems simple can have history one side of the border that is completely different on the other side of the border. In short, it is a will-o'-the wisp to assume that the negotiators have reached a complete agreement on all the issues that are going to arise. There has to be some room for play in the joints, some delegation of authority to the competent authority to work out particular problems in accordance with the principles which the negotiators have agreed upon.

In addition to working out particular problems within the ambit of the treaty, there are some unforeseen problems, some mistakes. Take a look back at my buses. We have no history as to why the negotiators of the 1942 treaty left out transportation of persons. Does that mean that the only resolution of the bus problem is for the executive branch to ask Congress for a protocol? — to amend the convention on that issue? If I were in Congress, my reaction would be that the administration proposing such an inconsequential charge would be crazy. There are so many other issues of much more pressing dimensions in the relationship in tax matters between the United States and Canada that it is inconceivable to me that a responsible reviewing body, such as the Senate, would allow the executive branch to try to to correct only one small problem like that. So does that mean we have to live forever with the problem? I repeat that answer. It is a live case.

A tax treaty is designed and intended to diverge from domestic law. There has been a lot of talk about a new generation of tax treaties, that suddenly the tax treaties are cutting loose from the moorings of domestic law and are going off and changing domestic law in ways that were never before changed. To a certain extent, there appears to be some truth to this, when you see an unusual provision such as Article 9(4) of the U.S./U.K. treaty or the efforts to reconcile the U.K. ACT system with the classical corporate tax system in the United States. But it is clear that a treaty is intended to change domestic law on both sides; otherwise, there would be no need for the treaty. In interpreting a treaty, one has to keep that in mind. The negotiators were trying to change domestic law for the purpose of alleviating double taxation and preventing fiscal evasion.

Relevant materials

Coming back to my second question — what materials are relevant in passing upon my motor vehicle case? It seems that there are two classes of materials that are relevant. I skipped very quickly in my hypothetical by telling you that there was nothing that bore on it, but in order to reach that conclusion, of course, I had to go back hypothetically again, and look at what there was. It seems that the first and obvious place of start is with the treaty language. One has to see whether there is any way of reading the language to achieve what seems to be a sensible result. Secondly, contemporaneous notes of the negotiators on either side of the border would be a prime source material. In the United States, as you know, we convert these notes now into technical explanations at the time the treaties are sent up to the Senate for consideration. The technical explanation or contemporaneous notes would also be a prime source of interpretation. I might add, in that connection, that although not everyone would endorse this view it is my opinion that a technical explanation of the treaty, based on the negotiators' notes would be more relevant on the interpretation of a treaty term than the comments of legislators in the ratification process, and more relevant than the Joint Committee explanation of the treaty.

What is the role of the Senate in the ratification? The Senate is advising and consenting to the ratification of the treaty. It seems, at first blush at least, that the notes of the people who negotiated the treaty are more centrally the statutory history than the Joint Committee explanation. Now, in practical effect there should be no serious divergences because, at least as matters function now, there is a great deal of interchange and there are opportunities for the negotiators to comment upon much of the legislative material. But obviously, there is a potential for divergence, particularly in areas which do not receive a great deal of attention in the ratification process. I spent a good share of yesterday trying to figure out, for example, whether the treaty between the United States and Germany required the Germans to provide exemption for employees of a U.S. Government instrumentality. Most of our present treaties cover both the U.S. government and instrumentalities thereof. The treaty with Germany does not.

What does that mean? One can argue it several ways. Since I think an instrumentality should be treated the same way as the underlying government, I would strive to reach that result. But again, on an issue like that, which is obviously not focused upon in the ratification process, and which may not be focused upon even in the negotiation process, there are opportunities for differences between the legislative materials and the notes of the negotiators.

I would also consider as important primary material in interpreting treaties, the representations made to the Senate in the ratification process by Treasury representatives. It seems that such representations are comparable to the notes of the negotiators. I would also place in the same category the models that are taken into account in negotiations, which today generally include the OECD Model, the U.S. Model, and, if dealing with a developing country, the U.N. Model. I would think that contemporaneous expressions of treaty policy can, in appropriate instances, be important.

Now, there is, however, a second class of less relevant materials which would include, for example, similar language in other treaties. There is a constant strain between the Treasury Department and the Internal Revenue Service on this issue. The Internal Revenue Service of course, is a mass operation. They like treaties to be alike. If the language in six treaties is similar it should be interpreted the same way, even if there were completely different negotiators and the notes are clear that terms were used in different ways. The Treasury wants each convention to be dealt with as a separate deal, a contract, in Mr. Ward's terms, between the United States and the other country. There is a constant tension on that issue.

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Secondly, more recent expressions of policy — how relevant are they? Apparently this motor vehicle case, is it relevant to the competent authority, or for that matter to a court, that, if asked today, U.S. treaty negotiators would say that, of course, they would equate the buses with the transportation of property, that there would be no reason for making any distinction between the two types of cases. Is that a relevant consideration in interpreting the treaty? If not relevant in court, is it relevant to the competent authority? That is the kind of issue we are dealing with today.

Interpretation by competent authority

Now, my third question is, again, who is doing the interpreting? I feel strongly, and I think it is the current view of the Treasury Department, that the competent authority is more than simply exercising a mechanical function sitting there with, in one hand, the treaty and, in the other hand, the Internal Revenue Code, maybe a dictionary, and spinning forth answers as to what words mean. I do not see that as the competent authority function. I would not go quite so far as to say that the competent authority has the right for all treaties to continue negotiations with respect to unforeseen circumstances, that may be too far. There is judgment to be exercised on how far the competent authority can go, at what point it crosses the line, and it becomes necessary to go through the formal steps of negotiating a protocol or a new treaty. But, I believe, and the Treasury believes, that there is room to correct problems under treaties where the words do not precisely fit, where there are strong policies for reaching a particular result.

To spell out a little further the divergence of view on competent authority, one view which I share is that the competent authority has the right and duty to take account of all my primary materials, and that, yes, present policies, present models, any available evidence that will help, can be relied upon legitimately by the competent authority in resolving particular double taxation problems that come up under a treaty. The other side of that coin is that, no, the only things that can be looked at are the treaty language, maybe the contemporaneous notes, the materials submitted in the ratification process, and then one is thrown into the Internal Revenue Code. Now, I can see the reasons why some would be more confortable with immediate recourse to the Internal Revenue Code once that relatively thin supply of primary materials is exhausted. But it is completely unrealistic to believe that treaty negotiators, in fact, have ever or do now negotiate treaties by trying to mesh the terminology used with what is in our Internal Revenue Code in the United States, or the domestic code of any other country. In the first place, now that we are operating on the basis of the agreed models, that is just not right as a starting point. The United States, for the sake of attempting to speed up negotiations, has adopted to a very large degree the OECD Model in dealing with developed countries, and, to a fairly large degree, much of the U.N. Model in dealing with developing countries. The relevant sources of interpretation, once the primary materials are exhausted, are the commentaries on those models to the extent that the United States has not explicitly reserved upon them and — a significant point — to the extent that the commentaries are clear. The OECD Model commentaries, in particular, are not always clear.

Procedures

Finally, what about procedures? Suppose the U.S. competent authority decides that a particular issue should be decided in a particular way. What does he do then? Does he put out a revenue ruling and wait until the sky falls? We have done that on several occasions. It has not been altogether satisfactory. Do we contact the competent authority of the other side? Suppose the competent authority on the other side says that he does not agree with the U.S. interpretation — is that dispositive of the issue? I would think that there is no good across-the-board answer to these questions, but I feel increasingly strongly that issues of international consequence involving treaty partners should be at least informally cleared with the competent authority of the other treaty country, at least to obtain an expression of their views, and that this procedure should be followed to the extent that we possibly can, given time restraints. I would caution that still leaves a fair amount of slippage in the area of private letter rulings, where, as you know, the Treasury is not involved and, for that matter in many cases, neither is the competent authority.

That concludes my comments. By the way, does anyone know what the right answer is in regard to the buses?

Principles to be Applied in Interpreting Tax Treaties *

by David A. Ward **

A considerable amount of scholarly legal writing has been done in Canada, Britain, the United States and elsewhere on the subject of international treaties generally and of treaty interpretation in particular. [1] Tax lawyers, accountants and others concerned with interpretation of tax treaties have not, it seems, often dealt with this area of the law, which has been reserved to that small group of specialists, the public international lawyers. This paper, therefore, is intended as a survey for tax practitioners of some of the well developed principles of public international law which may be brought to bear on problems of tax treaty interpretation. The comments are, of course, directed principally to Anglo-Canadian jurisprudential developments rather than to developments in the American courts. [2]

The treaty: a statute or contract?

The first question which should be resolved in dealing with questions of interpretation of treaties is the determination of whether a treaty is a contract or a statute. A tax treaty originates

* This article has been updated from a paper on the same subject delivered to the Canadian branch of IFA and published by The Canadian Tax Foundation, Can. Tax J. (1977) 263.

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1. See, Ad. McNair, *The Law of Treaties* (Oxford University Press, 1961); D.P. O'Connell, *International Law* (London, Stevens, 1970), 2nd. ed.; McDougal, Lassewell & Miller, *The Interpretation of Agreements and World Public Order* (Yale University Press, 1967); J.G. Castel, *International Law* (Butterworths, 1976), 3rd. ed.; J. Van Houtte, *Principles of Interpretation in Internal and International Law* (International Bureau of Fiscal Documentation, 1968); S. Rosenne, *Interpretation of Treaties, etc.*, 5 Columbia J. Transnational Law (1965), 204; G.G. Fitzmaurice, *The Law and Procedure in the International Court of Justice: Treaty Interpretation and Certain Other Treaty Points*, 28 Br. Yr. Bk. of International Law, (1951), 1; Harvard Law School, *Research in International Law, Part III, Law of Treaties; "Interpretation" of Tax Treaties: The Commissioner's Single Fact Method*, 15 Stan. L. Rev. (1962), 128; J.D.B. Oliver, *Double Tax Treaties in United Kingdom Tax Law*, Br. Tax Rev. (1970), 388; H.K. Lidstone, *Liberal Construction of Tax Treaties — An Analysis of Congressional and Administrative Limitations of an Old Doctrine*, 47 Corn. Law Q. (1962), 529; P. Germer, *Interpretation of Plurilingual Treaties, A Study of Article 33 of the Vienna Convention on the Law of Treaties*, 11 Harv. Inter. L.J. (1970), 400; and J. Hardy, *The Interpretation of Plurilingual Treaties by International Courts and Tribunals*, 37 Br. Yr. Bk. of International Law (1961), 72.

2. As is discussed later, the techniques of treaty interpretation in the

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as a contract between two sovereign states concerning taxation or relief from taxation by one state of the residents or citizens of the other. Such treaties typically cover income taxes or estate and gift taxes. Although created through bilateral agreement by the executive branch of government, tax treaties do not come into effect unless appropriate legislation is enacted.[3] Thus, in this sense, a treaty becomes a statute.

Implementing tax treaties by legislation probably follows the Canadian practice adopted by Parliament in 1926, following the recommendations of the 1923 Imperial Conference on Treaties.[4] Whether such ratification is necessary in law is debatable,[5] and recent indications have been given in Parliament that the government believes it has the right to make and bring into force international agreements (not specifically tax treaties) without the prior approval of Parliament.[6] Clearly, to the extent that a tax treaty is at variance with the provisions of the domestic law (e.g. the Income Tax Act), an amendment to the domestic law is a necessary condition precedent to the implementation of the treaty, and this can be effected only by Parliament.[7]

For whatever reason, invariably tax treaties are created, in the first instance, as bilateral international agreements, and are brought into force in Canada as part of the statute law through enabling legislation passed by Parliament. The question is: should such treaties be interpreted by the application of the ordinary rules of statutory interpretation, or should they be interpreted by the application of the rules applied to interpretation of contracts or by some generally accepted rules of international law?

If treaties are properly regarded as fiscal legislation, they should as other fiscal legislation be construed strictly.[8] Where treaties depart from domestic law, they invariably provide an exemption or reduction of tax beneficial to the taxpayer. The usual rule of construction of fiscal statutes, in dealing with exemptions, is to require the taxpayer claiming such exemption to prove not only that his case clearly falls within the exemption but also to convince the court that the exemption clearly applies to the facts of his case. In other words, the exemption is construed narrowly.[9] It could therefore be argued that treaties, if they are the equivalent of statutes, are to be strictly construed.

Should treaties be strictly or liberally construed?

There is authority, however, that such statutory rules of construction, applicable to fiscal legislation, should not be applied to tax treaties. McNair[10] believes that treaties generally should not be construed in a pedantic spirit and when ambiguous should receive a liberal construction. Van Houtte[11] has expressed the view that tax treaties must be interpreted, in the first instance, by methods similar to those used in interpreting a private contract. It has long been recognized by British courts that a treaty of alliance is not a thing stricti juris but ought to be interpreted with liberal explanations.[12] In interpreting and applying treaties, the courts have said they should be prepared to extend "a liberal and extended construction" to avoid an anomaly "which a contrary construction would lead to". As the court has recognized that "we cannot expect to find the same nicety of strict definition as in modern documents, such as deeds, or Acts of Parliament; it has never been the habit of those engaged in diplomacy to use legal accuracy, but rather to adopt more liberal terms".[13] Canadian courts have established that:

"The accepted principle appears to be that a taxing Act must be construed against either the Crown or the person sought to be charged, with perfect strictness — so far as the intention of Parliament is discoverable. Where a tax convention is involved, however, the situation is different and a liberal interpretation is usual, in the interests of the comity of nations."[14]

The English courts have also recently confirmed this principle of a liberal interpretation of international treaties. In referring to the construction of a British statute which implemented an international treaty to which Britain had become a party, Lord Macmillan said:

"It is important to remember that the Act of 1924 was the outcome of an International Conference and that the rules in the Schedule have an international currency. As these rules come under the consideration of foreign Courts, it is desirable in the interests of uniformity that their interpretation should not be rigidly controlled by domestic precedents of antecedent date, but rather that the language of the rules should be construed on broad principles of general acceptation."[15]

Canadian system have departed significantly from principles of statutory interpretation, in part embracing techniques which American courts would routinely use in interpreting statutes but which have been avoided in the Anglo-Canadian system.

3. Vanek, in his article *Is International Law Part of the Law of Canada,* 8 U. of T.L.J. (1949-50), 265, states that a treaty that affects private rights requires ratification of Parliament. He further suggests that a treaty made by the federal executive branch could, if it affects a branch of law in which the provinces have jurisdiction, be implemented by provincial legislation. See too: *A.G. Can. v. A.G. Ont. (Labour Conventions Case).* [1937] A.C. 326 and *Arrow River v. Pigeon Timber Co.,* [1932] S.C.R. 495, rev'g. 66 O.L.R. 577, rev'g. 65 O.L.R. 595, and the Canadian Government Memorandum of July 21, 1952, published in the United Nations Legislative Series, Laws and Practices Concerning the Conclusion of Treaties, ST/LCO/SER.B/3, 24 and 25. The federal government takes the position that it has the exclusive power to make international agreements: Hon. P. Martin, *Federalism and International Relations,* Queen's Printer (1968), 11-16, 24-28 and 30-33. However, the power of the provinces to make treaties in areas of law in which they have jurisdiction has received judicial approval: *Re Reciprocal Enforcement of Maintenance Orders Act,* [1956] S.C.R. 137. *Quaere:* how would an international treaty relating to provincial succession duty or gift tax be implemented?

4. H.C. Deb. (Can.) 1926, Vol. 5, 4758.

5. J.G. Castel, *International Law* (footnote 1), at 31.

6. H. of C. Deb., March 11, 1968 at 7467. As is noted later, most recently ratified Canadian treaties are specifically made subject to alteration, revocation, amendment or replacement by mere Order in Council which is tabled in Parliament rather than by legislation.

7. For a discussion of the legal steps required in the ratification process, see Gotlieb, *Canadian Treaty-Making* (Butterworths 1968), 38-40.

8. *Partington v. A.G.* (1869), L.R. 4 H.L. 100. For a complete discussion of the general rules of statutory interpretation in Canada, see: E.A. Driedger, *The Construction of Statutes* (Butterworths, 1974) and of the specific rules relating to taxing statutes, see C. MacNab, *Equity in Income Tax Cases,* 28 Can. Tax J. (1980), 445.

9. *R. and Provincial Treasurer of Alberta v. Canadian Northern Railway,* [1921] 1 W.W.R. 1178, varied 64 S.C.R. 264, aff'd [1923] A.C. 714.

10. A.D. McNair, (footnote 1) at 217 ff.

11. Van Houtte, (footnote 1) at 42.

12. *The Santa Cruz,* (1798). 1 C.Rob 50.

13. *Maltass v. Maltass,* (1844) Robertson's Ecclesiastical Reports 73 and 76. See also S. Rosenne (footnote 1). However, see Lord Wilberforce in *Buchanan & Co. v. Babco Ltd.,* [1978] A.C. 141 at 153: "... *the assumed and often repeated generalization that English methods are narrow, technical and literal, whereas continental methods are broad, generous and sensible seems to me insecure at least as regards interpretation of international conventions.*" It is submitted that this view has been overruled in the more recent decision of the House of Lords in *Fothergill v. Monarch Airlines Ltd.,* discussed infra.

14. RWS Fordham, Q.C. in *Saunders v. M.N.R.,* 54 D.T.C. 524 cited with approval by the Federal Court — Trial Division in *Canadian Pacific Ltd. v. Queen,* 76 D.T.C. 6120 and *Melford Developments Inc. v. Queen,* 80 D.T.C. 6074. In the *Canadian Pacific* case, the court added, "*The parties are in agreement that the terms of the treaty will override the Act and that it should be construed more liberally.*"

15. *Stag Line, Ltd. v. Foscolo, Mango & Co.,* [1932] A.C. 328 at 350 referred to with approval by the Federal Court — Trial Division in *Furness, Withy & Co. Ltd. v. M.N.R.,* 66 D.T.C. 5358 and in *Hunter Douglas Ltd. v. M.N.R.,* 79 D.T.C. 5340 and by the House of Lords in *Fothergill v. Monarch Airlines Ltd.,* [1980] 3 W.L.R. 209. See also *Bulmer Ltd. v. Bollinger S.A.,* [1974] 1 Ch. 401 at 425 where Denning, M.R. said: "*The draftsmen of our statutes have striven to express themselves with utmost exactness. They have tried to foresee all possible circumstances that may arise and to provide for them. They have sacrificed style and simplicity. They have foregone brevity. They have become long and involved. In consequence, the judges have followed suit. They interpret a statute as applying only to the circumstances covered by the very words .... How different is this treaty! ... Seeing the differences, what are English courts to do when they are faced with a problem of interpretation. They must follow the European pattern. No longer must they examine the words in meticulous detail. No longer must they argue about the precise grammatical sense. They must look to the purpose and intent.*"

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Therefore, the clear weight of authority would appear to be against using the type of strict interpretation which would normally be applied to an exempting provision of fiscal legislation in construing a tax treaty. The justification for this general rule of interpretation probably lies in the origins of a treaty generally as a contract or agreement between two or more States rather than in its formal ratification by Parliament as legislation. [16]

General canons of interpretation

In his excellent article, G.G. Fitzmaurice [17] classifies three main schools of thought on treaty interpretations:
(1) *intentions of the parties* or *founding fathers* school;
(2) the *textual* or *ordinary meaning of the words* school; and
(3) the *teleological* or *aims and objects* school.

The author (who at the time of writing was Second Legal Adviser to the British Foreign Office) notes that most cases involve a blending of the three schools of thought, with one of the three schools given primacy over the other two. The author correctly notes that the "teleological" or "aim and objects" school is usually applied to general multinational, social or humanitarian treaties and may not be used frequently in interpreting bilateral treaties such as tax treaties because the parties to bilateral treaties actually work out the specific terms through bilateral bargaining. Multinational treaties are not the result of such a precise bargaining process, and the court therefore has more scope of interpreting treaties by determining their apparent aims and scope. Therefore, in dealing with tax treaties, we are usually concerned with the interplay of two of the schools — the "founding fathers" or "intentions of the parties" and the "textual" or "ordinary meaning of the words" schools. Of the two, Fitzmaurice feels that in interpreting bilateral treaties, the "intentions of the parties" school should be paramount, since according to him it is the juridically natural view derived from well-known principles of private contract law. [18]

Ordinary meaning of the words

The more conservative view, however, is that the "textual" or "ordinary meaning of the words" theory of interpretation is paramount. As may be obvious, the language used in treaties generally (and tax treaties in particular) does not normally reflect the same degree of precision or detail as one has become accustomed to find in the Income Tax Act. There may be many reasons for this, including the necessity of working with a generally accepted style of drafting which accords with standards of most states. Obviously other states could not likely be persuaded of the advantages of the Canadian style of obscure and complex fiscal draftsmanship. It has been recognized that in construing treaties the court must attempt to give the widest scope to the language in order to include within it all matters intended to be included. [19] The court is bound to construe the words and not wholly depart from them, however, in order to attain the intended or reasonable consequences.

Courts should give wide scope to treaty language

If it cannot achieve such consequences by construing the words used, it is not empowered to abrogate the treaty merely because its consequences appear anomalous. [20]

It is also clear that the treaty is to be read as a whole, and particular phrases are not to be read in isolation or out of context. [21] In this regard, the natural sense of the words is to be followed, [22] unless perhaps if the result is unreasonable or absurd. [23] If, however, the natural and ordinary meaning of the words is ambiguous or leads to an unreasonable result, then the court should resort to other techniques of interpretation to discover what the parties intended. [24]

"Travaux préparatoires"

In interpreting contracts between persons in which there are ambiguities, the court may look to other evidence outside the contract for help in finding the intention of the parties. [25] Probably arising from this same principle is the rule of treaty interpretation; the tribunal in interpreting a treaty may consider the "travaux préparatoires" as evidence. [26] The real issue is whether this material can be examined only to confirm an interpretation which is fairly clear from the text itself even in the absence of a patent ambiguity or obscurity. [27] The International Court of

16. See R. Lenz, General Reporter, 2nd Subject, *Interpretation of Double Taxation Treaties*, Cahiers de Droit Fiscal International (1960), Vol. XLII, 299. The co-existence of the rule of strict construction of an exemption provision in the Income Tax Act with the rule of broad construction of a comparable exemption in a tax treaty was confirmed by Thurlow, J. in *Furness, Withy & Co. Ltd. v. M.N.R.*, 66 D.T.C. 5358 at 5363. Note should be taken of the dictum wrongly conceived, it is submitted, of Dumolin, J. in *Western Electric Co. Inc. v. M.N.R.*, 69 D.T.C. 5204, at 5210 "... *dealing, as I must, with a measure of exception, expressly enacted by the contracting parties to limit the extent of their own national laws and to devise special rules governing special cases of mutual interest, I feel bound to adhere closely to the current and ordinary meaning of the treaty terms. even more so than to provisions of any other statute.*"
17. See footnote 1.
18. Recent Canadian cases have confirmed that the purposes of a tax treaty, namely, the avoidance of double taxation, should be considered in arriving at an acceptable answer to an interpretative problem: *Hunter Douglas Ltd. v. Queen*, 79 D.T.C. 5340 and *Rutenberg v. M.N.R.*, 79 D.T.C. 5394.
19. *Shahmoon v. M.N.R.*, [1975] CTC 2361. See also Lauterpacht, 28 Harvard Law Review (1935), 564, and para. 1 of Article 31 of the *Vienna Convention on the Law of Treaties*, discussed below. Compare, however, the decision of the International Court of Justice in *Re Peace Treaties of 1947 with Bulgaria, Hungary and Romania*, [1950] I.C.J. Report 221 and *Davis v. Queen*, 78 DTC 6374 (aff'd 80 DTC 6056) where a rather strict, or textual, reading of the treaty was adopted without apparent regard for its underlying purpose.
20. "There is therefore no justification for interpreting the definition so as to distort the ordinary meaning of either word", per Thurlow, C.J., *Queen v. St. John Shipbuilding*, 80 D.T.C. 6272 at 6275. See also, *The Ionian Ships*, (1855) Spink's Prize Cases 193 and *Acquisition of Polish Nationality*, (1923) P.C.I.J. series B, No. 7, 20. This is also illustrated in the judgment of Jackett, C.J. in *Tara Exploration & Development Co. Ltd. v. M.N.R.*, to D.T.C. 6370 at 6377 (aff'd 72 D.T.C. 6288).
21. See *I.L.O. and Conditions of Labour in Agriculture*, (1922) P.C.I.J. series B, Nos. 2 and 3, 23.
22. Dictionary meanings of the words used are frequently used. See, for example, *Western Electric Co. Inc. v. M.N.R.*, 69 D.T.C. 5204; *Bank of Nova Scotia v. Queen*, 80 D.T.C. 6009 and *Queen v. St. John Shipbuilding*, 80 D.T.C. 6272.
23. *Polish Postal Service in Danzig*, (1925) P.C.I.J. series B, No. 11, 39; *Employment of Women During the Night*, (1932) P.C.I.J. series A/B No. 30, 373 and *Arbitration Between Petroleum Development and Abu Dhabi*, (1952) reported Int'l & Comp. L.O. 247, per Lord Asquith.
24. *Admission to the United Nations*, [1950] I.C.J. Reports 8 and *Fothergill v. Monarch Airlines Ltd.* (footnote 15). See for example, *McMahon v. M.N.R.*, 59 D.T.C. 1109 where the Exchequer Court in attempting to give some meaning to the concepts in Article I of the Canada—U.S. Convention interpreted the Article and the word "enterprise" by reference to the presumed sensible meaning as referring to persons and corporations.
25. *Bk. of New Zealand v. Simpson*, [1900] A.C. 182 and *Confederation Life Assn. v. Berry*, [1927] S.C.R. 595. These rules are discussed in Cross, *On Evidence*, 4th ed. (Butterworths, 1974), 546.
26. This was done by the Privy Council in *Molefi v. Legal Advisor et al*, [1970] 3 All E.R. 724. Compare however *Preen v. Simmonds*, [1971] 1 W.L.R. 1381 at 1384.
27. See Fitzmaurice (footnote 1), 5. In contract cases, such evidence, in cases as between parties, may be led only in cases of ambiguity: *Higgins v. Dawson*, [1902] A.C. 1 and *Confederation Life Assn. v. Berry*, (footnote 25).

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Justice has been reluctant to have recourse to "travaux préparatoires" where the text of the treaty is clear and leads to no absurdity in the context of the issue. [28] O'Connell seems to feel that no such restriction should apply as to the admissibility of "travaux préparatoires", stating:

"The primary end of treaty interpretation is to give effect to the intentions of the parties, and not to frustrate them. But as Lauterpacht expresses it, 'the eliciting of the intentions of the parties is not normally a task which can be performed exclusively by means of logical or grammatical interpretation'. Furthermore, the 'intentions' of the parties may never have crystallised or been formulated beyond a certain point. Every lawyer knows that the parties to a contract contemplate only performance: they enter into the transaction with optimism, and do not ordinarily advert to the problems raised by, for example, frustration. The courts pretend that the parties intended what they, the courts, believe they would have intended had they reflected on the matter. It is clear, then, that 'intention' is very often a fiction, and even when there was a conscious intention the words designed to be expressive of it may not be particularly helpful for this purpose. The same is true of treaty intepretation with the added difficulty that the parties may never really have wanted to come to agreement and may have deliberately left the area of operation of the treaty opaque.

The problem of treaty interpretation, then, is one of ascertaining the logic inherent in the treaty, and pretending that this is what the parties desired . . . .

The term 'travaux préparatoires' is employed to designate those extrinsic materials which had a formative effect on the final draft of a treaty, and which assist to this extent in the disclosure of the parties' aims and intentions. There is little dispute today on the permissibility of resort to these materials by international tribunals, due mainly to the admittedly cautious lead given by the International Court which demonstrated that even single words such as 'industry' are often not susceptible of fixed meaning, let alone expressions such as 'draw up a convention' which might mean anything from presenting a first draft to ratification. The most that the written words can do is set up a presumption in favour of a dictionary meaning, or one devised for application of the rules of syntax. It may be rebutted by the production of preliminary documents disclosing a different intention.

From a policy point of view resort to 'travaux préparatoires' is unavoidable. A municipal judge operates within an accepted context of social patterns, and is not open to the criticism of favouring a political position represented by one or other party. An international judge, however, is very vulnerable in this respect, and it is a guarantee both to him and to the litigant States of judicial impartiality if his area of discretion is delimited. Instead of devising a construction to a treaty which is open to alternative interpretations, he has the remedy of discovering exactly what the parties meant by examining their minutes of conferences, their correspondence and their rejected drafts. If objectivity is the aim of judicial construction, it is best achieved by this means. Furthermore, a treaty, unlike a municipal contract, often represents a compromise of vital political interests. To interpret it without reference to the struggle for compromise is gravely to over-simplify the problem of treaty application." [29] *(footnotes omitted)*

English Courts

The use of "travaux préparatoires" as an interpretative aid has recently been confirmed as a proper aid for English courts to use in interpreting treaties in *Fothergill v. Monarch Airlines Ltd.* [30]

"So far as purely domestic legislation is concerned it is well established as a principle of interpretation that, even where the words of a statute are ambiguous or obscure, the proceedings in Parliament during the course of the passage of the Bill may not be resorted to for the purpose of ascertaining what ambiguities or obscure provisions mean .... So Hansard can never form part of the 'travaux préparatoires' of any Act of Parliament whether it deals with purely domestic legislation or not . . . .

It is, however, otherwise with that growing body of written law in force in the United Kingdom which, although it owes its enforceability within the United Kingdom to its embodiment in or authorization by an Act of Parliament, nevertheless owes its origin and its actual wording to some prior law-making process in which Parliament has not participated, such as the negotiation and preparation of a multinational international convention . . . which Her Majesty's Government wants to ratify on behalf of the United Kingdom but can only do so when the provisions of the Convention have been incorporated in our domestic law . . . .

My Lords, it would seem that courts charged with the duty of interpreting legislation in all the major countries of the world have recourse in greater or less degree to 'travaux préparatoires' or 'legislative history' (as it is called in the United States) in order to resolve ambiguities or obscurities in the enacting words . . . .

Accordingly, in exercising its interpretative function of ascertaining what it was that the delegates to an international conference agreed upon by their majority vote in favour of the text of an international convention where the text itself is ambiguous or obscure, an English court should have regard to any material which the delegates themselves had thought would be available to clear up any possible ambiguities or obscurities." [31]

The Vienna Convention

Articles 31 and 32 of the Vienna Convention on the Law of Treaties [32] (1969) provide that:

28. *European Commission of the Danube,* [1927] P.C.I.J. Series B No. 14 at 31, *Article 4 of the Charter of the United Nations,* [1947-8] I.C.J. Reports, 63, *Admission to the United Nations,* [1950] I.C.J. Reports 4 at 8 and *Minquiers and Ecrehos Case,* [1953] I.C.J. Reports 47 at 71.
29. D.P. O'Connel (footnote 1), at 262. See also Lauterpacht, *Some Observations on Preparatory Work in the Interpretation of Treaties,* 48 Har. L.R. (1934-35), 575, and van Houtte (footnote 1), at 42.
30. See footnote 15.
31. See also *Hunter Douglas Ltd. v. Queen,* 79 D.T.C. 5340, where the court admitted oral evidence (apparently undisputed) of an officer of Revenue Canada as to the view of the Government concerning the meaning of particular words used in the Canada—Netherlands Income Tax Convention.
32. U.N. Doc. A/CONF. 39/27. May 23, 1969, to which Canada deposited its instrument of accession on October 14, 1970. A memorandum of June 4, 1970 prepared by the Department of External Affairs makes the following statement in respect of the convention:
"This Convention constitutes a law-making treaty laying down the fundamental principles of contemporary treaty law. Because of the paramount importance of treaties as a source of the international legal obligations binding upon states and the diversity and comprehensiveness of the interlocking network of treaties which today regulate the major part of transactions between states and serve to establish the relationships among them, the Convention must be viewed as virtually the constitutional basis, second in importance only to the U.N. Charter, of the international community of states."
See Castel (footnote 1), at 912. Rossenne (footnote 1), at 207, outlines the legislative history to Articles 11, 32 and 33 of the Convention.
The Vienna Convention came into force on January 27, 1980 with the deposit of the 35th instrument of accession. The following countries had (at September 26, 1980) signed, ratified or acceded to the Convention: Argentina, Austria, Australia, Barbados, Canada, Central African Empire, Cyprus, Denmark, Finland, Greece, Holy See, Honduras, Italy, Jamaica, Kuwait, Lesotho, Mauritius, Mexico, Morocco, Nauru, New Zealand, Niger, Nigeria, Panama, Paraguay, Philippines, Republic of Korea, Rwanda, Spain, Sweden, Syrian Arab Republic, Togo, Tunisia, United Kingdom, United Republic of Tanzania, Yugoslavia and Zaire. By Article 5, the Vienna Convention applies to treaties which are concluded between States after its entry into force.

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"Article 31

General rule of interpretation

1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose. [33]

2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:

(a) any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty;

(b) any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.

3. There shall be taken into account, together with the context:

(a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;

(b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;

(c) any relevant rules of international law applicable in the relations between the parties.

4. A special meaning shall be given to a term if it is established that the parties so intended.

Article 32

Supplementary means of interpretation

Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of Article 31, or to determine the meaning when the interpretation according to Article 31:

(a) leaves the meaning ambiguous or obscure, or

(b) leads to a result which is manifestly absurd or unreasonable."

Even in the absence of the Vienna Convention, it appears that there was no evidentiary rule which would exclude such evidence as "travaux préparatoires" in an appropriate case if an ambiguity exists. [34] It is pointed out that Article 32 is broader than the views expressed by the International Court of Justice and the House of Lords on the use of "travaux préparatoires". Whereas the International Court and the House of Lords restrict the use to cases where the meaning of the treaty is ambiguous or obscure, or where the treaty leads to an absurd result, the Convention permits the use of such material to confirm a meaning established by applying the textual rules of interpretation set out in Article 31. [35] It is doubtful whether a Canadian court would so readily admit such evidence in the interpretation of a treaty which was concluded before January 27, 1980, the date on which the Vienna Convention came into force, in the absence of a patent ambiguity, although it may be required to do so in dealing with the interpretation of treaties concluded after that date. [36]

Use of OECD Commentary

A specific issue in dealing with tax treaties is thus raised namely whether the Commentary to the OECD Model may be admitted as evidence of the intent of the parties when interpreting a text which follows that of the Model treaty. As has already been stated, when interpreting statutes in the Anglo-Canadian legal systems, the court will not admit evidence of the proceedings in Parliament as an aid to interpretation. [37] It is suggested that Parliamentary proceedings are also inadmissible in interpreting tax treaties brought into force by legislation. However, as evidence of "travaux préparatoires" may be admitted, the Commentary should be also considered as an aid to interpretation, certainly in cases of ambiguity where the treaty has been concluded after the Commentary has been settled and the treaty clause in dispute follows the OECD Model wording, provided, of course, the State whose taxes are in question has not noted any specific observation or registered any reservation to the Commentary. [38] Although it may be a valid argument that evidence of "travaux préparatoires" is not convincing evidence of intention because the best evidence of intention is in the final work, that is to say, the agreement or treaty itself, such an argument does not have much validity in respect of the Commentary which is akin to the minutes of the negotiators of a multinational treaty.

This view is supported by the stated purpose of and use made of the Commentary. As is said in the Report of the OECD Committee on Fiscal Affairs [39] to which the 1977 Model Convention and Commentary are annexed, the Committee believed that it is *"... most desirable to clarify, standardize and guarantee the fiscal situation of taxpayers in each Member country who are engaged in commercial, industrial or financial activities in other Member countries through the application by all Member countries of common solutions to identical cases of double taxation."* In reference to the earlier 1963 Draft Model and Commentaries, the Committee said, *"The existence of the Draft Convention has made it possible to facilitate bilateral negotiations between OECD Member countries and to reach a desirable harmonization between their bilateral conventions for the benefit of both taxpayers and national administrations. Moreover the existence of the Commentaries has facilitated the interpretation and enforcement of bilateral conventions along common lines."* On the intended use of the Commentary to the 1977 Model the Committee said, *"As these Commentaries have been drafted and agreed upon by the experts appointed to the Committee on Fiscal Affairs by the Governments of Member countries, they are of special importance in the development of international fiscal law. Although the Commentaries are not designed to be annexed in any manner to the conventions to be signed by Member countries, which alone constitute legally binding international instru-*

33. Article 31(1) has recently been cited in Canada in *Hunter Douglas Ltd. v. Queen*, 79 D.T.C. 5340 and *Melford Developments Inc. v. Queen* 80 D.T.C. 6074 in the U.K. in *Fothergill v. Monarch Airlines* (footnote 15) which also cited Article 32.

34. A consideration of earlier drafts of the treaty as an aid to interpretation has been approved by the Permanent Court of International Justice in *Treatment of Polish Nationals in Danzig*, (1932) P.C.I.J. series A/B, No. 44 at 33. British Courts have also used the technique for at least one hundred years: *Maltass v. Maltass*, (1844) 1 Rob. Ecc. 76, *Porter v. Freudenberg*, [1915] 1 K.B. 857 (C.A.), *Ellerman Lines v. Murray*, [1931] A.C. 126. This is permitted by Article 32 of the Vienna Convention and seems also to have support in Canada, see: *Ritcher v. King*, [1943] 3 D.L.R. 553 and *re Noble and Wolf*, [1948] 4 D.L.R. 135. See also D.J. Harris, *Cases and Materials on International Law*, 590, for a discussion of the background positions of the United States, Britain and France to Article 32 of the Vienna Convention. In *Fothergill v. Monarch Airlines Ltd.* (footnote 15), Lord Scarman said at p. 235: "Working papers of delegates to the conference, or memoranda submitted by delegates for consideration by the conference, though relevant, will seldom be helpful: but an agreed conference minute of the understanding upon the basis of which the draft of the article of the convention was accepted may well be of great value."

35. The recitals to the Vienna Convention indicate that the Convention is a "codification and development of the law of treaties". The interpretative provisions have been recognized as a codification of existing law in *Fothergill v. Monarch Airlines Ltd.* (footnote 15). *Quaere:* if the Vienna Convention does more than codify existing principles of international law, does it require enabling legislation to make it effective?

36. As O'Connell (footnote 1), at 253, noted: "It is said that where a treaty clause is clear and unambiguous it does not require to be interpreted. However, it may be doubted if a clear and unambiguous clause has ever been devised."

37. *Lyons v. Wilkins*, [1899] 1 Ch. 255, 264 and *S.E. Ry. v. Ry. Commrs.*, 50 L.J.O.B. 201 at 203 (H.L.).

38. For tax treaties concluded between 1963 and 1977, the commentary to the 1963 Draft OECD Double Taxation Convention on Income and Capital, published by OECD, 1963, might be more appropriate.

39. Published by the OECD, 1977. See pages 5 to 17.

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ments, they can nevertheless be of great assistance in the application of the conventions and, in particular, in the settlement of disputes."

In preparing the Commentary to the Model Treaty each State is free to record its disagreements with the official interpretation by noting its observations or making a reservation, and of course it is free to depart from the Model Treaty if it wishes to do so in negotiating particular treaty provisions. Therefore, in the absence of a specific observation or reservation by Canada, it is suggested that there is little reason to exclude the Commentary from the interpretative process, even in the absence of a patent ambiguity, particularly so for treaties concluded after January 27, 1980.

Subsequent practice and exchanges of notes and other documents

Article 31(3) of the Vienna Convention contemplates that in interpreting a treaty there may be taken into account, together with the context, any subsequent agreement between the parties regarding its interpretation or application and any subsequent practice in the application of the treaty. This provision is reflective of a view previously adopted by the International Court of Justice that subsequent practice of the parties to a bilateral treaty is usually a more reliable guide to their intentions than are "travaux préparatoires." [40]

As is noted below, however, unless Parliament has delegated its powers of amending the treaty — and the law arising from the enabling legislation — an interpretation, exchange of notes or other agreement of the parties which goes beyond mere interpretation and which has the effect of amending or adding to the treaty may be ineffective.

Plurilingual treaties

It is, of course, clear in Canada that both the English and French versions of the treaty are to be given equal weight in matters of interpretation. [41] The question arises: what weight is to be given to the version of the treaty written in a third or even a fourth language?

The answer seems to be contained in Article 33 of the Vienna Convention which provides as follows:

"Article 33

1. When a treaty has been authenticated in two or more languages, the text is equally authoritative in each language, unless the treaty provides or the parties agree that, in the case of divergence, a particular text shall prevail.

2. A version of the treaty in a language other than one of those in which the text was authenticated, shall be considered an authentic text only if the treaty so provides or the parties so agree.

3. The terms of the treaty are presumed to have the same meaning in each authentic text.

4. Except where a particular text prevails in accordance with paragraph 1, when a comparison of the authentic texts discloses a difference of meaning which the application of Articles 31 and 32 does not remove, the meaning which best reconciles the texts, having regard to the object and purpose of the treaty, shall be adopted."

Article 33 may add little to already established rules of interpretation, since as it has long been the British view that where treaties are drawn up in two authentic versions, Britain could not justify adhering only to the English version. [42]

Interpretation by reference to the law of the forum

Frequently, tax treaties use terms which may have a special meaning in tax law and perhaps may mean different things in different States. The issue arises in interpreting such bilateral tax treaties: which of the two possible meanings is to govern the interpretation?

When faced with this type of question, the Tax Appeal Board has interpreted the Canada—U.S. Convention in a manner consistent with an earlier decision in the U.S. Tax Court on the same point [43] and the Federal Court—Trial Division interpreted the Canada—Netherlands Convention in a manner consistent with that adopted by the Dutch Secretary of State for finances. [44] The desirability of a uniform interpretation particularly with multinational treaties has been well recognized, but its difficulties are apparent.

"Unfortunately, there can be no doubt but that at least some of the provisions of these articles have presented difficult problems and have resulted in acutely diverging views in the courts of other States which have adopted the convention. [There are] no less than 30 decisions of various courts, in Belgium, France, West Germany, the Netherlands, Italy and Austria. . . . Those decisions show no less than 12 different interpretations of the provisions of the Convention . . . ." [45]

Although the present Canada—U.S. Convention does not so provide, the OECD Model states that any term not otherwise defined by the treaty shall, unless the context otherwise requires, have the meaning which it has under the laws of that State concerning the taxes to which the Convention applies. This, therefore, gives the court of the forum the power to interpret undefined terms in accordance with domestic law. [46]

The question remains, however, when looking for the meaning of an undefined term in domestic law, which of various meanings is to be used. In particular, is the term to be defined by reference to its ordinary meaning, or by reference to its meaning in an ordinary legal and commercial sense? If the word has a particular meaning in the ordinary legal and commercial sense, but has a

40. See *South West Africa case*, [1950] I.C.J. Reports 135 and G.G. Fitzmaurice (footnote 1) at 20. For a discussion whether interpretative agreements between competent authorities bind the courts, see J.F. Avery Jones, et al., *The Legal Nature of the Mutual Agreement Procedure under the OECD Model Convention*, Br. Tax. Rev. (1979), 333 at 346.

41. Section 8 of the *Official Languages Act*, R.S.C. 1970, c. 0-2. See *The King v. Dubois*, [1935] S.C.R. 401 and *Irwin v. M.N.R.*, 62 DTC 1356. Some earlier treaties were signed only in the English language and are therefore unilingual.

42. Hardy (footnote 1) at 74. This article thoroughly examines the methods by which the court reconciles the two or more authentic versions, generally adopting that interpretation, if any, consistent with both. If this approach fails, and extrinsic evidence does not resolve the issue, Hardy finds the courts have launched into an inquiry as to which was the original text, giving it greater weight. See *The Standard Oil Co. Tankers case*, (1926) 2 R.I.A.A. 777 at 792. This method of resolving the difficulty was rejected, however, at the time that the Vienna Convention was negotiated: Germer (footnote 1) at 409.

43. *No. 630 v. M.N.R.*, 59 DTC 300.

44. *Hunter Douglas Ltd. v. Queen* (footnote 15). This method of looking to foreign case law was commented upon by Lord Scarman in *Fothergill v. Monarch Airlines:*
"The decisions of a superior court, or the opinion of a court of Cassation, will carry great weight: the decision of an inferior court will not ordinarily do so."

45. Megaw, L.J. in *Ulster-Swift Ltd. v. Taunton Meat Ltd.*, [1977] 1 W.L.R. 625 at 631.

46. See those treaties (some of which have been signed only, but are not yet in force) with Australia, Austria, Barbados, Belgium, Denmark, Dominican Republic, Finland, France, Germany, Indonesia, Ireland, Israel, Italy, Jamaica, Japan, Korea, Liberia, Malaysia, Morocco, Netherlands, New Zealand, Norway, Pakistan, Philippines, Romania, Singapore, South Africa, Spain, Sweden, Switzerland, Trinidad and Tobago, and the United Kingdom, all of which contain such a provision.

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different or expanded meaning under the Income Tax Act, is the Income Tax Act meaning to be applied to the treaty and, if so, if the Income Tax Act is subsequently amended, does it effectively change the meaning of the treaty? These questions have not been fully answered. First, it should be noted that the OECD wording does not specifically require the application of special meanings of words defined in the domestic taxing statute and the Commentary provides no clarification. [47] Second, it would appear that there has been no general resolution to this question internationally, as in some countries the courts look to the everyday meaning of undefined terms, while in others the courts look to the meaning in the tax legislation. [48] In Canada the position is still open. In *Associates Corp. of North America v. Queen* [49] and *Milford Developments Inc. v. Queen* [50] the Federal Court — Trial Division refused to find that a guarantee fee paid to a non-resident constituted "interest" for purposes of the Canada—U.S. and Canada—Germany treaties respectively. Both treaties had been concluded prior to 1974 when the *Income Tax Act* was amended effectively to deem such guarantee fees to be interest for purposes of the Act. In commenting on the argument of the Crown that the definitions of undefined terms are ambulatory and change with amendments to the Income Tax Act, Mahoney, J. in the *Associates Corp.* case said:

"The definition of 'interest' in the Protocol is not, by its terms, exhaustive. This is not, however, to say that it can be unilaterally expanded by Canada to embrace income that is not interest at all."

Clearly, therefore, specific later statutory definitions of treaty terms are not to be used. However, the judge went further and cast doubt on the relevance of an Income Tax Act definition even if made prior to the conclusion of the treaty as he seems willing to accept such a definition only if the provisions of the treaty are worded in such a way as clearly to include guarantee fees in the provisions dealing with interest:

"I should note that the tax conventions concluded by Canada since its enactment (that is the new definition of interest) in 1974 all contain expanded definitions of 'interest' which may well not be inconsistent with the [new definition in the Income Tax Act.]."

On appeal, however, the Federal Court of Appeal said:

". . . we expressly refrain from any finding that a 'deeming' provision in the domestic tax law might not, in other circumstances, be embraced by the provisions of international conventions." [51]

It has been suggested that where a problem of interpretation arises, other than one of a definition of terms, the application of domestic law should be avoided and the above described rules of interpretation which apply under public international law should be used with a view to obtaining an internationally consistent interpretation of the treaty. [52]

Interpretation by competent authorities

Article 25 of the revised OECD Draft provides, in part:

"3. The competent authorities of the Contracting States shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention. They may also consult together for the elimination of double taxation in cases not provided for in the Convention.

4. The competent authorities of the Contracting States may communicate with each other directly for the purpose of reaching an agreement in the sense of the preceding paragraphs. When it seems advisable in order to reach agreement to have an oral exchange of opinions, such exchange may take place through a Commission consisting of representatives of the competent authorities of the Contracting States."

The Commentary states that the purpose is to invite the competent authorities to resolve general difficulties of interpretation or application by means of mutual agreement. The view of the OECD is that such mutual agreements should be regarded as binding on the administrators. Although such an agreement may be binding on the administrators, it is questionable whether they would bind taxpayers or the courts. There appears to be no generally accepted view on this question. [53] Although Parliament clearly has the capacity to delegate its power to its own administrative bodies, [54] it is doubtful that a Canadian court would feel bound by such administrative determinations, or find in the language of Article 25 the intention to so delegate. [55] However, the implementing legislation for Canada's recent tax treaties expressly authorizes the Governor in Council by order to amend, revoke, replace or add to such treaties. Clearly, with these treaties the intention to delegate is clear, and administrative agreements as to interpretation may have the force of law if promulgated as Regulations.

Summary and conclusion

In summary, therefore, there seems to be clear authority that the well developed (now codified in the Vienna Convention) principles of international law relating to treaty interpretation will be applied by the courts in interpreting Canada's new tax treaties. At the present time there is not a large body of well reasoned Canadian jurisprudence dealing with the specific issues of tax treaty interpretation. In light of the large number of new Canadian tax treaties already in force, or signed and awaiting enabling legislation or under negotiation, these issues of interpretation must soon reach the Canadian courts with increasing frequency and such jurisprudence will be developed in the future. The lead in treaty interpretation is clearly shown in the recent United Kingdom jurisprudence and will undoubtedly soon appear in Canada.

47. The 1963 OECD Draft Model was ambiguous, but could be read as requiring a reference to terms as defined in the domestic taxing statutes.
48. See R. Lenz (footnote 16) at 298ff.
49. 80 D.T.C. 6049.
50. 80 D.T.C. 6074.
51. 80 D.T.C. 6140. In light of this statement, the relevancy of Income Tax Act definitions is still open. Compare: *Queen v. Cruickshank*, 77 D.T.C. 5226, where the court immediately turned to the Income Tax Act to find a meaning for the word "pension" but found no statutory definition. However, the word was held to include a lump sum payment out of a pension plan because such amounts were taxed as pensions under the Act.
52. R. Lenz (footnote 16) at 197 and 301. Compare: van Houtte (footnote 1).
53. Avery Jones, et al. (footnote 40) at page 346.
54. *Hodge v. The Queen*, (1883) 9 App. Cas. 117.
55. The treaties with Austria, Barbados, Belgium, Denmark, Dominican Republic, Finland, Germany, Indonesia, Israel, Italy, Japan, Liberia, Malaysia, Morocco, Netherlands, Norway, Pakistan, Philippines, Romania, Singapore, Spain, Sweden, Switzerland and Trinidad and Tobago contain somewhat similar provisions. The treaty with the United Kingdom does not provide so clearly for the competent authorities to make agreements respecting interpretations.

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Override of Tax Treaties by Ordinary Legislation

by Marshall J. Langer *

A number of bills now pending before the Congress are designed to tax capital gains derived by foreigners from their investment in U.S. real property. Three of these bills were former trade bills passed by the House of Representatives: H.R. 1212, H.R. 1319, and H.R. 2297. These bills have marvelous names: The Synthetic Rutile Bill, The Hawaiian Telescope Bill, and the Duty Free Entry of Carillon Bells to the University of Florida Bill. These are trade bills that have passed the House of Representatives, following which the Senate Finance Committee has deleted the entire text of each of the bills, moving the duty-free entry items to other bills. The Finance Committee has substituted entirely new texts that deal, among other things, with the subject of taxing foreigners on capital gains from the sale of real property. These bills were prepared by the staff of the Joint Committee and they were approved by the Senate Finance Committee in December 1979.

Another bill that would also tax foreigners on capital gains from real estate is H.R. 6007, which was prepared by the Treasury Department. It was introduced in December 1979 by Congressman Fisher of Virginia. Most of the bills dealing with this subject provide that any income tax treaty obligation that conflicts with the bills will be overridden after five years. It is likely that some bill dealing with this subject will be enacted during 1980, and it is apparent that both the Congress and the Treasury feel that, in order to be fully effective, this legislation must override existing tax treaty provisions.

Scope of pending legislation

The Synthetic Rutile Bill (H.R. 2297), for example, would impose a flat tax of 28 percent on capital gains derived by foreign investors from the sale of their interests in U.S. real property. The tax would also apply to gains realized by foreign investors on the sale of shares or other interests in U.S. *"real property holding organizations"*, whether corporations, partnerships, or trusts. A real property holding organization would be defined so broadly that it would include practically every closely-held entity investing in U.S. real estate. The tax would be enforced by withholding provisions, and every real property holding organization would be required to file an annual information return disclosing its shareholders.

Conflicting treaty provisions

The imposition of such a broadly-based capital gains tax would be in direct conflict with several existing U.S. income tax treaties. Treaties presently in force with Canada and the United Kingdom generally exempt from tax capital gains from the sale of U.S. real property derived by an investor from the other treaty country if there is no U.S. permanent establishment. This may not help in the long run because a new treaty is being negotiated with Canada, and it appears that the final steps toward ratification by the House of Commons of the new United Kingdom treaty are likely to take place by April 1980. When and if the new U.K. treaty takes effect, it will do so retroactively. There will be no further protection as to capital gains since the new U.K. treaty contains no restrictions on taxing such gains.

None of the other existing U.S. income tax treaties contains provisions that would directly protect an investor in real estate. However, several existing treaties do contain provisions that would exempt residents of the other treaty country from U.S. capital gains tax on the sale of shares of a corporation, whether or not the company whose shares are sold is a real property holding organization.

When we review the treaties, we find that the Netherlands Antilles treaty does not contain such a provision. Neither does the old U.K. treaty as extended to the British Virgin Islands. Nor does the treaty with Switzerland contain such a provision. You will find such provisions in the treaties with Sweden, Canada, the United Kingdom (the old treaty for as long as it lasts), the Netherlands (but not the Antilles), Germany, Finland, Belgium, Japan, Norway, Romania, and Poland. We are busily at work now trying to determine how we can make use of Polish holding companies to supersede these new provisions during the coming years.

The Synthetic Rutile Bill provides a special effective date in cases where treaties conflict with the bill. Where no conflict exists, the bill would take effect for sales in 1980 and thereafter. Regardless of any treaty conflict, the bill would apply to sales in 1985 and thereafter.

Can Congress override treaty provisions?

We come then to the question of whether or not the United States Congress can override an existing treaty by ordinary legislation? And, if it has the power to do so, should it do so in a case such as this? And, if the Congress does choose to override existing treaty obligations, should it give the Treasury five years or some other period of time within which to try to renegotiate conflicting treaty provisions? I am going to try to answer the first question on whether or not the Congress has the right to override an existing treaty by ordinary legislation.

I will leave to David Brockway, of the staff of the Joint Committee, the task of discussing the policy issues that are involved.

It seems clear that the Congress does have the right to enact a law which overrides an inconsistent treaty provision as domestic law, at least if its intention to do so is clearly shown. There is a one-paragraph statement of the law in Revenue Ruling 79—199.[1] Article VI, Clause 2, of the U.S. Constitution states that laws and treaties are the supreme law of the land. Income tax conventions are treaties within the meaning of that supremacy clause under the American Trust Company case.[2] Whenever possible, treaties and laws dealing with the same subject are to be read in a consistent manner.[3] Numerous cases hold that when a treaty and a law are inconsistent, the one last in date will control the other. Thus, when a law conflicts with a later treaty, the treaty prevails; and when a later law conflicts with an earlier treaty, the law prevails.

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1. 1979—1 C.B. 247.
2. American Trust Company v. Smyth, 247 F.2d 149 (9th Cir. 1957).
3. Head Money Cases, 112 U.S. 580 (1884).

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"The purpose of a law to override all or part of a treaty will not be lightly assumed. It should appear clearly and distinctly from the words used in the law." [4]

There is a good summary of the existing law in the Restatement Second of Foreign Relations, Section 145, which says that *"an Act of Congress enacted after an international agreement of the United States becomes effective, that is inconsistent with the agreement, supersedes it as domestic law of the United States if the purpose of Congress to supersede the agreement is clearly expressed"*. The Restatement adds that the superseding of the agreement as domestic law of the United States by subsequent Act of Congress does not affect the international obligations of the United States under the agreement.

The Internal Revenue Code contains two provisions dealing directly with the relationship between the Code and Treaties. Code Section 7852(d) states that no provision of the Code shall apply in any case where its application would be contrary to any treaty obligation in effect on the date that the Internal Revenue Code was enacted. That date was August 16, 1954. That provision was apparently included to prevent the enactment of the 1954 Internal Revenue Code from taking precedence over all pre-existing treaties on the ground that it was a new Act of Congress. Since it was later in time it might otherwise be deemed to override the pre-existing treaties. One of the interesting aspects of the section, however, is that it continues to apply to any treaty provision that was in effect prior to August 16, 1954, even with respect to new amendments of the Internal Revenue Code.

Code Section 894(a) states that income of any kind, to the extent required by any treaty obligation, shall not be included in gross income and shall be exempt from tax. That provision does not have a date so it would apply with respect to all treaties, whether or not they are pre-1954 treaties. The language of Section 894(a) is not very broad in scope. It merely deals with what is included in gross income, and not with other types of treaty provisions.

In enacting the Revenue Act of 1962, Congress expressed its intent to override existing treaty obligations, in Section 31 of that Act. A Conference Committee Report indicated that in the view of the Treasury there was only one conflict between the Act and treaties, a minor exception relating to the real estate clause of the Greek estate tax treaty. The conflicting treaty provision was successfully renegotiated shortly after the passage of the Act.

In enacting the Foreign Investors Tax Act of 1966, Congress expressed its intent not to override any existing treaty obligation. Section 110 of the Foreign Investors Tax Act (not codified) provided that *"no amendment by this title shall apply in any case where its application would be contrary to any treaty obligation of the United States"*.

The Senate Committee Report on H.R. 2297, [5] the Synthetic Rutile Bill, contains this clear expression of proposed Congressional intent:

"The amendments made by the provision will generally apply to dispositions after December 31, 1979. However, for a five-year period, gain will not be taxed to the extent required by treaty obligations of the United States. After that five-year period, for the renegotiation of conflicting treaty provisions, that is, after December 31, 1984, the provision will prevail over any conflicting treaty provisions remaining in effect."

It seems clear that Congress can override existing treaty provisions and that it apparently intends to do so in this case.

Real estate is only one of the areas where Congress may try to override treaties. Another is the foreign tax credit area, where several issues may be affected by existing treaty provisions. For example, what is a foreign income tax, and what limitations on credit should be imposed?

David Brockway, International Tax Counsel of the Joint Committee on Taxation, will deal with some of the policy questions as to whether Congress should override tax treaties and, if so, whether they should give the Treasury time to renegotiate these treaties.

When the treaty override question was raised in 1962, there was a barrage of protest from lawyers. The Committee on Taxation of Foreign Income of the American Bar Association said that the unilateral modification of tax treaties was, *"a shocking, unconscionable, and unnecessary violation of international agreements"*. Thus far, there has apparently not been any such strong opposition to the current override proposals.

4. Lee Yen Tai v. United States, 185 U.S. 213, 221 (1902).
5. S. Rep. No. 96-504, 96th Cong., 1st Sess. (1979).

Override of Tax Treaties by Ordinary Legislation

by David Brockway *

Before trying to answer Marshall's questions or address them, let me make a couple of general comments on his remarks.

First, I agree generally with what Marshall has to say about the power to override treaties by legislation. If there is a difference in our viewpoints, it is one of emphasis, and that is in the question of what is necessary for a statute to override an existing treaty obligation. I am not convinced myself that it is necessary for Congress to express clearly in the legislation its intent to override as such in the way it was done in the real estate bill, where we indicated that this was our particular purpose. I think that perhaps what the authorities stand for is the general rule of interpretation that you try to read the statute and the treaty in harmony and try to avoid a conflict if possible; that a subsequent statute should be viewed to be in conflict with and thus to override an existing treaty only if it was clear and distinct from the words of the statute and the treaty that there was an actual conflict between the provisions, but if he conflict is in fact clear and distinct it is irrelevant whether or not Congress ever expressed its intent to override as such. One project we are working on at the moment is a report on the foreign tax credit and the interrelationship of the credit and the tax treaties. We are going to have to take a position at some point this year on the question of what is necessary for legislation to override a preexisting treaty obligation; so by that time my thoughts will have been developed a little more fully.

Treaty provisions mostly prevail over Code

In any event, I think that, as Marshall said, the problem is basically solved at the moment by the Code provisions that say that, with respect to exemptions from income, the treaties prevail notwithstanding contrary Code provisions and, in the case of pre-1954 treaties, the treaties prevail in all respects. I should just note, however, that there is at least some possibility that those

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provisions will be examined by Congress within the next few years to see whether it wants to stick with the exact principles of Sections 894 and 7852. Whether these provisions are going to be changed is another question, but I think there is some concern, at least in the Ways and Means Committee, as to the general relationship between treaties and the statute.

I also note, as an aside, that in the Nat Boidman article that is in the materials, he mentions that in both the United Kingdom and Canada their principle is also that subsequent legislation will override a treaty. That being the case, I do not know that it is so shocking that we also take that position, although I gather from his article that they have the same reluctance that we do actually to invoke that power. After yesterday's discussion, though, I am somewhat reluctant to rely on Canadian and British precedents, after hearing that they do not take legislative history into account when interpreting statutes. That kind of thinking could put me out of work.

Turning to Marshall's principal question of whether we should override the treaties in the real estate bill, I would rather address the issues involved in whether Congress will override treaties in the bill rather than trying to make any judgment as to whether it would be appropriate for them to do so. First, as Marshall indicated, I do not think there is a great worry with respect to real estate held directly by foreign investors. There are only the two treaties, one with Canada and one with the United Kingdom, which limit the right of the United States to tax gains on U.S. real estate. The U.K. treaty will, I hope, go out of existence pretty soon. The Canadians have legislation similar to that we are contemplating and they would like very much to reach an agreement where each country can tax real estate gains by residents of the other country, and so I do not think there is going to be any great problem in reaching an agreement on that point, assuming we can ever get a treaty with Canada. My assumption is that within the five-year period, whether or not we put anything in the statute, there will be a change in both of these treaties on this point.

Real estate companies

Our larger problem is with corporations formed or availed of to hold real estate. It is something we have to deal with one way or another. The problem is that, if we just taxed the sale of real estate, the obvious alternative for a foreign investor holding stock in a corporation holding U.S. real estate is to sell the stock in the corporation, with the result that the new buyer gets a stepped-up basis and then liquidates the corporation without any U.S. tax. There are a number of possible ways of dealing with this problem. At the moment our judgment is that it is going to end best if we attempt to tax the sale of the stock. We have all along considered the notion of perhaps denying Section 336 treatment on the liquidation rather than taxing the sale of stock. Maybe we rejected it too soon and we are giving additional thought to that option. It would avoid many of these problems. In fact, one of the great attractions of that approach is that it does avoid the treaty problems. But for the moment, let us assume that the legislation will involve taxing sales of stock in U.S. real property holding companies.

Then the question is: will the Congress want to override the treaties if there is not a renegotiation within a reasonable period of time? I think there was a reaction that as long as there is one treaty outstanding which permits third country nationals to take advantage of that treaty, the legislation will not work. Right now, obviously nobody uses Polish holding companies, but there is no doubt in my mind that if the capital gains provision is changed in all those treaties except for the Polish treaty and if Poland would not effectively tax that income, Poland would become the new Netherlands Antilles.

Renegotiation of tax treaties may be difficult

I think that there is a feeling that something has to be done about the treaties which would prevent the United States from taxing foreign investors on gains on sales of stock in U.S. real estate holding companies. The Treasury is very concerned about the problem. I suspect with their attitude at the moment that there is no need at all for the provision in the legislation overriding any conflicting treaty provisions remaining after a five-year period for renegotiation. Realistically, they are going to try very hard to renegotiate these treaties on this point within the five-year period. However, the difficulty from Congress' standpoint is that it does not have control over whether or not the Treasury will actually succeed in renegotiating these treaties in that time frame. Notwithstanding Treasury's present intention, there is some awareness that if there is not something that automatically works to conform the treaties to the legislation after a resonable period, once the legislation is passed taxpayers will petition both the U.S. Government and the foreign governments about the problems of revising the treaties on this score, and it may prove to be very difficult to have all the treaties renegotiated in the reasonably near future. In fact, attorneys for foreign investors in U.S. real estate have warned me that I should not hope that the foreign governments were going to agree to renegotiate the treaties to allow us to tax this income. And I think there is some reality to that. For example, there has been a great deal of discussion on the issue of whether or not the Netherlands Antilles treaty should or should not be revised. I do not think that any of you would be surprised to hear me to say that it is not purely an academic issue. There has been a certain degree of pressure exerted on that issue and it is my guess that there would be in this context too. Consequently, it may not be so easy to renegotiate all the treaties to conform them to the legislation unless Congress in the legislation says that it is very serious about this and that the Treasury will have to act in one way or another.

Possible approaches

Having said that, I am not sure that the Congress necessarily has to do what was done in the Senate bill. It may well do what is in the Senate bill or it may well limit the degree to which it overrides the treaty. It does not really like to override tax treaties. I think there are some members who see restrictions on tax treaties as a positive good, especially some members of Ways and Means, but I think that most do not like overriding tax treaties and like to avoid doing so if possible. The principal concern here is one of avoidance of all taxes by the foreign investor, not so much of whether it is the United States or some foreign government which gets the revenue. In the present situation, there are many situations where U.S. real estate is held by third-country investors through a Netherlands Antilles holding company and no capital gains tax is paid to any country on the disposition of that property — that is the problem that is the real concern. So, conceivably, the legislation could limit the treaty override to situations where the stock of the foreign corporation is not directly or indirectly held by individual residents of the treaty country. That would substantially minimize the problem and should, at least in my view, deal with the legitimate concerns of the foreign government. There is no reason why foreign governments should have a strong concern in protecting the tax-free nature of investments by third-country investors.

Another possibility would be to limit the situations where the legislation overrides treaties to those where no foreign tax is paid or perhaps give a credit (a 906 credit) for any foreign tax paid on

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it, just to say to those governments with which we have made treaty arrangements — which essentially are agreements governing how the two countries are going to share tax revenues — that we are not attempting to take their tax revenues; that all we are attempting to do is to make sure that our legislation works as a practical matter, and we are willing to live, at least until we can reach a renegotiation of the treaty, with their getting the revenue on the gain as long as one of the two countries taxes it. In that regard, you might see possibly a combination of these two approaches.

Another possible approach would be to notify the foreign government of the legislation in some formal manner and ask them if they want to renegotiate the issue and give them the option of either renegotiating in a reasonably short period of time or telling them that we are going to terminate the treaty. You do not violate the treaty provisions that way and it is up to them to determine how seriously they take this issue. That is a possibility we have not really explored.

Another approach, and it may be, again, combined with some of these others, is to set out in the statute a defined and limited scope in which to renegotiate this issue, delegating to the Treasury the authority to enter into some sort of executive agreement to deal with the real estate problem. I do not know how well that would fly on the Hill. I listened with interest to David's remarks yesterday in which he advocated a very broad delegation of power to the executive through the competent authority process. I think I can safely say that the Congressional viewpoint on executive discretion in these matters is somewhat different. You know, we are all sort of prisoners of our institutional roles. But, there might be some way that Congress could specify exactly what it had in mind, establishing an executive agreement procedure to resolve the real estate issue but which could not be used to negotiate foreign tax credit issues and everything else. It might be possible just to deal with the treaty provisions limiting the taxation of real estate directly or indirectly held by foreign investors — to renegotiate that issue alone, and, as long as it fell within the scope of what was set forth in the statute, let it go into effect without going through the regular ratification process. Alternatively, Congress might develop a model that could go through Foreign Relations with some speed, a model which set out the types of concessions it thinks would be appropriate to make to the foreign government in exchange for their agreeing to our desires.

The question of whether Congress wil override in a large part depends upon how the statute is set up. If the statute is set up the way the Finance Committee bill is set up, I think there will be an override to some extent. Now, if it is modified, the need to override may diminish quite a bit. An example of where modification might diminish the need quite a bit is if we gave foreign investors a fresh start on the basis of any U.S. property they presently hold. If that were done, then in the next five years we would not pick up any significant revenue from the legislation in any event and so any need to override becomes less and less important. But under the Finance Committee Bill I would expect there would be at least some limited override.

The five-year period

On the question — Marshall's second question — of whether five years is an appropriate time, I do not remember where exactly the five years came from. It was in the Wallop bill in 1978 — I guess that is when it was first introduced and I truthfully just do not know where we got five years from other than that we have five years in a lot of other places so why not here. There was in fact some attempt made to analyze whether that period was too long or too short, but once someone had thought of a number, the inertia of having that number meant someone would have to justify another number and so I think you will find the five-year period sticking unless there is some substantial change in the bill as a whole because there is no particular rationale for any number. There is one area where conceivably it might be shorter. There has obviously been a fair amount of — I do not know what the euphemism is but I think I have heard it referred to as "upgrading" — but in any event I have been told that there have been quite a few transactions prior to the effective date in bearer shares of Netherlands Antilles corporations in order to get a fresh start in the basis of those shares. You do not know who is selling to whom but it is a reasonable assumption that they are related parties. One planning technique I have heard discussed is to take existing Netherlands Antilles real estate holding companies and drop their stock down into a Netherlands subsidiary to take advantage of the capital gains provision of the Netherlands treaty. I do not know whether that particular technique actually works under the non-recognition rules in the Bill, but there may be an abuse potential. If the Bill stays in the form it is now — that is, if the tax is imposed with reference to historical basis rather than allowing foreign investors a fresh start as some have urged — I think that possibly in this type of abuse situation there may be some sort of earlier override, although the Treasury would resist that fairly strongly.

General comments

Finally, if I could make just a couple of general comments. As I said before, I think there is, for most members of Congress, a great reluctance to override treaties unilaterally. They would rather figure out some way to work it out and I think we are going to try to some extent to modify this legislation to take that into account. I think they respond to the same policy issues that the bar committee responded to. I do not think that their attitude is quite the same; but we all recognize it creates problems with our treaty program if we enter into agreements and then unilaterally override them. Having said that, I think the potential for conflict between the treaties and the statute is increasing and at some point we are going to have to work out a way to resolve the conflicts. One reason for the increase is just that international business is increasing a great deal so that the treaties have become much more important. The awareness of the impact of treaties is also increasing a great deal. I think this is attributable in large part to the U.K. treaty because it was such a political issue. It upset a number of people on both sides and made them very wary of tax treaties. And also I think the Netherlands Antilles treaty gets a certain degree of publicity and highlights the issues in this area. The hearings in the Gibbons Subcommittee contributed to this. While I understand the feeling of that bar committee, I do not think Congress is going to ignore its jurisdictional prerogatives and that in large part may govern how they are going to react. The treaties, of course, are negotiated by the Administration without any Congressional input and they are presented to Congress essentially on a take it or leave it basis.

It is extremely difficult to change anything in a treaty after it has been signed. They govern most investment within and without the United States and major changes in tax policy are made through the treaties. For example, our whole withholding tax area is basically governed by the treaty policy rather than the policy of the statute. The insurance excise tax appears to have been effectively repealed through the treaties without any disclosure to Congress that this was happening. People wonder why I bring that up from time to time, but, to put it in context, we used to collect more revenue from the insurance excise tax than we did from the interest withholding tax. The modification of our tax policy through the treaties is a very real issue for the Congress, and in particular for the Ways and Means Committee, which does not participate significantly in the formation of treaty policy. There are Members who are very concerned about their

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role in the process of setting U.S. tax policy. Even in the Senate, Senator Gravel pushed in the Senate Finance Committee during its consideration of the 1978 Act for legislation that would take the jurisdiction of the tax treaties out of the Foreign Relations Committee and give it to the Finance Committee. That issue was avoided because the Senators do not like to have conflicts along those lines, but it indicates to some degree the concern there. If the tax writing committees write legislation which is regularly overridden by treaties in which they do not have any significant input, and if the tax writing committees have no practical way of changing those treaties, what you will find is that inevitably they will react adversely to the tax treaty process. Whether we have override in the future in any degree turns on whether the negotiators of the treaties take into account the concerns of Congress. One major concern is how broad the scope of the treaties is — whether the negotiators stick to actually eliminating double taxation (that is, actual taxation in a foreign jurisdiction and actual Federal taxation in the United States of the same income). A second concern is the extent to which they attempt to bring in novel provisions. I realize the desire to deal with particular problems that crop up differently in each country, but the more different types of provisions there are, the greater the possibility of a conflict between any legislative change Congress might want to make and some existing treaty obligation. Also, it is much more difficult for Congress to assess the impact of these new and different provisions. A related point in this area is the number of treaties. It is one thing when you have ten or fifteen treaties and they are basically similar and maybe you can renegotiate them without any great difficulty to reflect a tax policy change decided on by Congress. However, our treaty network is expanding very rapidly and there really is no possible way to renegotiate all our tax treaties in a short period. As Marcia Field indicated yesterday, Treasury is negotiating treaties with Malta, Bangladesh, Cyprus — that type of jurisdiction. The more treaties we get, the more and more impossible the process of attempting to renegotiate the treaties becomes. Eventually you may find Congress feeling itself somewhat tied in knots and just saying, "Well, we are going to override the treaties statutorily", unless a general agreement of all the parties is reached as to what are the appropriate matters to be included in treaties. There will have to be general agreement on the part of the tax writing committees that what is included in the treaties is acceptable to them. The treaties will have to be fairly limited in scope and not change that much from country to country in order to minimize the possibility of conflict between the treaty program and the desire of Congress to establish and control U.S. tax policy, particularly as it affects U.S. nationals and U.S. businesses anywhere in the world but also U.S. tax policy with respect to income of foreign residents and businesses that directly or indirectly arises out of the United States. There is a necessity that there be some agreement as to what the treaties should do, or there will be continuing conflict and more instances where Congress determines that it is necessary to override existing tax treaties unilaterally in order to implement changes in U.S. tax policy which it decides to adopt.

Mutual Agreement Procedure

by John F. Avery Jones [1]

I am going to speak about *mutual agreement procedure* and having heard Mr. Rosenbloom yesterday, I imagine it has another name in this country. Perhaps something like "the unilateral expression of views informally cleared with the other side" procedure.

I come from a country where the competent authority, the Inland Revenue, sometimes think they can write the tax laws. This came to a head the other day in a case in the House of Lords, the final court of appeal, in a case called "Vestey". I will not bore you with the details but what the tax authorities were claiming was they could decide not only whom to tax, but how much to tax them, under a particular piece of anti-avoidance legislation. I will read you just a short extract from one of the judges in the House of Lords, Lord Wilberforce, the senior judge, where he said this: *"A proposition that whether a subject is to be taxed or not or that if he is, the amount of his liability is to be decided even though within the limit by an administrative body represents a radical departure from constitutional principle. It may be that the Revenue could persuade Parliament to enact such a provision in such terms that the courts would have to give effect to it. But, unless it has done so, the courts acting on constitutional principles not only should not but cannot validate it."* I would like to put that concept into a United States context and ask you to imagine that the U.S. Model Convention, instead of reading as it did, contained just one article which reads as follows: *"The competent authorities may grant such relief from double taxation as they shall think fit."* Now if the Senate — and from my limited viewpoint from the other side of the Atlantic it seems to me that the Senate takes just a slight interest in what goes into tax treaties — were to pass such a provision, then I have no doubt that everything Mr. Rosenbloom said yesterday would be true. And I think I would even carry Mr. Brockway with me.

But the question which faces us this morning is not that at all. I want to pose the same questions in relation to the OECD Model. I suppose I should pose the questions in relation to the U.S. Model but my excuse for not doing so is that I am less familiar with it and in any case, it has not been adopted very widely so far. So, let me turn to the OECD Model and incidentally to the paper which you have with your bundle of papers.

Three types of mutual agreement in the OECD Model Convention

Now, like Gaul, I shall dvide the subject into three parts because in the OECD Model there are three types of mutual agreement. For those of you who do not have the model near you, I will jsut remind you what they are. There is Article 25(1) which talks about "transfer pricing", particularly where the individual taxpayer can ask (he can only ask) his competent authority to take up his case with the other country with a view to the avoidance of taxation not in accordance with the convention. That is the first type of agreement. The second type of agreement is found in the first sentence of Article 25(3), which provides that *"the competent authorities of the contracting states shall endeavor to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the convention"*, to which I shall refer as the interpretive provision. And the third type goes on to say, *"They [that is the competent authorities] may also consult together for the elimination of double taxation in cases*

1. *Editor's note.* See also J.F. Avery Jones et al.: "The legal nature of the mutual agreement procedure under the OECD Model Convention" in British Tax Review 1979 at 333 and 1980 at 13.

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not provided for in the convention." A rather surprising provision, you may think.

I do not claim that all types of mutual agreement neatly fall into one of those three categories. Obviously, there is an overlap. The specific case may be because there are doubts about interpretation of the convention. But, let us just use that as a framework.

A valid delegation?

Let me start at the end with what I described as a surprising provision, that is, that the competent authorities can eliminate double taxation in cases not provided for by the convention. In the United States, although this provision is in the model, my understanding is that it has only been used in treaties with Hungary and Poland. The provision is also not used in the United Kingdom, although my tax authorities were rather surprised when I pointed out to them that they had, in fact, used the provision once. Now we come to the point of validity. Let us assume that the competent authority does just that. And we turn up in court and we want to know what is the effect of that agreement. To put it another way, is there a valid delegation by, as I understand it in the United States, the President, with the advice and consent of the Senate, to the competent authority to add to the treaty. Now that, I think, is a very interesting question, and the fact that the provision is formed in two treaties means that it is no longer academic. It does seem to me that when it did get into those two treaties a point of very fundamental constitutional law was involved. And therefore, I looked, as I understand you spend all your time looking, at the legislative history, to see what was said about these provisions: "*The proposed treaty [this is the treaty with Hungary] contains various administrative provisions generally along the lines of the provisions contained in other U.S. treaties*"; and in relation to the treaty with Poland: *Thus, the proposed convention with Poland in general follows the approach of other U.S. income tax treaties.*" Well, I suppose these things cut both ways. If one must read the legislative history to find out what the treaty means and the legislative history does not draw attention to what the treaty appears to say, it may be that the treaty does not mean what it appears to say.

There, I think, is our first and very substantial point. I can tell you very roughly what the view in other countries is about this provision. It is difficult because a lot of other countries do not in fact adopt it. But Switzerland and Sweden appear to give it some validity. I have not, to my knowledge, found another country, with the possible exception of the United States, which is prepared to say that such a provision would in fact have legal validity. The reason I have a question mark about the United States is that if you read the legislative history, including the commentary to the OECD model, I think you will probably come to the conclusion that it was intended to be a delegation. Thus the answer is that it is probably legal but just wait until the Senate finds out about this. I do not know if Stanley Surrey is still here, but I gather he had a spot of bother trying to get a very much narrower provision through in the French treaty at an earlier time.

Well, so much for the surprising provision which, as I say, is not used very much. Let us look next at the more important one, the one about interpretation. "*The competent authorities shall endeavor to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the convention.*" And the question here is exactly the same. Is that a valid delegation by the President with the advice and consent of the Senate to the competent authority to agree? And I do emphasize agree. I do not think that a unilateral statement of opinion can possibly have any force. I am not an American lawyer but, I do think, even in this country it takes two to make an agreement.

Supposing we do have an agreement with the other competent authority as to the interpretation of a convention, what is the agreement's legal validity? Would you mind turning to page 348 in the paper which you received and you will see at the top of the page four propositions: [2]

(a) Whether there is any constitutional or other reason preventing delegation of the power to make such an interpretive agreement that is binding on the courts. And, as far as I know, the answer in this country is that there is no constitutional reason preventing it.

(b) If there is not, whether it was the intention of the interpretive provision that an interpretive mutual agreement should be binding on the courts. That, I feel, is a matter where the Senate comes in.

(c) If so, whether the mutual agreement is a valid exercise of such a power, i.e. whether it falls within the power granted by the interpretive provision, e.g. whether it is interpretive rather than legislative. That, of course, is in a treaty which does not contain what I described as the surprising provision.

(d) If so, was the agreement intended by the competent authorities to exercise its powers under the interpretive provision.

That is where the competent authority comes in but, I think, that it is the first time the competent authority comes in. I think the law is that they come last, and what matters in the legal hierarchy is what the Senate thinks. Here again, some countries will accept that there is a valid delegation. This is a matter of internal law and I can quote Sweden and Switzerland again as countries where that is the case. I can equally quote, and you will see this at the bottom of the same page, Germany, Belgium, Canada, Japan and the Netherlands, where it is quite clearly not accepted as a sufficient delegation and they make the comment that the position is quite different. Interpretation of a treaty is in the last resort the prerogative of the courts, which I also hope, is the position in this country. You will see we do not say in this article what the position in the United States is, and I cannot speak for Sidney Roberts, but presumably the reason we do not say that, and the same is true of the United Kingdom, is because the position has never been tested in the courts. This makes me think that maybe some of Mr. Rosenbloom's remarks were wider than is justified by the present state of judicial decisions.

Is mutual agreement binding on the courts?

When I say: the courts may not give effect to the agreement as a legally binding agreement, I certainly do not go as far as saying that the court should take no notice of the agreement. If I can again speak in American terminology, the agreement is something like what the courts would do to a revenue ruling. At least they will read it. They will give some weight to it. I do not know, or perhaps I should say I gather Sidney does not know, exactly what weight is given by the courts in this country to an interpretation agreement.

You will see, on page 350, [3] the extract from the Vienna Convention that was mentioned yesterday, "*there shall be taken into account together with the context, any subsequent agreement between the parties regarding the interpretation of the treaty*". Now that seems to me to fit this admirably. Here is a subsequent agreement, as to interpretation of the treaty, and what the codification of international law made by the Vienna Convention seems to be saying, is that you should take it into account, which is very different from saying that it is legally binding.

2. See article indicated in note 1, British Tax Review at 348.
3. Id. at 350.

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Does mutual agreement bind competent authority?

So much for the courts. What about the competent authority? The OECD commentaries say that the mutual agreement in this context is binding on the competent authorities. I find it difficult to know exactly what this means. The way I would look at it is, supposing the competent authorities were arguing a case in the court. Could they go against such an agreement? Here again, I can quote two countries where they cannot. Obviously again, Sweden and Switzerland because it is binding on the courts anyway. We could include Germany, Belgium and the Netherlands as countries where the competent authorities could not argue to the contrary. As I understand it, in the United States and Canada there is absolutely nothing to stop the competent authority from arguing any proposition it likes in the courts. Certainly in Canada it is done so and, in the United States, it has argued against a ruling or something like that.

Just to summarize at this particular point, it seems to me that (I suppose I should not say what the position seems to me to be, but I should pose questions for you to answer) if the competent authority makes an agreement with the other competent authority on the interpretation of a treaty; first, does the agreement bind the courts absolutely? And the andswer to that seems to me fairly clearly to be "no", although it has never arisen. Second, are the competent authorities even in the position to argue to the contrary in the courts? I would hazard a guess that they probably are. So I trust that that analysis — and I think that is the correct analysis whether or not I have come to the correct conclusions — is the sort of analysis which one should put to Mr. Rosenbloom's remarks yesterday in determining what is the legal status, and what matters is the legal status, of an agreement made by the competent authorities.

Relationship between mutual agreement and court decision

Let me now look at the most familiar type of mutual agreement, the one that, if I had asked anyone before I started what mutual agreement was all about, I am sure you would have all said: it is the familiar one about transfer pricing and all that. Just let me make a few, I am afraid they will be disconnected, comments on what I think the scope of this is. In asking a similar question, what is the relationship with the courts, the question is, I think, differently posed because one is not interested in what is the validity in the courts of an agreement made between the competent authorities relating to a single taxpayer dealing with a case of, say, transfer pricing. If the taxpayer does not like the agreement he can just not accept it. I think the question here is, can you make the agreement at all? Any taxpayer, of course, has a choice. He can either go to court or he can go to the competent authority and, indeed, subject, of course, to time limits, he can do both in either order. Except, I understand, in Sweden where you have to make the choice at the very beginning. It is always worth bearing in mind if you are in this field that what matters is not your law, but the other person's law. Supposing one tries the mutual agreement procedure first and it fails. They do not reach an agreement or the agreement is not satisfactory to you, what can you do? You can go to court. And, as far as I know, with the exception of Sweden, certainly of the countries considered in this article, there is nothing to stop you going to court as long as you have kept your time limits open and that's a fairly straightforward matter.

Now, what about the other way around? You go to court in either or maybe both countries and you do not like what the court decides. Can you now have a mutual agreement? Well, first of all, there is the time limit aspect. You have got to present the case within three years from the first notification of the action resulting in taxation not in accordance with the convention. I do not know how fast the courts are in your country but three years would not be an awful long time in my country. Assuming we are still within the time limits, can you override (and this is implicitly in favor of the taxpayer, of course) the court decision? As I understand it, you cannot in the United States unless the treaty says you can. If the treaty overrides all procedural barriers then the treaty means what it says. If the treaty says you can merely override internal time limits then, as I understand it, the position is, and it is the same in France, that you are stuck. You cannot vary the mutual agreement because the court decision is final. In other countries that is not, in fact, the case. Canada, for example, has legislation which specifically states that the mutual agreement can override a court decision. This makes me think, because as you heard David Ward say yesterday they have taken our legal system, that probably in countries like mine and Australia you are in the position that, there being no legislation to say that you can override it, you cannot do so. But that is uncertain. It has never happened in my country. But certainly in other countries, and I can point to Sweden, Switzerland, Japan, Netherlands, Belgium and Germany, it would be all right to override it. I think all that points to a proposition I made a moment ago, that really what counts is not your law but the other person's law, and if you start a mutual agreement procedure, or you start court proceedings, you have got to know where you stand in the other country.

How does mutual agreement fit in the legal system?

I do not want to take up any more time in introducing the topic but to come back to the main point which I would like to make: how does the mutual agreement procedure fit in with the internal legal system? In most cases, the answer seems to me that it just does not fit. You have this proposition that maybe you cannot have a mutual agreement after the court proceedings in some countries. It may be that if you do have a mutual agreement you are out of time for applying it, either in your own or in another country. That, of course, is subject to the point in the OECD Model which now says that you can implement it notwithstanding time limits. (There is a rather fascinating point on this. You have a statement in the new U.S. — U.K. treaty which says that any mutual agreement made shall be implemented and I gather there is a revenue ruling which says that means you override the time limits. But, the United Kingdom put in a reservation about overriding time limits so I think you may have pulled a "fast one" on us, as I do not think we realized what you said, or what you meant when you did say it.) And then, lastly, there is the point I started with. What is the legal effect of mutual agreements, either on the question of interpretation or on my surprising provision over rewriting the treaty? It seems to me very odd that that is a subject which, at this late stage in legal history, we could still be arguing about and I think it is certainly very unclear. So if I can say rather what the law should be, rather than what I think the law is, I think there certainly should be provisions which bring the mutual agreement procedure into the internal legal system. I can quote you Japan as one example, which specifically extends time limits under their internal law when a mutual agreement has been made.

May I end by hoping that I have asked some of the questions. I certainly do not claim to have answered them and I hope that this is a subject which we can consider in greater depth at the conference in Berlin. But, I do believe that this is the constitutional question of the 1980s. It is the question of what is the power of the competent authority? And what is the power of the Senate?

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Source Rules in U.S. Tax Treaties

by Paul McDaniel *

I should explain that my initial assignment in this part of the program was to comment on the very fine paper and outline prepared by Bob Patrick. But as we talked about the reflections that his paper inspired, it seemed it might be more useful to reverse the speaking order. Thus, my comments on Bob's observations will come first and then his formal presentation will follow. I hope the reason for that change in order becomes clear.

The purpose of my remarks is to raise some issues with respect to the treatment of source rules in U.S. tax treaties. I approach the matter by asking this question: *"In what situations is it appropriate or necessary for the United States to consider modifying its statutory source rules by treaty?"* (In my remarks, I assume that the present statutory source rules are acceptable; I am not proposing to question the wisdom or desirability of those particular rules.)

Bob Patrick's discussion then will provide an analysis of the actual instances in which such source rule modifications have been agreed to by the United States or in which modifications would be made by the various model treaties. Moreover, I think as you consider Bob's analysis, a further question will be raised: Whether we can discern from existing U.S. treaties principles which do in fact appear to guide the United States when it agrees to modify its source rules by treaty.

It is important to keep in mind the elementary proposition that the U.S. statutory source rules are not self-operative taxing provisions themselves. Once an item of income or deduction is sourced, it remains for other provisions to provide the tax results that flow from that sourcing.

In my remarks I will examine three categories of operative tax rules to try to identify the situations where treaty modification of U.S. statutory source rules is appropriate for consideration.

I. *Category One:* The issue is potential double taxation of U.S. persons doing business or investing in another country (hereafter referred to as "Country A") because the source rules of the United States and Country A conflict, with the result that the foreign tax is not fully creditable for U.S. purposes.

There are various combinations of source rules which potentially produce conflict.

A. As to items of gross income:

Case 1: The United States sources the income in the United States; Country A sources the income in Country A. Double tax may result and in this situation the U.S. may consider modification of its source rules by treaty to prevent that result.

Case 2: The U.S. sources the income in the United States; Country A also sources the income in the United States. There are no problems of double taxation here because of the agreement on the source rules. But, as I will discuss later, despite this agreement on source rules, it is possible for problems still to arise, as the 1978 French protocol reveals.

Case 3: The United States sources the income in Country A; Country A sources the income in Country A. Here there is no problem because the U.S. foreign tax credit will operate to relieve double taxation.

Case 4: The U.S. sources the income in Country A; Country A sources the income in the United States. As long as Country A is an exemption country there is no double tax problem. There is a certain circular problem which arises if both countries are foreign tax credit countries, but it is not a problem of double taxation.

B. As to deduction items:

Case 5: The U.S. treats the deduction as U.S. source; Country A as A source. The U.S. foreign tax credit is increased and there is no problem of double taxation.

Case 6: The U.S. treats the deduction as U.S. source; Country A as U.S. source. Again there is no problem of double taxation.

Case 7: The U.S. treats the deduction as A source; Country A as A source. The U.S. foreign tax credit is reduced, but no double tax problem results because the Country A tax is also reduced.

Case 8: The U.S. treat the deduction as A source; Country A treats the deduction as U.S. source. Here the U.S. foreign tax credit is reduced, but A's tax is not. This is the appropriate case for the U.S. to consider treaty modification of its source.

Thus, in Category One, out of eight possible combinations of source rules, only two give rise to potential double tax problems: When both countries source an income item as domestic; and when both consider source of deduction items as foreign (Cases 1 and 8). In these situations, the U.S. may consider modifying its source rules by treaty. The question we can ask then, as we look to the discussion by Bob Patrick, is the extent to which the treaty source rules that have been agreed to by the United States modify our statutory source rules to meet one of those two situations.

II. *Category Two:* The issue is the United States taxation of foreign persons doing business or investing in the United States. Again one can look at the matter by examining the same eight cases as in Category I.

A. As to items of gross income:

Case 1: The U.S. sources the item in the United States; Country A sources it in A. Because of the possible double tax result, the U.S. could consider modifying its source rule.

Case 2: The U.S. sources the item in the U.S.; A sources it in the U.S. No double tax problems are created by the source rules.

Case 3: The U.S. sources the item in A; Country A also sources it in A. Again there is no double tax problem, unless the U.S. treats the income item as effectively connected income under Section 864(c)(4). Although in the latter situation the U.S. gives a Section 906 foreign tax credit, the U.S. could deal with the issue by providing in the treaty that only U.S. source income attributable to a permanent establishment is subject to U.S. tax. This approach was adopted, for example, in the U.S.—Swiss treaty.

Case 4: The U.S. sources the item in A; Country A sources it in the U.S. There is no double tax problem; if the Section 864(c) rules come into play, the situation is like Case 2.

B. As to deduction items:

Case 5: The U.S. sources the item in the U.S.; Country A sources it in A. The U.S. tax is reduced so there is no problem of double taxation.

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Case 6: The U.S. sources the item in the U.S.; Country A sources it in the U.S. The U.S. tax is reduced and there is no problem of double taxation.

Case 7: The U.S. sources the item in A; Country A sources it in A. Again no problem of double taxation arises from the source rules. If Section 864(c) applies, the situation is like Case 5.

Case 8: The U.S. sources the item in A; Country A sources it in the U.S. Here there is a double tax, and it is appropriate to consider a change in the source rule by treaty.

Thus, in Category Two, the same two combinations of source rules present cases where the U.S. might modify its source rules: Where both countries source an income item as domestic, and where both countries source a deduction item as foreign. (One possible additional candidate is where Section 864(c)(4) treats an item of gross income as effectively connected with a U.S. trade or business.)

III. *Category Three:* The issue is the qualification of a U.S. individual or corporation for a U.S.—granted preference (tax expenditure).

Examples include Section 913, which is based on foreign source earned income, and deferral, which operates only for foreign source income of foreign corporations. In these situations, the source rules operate as eligibility standards to determine (in part) whether the taxpayer can qualify for the tax subsidy. As a treaty matter, modification of the U.S. source rules in these cases is a question of extending or cutting back the statutory tax preferences.

The 1978 French Protocol issue

Even though there was no disagreement that dividend and interest income of U.S. citizens residing in France was U.S. source, double tax problems nonetheless arose. The problems were created because of the interaction of residence and citizenship-based tax jurisdiction. The resolution, however, was effected by modifying the U.S. source rule to treat part of the U.S. source income as foreign source and then letting the foreign tax credit rules operate to relieve double tax. We can ask the question whether modification of the U.S. source rules to resolve a non-source rule problem was an appropriate or desirable treaty technique.

Income Tax Treaty Source Rules - A U.S. Perspective

by Robert J. Patrick, Jr. *

In discussing source rules today as a preliminary introduction to the September Paris Congress on this topic, for which I am serving as the General Reporter, I have been impressed with the schematic framework just presented by Paul McDaniel. At this point I feel very much as if he is sitting back and being able to observe the forest, and I am still laboring out there among the trees. With national reports now having been received from some 24 countries, outlining (in most cases, in some detail). their individual source rules, and also trying to take into account the consequences of source rules for treaty purposes, I am certainly in midstream in drawing conclusions and observations. Therefore, I thought the most useful thing for presentation today would be to concentrate upon one of my concerns in the general report and briefly discuss the application of treaty source rules. This services as an introduction to the larger subject of the general need for source rules and the actual role that they play.

One of my principal objectives in preparing the directive for this topic for the Paris Congress is to provide, through the individual country reports to be printed in the *Cahiers*, some general reference material on individual country rules on what we would call "source of income", or determining the origin of income and expenses. This is a subject on which it is difficult to find analyses or detailed descriptions of individual country rules, as compared to other areas of comparative tax law.

Source: one of the bases for taxation and tool in relief for double taxation

As a preliminary observation, after having been accustomed to embarrassment over the arbitrariness of certain U.S. source rules, such as our passage of title rule, which has certainly been questioned on intellectual grounds for a good many years, I find upon reading some comparative rules from around the world that I am a little less embarrassed by our own. Moreover, I am not certain at the moment as to how well anyone has been able to deal with some of these issues where it is necessary to determine source of income. I am also impressed that even among countries with substantially common jurisprudence in internal law, there is a wide variation in the rules adopted for determining the origin of income. Moreover, there are a number of items of income for which all countries have some uncertainty about what the proper source should be. I would cite such important areas as currency transactions or income or loss on the disposition of certain assets, while questions of source regarding insurance transactions are among other latecomers to the codification of source rules.

I do want to comment on how one perceives the role of source rules in the first place. My observations are tentative at this point, but I hope the *Cahiers* will provide a start toward future consideration in IFA and elsewhere of the general principles of the subject. From the practical standpoint, I am inclined to regard the concept of source as being a tool that is used to achieve certain results. Most often the practical question is which country is going to tax certain income. Source is what we consider one basis of taxation — source or origin. The other basis, which is widely accepted internationally, is, of course, residence. The United States is almost alone in also using citizenship as a basis for taxation in the case of individuals. Therefore, in looking at the concept of source of income and in determining whether we should change source rules, it is helpful to focus on the fact that generally we are looking at which country is going to have a taxation right. Or, more fundamentally, as I think Paul McDaniel suggested, will there be any taxation at all. After that determination is made, source rules are used again, and probably secondarily, as a tool in relief of double taxation.

These primary operative functions of source rules are the practical limitations on negotiators in tax treaties and are implicit in the decisions of writers of tax legislation. However, it is certainly possible, and in U.S. practice it is a fact, that source rules can be written that are, at least in form, independent of any substantive rules imposing tax. The most challenging question is whether there is any objective criteria or set of principles for judging whether a particular source rule is desirable or, indeed, what the

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source rule for a certain type of income should be. The national reports that were submitted generally do not offer reasons for the rules of national legislation.

What is the answer to this fundamental question? Why do we say income has one source rather than another? One must go to the League of Nations documents, and the Committee of Experts of the League, to attempt to determine the economic connection of income and to find theoretical discussion of this question. No very much theoretical work on this has been done since that time. Different countries have perceived of origin of income in a certain way, and perhaps the knowledge is lost in history, custom or practice of exactly what any legislature had in mind when it decided that the origin of particular income was Country A rather than Country B.

Significance of source rules

Short of providing the rationale behind particular source rules, one effort I have been making is to identify the relative significance of source rules in national legislation. I believe that with the United States emphasis on these rules, we accord to the concept of source a substantial independent existence as a fundamental feature of our taxation system. But it is very clear, as one reads the other national reports on source rules, that other countries are to a great extent able to function with a tax system that rarely talks about source or origin of income. Nevertheless, every tax system, even when it does not employ the language of source, makes distinctions as to the economic origin of income. They need to know for various purposes the origin of income although they may think only in terms of items that are taxable or non-taxable income.

Expense allocation rules

For income tax purposes we are generally talking about net income. Regardless of the degree to which a country has developed source rules for income, no other country has sought to deal in detail with expense allocation in the degree that we have done in recent years. Again, at least in theory, other countries have exactly the same problems which the source and expense allocation rules attempt to solve, and that is true whether the foreign system is a territorial system (exempting foreign source income of residents) or a foreign tax credit system. A clear fact emerging from the reports, however, is that the expense allocation rules have been given much less attention and appear to have considerably less development in internal law of other countries than that which has occurred in the last decade in the United States.

A very important part of the subject which I will not be covering in the IFA report should be noted in passing. That omission is the issue of characterization of the nature of income and its impact on source determinations. There are rather fascinating tax consequences that flow from different legal characterizations of transactions that are quite similar in substance and might involve, for example, in one case, the sale of something identified as property, and, in another case, the licensing of a process to make that property, or, in a third case, a contract requiring payment for the services to make that property. The consequences in international tax rules change dramatically from these characterizations, yet we quite arbitrarily divide economic activities into categories and give them very different treatment as to whether they are producing foreign or domestic source income.

Income tax treaties

I would like to turn specifically to income tax treaties. Both the OECD Model income tax treaty and the U.S. Model treaty (largely based on the OECD) employ rules of source. The development of source rules in U.S. treaties is roughly divisible into pre-1968 and post-1968 treaties. In pre-1968 treaties, the concept of source as such was not given much attention. For example, there was some notion that income originated in Canada, or originated in the United States, or should be apportioned, or perhaps originated somewhere else. But there is little development of this notion in the language of the treaties, and there was no separate article on source rules in these older treaties. Around 1968 (and in treaties as recent as the Korean treaty that finally went into force a year or so ago, but was based on the type of negotiating form that was used in the early 1970s), there is a separate article containing a list of source rules. As one looks at that article, one can see both the issue of how much internal law on source the U.S. was able to urge upon foreign tax systems, and, assuming U.S. rules were adopted, how much could be inserted without a great deal of detailed explanation. One also senses the inevitable incompleteness that arises in trying to incorporate the Internal Revenue Code rules on source. For example, these treaties with separate source rules generally provide that income from the purchase and sale of tangible personal property should be treated as income from sources within the contracting state only if the property is sold in that contracting state. But what about treatment of income from the manufacture and sale of property manufactured in one state and sold in the other? The treaty appears silent on that. I think the U.S. began to perceive drafting problems and questions about the effectiveness of trying to write all U.S. statutory source rules into treaties.

U.S. Model Treaty

At the time the U.S. Treasury published a Model treaty in 1975, the Treasury made an effort to adopt the OECD language in U.S. treaties. One judgment was that what would be regarded as source rules or their equivalent in the OECD Model were not all that bad for tax treaty purposes; namely, assigning primary taxation in one country and providing double taxation relief in the other country. So the U.S. has made an increased effort to adopt the rules of the OECD Model. Yet, as I will mention in considering some of these specific treaty rules, there are fairly substantial questions as to how clearly they identify origin or source.

The current U.S. Model generally combines source rules in the operative articles themselves. For example, the interest article will contain a concept of origin of the income covered. The U.S. Model treaty also contains, in the tax credit article, some special rules relating to source of income.

The permanent establishment rule

Looking at the structure of tax treaties, one observation is that there is a very important functional rule in treaties that, where applicable, does supersede numerous detailed rules about the source of different items of income. In using the permanent establishment concept, with income attributable to an establishment located in a country being made taxable in that country, the treaty tells you what you need to know. It permits you to have a general rule and treat as income attributable to a permanent establishment the connected operating and investment income of the enterprise. The fixed base rule has a similar result in the case of independent personal services. Here then is a rule that operates as a source rule in giving a situs to the income and operates functionally with the other provisions of the treaty on relief from double taxation to identify which country is going to tax and which country is going to give double tax relief. It is important, particularly if one is used to looking at tax rules from the United States' perspective, to have in mind the fact that the OECD Model is influenced very strongly by a territorial concept so that if the situs country has the exclusive right to tax the income of the permanent establishment, then under the internal law of a number of countries there is no problem in saying, "*And we the place of incorporation and the company headquarters will not tax that income.*" It makes resolution of double taxation easier for such countries than in the case of the U.S. which says, "*However, we are still going to tax United States companies just as if the treaty and its permanent establishment rule had not*

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come into effect." The U.S., therefore, must provide in the treaty that the fact that the income is attributable to the foreign permanent establishment gives it a foreign source at the establishment for U.S. tax purposes. At that point the tax credit article can provide relief.

However, while the basic rule of the treaties about "attributable income" servies a very useful functional approach, it is my impression there is little guidance as to *when* income is attributable to a permanent establishment or, in the case of individuals, to a fixed base. At least the United States and some other countries have attempted to articulate how you get income effectively connected to a permanent establishment, but there appears to be no generally accepted statement of the principles. The attribution rule, once there is a determination of attribution, is really a rule that, although income in question may arise (under technical source rules) either in the country where the permanent establishment is located or elsewhere, it will be regarded as having its origin at the permanent establishment or fixed base. The U.S. Treasury, when discussing this issue in its technical explanations of treaties, has said that insofar as a foreign company has a permanent establishment in the United States, the income that is attributable to that establishment is narrower than U.S. internal law which provides that all business income is attracted to the permanent establishment. In addition, according to the Treasury, the income actually attributable is not only that generated by the permanent establishment from the activity of the establishment from sources within the United States but it also includes those attributable items of foreign source income of a permanent establishment that the U.S. taxes under the Code; that is, the foreign source income that is connected with certain designated business operations (see I.R.C. Section 864(c)) carried out in contact with the U.S. establishment even though technically, under U.S. law, the income is from foreign sources and, in general, the U.S. does tax foreign source income of non-resident aliens and foreign corporations. This is an illustration of how useful the attributable concept can be as an overriding or substitute source rule.

Per-country foreign tax credit limitation

I would add as a footnote that it is my judgment that the United States never really has had a true per-country foreign tax credit limitation. I also have some doubts about whether other countries have a true per-country limitation where income flows through foreign affiliates or subsidiaries to the parent country and is commingled, along with foreign taxes, at some offshore holding company or operating company situs. Because of the fact of commingling of income and operations at subsidiary levels, it is very difficult to think of how one would have a per-country rule that would actually work as a practical matter if our full source rules were applied. The simplest illustration of the problem is to take U.S. source rules under a per-country limitation of the foreign tax credit and apply them to, say, a subsidiary in Canada of a U.S. corporation where the subsidiary is making sales both in and out of Canada. As a practical matter, to what extent would anyone in computing the foreign tax credit look at whether or not title was effectively passed outside of Canada in determining whether the sales income of the Canadian company was Canadian source? It is not simple to impose our detailed source rules at either a foreign branch or subsidiary level, and tracing income at a sub-subsidiary level is extremely difficult. For that reason, if anyone wanted to try to write a true per-country rule, one ought to consider looking at the permanent establishment and attributable income concept not only for branches but perhaps for subsidiaries as well. This assumes, however, that there could be agreement on what is "attributable income".

The "other income" article

A second overriding treaty rule that seems to solve some of the mechanical problems of source is the "other income" article. The significance of this article is often overlooked, but it can assume great importance depending upon how narrowly or broadly defined are other operative articles, such as those covering interest and royalties. The usual OECD or U.S. model treaty provision says that income not specifically covered in another article is taxable only in the place of residence. Income that is subject to this "other income" article may include third country income or it may include income arising from the residence country itself.

Individual items of income

Turning to the individual items of income under treaties, as I previously noted the U.S. and OECD model treaties place source rules in most instances in the operative taxing rules for various items of income. The exact scope of these rules varies from item to item.

The treatment of income from real property provides perhaps the greatest degree of uniformity in source rules that one finds in any of the national reports. There would be no conflict with the basic rule of Article 6 of the model treaties that real property income has its origin at the situs of the property. In contrast, under national laws there would be a wide variation in the source of income on the sale of tangible personal property. The permanent establishment attributable income rule helps to resolve such conflicts, provided that the double taxation article is coordinated with the taxation article.

With activities such as shipping and air transport where you have international traffic that is a treaty defined concept, you have an international effort to agree on a method of taxing truly peripatetic activities using a special set of rules which frequently modify national legislation.

There is a considerable degree of national uniformity in treating interest as arising in the state of residence of the person paying the interest, but it is by no means the uniform rule under national law even among OECD member countries. The residence rule is adopted in Article 11 of the OECD and U.S. models.

Article 12 of the OECD and U.S. models, covering royalties, provides less assurance as to what exactly is covered. The OECD treaty refers to royalties "arising" in a state. But even in the U.S. model which tries to define where a royalty arises in terms of its use (based on the U.S. statutory rule), it is still not clear how the rule is applied where use in more than one country is involved. Moreover, for drafting purposes, the scope of the source may be defined to affect the result depending upon whether there is going to be exemption from tax or a positive withholding tax in what will be designated the source country.

Special mention should be made of how the treaties are used to define source of income in the area of services, especially with respect to independent services and services rendered by a company furnishing services of employees to others. This is a useful illustration of how treaty source rules are being adapted to resolve current conflicts as to which jurisdiction may have the primary taxing right because of source and which country will give tax relief. There are a number of issues in connection with the source of income from services in the present agreements. These include whether services are covered under the independent services article or under the permanent establishment and business profits articles. The U.S. Treasury, in technical explanations of recent treaties, has attempted to set forth the U.S. position on this question. But the basic negotiating conflict that exists is between taxing income from services based on the place of performance of the services, the rule in a number of countries, versus treating the origin of service income as being the residence of the person paying for the services, or where the services are "utilized", regardless of where the services are physically performed. Of course, for a U.S. taxpayer, use of a rule other than the place of performance as the source rule for income from services immediately raises a foreign tax credit limitation problem, since for foreign tax credit purposes there is no foreign source income

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when services are performed in the United States.

In this service area, we see increasing evidence of a shift in U.S. treaties toward a treaty change of source. While the U.S. Internal Revenue Code rule says the source is where the services are performed, an increasing number of treaty provisions provide that for purposes of calculating the foreign tax credit, when a foreign country imposes tax on certain types of service income, regardless of where the services were performed, the U.S. will treat the income as from sources in that country. There are provisions of a limited nature like that in the pending Moroccan treaty, where services rendered anywhere on behalf of the Moroccan government are treated as Moroccan source income. There are also provisions in the pending Philippine treaty suggesting some shift in the source of certain service income through rules permitting taxation of an enterprise on a net income basis where services are furnished for 183 days or more. In the pending Jamaican treaty, income from services rendered by a U.S. company to its affiliate in Jamaica and independent consulting services are Jamaican source once an initial threshhold of physical presence has been met. The issue in these latter treaties is identifying the service income "attributable" to a permanent establishment.

Relief from double taxation

The operative provision of U.S. treaties to relieve taxpayers from double taxation is Article 23 of the U.S. model which provides a credit for covered foreign taxes. The U.S. model and recent treaties do provide some source rules in that article, including rules for interest, royalties and dividends to provide such income with the necessary foreign source content for purposes of the foreign tax credit limitation. In this regard, the U.S. model adopts the OECD approach where income attributable to the permanent establishment that is taxable in a foreign country is going to be treated as if it had its origin there for U.S. tax credit purposes. Thus, income that is taxable in the other jurisdiction will be treated as having a source in that country.

There is then the question of the relationship of the U.S. model treaty's credit article and its source rules to the U.S. Tax Code. Is there an independent treaty credit? Clearly there is. This is expressly provided in the U.S. model. I believe it is also implicit in the history of earlier U.S. tax treaties that, unless there is a statement to the contrary in connection with the treaty, the treaty structure is such that the U.S. assures a treaty foreign tax credit to U.S. citizens and residents for the foreign taxes that are the subject matter under the treaty. The saving clause, under which the U.S. can generally tax Americans just as if there were no convention, says by way of exception that U.S. citizens and residents shall be entitled to the foreign tax credit provided in the treaty. The formulation of the credit article in the U.S. model is that the credit is to be provided under the treaty for the appropriate amount of the foreign taxes covered in the treaty, subject to the procedural requirements of the Code, e.g. gross-up for dividends.

Protocol to the French Treaty

In its Technical Explanation of the Protocol to the French Treaty that was adopted in 1979, the Treasury stated its position that there is an independent treaty credit and also discussed the per-country limitation. The Treasury says that while the treaty provides a treaty credit for the covered French taxes paid in France on French income, that does not mean you can use the per-country calculation as long as U.S. statutory rules require use of an overall limitation.

An aspect of the French protocol that deals with a serious source rule problem involves the U.S. citizen resident in a treaty country who receives income taxed in that country on a residence basis, and who is taxed in the United States on the basis of citizenship. Both countries would tax income from U.S. sources. The underlying question is which country is going to give double taxation relief with respect to such income. The mechanism of the protocol to the French Treaty produces a sharing of tax revenue by the U.S. and France. In the case of services rendered in the United States by a U.S. citizen residing in France, the protocol provides for an exemption on the French side. In the case of U.S. source dividend and interest income, the protocol establishes the U.S. right to impose tax at a rate up to the withholding tax rate imposed on U.S. source dividends and interest paid to a French resident who is not a U.S. citizen. France will credit the U.S. tax. In addition, the treaty further changes what would be the effect of U.S. statutory law to state that an additional amount will be treated as French source income. The French may tax that amount and the U.S.will give a foreign tax credit for that French tax. A further residual right of taxation is reserved for the U.S. on a citizenship basis.

Branch of U.S. company

A somewhat similar problem arises in the case of a foreign permanent establishment of a U.S. company subject to tax abroad and subject to tax in the United States on its world-wide income. Resolution of double taxation requires the efforts of two countries negotiating a treaty to reach some agreement on which country will give double taxation relief on U.S. source income as well as for third country income. Here a variety of factors come into play, including (i) the effect of the non-discrimination article in the treaty, (ii) whether the permanent establishment is unilaterally given foreign tax credits in the foreign country on what that country considers foreign source income, and (iii) whether there should be either the granting of full tax relief including a credit for U.S. tax imposed on a nationality basis or a refusal to provide credit to a U.S. company forcing it to rely on the consequences of the overall limitation. I would raise the question as to how a treaty resolution compares with the U.S. legislative rule in Internal Revenue Code Section 906 where the U.S. unilaterally provides a foreign tax credit to a foreign corporation's permanent establishment in the United States with respect to the foreign source, as the U.S. defines it, effectively connected income of the permanent establishment taxed by the U.S. I am unaware of any other country that provides, by internal law, for such a tax credit. The question raised at the time Section 906 was adopted was, suppose there is a foreign branch in the United States of a foreign company that receives income subject to foreign tax and to U.S. tax; is the branch entitled to a foreign tax credit if the basis for the foreign tax is the branch's home country's taxation of world-wide income? The United States position was that the U.S. should provide a credit for the foreign tax in that case on foreign source income, but not for the foreign tax on U.S. source income. The granting of credits for a permanent establishment is not an answer that is readily adopted by other countries, even in tax treaty negotiations. The problem of double taxation of permanent establishments on third country income remains an unresolved treaty question.

Finally, with regard to the Internal Revenue Code Section 861 type of allocation of expense rule, there is virtually no real coverage of the problems under the treaties except where the allocation matches a Section 482 intercompany pricing allocation. The national reports indicate that there has not been much analysis of this problem in most countries, nor is there even general recognition of it as a problem or an issue. In our wisdom, or zeal or misapprehension, the United States has gone quite a long way in identifying this allocation issue as one affecting international taxation, and it may become an active area in future treaty considerations. But I think right now, when one is only beginning to identify some of the problems about the source of income, we are a long way from knowing what sort of treaty rules one might see develop regarding expenses.

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TAX GLOSSARY

by H.W.T. PEPPER *

THINLY-CAPITALISED COMPANIES (CORPORATIONS) - Under a corporation tax regime where classic corporate income and the dividends paid thereout are both taxed without imputation relief (see ECONOMIC DOUBLE TAXATION), it is more favourable for a company to minimise its equity capital and rely heavily on borrowed money. Interest paid on loans, debentures, convertible stock, etc. is normally deductible in determining profits whereas dividends on equity shares are merely regarded (as taxable) distributions of profits.

In double taxation treaties interest on borrowed money is often given favourable tax treatment (exemption, or abatement of the tax rate) where the interest is payable to a non-resident. An enterprise, set up with foreign capital, may, thus, also have a tax "incentive" to finance its operations with loans instead of equity capital.

This form of tax avoidance which results in companies having an abnormally low proportion of equity capital is usually countered by legislation which deems a certain part of the loan interest to be dividends or distributions of profit.

THIRD-TIER FOREIGN TAX CREDIT — A U.S.A. taxpayer who owns 10 percent or more of a foreign corporation (regarded as a "first tier" foreign corporation) is entitled to relief for tax paid abroad by that corporation (regarded as, or "deemed", paid by the taxpayer) in computing his tax on income from that corporation. If the foreign corporation in turn owns 10 percent or more of another ("second-tier") corporation the former is regarded as having paid the proportionate part of the latter corporation's foreign tax. Finally, if the second-tier corporation owns 10 percent or more of another ("third-tier") corporation the second-tier corporation receives relief for its deemed-paid share of the third-tier corporation's foreign tax, which thus passes at third-hand to the original taxpayer. There is no relief for fourth-tier or more remote subsidiaries tax paid overseas.

THRESHOLD, TAX — See TAX THRESHOLD.

TILLAEGSSKAT — (Denmark) Additional tax, Surtax.

TIMBER PROFITS TAX — A tax, additional to ordinary income tax, imposed on the profits of timber-felling or logging concerns in Malaysia. The tax is intended to fall more heavily on the profits from the richer stands of timber, as a form of RESOURCE RENT TAX (q.v.).

TIME APPORTIONMENT RELIEF — Under the U.K. capital gains tax rules (which commenced 6 April 1965), a gain which consists of the excess of disposal proceeds of an asset acquired before 6 April 1965 over its original cost may be apportioned so that only the proportion on a time basis which accrued between 6 April 1965 and the date of disposal is charged with tax.

TIME LAG — See DECALAGE D'UN MOIS.

TIME LIMITS — Apart from the routine administrative time limits imposed on taxpayers for filing returns, making payments, etc. (which limits may usually be extended for adequate reasons), there are also legal limits for making assessments and claiming refunds. See STATUTE OF LIMITATIONS.

TIN PROFITS TAX — A tax, additional to income tax, imposed on the profits of tin-mining concerns in Malaysia, which falls more heavily on those mining the richer deposits and may have no impact at all on those working marginal deposits. The tax is in the nature of a RESOURCE RENT TAX (q.v.).

TITHE REDEMPTION ANNUITIES — Annual payments under the British Tithe Acts of 1936 and 1951. The payments, which were a charge on certain lands, replaced TITHES (q.v.) and 5/6 of the payments are deductible for income tax purposes. The annuities were extinguished on 1 October 1977.

TITHES — In Britain and many other countries, tithes were a charge (theoretically of one tenth) upon the produce of certain land for the benefit of the church. In 1936 tithes were converted in Britain to fixed annual payments known as TITHE REDEMPTION ANNUITIES.

TOLDAFGIFT — (Denmark) Customs duty.

TOLL GATE CHARGE — In the U.S.A., certain company liquidations, reorganisations, and incorporations involving foreign affiliates require an advance ruling from the U.S. Treasury to ensure qualification for non-taxable or tax deferred status. In some circumstances the applicant may be required to pay, as a condition of obtaining the ruling, what is known as a "toll gate charge", which is a kind of tax on the property or shares being transferred.

TOLLS — See ROAD TAX, ROAD TOLL.

TOP-SLICING RELIEF — The term applied to relief granted under a graduated direct tax regime to avoid excessive tax being charged where, because of "bunching", an unusually large amount of income or gains would fall into a single tax year. The relief given is usually in the form of allowing a notional spread of the lump sum involved over a period of years. Relief in Britain is granted in respect of such items as GOLDEN HANDSHAKES (q.v.) where the compensation for loss of employment is otherwise taxable when payable, certain gains from insurance policies, and in respect of premiums on leases.

TOTALISATOR TAX — A totalisator is an apparatus through which bets may be made at a race course. The odds are not predetermined but are calculated by the totalisator for the winning horses on the basis of the total amounts actually staked on all the horses in a particular race. Where such betting is taxed it is a simple matter for the apparatus to calculate its own tax bill and take it into account in reckoning the net winnings, and the tax collection process is a very simple one.

TOURIST TAX — Taxation on tourists is generally restricted to a service charge or airport tax levied when the tourist leaves the country by air, but indirect

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taxation in the form of a room tax or a hotel and restaurant tax may be applied to the grade of hotels and restaurants commonly used by tourists so that the tax falls mainly on that class of taxpayers. (See also HOTEL TAX, ROOM TAX, TRANSIT TRAVELLERS TAX, AIRPORT TAX, SECURITY TAX.)

TRADE ASSOCIATIONS — It is fairly usual to treat trade associations as mutual organisations which are not taxable on any surplus transactions with members (see MUTUALITY PRINCIPLE), provided the association has duly registered under any statutory requirement governing the administration of such organisations. Where such an association makes a special levy on members for some capital project, or for some joint contribution for a purpose which would not carry a right to tax deductibility, arrangements may sometimes be made for the association to account for tax on such contributions as an alternative to disallowances being made in computing the profits of all the individual contractors.

TRADE UNIONS — It is usual to make special income tax arrangements regarding trade unions which have been duly registered under trade union legislation. Generally speaking, income tax will not be charged on the surplus of receipts from members over outgoings (see MUTUALITY PRINCIPLE) and tax exemption is sometimes given in respect of the investment income of the union, particularly where its constitution embodies activities similar to those of a friendly society.

TRADER, SMALL, RELIEF FOR — See SMALL TRADERS.

TRAINING LEVY — A training levy may be imposed by a government where the government itself is largely responsible for training workers for certain types of industrial, mining, or agricultural tasks for which there is a demand for skilled workers. A refinement is to allow rebates from the levy to employers who train their own workers to an acceptable level of skill.

TRANCHE SYSTEM — The method of levying tax at graduated rates whereby the tax rate increases on successive tranches, or slabs, of income or capital. The system is commonly used in graduated personal income taxes, death duties, and gift taxes.

TRANSACTION TAXES — Taxes levied on commercial transactions, usually at a low rate percent on a multi-stage basis. An example was the 0.6 percent tax levied on transaction in Belgium before the switch to V.A.T. Such taxes are really CASCADE TAXES (q.v.).

TRANSFER PRICING — A method whereby an international trader may adjust prices for his goods, manufactured in one country and sold in others, so that an undue proportion of total profits is allocated to the country with the lowest taxes. See also ARM'S LENGTH PRICE.

TRANSFER TAXES — There are various examples of transfer taxes in operation — see CAPITAL TRANSFER TAX, CONVEYANCE TAX, STAMP DUTY — that in Italy is levied at 10 percent on the value of the land when land and buildings are transferred. The tax is also payable on the value of the buildings concerned where these are not subject to V.A.T. (See also CAPITAL TRANSFER TAX, GIFT TAX, STAMP DUTIES, TRANSMISSION TAX.)

TRANSIT TRAVELLERS TAX — A tax, which has occasionally been charged on tourists who visit a country only briefly, e.g., those making a call of a day, or part of a day as passengers in a cruise liner, usually as a contribution towards the cost of providing facilities for such tourists. In some instances the "tax" takes the form of a landing charge. In general such levies are not usually recommended by those advising on tourism, on the grounds that tourists tend to resent even a small tax which has to be paid in order that they may visit a country. Where, however, a global charge is payable by the visiting cruise ship, instead of by individual passengers, the levy, which is justifiable, is usually collected smoothly, on the UNMERKLICHKEIT (q.v.) principle. (See also AIRPORT TAX, SECURITY TAX.)

TRANSITION ADJUSTMENTS — It is usual to make special arrangements on the introduction of a new tax in respect of existing taxes. For example, with the introduction of unified personal tax in Britain in 1973/1974, taxpayers were allowed extra time in which to pay the surtax due from them in respect of 1972/1973 incomes which would normally have been payable during 1973/1974. When V.A.T. is substituted for another form of sales tax, it is usual to make transitional arrangements to allow relief against V.A.T. for sales tax embodied in stocks of commodities which are in hand at the commencement of V.A.T.

TRANSPORTATION TAXES — Taxes levied on vehicles using public highways, ships, boats and barges using canals, rivers and waterways maintained by the government, and upon aircraft using airports. Examples include the historical LOCOMOTION TAXES (q.v.) in Britain, the federal excise tax on transport in the U.S.A., and the inclusion of charges for the carriage of passengers and freight in certain V.A.T. systems. (See also ROAD TAX, ROAD TOLL, VEHICLE TAX.)

TRANSMISSION TAXES — Taxes (1) on the transmission of assets by gift or by death (see GIFT DUTIES and DEATH DUTIES), and (2) on the transport of oil, etc. by pipeline.

TRAVEL TAX — Travel is a subject for taxation in several countries: Japan has a 10 percent levy on the higher classes of passenger travel, the U.S.A. has a 10 percent Federal excise on inter-State travel, and Israel taxes its residents on the cost of foreign travel. The term "travel tax" has also been given to the 2 percent levy introduced in 1974 on air package holidays to build up a fund (known as the Air Travel Reserve Fund) to compensate holiday-makers who suffered loss through the financial failure of their travel agents. Several such failures had occurred in 1974 after the sharp increase in world oil prices added materially to the cost of (pre-paid) air transport. Once sufficient funds had been collected, the levy was suspended and the need for it has since been reduced by a system of bonding operated by the Association of British Travel Agents in conjunction with the Civil Aviation Authority.

TREATY, DOUBLE TAXATION — See DOUBLE TAXATION.

TREE AND FRUIT CONCEPT — See FRUIT AND TREE.

TRIPLE ASSESSMENT — A tax levied in 1798 in Britain by Pitt consisting of a levy of 3 times the previous year's tax with a ceiling of 10 percent on income and charged upon (a) those who kept carriage or saddle horses and (b) those who paid inhabited house duty, or window tax. The law was an immediate precursor of income tax. (See also EXTERNAL INDICIA OF WEALTH.)

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TRUST — A trust has been defined as the relationship between persons and property under which property is vested in persons known as trustees, who control the property for the benefit of persons known as beneficiaries. A trust may be set up by a living person, known as a settlor, or under a Will after his death, by the written instructions of a testator. For tax purposes, where the income of a trust is fully distributed to the beneficiaries most countries' tax codes "look through" the trust and tax the beneficiaries directly on their shares of the income. Where trust income is accumulated the tax treatment varies according to the nature of the trust provisions and the tax law.

— *Accumulation and Maintenance Trust:* A trust, the income of which is accumulated for the benefit of a beneficiary, usually a child, and usually for a period of up to 21 or 25 years. A normal provision is that money may be disbursed before attainment of the specified age, but only for maintenance of the child. Such disbursements will form income of the beneficiary while the remaining trust income will usually be taxed at a flat rate (in the U.S. currently at 48 percent).

— *Discretionary Trust:* A trust in which the trustees have absolute discretion as to whom among usually a large number of potential beneficiaries should actually benefit. Where such a trust is used for tax avoidance, the trustees, though not bound to do so, usually heed the suggestions of the settlor as to who should in practice benefit. Anti-avoidance legislation has for the most part destroyed the value of such trusts for tax avoidance, e.g., in the U.K.

— *Sprinkler (Sprinkling) Trust:* The term used in the U.S.A. for DISCRETIONARY TRUSTS (q.v.), presumably because the trustees have power to "sprinkle" the benefits upon which beneficiaries they think fit.

— *Charitable Trust:* A trust set up for purposes beneficial to the public, e.g., for the relief of poverty, the advancement of education and religion, and other objects beneficial to the community. Donations to a charity may be exempt from gift or capital transfer taxes, capital gains tax. (See also CHARITY, DONATIONS, EXEMPTION, INVESTMENT TRUST, REGULATED INVESTMENT CORPORATION, UNIT TRUST.)

TRUSTEE PRINCIPLE — The principle that taxpayers who deduct or withhold income taxes from other taxpayers, or who are registered for the payment of sales taxes and include a sales tax element in the price charged to their customers, are all collecting tax on behalf of the tax department to whom they are responsible, much as a trustee is responsible to the beneficiaries of a trust, for remitting and accounting for the tax thus collected.

TURNOVER TAXATION — The word "turnover" nowadays usually is synonymous with "sales" or "recipts", but "turnover tax" is also a term sometimes given to the cascade taxation which applies to all stages of manufacture and distribution. The turnover tax in Eire, however, was a single stage retail sales tax upon the sales or turnover of retailers (since replaced by V.A.T.). The word "turnover" has another connotation in that it sometimes means the number of times a trader "turns over" his capital or trading stock during the year, but this is now an old fashioned use of the word.

TURNPIKE — See ROAD TOLL.

U

UDBYTTESKAT — (Denmark) Dividend tax.

UMSATZSTEUER — (German Federal Republic) The value added tax.

UNA TANTUM — The term used in Italy for FORFAITAIRE (q.v.) treatment of certain commodities in the context of CASCADE sales taxation, which preceded the present V.A.T. (IVA).

UNDEPRECIATED CAPITAL COST — A term used in the Canadian tax code and defined as the original cost to the taxpayer of a depreciable asset less the depreciation allowances of previous years, plus subsequent additions to the asset and less subsequent disposals. To the uninitiated the term seems something of a misnomer since in the calculation the original cost *is* depreciated! Where the sale or salvage proceeds of the asset exceed the undepreciated capital cost the excess is recaptured (see also BALANCING CHARGES). A capital gains tax charge would only arise if sale proceeds exceed the original cost.

UNDERLYING TAX — Tax which is charged upon corporate income out of which dividends are paid, but which does not appear as a direct deduction or withholding from the dividend itself.

UNDISTRIBUTED PROFITS TAX — A tax on corporate profits which have not been distributed to the shareholders. There are various systems of taxing corporate profits and distributions out of these profits; for example, in Britain attempts were made at one stage through the imposition of a discriminatory profits tax to discourage distributions as an anti-inflationary measure — distributions were at one time subjected to a 27.5 percent rate while undistributed profits were only charged at 2.5 percent. On the other hand, the corporate tax system of the Federal Republic of Germany involves the taxing of undistributed profits at a much higher rate than distributed corporate profits. Both in Britain and in Germany dividends are also taxed in the hands of the recipients. The German system of taxing profits is designed to encourage corporate distributions and thus a healthy capital market, since there is a fiscal "penalty" on the retention of profits. In principle, it is considered that a company which pursues a full distribution policy and the obtaining of fresh finance by rights issues and thus submits its operations to scrutiny by investors should be more efficient than a company which merely ploughs back retained profits without submitting itself to periodical stock market tests.

Where a company had retained profits over the entire period of its operations and is then wound up, tax avoidance could take place through the distribution to shareholders of accumulated profits in "capital" form. Accordingly, most countries in their tax law provide for the additional taxation of accumulated undistributed profits distributed to shareholders on company liquidations. In the case of CLOSE COMPANIES (q.v.) there is usually also an annual requirement of minimum distributions to shareholders, failing which the tax law may deem such distributions to have been made and charge tax accordingly.

[to be continued]

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Paris Congress 1980
Results of the discussions

At the end of the Paris Congress of IFA a resolution was adopted on Subject I and with respect to Subject II only a summing up was issued.

SUBJECT I:

Dialogue between the Tax Administration and the Taxpayer up to the Filing of the Tax Return

Resolution (translation*)

Relations between the tax authorities and taxpayers have undergone a considerable change during the last decades in almost every I.F.A. member country. This is due to the growing number of taxpayers, the increased complexity of tax legislation and the increase in the tax burden. In addition to formal, legal relations, a dialogue of a rather less formal nature has been developed, starting well before the filing of the tax return.

Congress is of the opinion that such a dialogue may be of great interest, in that it allows the taxpayers, on the one hand, to obtain more knowledge of his rights and obligations in fiscal matters, and, on the other hand, the tax authorities can reach a better understanding of real situations and conditions. In the opinion of Congress, a satisfactory dialogue between the tax authorities and the taxpayer, prior to preparing and filing the return, is in many cases, an essential condition for creating a favourable tax climate and a cost-effective method of tax collection.

In order to ensure the satisfactory organisation of the dialogue, measures should be taken to inform and protect the taxpayer, and ways found of preventing practical and legal errors, as well as tax fraud. These measures would concern the tax authorities, the taxpayers, the taxpayers' representatives and the legislators.

Congress makes the following recommendations:

1. Within the framework of the dialogue the tax administration should provide the taxpayer with full and clear information as to his rights and obligations. Information of general interest, especially administrative directives, should be readily accessible to all concerned. As far as possible, directives should be elaborated through cooperation between the tax authorities and qualified representatives of taxpayers. Points of law included in any published directives should be respected by the tax authorities and never withdrawn with retroactive effect.
2. Congress considers that a procedure for obtaining an advance ruling is an important element in a satisfactory dialogue. The subject was discussed in the Congress in London of 1965, and copy of the Resolution is attached hereto.
3 It is a condition of establishing a satisfactory fiscal climate that the taxpayer has an essentially positive attitude towards the collection of tax and compliance with the procedures. It is therefore important that schools and universities provide a general understanding of the aims of public finance and the role of taxes. Conversely, officials of the Tax Administration should be trained in the dialogue with taxpayers.
4. Within the framework of the dialogue between the authorities and the taxpayer, tax advisers play an important intermediary role. Because of the important position of the advisers, rules or practices should be elaborated in order to guarantee technical competence as well as correct professional standards.
5. Finally, the legislator has a great responsibility for the satisfactory working of the dialogue between the authorities and the taxpayer. This dialogue is made particularly difficult by the existence of regulations which are complex and frequently modified. The simplification of the regulations would create the essential basis for a more successful dialogue between the authorities and the taxpayer.

APPENDIX

The 19th Congress in London – 1965

Resolution Subject II (original version)

Advance Rulings by the Tax Authorities at the Request of a Taxpayer

The Congress points out that the complexity of fiscal legislation is constantly increasing in all countries and for this reason it has become increasingly difficult for the taxpayers to obtain reliable information concerning the application of tax laws, which is prerequisite for all financial planning. This situation, combined with high tax rates, constitutes a serious problem of legal security. Therefore it is important that taxpayers be provided with an opportunity to obtain an authoritative opinion on the meaning of the law before taking measures, the fiscal consequences of which are uncertain.

The Congress finds that the State, which must demand farreaching cooperation from taxpayers, should ensure that the position of taxpayers is facilitated in this respect. This would at the same time establish a better relationship between the fiscal authorities and the taxpayers.

The Congress, noting with satisfaction that taxpayers have in some countries been accorded by legislative means an opportunity to request advance rulings and that the fiscal authorities in

* The original version is in German.

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many countries answer the inquiries of taxpayers without a statutory to do so, has decided to make the following recommendations to improve the position of taxpayers:

1. Taxpayers should be offered an opportunity to obtain within a reasonable time advance rulings concerning the tax consequences of planned bona-fide transactions, at least if they are of material significance to the taxpayer or of general legal importance.
2. The opportunity to obtain advance rulings should not be limited to special problems nor to certain taxes, but in principle it should be possible to issue advance rulings concerning all taxes.
3. The fiscal authorities should adhere to the position taken in an advance ruling upon which a taxpayer has relied in good faith. Any subsequent change in the law should be applied as far as possible without retrospective effect.
4. It is desirable that there should be a right to appeal against advance rulings in those countries where this is administratively and legally practicable.
5. It is desirable that a method of publication of advance rulings should be devised, to ensure the uniform application of the law.

SUBJECT II:

Rules for determining income and expenses as domestic or foreign

A summing up of the Congress discussion
(original version)

1. Most countries have established in their domestic tax laws rules to determine, in respect of different categories of income, the rights of the State of source and those of the State of residence, domicile, or citizenship.
2. However, the rules determining income as domestic or foreign often reveal wide disparities between countries in their definition and operation. In the absence of any generally accepted principles, such disparities may lead to problems of double taxation.
3. Moreover, there is no generally recognized basis for allocating expenses to domestic and foreign taxable income in order to determine net income liable to tax or subject to double tax relief. This also may lead to problems of double taxation.
4. It is now accepted that for the continued development of world trade and investment, every effort must be made to adapt domestic (unilateral) tax laws so that rules as to the source of cross-border income and the allocation of expenses are harmonized.
5. The Congress has discussed a number of different approaches to determining income as domestic or foreign and the lack of harmony in domestic tax laws is particularly evident in this respect as to business income, income associated with transfers of technology and income from the rendering of services.
6. The practical solution to taxation conflicts arising from unharmonized domestic laws is seen in the conclusion and revision of an increasing number of bilateral double tax conventions, having regard to the efforts of international bodies in establishing acceptable convention guidelines. These conventions should achieve a compromise between contracting States in their differing approaches to recognizing income as domestic or foreign.
   The problem of expense allocation to cross-border income can also be resolved through bilateral double tax conventions. Such conventions may use alternative means of recognizing expense allocation either by permitting the deduction of reasonably attributable expenses or by limiting the rate at which taxes may be levied.
   States should cooperate so that the same expenses be considered applicable to a given item of income by both the country of source and that of residence, domicile or citizenship of the taxpayer.

Conference Diary

JANUARY 1981

The Economist: Joint ventures in China (including: Some practical tax case studies), London: January 29; Zürich (Switzerland): February 2 (English).

European Study Conferences: Direct investment in oil and gas and related tax planning, London, January 27 (English).

FEBRUARY 1981

Management Centre Europe: International Tax Management (including: Inter-company pricing: licensing, service fees) (Seminar), Brussels (Belgium), February 12-13 (English).

Practical Conferences: Tax avoidance and evasion, London, February 4 (English).

MARCH 1981

Management Centre Europe: Managing and Developing Foreign Subsidiaries (including: Tax in international operations), Brussels (Belgium), March 4-6 (English).

APRIL 1981

Management Centre Europe: Fourth MCE International Tax Conference. Chairman: Prof. J. van Hoorn Jr., Co-Chairman: A.G. Davies C.B.E. Main subjects: Transfer pricing: Government and business views on tax avoidance; Taxation of international leasing; small meeting groups directed by members of the faculty, Munich (German Federal Republic), April 8-10 (English).

SEPTEMBER 1981

35th Annual Congress of I.F.A.: I. Mutual agreement procedure and practice; II. Unilateral measures to prevent double taxation, Berlin (German Federal Republic), September 21-25 (English, French, German, Spanish).

FOR FURTHER INFORMATION PLEASE WRITE TO:

European Study Conferences Limited, Kirby House, 31 High Street East, Uppingham, Rutland, Leics. LE15 9PY.

International Fiscal Association (I.F.A.): General Secretariat, Woudenstein, Burgemeester Oudlaan 50, P.O. Box 1738, 3000 DR Rotterdam (the Netherlands).

Management Centre Europe: Avenue des Arts 4, B-1040 Brussels (Belgium).

Practical Conferences Administration Offices: 270 Cartechatch Lane, Enfield Middlesex EN1 4BG (United Kingdom).

The Economist (Conference Unit): Mrs. Marion Bieber, 25 St. James Street, London SW1 1HG (United Kingdom).

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